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INSIDE:

Dunedin Court Slays Zombie
PG 2

Voluntary Administration: What is it Good for?
PG 2

The Cummings and Goings of the *Smash Her* Women
PG 3

Preferential Cap Raised
PG 3

A Comrade Falls
PG 4

The Stripper, Her Lover, His Wife and Their Children
PG 5

PPSA Gets Some Clarification
PG 6

Money Laundering and North Korean Guns
PG 8

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Dunedin Court Slays Zombie

Down in sunny Queenstown a GJ Gardner franchise, Hartland Construction Limited, got into trouble. They lost their franchise agreement and creditors were circling.

One, Adams Plumbing, issued liquidation proceedings.

As diligent readers of this newsletter will know, once a company has been served with liquidation proceedings they have ten working days to appoint a liquidator or Voluntary Administrator. After that the company enters what we at Waterstone call the Zombie Zone. The company is not dead but cannot die. They carry on, lifeless creatures, awaiting their appointment with the High Court.

Hartland were a little slow of the mark and by the time they consulted Auckland insolvency expert Bryan Williams they were in the Zombie Zone. Williams engaged with Adams Plumbing and other creditors. The creditors proposed to support the appointment of Williams as Voluntary Administrator if the High Court would ratify his appointment.

The Voluntary Administration legislation has a wonderful catch-all provision, 239ADO, that states:

> *"The Court may make any order it thinks appropriate about how this part is to operate in relation to a particular company"*

This part refers to part 15A, the Section of the Act dealing with Voluntary Administration.

The court placed weight on the presence of creditors supporting the appointment of Williams and approved the application. The company was subsequently placed into liquidation.

Williams, of BWA Insolvency, is a strong advocate of Voluntary Administration and has enjoyed success in this area. He is a lone but articulate voice with most insolvency practitioners preferring a hive-down or the Part XIV Compromise.

Voluntary Administration: What is it good for?

Voluntary Administration was hailed as a revolution in insolvency, our version of Chapter 11, the success of the Australian regime was going to be replicated here. Companies in trouble would have a new and exciting tool. Businesses would be saved. Creditors would be paid. Orphans would reunited with their parents.

Yes, well.

Voluntary Administration has been a complete failure. The legislation appears to have been written in crayon by a committee of drunken smurfs and the Courts literal interpretation of parliament's incoherent doodling has exacerbated the problem.

There have been no more than half a dozen companies who have been restructured, I can only think of only one. Its more obscure provisions have been used as back-door measures to circumvent the restrictions of the better written Companies Act.

Had the legislation been better drafted the regime would have been successful. However, there are no moves to reform Voluntary Administration.

3 common (ab)uses of the VA regime:

Overpowering minority shareholders

No one likes a minority shareholder, especially when you used to be married to them. Liquidators are appointed by shareholders, not directors, and requires a special shareholder resolution of 75%. A director can find themselves stuck at the head of an insolvent company if an intransigent minority shareholder refuses to support liquidation.

A board resolution appointing an Administrator short-circuits the problem. Liquidation follows Administration as surely as vultures follow carrion and the frustrated minority shareholder can do little but express their disgust at the process.

Overpowering secured creditors

Once a firm is in Voluntary Administration there is a moratorium period of at least five weeks (which can be extended by the courts) where an Administrator can continue to use the assets of the company and frustrate the security interests of creditors who otherwise would be able to recover their assets.

This is useful if the insolvency practitioner wants to run the business for a limited period in an attempt to sell the business, although the Administrator does incur personal liability for the costs of using the assets during the Administration.

Shielding Directors

However, the most useful provision of the VA regime is the ability to protect directors from the provisions of the Companies Act around reckless trading. Typically these actions are only taken by a liquidator. If a company is in Administration and the creditors agree to a DOCA at some nominal percentage of the debt they are owed, then the company is returned to the board and the directors are effectively shielded from any recovery action.

In our view, this last provision, although heavily criticised in Australia, is a legitimate use of the VA regime. Creditors who vote for such an arrangement do so in the full knowledge of the consequences and the threat of insolvent trading is more potent that the reality and can be a useful mechanism to encourage directors to put their hand in their wallet to pay something to their creditors.

The Cummings and Goings of the *Smash Her* Women

Nelson, there must be something in the water.

It is a tired saying that a firm is only as good as its people. Not sure that is always true. Some firms seem to do well despite the calibre of their employees but if it is true then bad staff mean bad business, so it is surprising that so many employers are fearful of wielding the axe.

Anecdotal evidence indicates that directors fret about the cost of a personal grievance. The EMA published a study at the end of last year that said the cost to employers of losing in the Employment Tribunal is 34k. A recent media report told a horror story of the Nelson employer who received a $5,000 cost award for firing an employee for threatening her supervisor.

But both these facts need deeper analysis.

The Nelson story is a shocker. The employee in question, a Ms Cumming, was a telemarketer whose partner had been recently fired from the same firm. At some point Ms Cumming and her supervisor, Ms Boon, had words and Ms Cumming told Ms Boom she was going to *Smash Her* if she did not shut her mouth. It was December; Ms Cumming went on sickness leave.

Come January a manager got involved and had a meeting with the now invalided Ms Cumming and Ms Boom. The meeting did not go well. Ms Cummings did apologise, but warned that if her supervisor "got in her face again", there might be trouble.

At this point Ms Cumming was fired. She had enrolled in some study that began shortly after her dismissal.

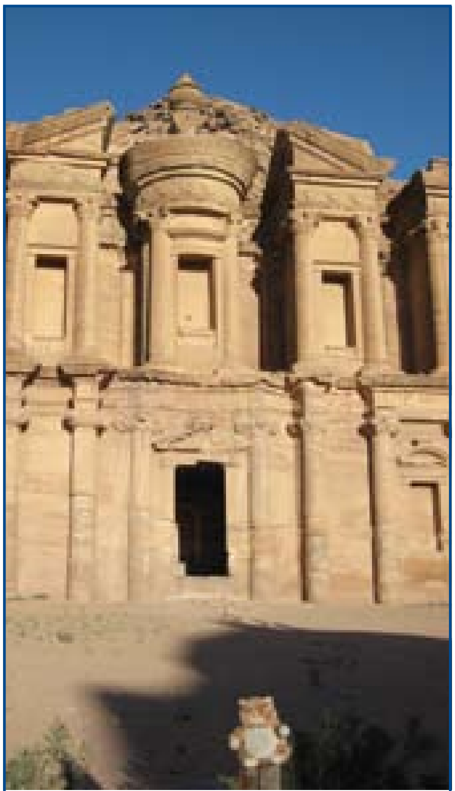
The tribunal criticised the employer for not allowing Ms Cumming to have a support person; compensation was going to be awarded. Their starting point was $10,000, which was cut in half on the basis that Ms Cumming's apology was not sincere.

There was no award for lost wages on account of Ms Cumming enrolling in study. Harsh, you might think, but look at it differently. What would you pay to be able to dismiss a toxic worker? $5k is a bargain.

The EMA story, reported in their September 2011 Business Plus newsletter, (available online), shows that there are usually less than 600 employment cases a year; most fired staff do nothing because they want a reference or because they cannot afford a lawyer.

Of cases that are filed employees win about 60% of the time but the average award for hurt and humiliation is $6,000. The biggest cost is not the tribunal's award but the cost of your lawyers.

Toxic staff do not leave, but they will drive away your good staff. They demotivate those who want to work, and are taking the place of a good employee who wants to work for your firm. Often, however, it is not the employees' fault. Most people are not bad or lazy. If they are not working in your business it maybe because they are not a good fit and there is a better job out there for them.



Our mascot prudence, at Petra: Jordan.

Preferential Cap Raised

The maximum amount an employee can receive as a preferential payment has been raised by an Order in Council (happens every three years) from $18,700 to $20,340.

This is the aggregate of an employees pay, and it includes redundancy, holiday pay unpaid wages, commissions etc. It does not include reimbursement for expenses or other staff loans to the company.

If an employee is owed more than this amount, they can claim in the liquidation as an unsecured creditor.

Liquidators and receivers must take PAYE out of this amount, so the cap is the gross amount. In most cases staff receive little or nothing from an insolvency because the assets are covered by a General Security Agreement and the assets are paid to the secured creditor, although stock and debtors can be used to pay staff.

However, the rising popularity of factoring as a means of financing firms means that this avenue is also slowly being restricted.

A Comrade Falls

Insolvency attracts some colourful rogues, the editor of this publication falling into that category, but none was more flamboyant that Pat Norris; the Nihilist of Nelson. Pat lived by his own rules. He should have stuck more strictly to those proscribed in the Companies Act.

Waterstone first met Pat Norris at an insolvency conference a few years ago. Back then he was larger than life. Life caught up.

Soon afterwards Pat shot to international fame for installing security cameras in his property where he was able to keep an eye on his estranged wife. He was chastised in Parliament by Nick Smith for charging $200 an hour and came to the attention of the Companies Office. He became embroiled in a series of legal battles with the Crown, not without some success, but his luck ended in the Nelson District Court in October 2012.

The Companies Act directs that liquidators must keep money from a liquidation in a trust account, or in an account in the liquidated companies name (regulation 37). Norris did not do that. In the case in question he receipted $80,000 from a liquidation into his general account, which was overdrawn at the time. Evidence presented to the Nelson Court showed he quickly spent the money, only creating invoices long after the money was gone.

Norris claimed that there is not a statutory trust relationship between a liquidator and the liquidation, but rather a debtor/creditor one. He was right, there is not a statutory relationship but the court found there was a common law trust relationship and his case foundered.

Norris defended himself and the transcripts made for entertaining reading but humour was not enough. He was convicted on one count of theft by a person in a special relationship. As the conviction was one of dishonesty he is prohibited from acting as a director for a period of five years (Section 382(1)(b)) and by extension is also prohibited from being a liquidator (Section 280(1)(k)).

In one final act of defiance Norris sought to resign his remaining four liquidations in favour of a local retired car salesman. This was not looked upon kindly by the Companies Office who declared his resignation invalid and replaced him with liquidators from Ernst and Young. Naturally, Norris is challenging this in Court.

Norris became the poster boy for the need to regulate the industry. As he himself described to the court, all that is required to be a liquidator is to pass the mirror test; place a mirror in front of your nose. If it fogs up, you are breathing. You pass.

Norris, it needs to be said, is not a bad person, although (and we say this as a friend) he was a terrible liquidator. The lack of regulation around insolvency made this situation inevitable. Insolvency is like checkers. Easy to learn, hard to master. The promise of easy rewards and loose oversight attracts many like Pat Norris; good people who quickly get out of their depth and end up drowning.

One bad decision is papered over with more bad decisions until all that is left is a paper mache mess. Regulation cannot come soon enough.

Pat Norris, on learning of his conviction.

Searching Norris

Norris was subject to two exceptional searches.

Searching Norris (1)

Anton Pillar Orders is a case-law solution to the risk that a party to litigation will destroy or conceal documents. It dates back to a 1976 British case and it is not a search warrant, it is an instruction to the defendant to consent to the search. A defendant can resist an Anton Pillar but this will be considered Contempt of the Court order and the court will draw a negative inference.

In 2008 the High Court Rules were amended (Rule 33.1-3) to formalise these orders into Search Orders. Again, such an order is not a search warrant but an order to the defendant to allow a search to commence.

The applicant need not be a litigant, it is enough that litigation is anticipated. There must be strong evidence that documents relevant a case may be concealed or destroyed.

After Norris was convicted the liquidators appointed by the Official Assignee to replace him obtained just such an order. Under the rules those who are granted a search order cannot take part in the search, this must be done by their lawyers, and the court will appoint lawyers to represent the interests of the person being searched.

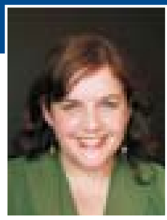
Searching Norris (2)

Section 365 of the Companies Act allows the Registrar of Companies to authorise a search if, amongst other things, "... in the Registrar's opinion, it is in the public interest.."

The person so authorised has the power to search any premises where company records may exist. In 2010 just such an order was issued allowing employees of the Ministry of Economic Development to enter Norris' place of business and inspect and remove for copying documents relating to four companies in liquidation.

Information obtained in such a search can be used in a criminal proceeding against the person but, according to the commentary on the section, not for any civil claim. Legally privileged material, however, remains outside the reach of this section.

This is a rarely used but exceptional power.



The Stripper, Her Lover, His Wife and Their Children

Selina J Trigg, Family Law Results, Auckland

The case of *EP v HP and anor* illustrates how complicated family relationships can be and the importance of having a will. The names have been changed.

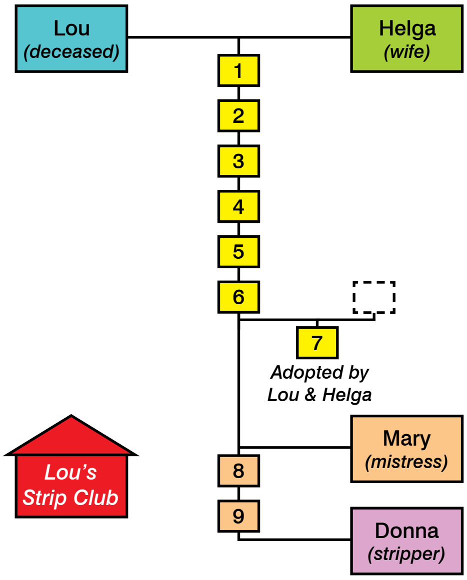
Lou and Helga were fecund Ukrainian immigrants living in Wellington with their seven children, six of their own and one adopted grandchild. Lou was a successful entrepreneur skilled at time management and extra marital relationships, one of which produced two children. Lou spent considerable time with these children and their mother, Mary, in a home he owned. When the relationship ended, Lou brought the children to the home he shared with Helga to be raised there.

Lou owned a strip club, naturally. Donna worked in the club, serving drinks, cleaning and filling in when a stripper didn't show. Donna progressed from sharing nights with Lou in the strip club's changing room to moving into Lou and Helga's marital home.

Lou never completed a will. He told his lawyers he would not die, that he was not married and his family were getting nothing. Unfortunately for Lou, he died. Due to the lack of a will his five million dollar estate was administrated under the Administration Act.

Upon Lou's death, wife Helga sought her relationship property entitlements from Lou's estate. Ex-stripper Donna worked out the best outcome for her was not to seek her relationship property entitlements because she claimed a share of the estate in accordance with the Administration Act.

Lou's children from his relationship with Mary brought two claims – the first that Lou had promised them one of his properties in exchange for services and the second being a claim under the Family Protection Act that



as his children, Lou should've ensured they were provided for out of his Estate and failed to do so.

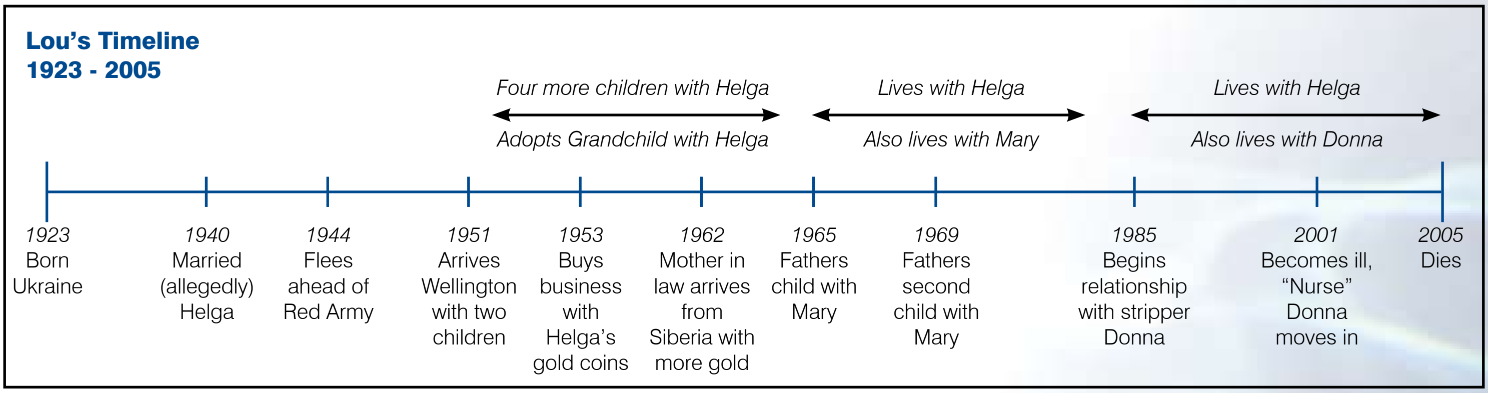
Challenges were made to the validity of Lou and Helga's marriage as a marriage certificate could not be produced and Lou had (albeit self servingly), at times, told others he was not married. Everyone disputed whether Donna and Lou were ever in a de facto relationship, saying she was merely his caregiver. Likewise, there was dispute over the nature of Lou's relationship with Mary and the claim that Lou had promised Mary's children a property.

The Court found:

- Lou and Helga had been married;
- His relationship with Mary was not merely an affair but had transcended into the status of a de facto relationship;
- His relationship with Donna was a de facto relationship;
- Helga received half the estate, being her relationship property entitlement.
- Of the remaining estate, Donna got just over 1/3 and the remainder was split unequally between Lou's children, including those from the relationship with Mary.

What can be learned from our Ukrainian Strip Club Owner?

- The law allows for multiple relationships - a de facto relationship can exist when you are still married and living with your spouse. Therefore, you (or your estate) could face the prospect of more than one property claim.
- Wills matter. Litigation should not be the eighth stage of grief for your loved ones. Sound estate planning could have avoided the multiple legal claims against Lou's estate.
- When faced with multiple claims against an estate, the Court will decide the Relationship Property claims first. Then any claims to the balance under the Family Protection Act and Testamentary Promises Act will be dealt with. Whatever is then left over will be distributed between the beneficiaries under the will or under the Administration Act if there is no will.
- If Lou wanted his family to receive nothing, some claims may have been avoided through careful Family Trust structuring. If Lou's assets were in a trust, there would be little in Lou's estate to make a claim to; and finally
- Everybody dies.



PPSA Gets Some Clarification

The PPSA is about ranking different securities, but unhelpfully there are gaps in the legislation. Two questions have been raised by practitioners and recently resolved:

	Question	Answer
Case One	Securities can change their ranking over time (Security is registered, it lapses, etc); Once a company is insolvent, what date does the liquidator or receiver use to settle competing priority claims?	Priority issues are settled once the securities come into conflict. It is established that conflict occurs when a liquidator or receiver is appointed. Changes to the PPSR after this date have no effect.
Case Two	If Security A is registered first in time, but signed after Security B is both signed and registered, who wins?	The party that registers first will prevail. *Perfection* is when a security is both registered, funds advanced and paperwork signed. The party who registers first will win over a party that perfects first.

Case 1

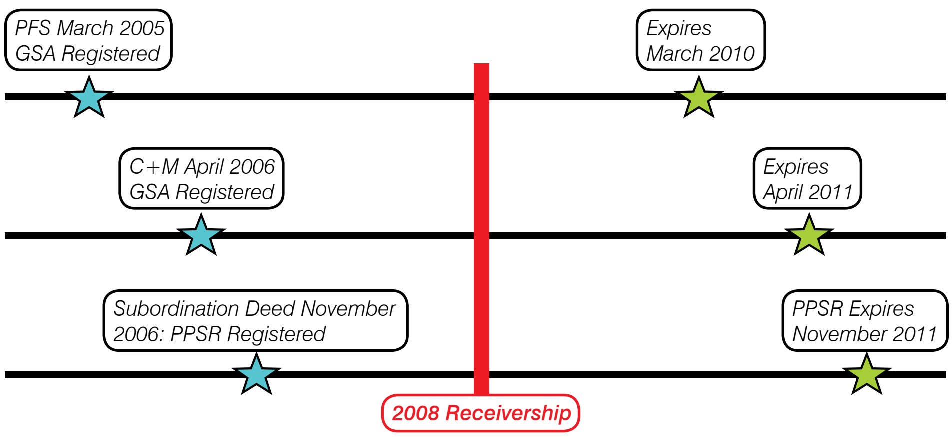
The first involved a dispute between two security holders. The timeline is important.

Anthem Holdings Limited, (a wine firm) obtained a loan from Property Finance Securities (PFS) and granted PFS a GSA in March 2005.

Anthem then sought a loan from Capital and Merchant (C+M) and granted them a GSA in April 2006.

C+M sought a subordination, which PFS granted in November 2006. PFS agreed to be subordinated to C+M. This was registered on the PPSR.

The time line looked like this:



Critically, there was nothing in the deed about when the subordination ended. Anthem went into receivership in 2008.

By the end of 2011 PFS argued that because the PPSR registration of the subordination deed had expired, that the subordination itself had ended. This argument was a little counter-intuitive but as the agreement was silent on the duration of the subordination and the registration was for a strict five year period, PFS thought they had a case.

The case is Gibbston Downs v Perpetual Trust. David Henderson's company, Gibbston Downs, purchased the PFS security. Perpetual Trust represented the interests of C+M.

PFS lost. The judge knocked their argument back. C+M had a clear intention that the subordination of PFS's debt was not for a specific time, the subordination would remain until the C+M debt was repaid. Although subordination deeds can be registered on the PPSR, they have no determinative value.

Helpful to the C+M receivers but not interesting. However, if this argument had succeeded, it would have relied on the security issues to continue to be in play long after Anthum fell into receivership and it was the Court's comments here that are interesting.

PFS's argument was that the priority of securities could continue to change after the date that the securities came into conflict. The Act is silent on this matter and it is common for creditors to register on the PPSR after the company has fallen into receivership or liquidation.

The leading authority is a Canadian case (we lifted our PPSR case verbatim from Saskatchewan); Sperry Inc v Canadian Imperial Bank of Commerce, where the Canadian courts were clear: Once the competing securities come into conflict, then the issues become crystallised.

The High Court in Christchurch deferred to the Sperry case and declared that once a company falls into the hands of a receiver or liquidator then the issues crystallise.

Registering on the PPSR post liquidation or receivership for past debts is pointless.

Joie de Vivre

Anthem's director was the colourful David Henderson, (Southern). Henderson and the receiver of Anthum, Paul Sargison, became embroiled in a tug-of-war over a statue; the Joie de Vivre.

A frustrated Henderson ranted to the Otago Daily Times:

> *"This is just a continuation of incredibly childish and unproductive games by silly little men who get paid by the hour."*

It did him no good, Sargison kept the statute and Henderson lost his Joie de Vivre.

Joie de Vivre
JOY leaves ANTHEM.

Photo courtesy of Paul Sargison

Case 2

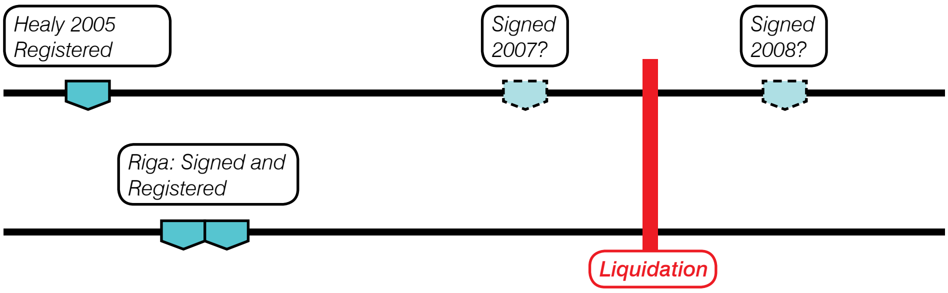
The second case involved two competing claimants over funds held by a liquidator (Waterstone, as it happens).

The first claimant (Healy) had registered back in 2005, but did not sign the paperwork. The second claimant (Riga) had a GSA signed and registered in 2006.

When asked for the paperwork both parties supplied them, but the liquidators had concern over the first claimant's paperwork and sent it off to be forensically examined.

The forensic analysis showed that the paperwork had been backdated, and the liquidators suspected that they had been signed post liquidation but were certain that the documents had been signed after the GSA holder had signed their paperwork.

The time line looked like this:



Faced with this uncertainty the liquidators favoured Riga. Healy tested the matter in the High Court and the High Court made two findings:

A) The documents were likely signed post liquidation, and therefore legally void
B) Even if they were signed pre-liquidation, they were signed after Riga had perfected, and therefore Riga would prevail.

The second part of this finding was not widely accepted by legal and academic commentators.

Healy took the matter to the Court of Appeal and the Court of Appeal made two different findings:

A) The court is unable to determine when they were signed.
B) If they were signed pre-liquidation, then Healy would prevail.

The issue is Section 66 of the PPSA, which states that unless there is another priority rule in the Act, whoever registers first will prevail. The High Court accepted the liquidator's arguments that Section 36, which deals with the enforceability against third parties, was a priority rule.

> Section 36: An oral security is valid. If you lend money to a company and agree on a handshake that you have a security then your security can be enforced against the company. You can register this on the PPSR if you want.
>
> However, if there is a competing claimant then your security must be in writing, otherwise it will fail against the third parties written security agreement regardless of when it was signed or registered.

The Court of Appeal did not; they favoured the conventional wisdom, that what matters is who registered first regardless of when it was signed.

The first thing to remember is that you can register on the PPSR at any time. You do not need the permission of the debtor to do so. If you have a mind to, you can legally register a GSA over Air New Zealand even if they do not owe you any money (we do not recommend it). It will have no legal validity unless you actually advance money to the airline and, critically, they agree to the security.

It is common and legitimate commercial practice for firms intending to advance credit to register on the PPSR. The importance of doing so has become ever more clear.

Money Laundering and North Korean Guns

Back in 2010 a plane charted to New Zealand registered company, SP Trading, was seized by Thai police and found to be involved in smuggling arms for North Korea.

A little awkward, but also kind of cool, let's be honest.

The issue was that anyone can register a New Zealand company. You do not need to be in New Zealand, in fact, you do not even need to exist as there is no means that the companies office can use to verify your identity.

The MED looked at this issue, including the fact that any man and his dog can register a company, and looked at five responses. Only two of the proposals survived and legislation to enact them has been drafted.

The bill is the Companies and Limited Partnerships Amendment Bill. It is currently so low on the priority list it does not even appear on the order paper, yet it is coming. The two changes are:

The New Zealand Agent

A company must have a New Zealand resident director, or a director who lives in an *Enforcement Country*. If it does not, then the company must appoint a Resident Agent. This agent is not liable for any of the duties of a director, such as reckless trading, although they will be liable for breaches of a number of sections of the Companies Act around maintaining company records, but the maximum consequence for a Resident Agent is a $5,000 fine, which is not a deterrent.

The resident agent can be used for legal documents and servicing a Resident Agent will be a valid means of servicing the company.

An Enforcement Country is a country that can enforce New Zealand judgements; mostly first-world Commonwealth nations.

Schedule Ten

The Companies Act is going to get a new schedule that empowers the Registrar of Companies to enforce compliance with the reporting obligations of Companies.

These additional powers mostly revolve around giving the Registrar more powers to de-register companies. The current law allows the Registrar to remove a company if he believes there is no reason to keep the company registered. The new law allows the company to be struck off if there are reasonable grounds to believe that the company has no proper reason for being. This is a significant shift in legislative thinking and places the burden of proof onto the company that is subject of the Registrar's interest.

This Russian built Il-76 cargo plane was chartered by SP Trading Limited, a New Zealand registered company, for the purpose of North Korean arms smuggling. Here is it being detained by the Thai military in 2009.

Proposal	Recommendation	Result
Identity Verification of Directors	ID forgery too easy	Abandoned
Increased Registrar powers to enforce registry information	Recommended by the MED	Adopted. Being legislated
NZ Director or Agent	Proceed	Being legislated
Require Director Date of Birth	Recommended, but not searchable on register	Abandoned
Mandatory tax numbers for directors and shareholders	Despite some logistical issues, recommended	Abandoned

Law Commission to look at Joint and Several Liability

The liability of local councils for the entire cost of a leaky home may seem unfair when the council's negligence was not the only contributing factor. Under current common law however, councils can be held fully liable under the principle of Joint and Several Liability.

Typically the defendant will only be held jointly and severally liable if their actions lead to the same loss as other possible defendants. The counter legal philosophy is proportionate liability where each defendant's liability is for the loss or damage that the court determines is just, taking into account the relative level of fault or negligence of all of the parties involved.

The legal underpinnings of both are very different but the key difference is under the joint and several liability doctrine it is the defendants who must bear the risk of their other defendants becoming insolvent. This is why local councils are being caught as the other parties, mostly property development limited liability firms, have long ceased trading.

Under proportional liability is it the plaintiff who must take this risk. The Law Commission is just commencing its review. Typically Law Commission reviews receive a very small number of submissions. The opportunity to have an impact is therefore substantial for those with an interest in this area. Details are available at the Law Commissions website.