waterline

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INSIDE:

Liquidator Shock; Court reviews fees

Liquidators and Their Fees!

Back in pre-Covid times, 2019 or thereabouts, a chill went through the insolvency profession and it had nothing to do with regulation or those undesirables who may successfully force their way pass the self-appointed gatekeepers.

David Levin and Vivien Madsen-Ries had sought to have their fees approved on two unrelated insolvencies; Salus Safety Equipment and Green Securities. Both were old files, work had been done, and both had run for many years.

Green Securities

In the case of Green Securities, a hair salon trading as a Rodney Wayne franchise, the liquidators decided to trade the business on. The business subsequently went into receivership and there was a distribution from the receivers when the business was sold. The liquidators then successfully took the director to court for breaches of duties.

The director sought to do a compromise with his creditors, which the liquidators opposed, resulting in the director's bankruptcy. They claimed in the bankrupt's estate and recovered $187,500, as well as a further $164,000 for another company under their control.

The Commissioner of Inland Revenue received over eighty cents in the dollar on her preferential claim of $114,072 and the liquidators sought to claim $159,000 in fees. The legal costs were a mere $20k, which is evidence that these liquidators were prudent fiduciaries when obtaining legal services and spending creditors' money.

On this author's assessment, this was an excellent outcome, but then, this author is an insolvency practitioner, so there may be issues with objectivity.

As this was a court liquidation, the issue of fees went to an associate judge for approval. The judicial officer in question, now retired, was unimpressed. He criticized the number of staff who had touched the file, the decision to pursue a breach of directors' duty claim rather than a current account one and even the number of causes of action pleaded.

One area where some readers may have sympathy for the position taken by the court was the fact that, at one point in this file the liquidators had $139k in the account. They could have paid this to the creditors and closed the file. However they elected to pursue the director and, although they recovered funds from this approach, more was spent in legal and liquidators' fees in chasing this money than was recovered.

The fees were reduced to $120,000 and the legal expenses were also cut by $5,000.

In the defense of the two liquidators, however, it cannot have been known to them when they began the litigation what the outcome would have been. To hold liable a liquidator, or any office holder, for making a reasonable decision based on available information because hindsight shows that an alternative option was preferable is to require a degree of omniscience from the insolvency profession that we do not possess.

Salus Safety Equipment

It was a similar story for Salus Safety Equipment. The business had failed and was liquidated on application by the IRD. The liquidators identified a breach of duty and sought a settlement with the directors for the entire amount of the outstanding creditors.

The directors, perhaps knowing the reputation of these liquidators, prudently agreed to pay the entire debt, with $50k up front and the balance at $1,000 a week until paid in full.

Here $94k in fees were being sought, which would work out to an average hourly rate of $208 per hour. However, the same associate judge was critical of the level of time spent on the file and the number of staff engaged. Over the years twenty-four people had worked on this liquidation, a fact that attracted negative judicial comment.

There was even a comment that a smaller insolvency firm could have handled the file more efficiently and an allegation of 'padding' on the time sheets. There was a total of 422 hours spent on this insolvency, and the time allocation that caught the judicial eye was the 103 hours spent on 'cash management'.

The court also felt that much of the work done on this file was 'routine' and that the directors did not contest the settlement made should have made this a simple and straight forward assignment and although the liquidation ran for five years, it was not large nor was it complicated.

Critically, there was a finding that 400 hours was high for such a liquidation and the level of fees were '…out of kilter…' with what the associate judge saw in comparable files and that a smaller, more efficient firm, would have achieved the same results but with fees of $30,000.

As a consequence, the fees were scaled back to just $30,000.

A key feature of both cases was that confirmation from the IRD was provided to the court that the IRD was happy with the fees charged. However, the Associate Judge took the view that, if the Commissioner was the only creditor affected by the fees charged by the liquidators, then her opinion would be determinative, but that was not the case in either file.

The Court of Appeal

The liquidator challenged these decisions in the Court of Appeal, and they were successful, although on a narrow technical basis. The liquidators did not ask the Court of Appeal to approve higher fees, only that the decision be set aside on procedural unfairness grounds.

The liquidators claimed that the findings against them were a breach of natural justice, because they were given no opportunity to respond to some of the claims, especially those that impugned the integrity of the liquidators.

The issue for the liquidators appeared to be one of clearing their reputation, rather than the quantum involved. As the lawyer for the liquidators presented:

> *"In these cases the Associate Judge delivered judgments which contain a number of findings that can be described as findings of malpractice or, at least unconscionable behaviour."*

Another issue of contention was a claim by the liquidators that the Associate Judge should provide some context or evidence of his claim that the fees charged were out of kilter. This did not get any traction, however, as *"accumulated experience…is not evidence in respect of which some disclosure obligation arises. No complaint can be levelled at Associate Judges for drawing on such experience."*

The liquidators had more success on the natural justice grounds. If a judge criticises someone in a judgement there is an expectation that the judge has carefully weighed the evidence after giving the person criticised an opportunity to be heard.

This did not happen and was critical in the successful appeal.

Role of the Court in setting liquidator's fees

The Court of Appeal went a little further, exploring the role of Associate Judges in reviewing and setting liquidators' fees. The court is exercising an inquisitorial jurisdiction, rather than the adversarial one the court is used to.

This reflects the fact that there is very rarely any creditors on the opposite side, challenging the fees being claimed by the liquidator. The onus is on the liquidator to convince the court and where we cannot, as happened to Waterstone in one case recently, (Quantum Grow, for those who are curious) the fees claimed are not granted.

The Court of Appeal acknowledged that the public policy of having the court exercise this oversight was that the creditors, who are diverse and not easily able to act collectively, are not well placed to challenge a liquidators' fees.

This process is not merely a 'rubber stamp' for liquidators seeking the courts imprimatur on what they have charged.

Padding

One issue that arose was what was meant by the term 'padding'? Clearly it depends on the context, but the liquidators felt that it carried a taint of fraud, although the court entertained the idea that it could merely have meant 'over-servicing'.

The lawyer for the liquidators relied on a Google search to determine his definition for padding, but, well, readers may wish to try this exercise for themselves to determine what the lawyer in question had actually been searching.

However, the Court of Appeal did conclude that if the Associate Judge was going to accuse the liquidators of padding, whatever the meaning, then they needed to be given the opportunity to respond; even if the response was to merely state that their time sheets were real and they were spectacular.

The Court did not accept several of the liquidators' other key objections; the main one that the associate judge should provide evidence for his assertion that the costs on these two files were out of kilter with similar files.

However, as there had been a breach of natural justice, the decision was set aside, and sent back to the High Court for a final determination.

Here at Waterstone we are pleased with this decision. It is our belief that the fees charged by David Levin and Vivien Madsen-Ries were entirely reasonable for the outcomes achieved. It is our experience that few other practitioners could, or would, have achieved the same result given the opportunity, and would have charged substantially more for considerably less had they been appointed.

They are real and they are spectacular.

A Trip Down Roslea Path

The case on the previous pages provides an opportunity to revisit the guidelines for liquidators' fees as outlined in Roslea Path, something that from anecdotal evidence we are observing, many in the industry would be wise to do.

Roslea Path was a High Court case where a joint bench of Justices Venning and Heath took the opportunity to clarify the issue of what liquidators can charge and what they cannot. Central to charging for an insolvency is time; liquidators swap time for cash. We are dancers for money.

In Rosela Path the court stated:

> *"Fair and reasonable renumeration reflects the value of the services rendered to the creditors of the company…'Value' is an elusive concept which goes beyond mathematical application of hourly rates spent by individuals involved in administrating the company's affairs."*

However, the value to the creditors is measured in time spent, not the quality of those hours. The challenge for creditors is that there isn't any realistic means to assess value for money, and even if there was, there isn't any realistic way to effect their preferences.

On rare occasions the creditors will replace a liquidator in favour of one with a better reputation, in the eyes of those creditors, but even then the process isn't transparent.

The truth is that liquidators get to set their own fee, and in the absence of supervision and evidently even with the threat of supervision, not all liquidators act perfectly. Many creditors feel that they are not getting value for money, and sometimes the court will agree.

In the Levin and Marsden-Reis case on the previous pages, the principles were re-stated, and they are worth going over, to assist some of our colleagues in the industry who seem to need a refresher.

1) Liquidators are fiduciaries. There is a conflict between our interests (getting paid) and that of the creditors, who have to bear the cost.

2) Liquidators, all liquidators, are officers of the court.

3) Liquidators must justify their claims for remuneration and bear the onus of doing so. Any uncertainty weighs in favour of the creditors.

4) Fixing liquidators' fees requires judicial judgement; the judge can draw on their own experience.

5) The court will make a determination of the fairness and reasonableness of the fees charged and results obtained.

6) The court will consider where there have been unnecessary over-servicing

7) A "broad-brush" approach is acceptable

8) The fixing of remuneration needs to be proportionate and not unduly prescriptive, and not add costs to creditors.

At this time, it is useful to restate the timeless words of Justice Robinson in Goldamost Dynamics;

> *"Liquidations are not a bottomless well from which insolvency practitioners may drink… where there is demonstrated misconduct on the part of the liquidator, fees may be disallowed in whole or in part".*

Liquidator's value is still measured in time, not value performed.

Indexing Inflation

One of the fun aspects of our post-pandemic environment has been the re-emergence of inflation. Currently running warm, if not yet hot, this throw-back from the 1970s is back.

For many readers, inflation will be like Georgie Pie restaurants and rotary phones, something known about only as a reference from the movies; yet here it is; alive and kicking in the real world. How exciting.

Also coming back are centralised wage bargaining, with the Fair Pay Agreements legislation likely to become law by the end of this year.

Contracting in an inflationary world, however, requires a different set of skills than one where we assume that prices rise only marginally over time, and one of the main challenges is the annual wage review.

In better times, most employers would have an annual discussion, possibly linked to a performance review, on the level of wage increase for the year and, things going well, a bonus. When prices were bubbling along by two percent a year, this was a perfectly acceptable way to manage employment arrangements.

Inflation was, for many employers, a useful tool of managing non-performing or under-performing staff. By leaving the staff member on their old wage, this amounted to a pay-reduction. Over several years, this could become significant and was a means of gently reducing the cost on the business of a staff member who was doing enough to remain on the pay-roll, but not enough to warrant their salary.

The Fair Pay Agreements, likely to become law next year, will complicate this further. This law change will increase the number and scope of collective industry-wide agreements and annual CPI adjustments will be included into the arrangements, removing this small staff management tool.

Of more concern to some readers of this newsletter, is that the law makes no provision that would exclude lawyers and accounting staff from being subject to a collective agreement. If a thousand salaried lawyers or accountants can be corralled into backing such a scheme, the profession will be faced with its own collective agreement.

We live in interesting times.

A Practice of Uncertain Merit

There has been a trend in recent years where a secured creditor with a GSA over a company will appoint both a receiver and place the company into Voluntary Administration. Under the Companies Act, a GSA holder has a statutory right to appoint an administrator and it does not need to be a contractual right inserted into the security deeds.

Sometimes, where the board and the secured lender are acting in concert, the board will appoint an administrator contemporaneously with a receiver being appointed, and the implication is that this was worked out and agreed in advance.

The purported justification for this practice is that an Administration provides a moratorium that prevents minor secured creditors from recovering their assets and exercising their rights. Even if this was the real reason, it is not correct to act in this manner. The reason why the moratorium was inserted into the Voluntary Administration regime was to give a company time to resolve its financial issues, not to prevent creditors from exercising their security rights when there is no prospect of the company being salvaged.

Insolvency practitioners who take these appointments should appreciate that they are acting in direct contravention of the interests of these secured creditors. If there is no plan to propose a Deed of Company Arrangement, and we can assume this to be the case if the company is in receivership, then taking the appointment as an Administrator under these circumstances seems at odds with the stated first Principle of insolvency profession:

INTEGRITY

OBJECTIVITY

IMPARTIALITY

PROFESSIONAL BEHAVIOUR

There is another explanation. Placing the company into administration has the merit of preventing the shareholders or any other creditor appointing a liquidator. An Administrator is not required to present a first report with a list of creditors, and so replacing an Administrator at the first meeting is very difficult.

One of the roles of a liquidator is to supervise a receiver. A reasonable creditor may assume this isn't going to happen if the GSA holder who appoints the receiver also manages to choose the Administrator, knowing that the administration will inevitably lead to a liquidation.

Voluntary Administration was designed to assist companies seeking options to trade their way out of insolvency. It was not designed as a means by which secured lenders and those they appoint as receivers to avoid the legitimate scrutiny of an independently appointed liquidator.

This practice is legal, but it is difficult to see how it is ethical. Liquidators are not lawyers. We are not here to ruthlessly advance the cause of our clients within the confines of the law. We have a different set of obligations and it is time some members of this profession began to appreciate this distinction.

A lack of work does not excuse a lack of morality. This practice should cease.

Debt and Income

According to Stats New Zealand, a helpful government department who monitors these sorts of things, the level of debt held by households has been rocketing up. We read a lot in the media about the level of sovereign debt, but the level of personal debt also matters in an environment of rising interest rates.

They helpfully graph the data, based on the income level of the population. Mortgage debt increased by thirty percent between 2018 and 2021. This is a staggering statistic, especially when you consider that the vast number of households would have seen their mortgage decline. This ratcheting up was created by the small percentage of households taking out new loans.

Loans secured on property represents nearly ninety percent of all household debt and the average mortgage rose $56k to $260k for the thirty percent of households that have a debt on their primary residence, which means that the increase will be heavily concentrated in a small number of households.

When we consider the macro implications of a tightening monetary policy, this has serious implications. In the past, a rise in interest rates would be felt by a large swath of households, sucking a small amount of demand from most of us and helping to dampen demand.

Looking at this data, it seems likely that the rise in interest rates is going to hammer a small percentage of mostly new homeowners disproportionately, possibly causing many to lose their homes.

The graph below shows how the level of debt has risen over time, and broken down between low and high income earners. Low income earners, those in Quintile One, have doubled their level of debt between 2018 and 2021, and almost certainly have increased it substantially since.

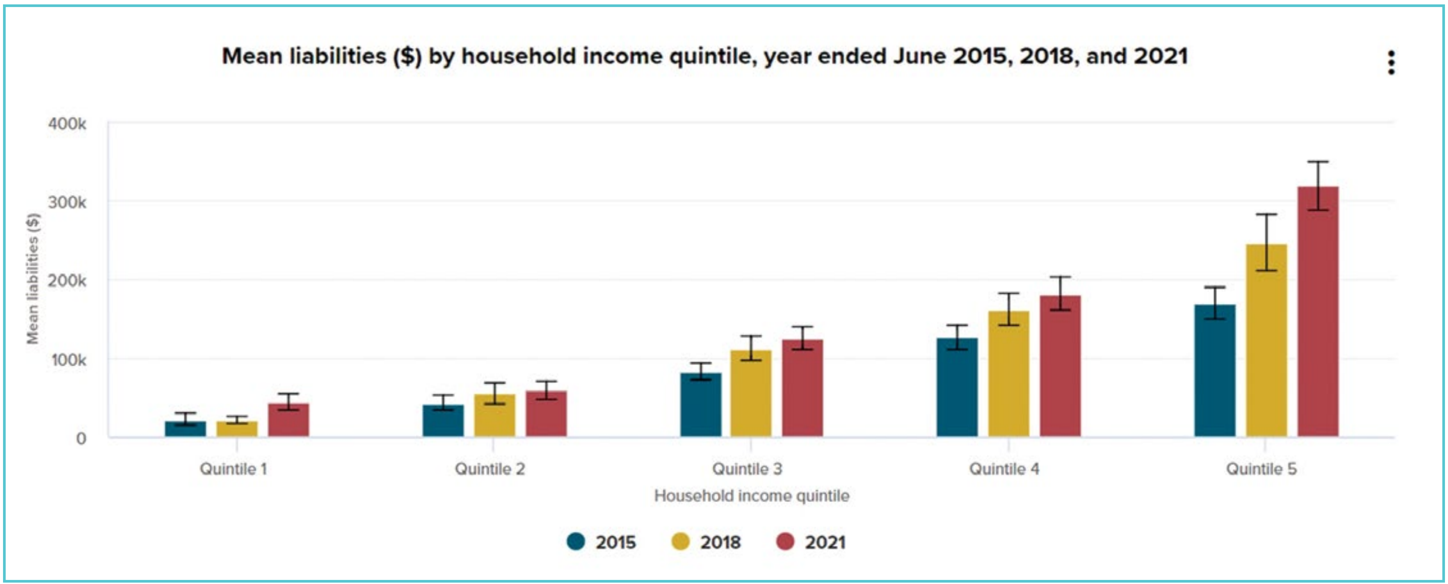
As the cost of borrowing rises, those on low or fixed incomes are going to be forced into making difficult economic decisions but we can be confident that many will choose, or be forced, to default.

This is going to place pressure on their lenders, whose business is built on a level of default, but not at the rates that are probably going to occur in the next year or two.

At the higher end of the income scale we can see that debt has risen in absolute terms much more, but in relative terms a lower percentage. What is telling is how fast this is rising. It implies that households are borrowing to pay the bills, not to buy investment properties. In short, many families are going backwards and when rises in the OCR result in rises in consumer lending, these households will come under increased financial stress.

Homeowners, of course, face the double pain of rising mortgage costs and falling asset prices. However, the wider economic story is one that should be keeping many directors up into the small hours. Consumer spending is certain to fall; not just on restaurant meals but on white-wear, cars and upgrading mobile phones.

This, of course, is exactly what the central bank wants to happen. A fall in consumer spending reduces demand which helps keep inflation under control. For those of us engaged in commerce, however, it pays to understand that even a small increase in the cost of debt is likely to have an effect on the revenue of our operations.

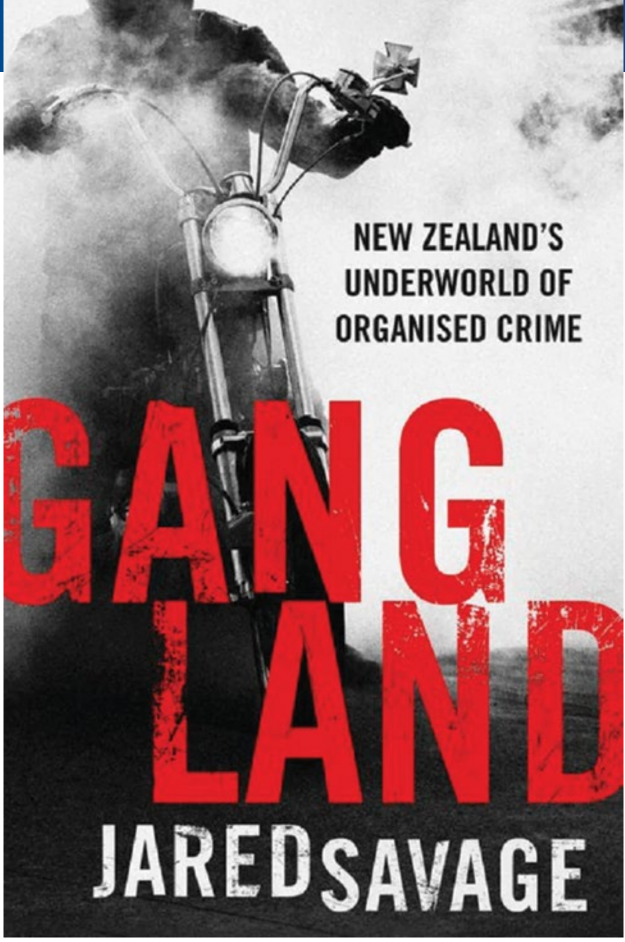


The graph from Stats NZ shows the increase, broken down by income level, with Quintile 1 being low income and Quintile Five being high income.

Gangland: A journalist takes us to the darkside

The Wire became a hugely popular TV series, based on the lives and drama of Baltimore drug dealers and the police who chased them. Living down in our corner of the antipodes, we might think that such activity was something only the Americans could get up to; and we would be wrong.

Jared Savage is a NZ Herald crime reporter who has been covering the evolution of our drug industry and the court trials that flow from them, and in his book Gangland he details some of the more audacious moves by those importing and distributing narcotics in the land of the long white cloud and the police who track them.



In Gangland, award-winning investigative reporter Jared Savage shines a light into New Zealand's rising underworld of organised crime and violent gangs.

The book is broken into a number of chapters that trace the history of methamphetamine and similar product into New Zealand; starting with William Wallace, a character that Savage compares to Walter White.

Wallace was an industrial chemist at a loose end after being made redundant from Air New Zealand who turned his skills to the manufacture of meth. He was a success earning "Bucket loads of cash" according to the judge, when Wallace received ten years in 1998 for his efforts.

Wallace was the start, or near the start, of a wave of creative and entrepreneurial drug suppliers who sought to produce locally, or import, the product that was proving to be both popular and profitable.

Many readers may recall a story from 2016, when an importing scheme involving an inflatable on 90 mile beach came adrift. The media reported on the huge haul that was recovered, a staggering half a ton of meth was intercepted.

What the news stories at the time didn't detail, and what Savage's book does, was the misadventures of those behind this audacious endeavour. The inflatable was meant to meet a boat out at sea, but the crew members sent to New Zealand didn't have any idea what they were doing, how to sail a boat, or even where they could get one.

New people had to be flown in, while those out at sea were running out of fuel and water. This might have been organised crime, but it wasn't well organised. The cast of villains in this book makes for great reading. The Four Eyed Dragon, 'Rocky' and the Ferrari driving Michael Cavanagh are all fleshed out in this drama and because they feature in a book sourced from court documents, we know that all of their stories end badly.

The worst end is suffered by the photogenic and charismatic Josh Masters, founder of the Killer Beez, who became a paraplegic after a gang shooting. Yet, news stores from April this year describe him as still being involved in his gang and motoring around on a quad-bike these days.

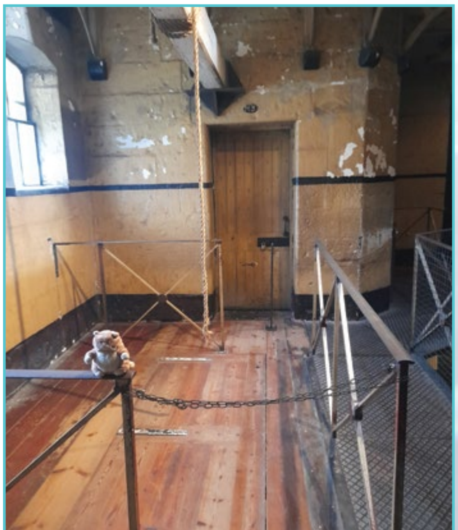
But the real story here isn't the drug importers but those deployed to stop them. Savage lifts the veil on the police efforts, on what they look for and who they decide to target. Police officers such as Greg Turner and Bruce Good, and their efforts within the police to maintain a degree of autonomy and freedom of action, gives the reader a full 360° perspective.

Savage laments, at the end, of the futility of the enforcement efforts. "But these dogged investigators must feel like they've got their finger in the dyke, when the dam has burst." He is critical of the state's failure to move quicker to stem the incoming tide, but also of the unwillingness to tackle the demand side of the equation.

What Gangland does make clear is that the current strategy is doomed. We cannot arrest our way out of our meth problem, a view Savage explains that is held by himself and many of the senior police he interviewed for his book.

It isn't clear that an approach on dealing with those who want to consume the product is likely to succeed either; people have been seeking and indulging in mind-altering substances for as long as there have been people.

However; Savage's book does not seek to solve this problem. He sets out to tell a story, using a number of cases and characters to do so. He succeeds. It is an excellent book and will leave the reader with an appreciation and an understanding of the underworld happening all around us.



Our mascot Prudence, inspects the gallows at the Old Melbourne Gaol.

Breakfast Event

Waterstone re-commenced our Breakfast Series in May with David Seymour, launching his alternative budget at our event. We have since held another one with Kirk Hope, from Business New Zealand and the next one, in August, will be with Barry Soper. If you are interested, get in touch for an invitation.

Held at the Rooftop, QT Hotel, in the Viaduct.

A warm crowd.

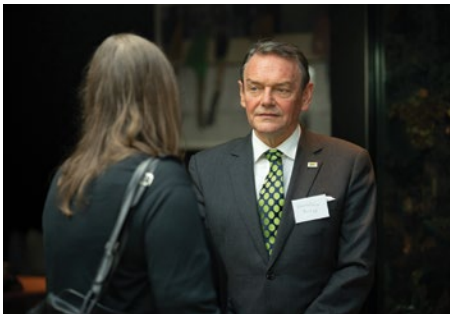
A lawyer from Hesketh Henry, arriving late, looking shady.

Gravity director, Andrew Kingstone, opens the event.

The Act leader makes his pitch.

Deputy leader, Broke Van Velden.

Talking to the media.



ACT MP Damien Smith.

A visitor from the Hawkes Bay.

Kelly Cocks; telling it like it is.

Adam Botterill and friends.

An old man in an ill-fitting suit.