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waterstone INSOLVENCY

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Giving an unwanted liquidator the shove

Pandey Power

There isn't much to recommend being a motelier. It is hard to catch a full episode of Coronation Street with transient clients wandering in at all hours and the racket made by raucous netball teams on the turps that would keep Miley Cyrus awake.

But despite all of these pitfalls and unwanted drama the lonely souls of this forlorn industry undertake the Lord's work. Without them travelling salesmen would be sleeping in cars and illicit affairs would be conducted behind bike sheds and the disabled toilets.

Shudder the thought.

For many decades, perhaps too many, Brian and Brigit Lawrence lived the motelier's dream; handing out 300ml cartons of milk and cataloguing an endless stream of lost phone chargers.

Their career came to a watery grave when they leased the Lakewood Rotorua in 2003. Although the motel looked lovely in the sulphuric moonlight it had a plumbing problem. It leaked like a terraced house in Avondale.

The Lawrences went to their landlord, NZ Properties Holding Limited and asked them to fix the plumbing. The answer was no. As time passed the Lakewood lived up to its name and became so waterlogged it began to resemble the dining room at Kelly Tarltons.

Frustrated by inaction the Lawrences sought and obtained a meeting with the man himself; Prakash Pandey, scion of the Pandey family to whom the Lakewood was but a minor asset in a vast property empire. The meeting didn't last very long and in his evidence to the court Brian claimed that Prakash bragged; "I'm worth three hundred million. Sue me."

The Lawrences took Prakash up on their offer.

The case took more detours than a jeepney ride through Patpong but by 2011 NZ Properties saw the writing on the wall and abandoned their defences, asset stripped millions of dollars of real estate and allowed justice to take its course.

Sadly for Prakash and the Pandey Empire they didn't appoint a friendly liquidator. Instead they left the decision of liquidator up to the Lawrences and the court.

This was a mistake. Waterstone was appointed.

Once in office Waterstone asked the directors for the books and records of this company. What we got was a request for a creditors' meeting. Half a dozen creditors, mostly other firms in the Pandey Empire, turned up and voted to fire us. However, court appointed liquidators can only be replaced by the courts, so the issue went before Justice Venning.

We were, Prakash told the court, too aggressive. Evidence was brought before the court that indicated the liquidators might be racist, acting as debt collectors and generally socially unpleasant.

The High Court agreed with at least some of these criticisms and Waterstone was unceremoniously thrown out of office. This came as a shock. As far as we were aware there was no statutory bar to liquidators being racist, acting as debt collectors nor being socially unpleasant.

The learned Judge made his views amply clear;

> While it is unnecessary to resolve exactly where the blame for the lack of progress in the liquidation lies, it seems that the current liquidators may, at the least, have contributed to the delays in progressing the liquidation by the confrontational approach they have taken.
>
> …. the current liquidators appear to have adopted an, at times unnecessarily confrontational approach to the Pandey interests which, even if undertaken with the interests of the seventh respondents* at heart, has been counter-productive and costly.
>
> * The Lawrences
>
> Grant & Khov v CP Asset Management Ltd & Ors [2012] NZHC 3488

The Court of Appeal, with the assistance of tenacious Wellington Barrister Kevin Sullivan, was prevailed upon to reinstate Waterstone. Adding, for good measure this helpful quote;

> The creditors of a failed company are ordinarily entitled to have its affairs thoroughly investigated to learn whether it has any assets, or the liquidator any rights of recourse, that might repay them. Where a creditor, or in this case the liquidator, is prepared to fund such investigation, the Court will not lightly deny them the opportunity that it represents.
>
> Court of Appeal Grant and Khov v CP Asset Management Limited

Dogged Wellington Barrister discussing the case with his clients.

Despite Waterstone being reinstated, the Pandeys were not willing to hand over the books and records of the company without a court order. There were a total of 14 High Court judgements and one Court of Appeal decision and one unsuccessful leave application to the Supreme Court.

This was a fight with two evenly paired opponents prepared to go the distance. The liquidators were of the view that the asset stripping in the years prior to liquidation created a liability not just to the directors of the failed company but also to the other companies in the Pandey group. We were seeking a pooling order in addition to various breaches of directors' duties.

In response the Pandey interests were refusing to concede anything, as is their right. No quarter was sought and none was given. To be clear, the directors of the failed company and their advisors were within their rights to take the stance that they did. Liquidators are subject to judicial oversight and not all of the court decisions went our way.

There are two sides to every dispute and it became clear that the Pandey family were genuine in their belief that the underlying claim by the Lawrences was baseless. While this helped explain their unyielding stance this was never tested. The Lawrences had obtained judgement by way of formal proof and as a result there was a judgement debt against the companies and this was the basis of the liquidator's position.

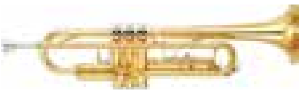
For two years after the Court of Appeal reinstated Waterstone every single issue was litigated. Even minor cost awards went before the court and so tenacious were the parties that at one stage the liquidators were served with a bankruptcy order over a disputed costs award and in response we obtained a sale order over 16 Fort Street over a relatively trivial judgement debt.

At some point, however, cooler heads intervened. The Lawrences reminded us they weren't going to live forever and new counsel for the Pandey interests pushed for resolution. When the end came it came quickly. A settlement was reached for two million, which was split between the Lawrences and the Liquidators.

We gave them a cheque.

Most liquidations end in disappointment for creditors. This is one of the very few where a result was obtained. We were able to get this result for one simple reason; we employ a team of talented, keen young lawyers which allowed us to fund a three year legal fight that would have cost us over half a million dollars had we been paying external counsel.

We don't usually use these pages to blow our own trumpet, but we are doing so here.



The cook, her husband, a liquidator and his Lawyer (not in that order).

Where Truth Comes to Die

Our mascot, Prudence inspecting and contrasting past editions of the Truth.

Pravda, for those of a certain vintage, will resonate as the name of the newspaper of the Communist Party of the Soviet Union. It was founded in 1912 and is still in print, although much reduced from its glory days as the official organ of the Soviet government.

Pravda is Russian for 'Truth', which has a nice Orwellian vibe and creates a tenuous link to an iconic New Zealand newspaper, The Truth. Founded in 1905 the Truth survived for over a century, two world wars and the Muldoon Administration before finally collapsing in 2013.

In its heyday the Truth was a respectable broadsheet with an unforgiving right-wing approach to the world. Sadly, as the rivers of gold that were classified advertising dried up the Truth slowly became a sordid tabloid sex-rag.

The masthead and intellectual property was separate from the trading entity, which was liquidated in 2013. These were held by Multi Media Solutions which fell into liquidation with Waterstone last month.

As a consequence, we have inherited a century of tradition as well as the bound copies of The Truth. We are where the Truth finally comes to rest.

Regulate This

It's always nice to see real life follow economic theory. The concept of *Regulatory Capture* predicts that an industry, once regulated, will seek to game the regime to benefit themselves at the expense of consumers.

We can see this playing out in the insolvency industry.

As things stand no one outside the industry seems that unhappy. No business group, union or professional creditors are clamouring to 'fix' insolvency. If asked, most would probably complain about passive liquidators who didn't do enough to chase directors or grizzle that our fees magically matched the value of assets recovered.

However, no one has actually asked the business community so their views remain unknown. What is known is that insolvency partners from the big accounting firms have been whining for decades about how appalling it is that any idiot with a pen can become a liquidator. They point to the occasional outrage and demand the government build a wall to protect them.

It's all sophistry but Goldsmith has buckled to the constant pleading from these indignant penguins. He commissioned a working group consisting of four partners from the big four accounting firms and the lawyers who feed of them; with a debt collector and government lawyer thrown in to form a perfect basket of deplorables.

This panel was always going to recommend regulation and indeed they have, but they have gone further. They want to be the regulators.

RITANZ, a sub-set of the Institute of Chartered Accountants, has around three hundred members, mostly staff members of the large accounting firms and their symbiotic lawyers. It isn't representative of the insolvency industry much less the wider commercial community.

Those elected to run it look a lot like those on the Minister's advisory panel with one person sitting on both. It isn't a surprise they have suggested that they, through RITANZ, be given the opportunity to fix a problem that only they can see.

RITANZ would get to oversee who can join the industry, who to discipline and who to expel. They will decide what qualifications are acceptable, the level of infrastructure needed and the highly subjective 'good character' assessment that they, and only they, are worthy and competent to assess.

For the sake of transparency it's not certain that Waterstone would pass so we're not disinterested observers.

Having such a small industry regulate itself makes as much sense as getting the Taxi Federation to regulate UBER or Sky City to hand out gaming licenses. Self-regulation isn't regulation at all. It's the creation of a closed shop.

Goldsmith and the bureaucrats advising him should see this nonsense for the land-grab that it is. If the industry is to be regulated, and it really doesn't need to be, then best have the dead-but-disinterested hand of the state than the grasping self-interested seeking to regulate themselves a safe sinecure protected from the cold winds of competition.

This piece was published in the NBR Online on the 22nd of October 2016.

Come up and see Prince Albert's Etchings

In a world where the most intimate parts of a celebrities anatomy is only a few ill judicious clicks away it can be fun to look back on simpler times.

Queen Victoria and her beloved Prince Albert took up etching, to help wile away the hours between State Dinners. They engaged a tutor and whilst their artwork wasn't Van Gough it did provide a glimpse into their gilded lives.

Albert was a little careless and 63 of his etchings fell into the hands of the gloriously named Jasper Tomsett Judge. Judge prepared the etchings for publishing and his publisher, William Strange, sent an advance copy to the Palace.

This was ill judged. Prince Albert was not amused and went to court to get an injunction to prevent the publication.

The only problem was, on what grounds? There wasn't any privacy legislation but there was the concept of an author's property rights, specifically the right of first publication, and it was on this basis that an ex-parte injunction was given.

At the full hearing Prince Albert argued (sadly, not in person) that he had a property right in the etchings. William Strange countered with outrage, bluster and protestations of innocence.

The judge decided that a person had a property right in that which he produced. If he elected to keep this private, then that was his right on how to dispose of his property. If he choose to publish or sell his work, then he could expect to lose some control over it. As Albert had produced the etchings and had chosen to keep them private, then it would be a violation of his property rights to allow them to be disseminated.

William Strange appealed. The appeal court upheld that Albert had a property right in his etchings and that privacy was an inherent part of that. They went further; that as Strange and Judge could not explain how they had come upon the items and it was clear that the Royals had kept the etchings private; the court concluded;

> *"The catalogue and the descriptive and other remarks contained therein could not have been compiled or made, except by means of the possession of the several impressions of the etching surreptitiously and improperly obtained."*
> Prince Albert v Strange 1849

This was a breach of confidence and as such Strange had no right to the material and could not print it. More eloquently they found…

> *Judge's case... to be one of entire and undissembled dishonesty. It would be a slur on jurisprudence, an insult to the administration of justice in this country, if such a breach of trust, to use the mildest phrase, should be without remedy*

The importance of this case, not acknowledged at the time, was the establishment of a copyright in unpublished work. To an extent the importance of this case was superseded by the Copy Right Act in Britain in 1911 and similar legislation in New Zealand. However, the case continues to resonate in the importance attached to breaches of confidence and was instrumental as recently as 2013 involving a case where an employee emailed a spreadsheet of 83,000 EQC claims to an external contractor who promptly proceeded to distribute the material.

In a replay of the Prince Albert case EQC went to court to get an interim injunction preventing publication then sought, and obtained, a permanent suppression order on the basis that then documents were obtained by way of a breach of contract.

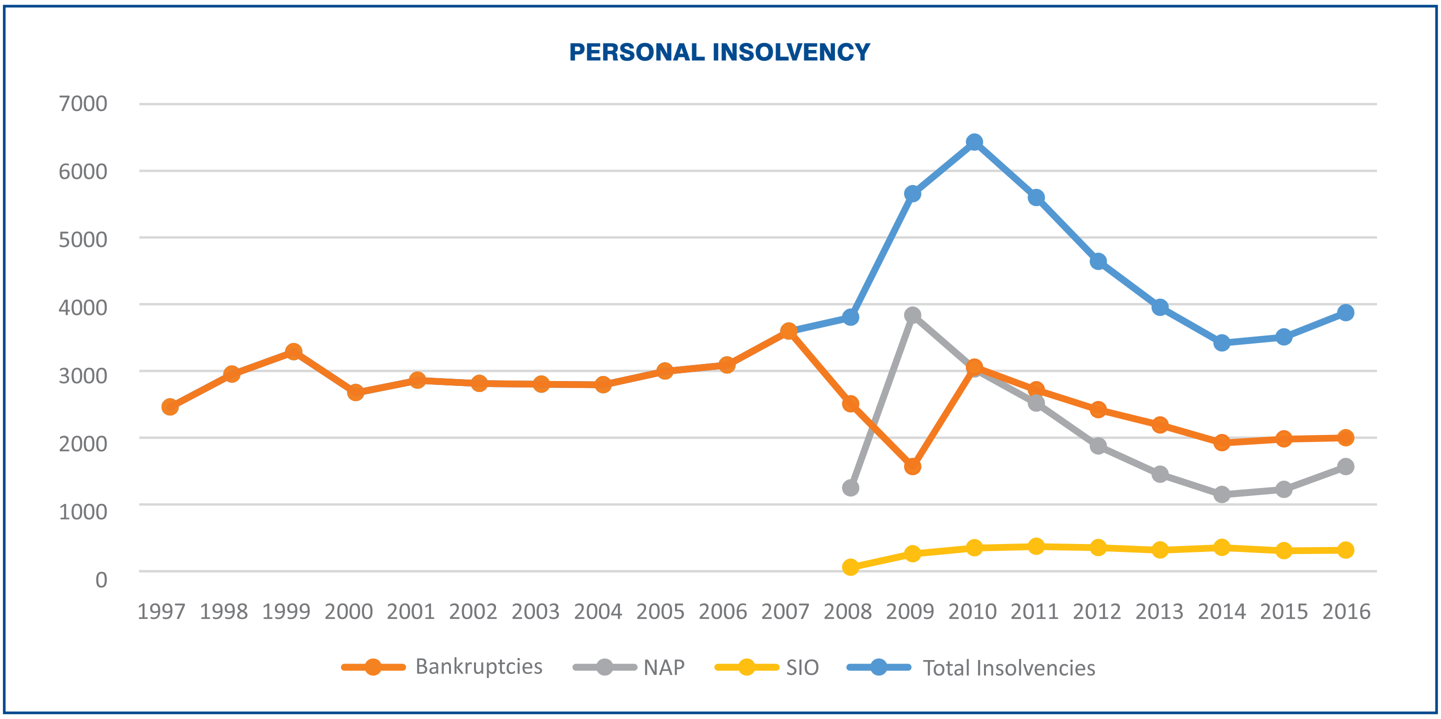
This remarkable story has a delightful denouement that, sadly, begins with the untimely death of Prince Albert in 1861. Queen Victoria gifted the collection of etchings to her friend, Sir Thomas Martin in 1869.

Presumably they were handed down and carefully protected until, in May this year, they surfaced at an auction house in London where they failed to reach the reserve of £24,000.

At the time, this case was a tabloid sensation. The British Media loved this tale and the public couldn't get enough of it. The Hundred Acre Wood was brutally harvested to keep up with the publications of newspapers covering the story, yet the passage of time saw the artwork at the centre of this scandal worth less than an average new car.

An etching by Queen Victoria; part of Judge's illicit collection.

Bankruptcy Hits



Being a statistician is a deeply frustrating career. Changes in methodology, gaps in the data and a pitiful salary make it even less satisfying than being a dental hygienist. The above data set is a case in point.

Right before the 2008 economic meltdown the government radically changed the nature of personal insolvency by bringing in the No Asset Procedure, or NAP.

This is a form of bankruptcy "lite" and only the following could qualify;

- Debts less than $40,000 (now $47,000)
- Have no realisable assets
- Cannot repay the outstanding debts
- Have not been through the NAP or bankruptcy before

If accepted they remained under the NAP for a mere 12 months before being discharged and their debts wiped. Looking for a trend gets tricky as the economy fell into a hole as soon the NAP and its sister regime, the Summary Instalment Order (S.I.O), was launched.

Bankruptcies were running at three thousand a year but have dropped to a steady 2,000 currently. The NAP peaked at nearly 4,000 at the same time as our finance industry was unravelling but has levelled out.

Now that the initial spike has worked itself out, it appears that up to a thousand debtors who otherwise would have been forced into a three year bankruptcy regime due to relatively trivial debts are taking the NAP option and another thousand other debtors who would have struggled on with their debts are also using the NAP regime. This would appear to be a successful innovation.

Setting a Bad Trend

We have been strong advocates of the Part XIV compromise regime. It allows for companies to make an offer to their creditors as an alternative to liquidation. If a majority of creditors with over 75% of the total debt agree to a compromise it becomes binding on all creditors.

We've always been uncertain about the merits of including related party debt in a compromise but ultimately it is up to the company. The case law on this issue has been silent.

Trends is a publishing business. They received money from Callaghan Innovation and after a falling out were asked by Callaghan to repay it.

Facing financial stress Trends came to Waterstone and we outlined their options. They elected to propose a Compromise under Part XIV of the Companies Act. The key elements of this deal were;

- Smaller creditors, up to $1,000, were to be paid in full
- $170,000 to be paid over time to the unrelated creditors
- Related party creditors would not receive any funds but would be entitled to vote

A meeting of creditors was convened and the proposal was passed with a majority in number but the 75% of creditor's by dollar value was only achieved with the assistance of related party votes. Those creditors who voted against the Compromise took the issue to court. The court can overturn a Compromise if it believes there are material irregularities in the Compromise or that it involved unfair prejudice.

Those opposing the Comprise contended it involved unfair prejudice because;

- Trends would have had to pay just $179k to be released from a million dollars' worth of debt
- The creditors who voted "No" could have done better in a liquidation

They also argued that the proposal was irregular;

- There was insufficient information about Trends financial position to allow them to make a decision
- Related Party Creditors should not have voted
- Under $1,000 creditors were a different class and should have been excluded
- The Callaghan debt should have been in a different class because it was disputed

The Court rejected the Compromise.

Unfair Prejudice; Related Party Debt

This case sets a new benchmark for Part XIV Compromises by ruling that related party creditors are in a separate class. Their interests are so significantly different from the unrelated party creditors that they cannot reasonably form a common cause with them and should be excluded.

Unfair Prejudice; Motivation

The Court turned its mind to the motivation for the single meeting of creditors and whether this was an attempt to manipulate the vote. No evidence was given by Trends, or Waterstone, on this point and the court found against Trends.

Unfair Prejudice; Liquidation Preferable

Expert evidence was brought to bear that liquidation would have been economically better for the creditors than the Compromise. However, the court was unconvinced and it wasn't accepted.

Irregular: Lack of financial information

The contention that a lack of information amounted to an irregularity was dismissed. There is no statutory obligation to disclose any financial information although clearly creditors are likely to view a lack of information as a reason not to vote for a compromise.

Irregular; Class for those under $1,000

Unfortunately, this issue wasn't determined as the votes of these minor creditors did not affect the outcome. However, in reference to other cases it seems likely that if the decision to include the minor creditors for full payment was for administrative conveyance and not an attempt to manipulate the vote this probably would not have been viewed as an irregularity.

Irregular; Callaghan in separate class

Again, no definitive ruling, just commentary and this issue was complicated because Trends had a counter-claim against Callaghan. The court noted that putting Callaghan into a separate class would have given it a veto over the proposal which would have been unfair to the other creditors and therefore including them with the main body wasn't prejudicial. However, the existence of the counter claim meant Trends could keep this claim despite thwarting Trends claim against it.

Relief

The court chose to set the entire Compromise aside rather than a more limited order that the challenging creditors were not bound by it.

We should mention that the judgement did include a few pointed comments in our direction. That goes with the territory. We weren't invited to give evidence and nor were we parties, so we must just accept these slings and arrows in silence.

Related and unrelated creditors need to be kept separate.

How to Fire Your Liquidator

Replacing a liquidator isn't a simple process. Once appointed the playing field is tilted heavily in favour of the incumbent and most creditors aren't even aware that it is possible to replace a liquidator.

Here is a simple guide, which we publish certain in the knowledge that it will be used against us!

First, it is important to understand that liquidators can be appointed in two ways, by the courts or by the shareholders, leaving aside those who come into office at the end of a Voluntary Administration for the moment. However, to help understand the process, let's start at the creditor's meeting.

The Vote to Replace

The resolution to replace a liquidator must be passed with **both**;

Over 50% of creditors by absolute number

Over 50% of creditors by dollar value

If there were twenty creditors, twelve voted to replace the liquidator, eight against, but the eight voting No had 60% of the total outstanding debt then the resolution would fail.

The Creditors' Meeting

Who can vote?

At a creditors' meeting only creditors who have filed a proof of debt can vote. It is possible to turn up to the creditors' meeting, preferably half an hour before, with a proof of debt, and the liquidator should accept that creditor for voting purposes. There isn't any firm rule on who can represent a creditor at a meeting, but a staff member, director or shareholder should all be able to vote. A lawyer acting for the company should also be allowed to vote on the companies behalf.

If the creditor is an individual, then that individual must appear in person, or if a trust then a trustee must attend in order to vote.

Proxies?

If the creditor cannot attend in person then they can send a proxy. This proxy must be sent to the liquidator a full 48 hours before the start of the meeting. If someone turns up to the creditors' meeting with proxies that were not provided to the liquidator two working days before hand they cannot be accepted.

Related Party Debt?

Creditors in a liquidation who are related to the shareholders and directors who have filed a proof of debt can vote. In fact, the liquidator has no discretion. A liquidator cannot refuse to accept a vote from a related party.

The Replacement Liquidator

A pre-requisite for a liquidator being appointed is that the liquidator consent in writing to their appointment. This document is, unimaginatively, called the "Consent to Act", and should be provided at the creditors' meeting.

Calling a Creditors' Meeting

Typically a liquidator will dispense with a creditors' meeting and this will be done through the first liquidator's report, which must be posted to all known creditors and published on the Companies Office website. Practically speaking a creditor who wants to call a creditor's meeting has ten working days from the date this notice was uploaded to the Companies Office. If no such meeting is called in that time, the window to replace the liquidator will have closed.

An important feature of the first liquidator's report is it must contain a list of all known creditors. This is helpful information as it allows someone wanting to replace a liquidator by giving them a contact list of creditors to lobby from. However, if new creditors come to the attention of the liquidator between the time they uploaded their report and the date of the creditors' meeting they are not obligated to circulate this information.

Once the resolution has passed

A liquidator appointed by the High Court can only be replaced by the Court, but a liquidator appointed by the shareholders vacates office as soon as the resolution is passed. A liquidator appointed by the Court and replaced at a creditors' meeting must apply to the Court. It is at the Court's discretion whether to replace the liquidator or not.

Until such a hearing is held there is no change in liquidator and if the decision is contested it can take over a year for the Court to hear the matter.

The Retiring Liquidator

Regardless if the retiring liquidator was appointed by the Court or the shareholders, they are entitled, to their fees ahead of the replacement liquidator. This can be a significant burden on the effectiveness of the new liquidator, who must clear the old liquidator's debt before earning any fees themselves.