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waterstone INSOLVENCY

EDITION 5

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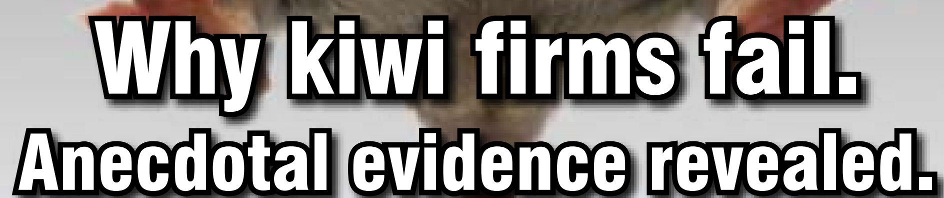


Voluntary Administration and the GSA

Pity the GSA holder. More often than not a GSA is a worthless piece of paper. GSA holders are often surprised by this.

A GSA does not cover the company's main assets, their debtors book and inventory.

Section 2(1)(b) of Schedule Seven (that legislates how the liquidator must distribute a liquidated company's assets) specifies that a firm's stock and debtors are not available to a GSA holder, and must be used to pay preferential creditors.

In an insolvent firm almost all physical assets have a specific PPSR security, land is always mortgaged, and it is pretty rare to find cash in the bank. What is left is office furniture and outdated computers.

Confronted by little or no unencumbered assets being available, the options facing a GSA holder when the debtor company begins to struggle are limited.

In many cases GSA holders are walking away from their debts. We think they should look closer at the Voluntary Administration (VA) regime.

One of the main benefits of the VA regime is the ability to allow firms with positive cash flow but large historical debts to be financially restructured and trade on. A deal to restructure the creditors, the Deed of Company Arrangement (or DOCA) is not binding on a GSA holder, whose debt can remain intact even as unsecured creditors see the value of their debt slashed.

For a GSA holder this is a critical point.

Not only does their debt remain intact, their financial position is greatly enhanced as the balance of the business is improved and the prospect of being repaid is correspondingly greater.

One area of the new regime that has not received much coverage is the fact that the new legislation specifically gives the right for a GSA holder to put a company into Voluntary Administration, as opposed to receivership (section 239K). To date, this right has never been exercised.

In almost all cases where there is a viable business buried in a bad balance sheet the best return for all parties is where the business is able to trade on and repay the GSA holder back over time.

A GSA holder may consider putting a company into VA if they wish to see the unsecured debt restructured and the business to continue on as a viable entity.

Eleven interesting ways to become bankrupt

According to Paul Simon, there are fifty ways to leave your lover (and this was before texting, twitter or simply updating your facebook status!). However, there are eleven ways for the courts to bankrupt an insolvent (the legal term for someone unable to pay their bills but not yet bankrupt). We detail those eleven here.

"Just slip out the back, Jack"

Section 17
Failure to comply with a bankruptcy notice, or failing to pay a due debt.

Section 18
If a debtor puts most of his assets in trusts for the benefit of a limited pool of creditors, this is an act of bankruptcy.

Section 19
Fraudulently disposing of assets, or attempting to favour one creditor over another.

Section 20
Leaving, attempting to leave, even obstinately remaining outside our shores, if done with the intention to defeat creditors is an act of bankruptcy.

Section 21
Avoiding creditors can itself be an act of bankruptcy. An entertaining case in the commentary is Mr Puels. Halfway through a meeting with his creditors in 2005 Mr Puels received an 'important call'. In classic Basil Fawlty style, Mr Puels simply left the room and did not return to that meeting. He subsequently avoided his creditors assiduously. The court was unimpressed and Mr Puels was declared bankrupt.

Section 22
If a person advises any of his creditors that he is about to suspend payment of their debts.

Section 23
Perhaps the oddest Section. The insolvent must be in a meeting with his creditors and must:

A) Admit that they are, in fact, insolvent and be required by a majority of creditors to apply for bankruptcy
or:
B) The Insolvent undertakes of his own volition to apply for bankruptcy but fails to do so in two working days.

Section 24
The debtor defies a court order concerning enforcement action against the debtors assets, ie: the court orders the surrender of property and the debtor defies the court order.

Section 25
The debtor fails to sell assets as ordered by the court.

Section 26
A debtor has insufficient goods to satisfy an execution order.

Section 27
A debtor moves or hides assets with an intention to defeat their creditors.

Section 29
A person required to hold a trust account (Real Estate Agent, Lawyer, probably even a liquidator) fails to comply within five working days of an order to pay trust money.

Why do birds sing, and why do companies fail?

One of the most misquoted bits of information about insolvency is that 80% of businesses fail in the first five years.

In New Zealand there are less than three thousand liquidations per annum, a fraction of the number of businesses. Of course, a liquidation is not the only form of failure. The most common process in New Zealand for a firm to disappear is for it to be struck off the companies register.

There is no structured method of measuring company failures in New Zealand, nor for investigating the reasons, or even of being able to identify the quantum. All we are left with is anecdotal information from insolvency practitioners.

So here is some anecdotal information from our practice!

We took the most recent 150 insolvencies we have undertaken (138 liquidations, six voluntary administrations and six receiverships). We excluded the solvent liquidations.

We then took a view as to the cause of the failure. If there were multiple causes of the failure, multiple reasons were given by the case manager of the file.

We got the following results:

	A Factor	Only Factor
Economy	24.4%	18.9%
Incompetence (director, manager)	41.7%	29.9%
Misappropriation by directors of company assets	15.7%	11.0%
Flawed Business Model	14.2%	11.8%
Insufficient Capital	0.8%	0.8%
Misfortune	9.4%	0.8%
Shareholder Dispute	5.5%	3.1%

The stand-out result for us was that the competence of the director was a factor in 40% of business failures and the only reason in nearly 30%.

Old chestnuts such as a lack of capital barely rated a mention and dubious business practices and a faltering economy were also primary drivers.

Misappropriation of company assets is a major problem, especially with directors who have been through the liquidation process previously.

Of course, this is not a representative sample. No scientific analysis can be attributed to this data and the subjective opinions of insolvency practitioners observing the failure after the fact can be expected to colour the data according to their own bias. But it is interesting.

Failing firms

Section 47 of the Commerce Act prohibits the acquisition of one business by another if such a merger would substantially lessen competition in the market that the two firms operate in.

Section 66 of the Commerce Act allows for the Commerce Commission to approve for clearance proposed acquisitions in advance. The Commission will grant this clearance if satisfied that the acquisition will not substantially reduce competition.

The Commerce Commission will consider allowing a merger if the firm being acquired is failing. The reasoning is, or part thereof, that if the firm was going to fail the assets and resources employed by the failing firm would depart the industry anyway, so their being acquired by a competitor will not actually reduce competition.

The Commission is forward looking in this respect. It does not look at *what is*, it looks at *what is likely* to be if the proposed acquisition does not occur. In their own words, they look at *"with and without the merger, not before and after"*.

Prior to such consent being given the commission will want to be convinced that the firm or division is actually failing. *"Claims of imminent failure will not be accepted at face value."* Two cases show the Commission's approach.

The first was an application by Southern Cross Health Care to enter a joint venture in Palmerston North. Southern Cross wanted to merge its hospital with another in the region. The Commission rejected the application because Southern Cross was unable to provide proof that the board of Southern Cross had considered closing their hospital, and there was no evidence of alternative strategies being employed by Southern Cross (such as price rises, etc) that would provide evidence that Southern Cross was serious about closing the hospital. In essence, the Commission did not believe that failure was imminent.

A contrasting example was that presented by Fletcher Building when they wanted to acquire two divisions of Stevensons masonry business.

Stevensons was able to demonstrate, through board resolutions and attempts to previously divest itself of the divisions, that they had decided to exit the relevant markets, by either closing or selling the loss making operations. In this case the Commission allowed the acquisition.

The Commission will look at the internal cost structure of the parent company, including any possible internal allocations, such as contribution to corporate overhead, and (as in the Southern Cross case) strategic reasons why the parent company may want to keep a loss making subsidiary.

Evidence that the commitment to exit the market is genuine will be the Commission's starting point. Failure to convince the Commission on this point will result in the application proceeding no further. If the Commission is satisfied that the commitment to exit is genuine then they are undertaking to process the request for a Section 66 approval expeditiously.

This dead cat has some bounce

A famous American Economist, Herb Stein, once declared that: "If something cannot go on forever, it will stop."

The New Zealand Treasury advises that the cash shortfall in the five months to the end of November 2009 was $5.28 billion. The department of statistics estimates that there are 2.1m kiwis in employment. Putting those two numbers together gives us a burden of $2,500 per working New Zealander in those five months, or over $110 a week per working citizen.

Clearly, the New Zealand government cannot continue to borrow at such a rate forever, but it can do so for a long, long time.

New Zealand's government debt to GDP ratio is only 12.3%. Japan's government debt to GDP ratio hovers at around 200%. Greece, facing default on its sovereign debt, is well over 100% of GDP.

The government's own forecasts show a ballooning of government debt to around 40% of GDP. The hope is that economic growth will solve the problem, saving the country from some unpalatable alternatives.

If the current level of government borrowing sparks renewed economic growth this will mean a larger economy. As long as the interest payments are kept current, the debt burden will manage itself down over time. Similar to borrowing $50,000 when you are a poor student but repaying it twenty years later from the healthy profits of your successful dental practice.

This has proved a successful strategy in the past for New Zealand (and for some dentists) and despite the handwringing from some commentators there is hope that this strategy will prevail. Three things bode in the country's favour:

1) The first is demography. New Zealand is getting grey but it is a gentle decline. Our average age has risen from 34 a decade ago to 36.5 currently, and there is a consistent influx of urchins to put some spring in our increasingly arthritic step. Of the 47,000 increase in population last year, 12,500 was from net migration. Net population growth is still at a healthy 1.1% per annum. Of course, as your grandfather will tell you, the quality of young people in his day was far superior to that of today's youthful rabble, so an increase in population is no guarantee of success, (see Bangladesh) but economically it means that the debt burden being raised by Bill English today will be spread over more people tomorrow. Even if some of those people, or their parents, currently live in Shanghai, London and Durban.

2) The second thing going in the governments favour is the low level of current government debt. This allows a large level of wriggle room. A low debt to GDP ratio gives borrowers confidence that the New Zealand government is a good bet, and the independence of the Reserve Bank makes it difficult for the government to default on its obligations by printing money. Thus, the government can easily borrow the twenty to forty billion dollars planned by Mr English without causing a credit downgrading or crisis of confidence in the New Zealand dollar or economy.

3) The third thing working for our Finance Minister is that the strategy appears to be working. Confidence is up, spending is on the rise, and although unemployment is sticky most people who have jobs are confident about keeping them. Confident people spend, and when consumers spend business people invest to try and capture some of that spending.

However, there is a huge risk in the government's strategy.

The current feeling of economic well-being is being fuelled by a warm bath of borrowed money and not underlying private sector activity. The private sector is not foolish. They know what the government is doing and they know that there is a cost to this borrowed money. A rational approach by the private sector in this environment is to do enough to capture a share of the government's money as it cycles around the economy but not commit capital to projects that would actually contribute to underlying economic growth.

If the government runs a deficit for one or two years the private sector may believe that the additional debt burden is manageable with no significant impact on medium or long term economic activity. But with each passing year the cumulative debt burden becomes more of an issue and the ultimate costs will weigh on private sector thinking, reducing any enthusiasm for investment.

If economic growth does not solve the problem the government faces some unpleasant choices:

1) Raise taxes or cut spending. Always possible but much more difficult in an MMP environment than it was when Sir Roger Douglas and the honourable Ruth Richardson warmed the hot seat.

2) Print money, allowing the value of the dollar to fall relative to real goods; ie; inflation, making those who hold government bonds pay the real cost. Again, very difficult given the statutory independence of the Reserve Bank and the economic fallout that would befall the economy if this was revoked.

3) Default; taking the Argentinean route, pay cents in the dollar when the markets get over the shock.

If either of the above three seem unlikely, so did floating the dollar, removing export subsidies and selling most of the government's huge asset base in 1984. If something cannot continue forever, it will stop. There is a cost to borrowed money and somebody must pay that cost.

The current government strategy may prove successful, in which case the cost will be small and spread evenly over a larger and more prosperous New Zealand. But it might also fail, and if it fails New Zealand is in for a long period of increasing debt, reducing private sector investment and a delayed day of reckoning that will be all the more painful when it finally arrives.

Cute today, but like government debt, will be a hard to control when it is larger.

Voidable Transactions: The why

By Bruce Wang

Consider two conflicting public policy goals:

1. In a liquidation all creditors are to be treated equally, paid according to the priority set down by Schedule seven (staff first, overdue GST and PAYE, then unsecured creditors).

2. It is important that suppliers to firms in trouble continue to supply, enabling struggling firms an opportunity to trade out and return to profit.

During the insolvent period of the company it is common for the director to make preferential payments to some creditors. Those creditors are often connected to the director, hold some commercial power or the director has a personal guarantee.

The purpose of introducing voidable transactions is to give the liquidator power to unwind payments if the liquidator considers that a payment has given the one creditor a better result than what could be achieved in a liquidation.

Because of this power, firms became very wary of dealing with other firms if insolvency is suspected. In an attempt to meet the first goal, the second objective was compromised.

This thinking was behind the legislative change from the *ordinary course of business* defence to the *running account* test.

For a transaction to count as *insolvent*, and therefore *voidable*, the liquidator must establish that the transaction enables one party to receive more towards satisfaction of a debt owed by the company than the party would receive, or would be likely to receive, in the company's liquidation.

Previously, if the recipient of the funds could prove that the payment was made in the *ordinary course of business*, the payment was not recoverable by the liquidator. This was a difficult test, especially if the supplier changed terms from credit to Cash-On-Delivery as a result of non-payment problems.

A significant change to the legislation made by the Companies Amendment Act 2006 is the inclusion of the *running account* exception, replacing the *ordinary course of business* test.

When challenged over insolvent transactions, many creditors are still relying on the old exception rule, unaware that the legislation has changed.

The government's decision to introduce the *continuing relationship* or *running account* exception was based on a perception that this new test had worked well in Australia, appeared to be more certain than the *ordinary course of business* test, and would encourage creditors to continue to deliver to their probably insolvent customers.

Section 292(4B) of the amended act directs the courts to view a series of transactions that are part of a continuing business relationship between the company and its creditor as a single transaction. When deciding whether that transaction is one that enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or be likely to receive, in the company's liquidation.

Put simply, if in the six months before your customer's liquidation you provide goods and services worth $X, and you receive more than $X, then only the payments that you received over $X can be challenged under the running account test. If you are paid for the goods and services you provided in the last six months, payments equal to the value of the work done are safe. It does not matter if the payments were credited to older invoices.

As an example: assume a firm where it was standard practice for goods to be supplied in one month with payment to be made on the 20th of the following month. Suppose this practice was followed by a company and its main supplier. When the company became insolvent it owed the supplier $50,000. The supplier became aware that the company had cash flow problems, but agreed to continue to supply goods to a value of $5,000 a month so long as the company paid at least $5,000 a month at the start of each month (not on the 20th of the month as had previously been the normal practice). The supplier also demanded a one-off payment of $10,000, which was paid.

The supplier was also made aware that the company was attempting to delay payment to some of its less important suppliers. In this case, supplies continued to be made and payments continued to be received for the next 6 months. At the end of that 6 month period the company went to liquidation.

In some cases the liquidator can go back 24 months but normally they stop at six months.

Under the previous rule each of the ten payments of $5,000, plus the extra $10,000, made by the company to its supplier following its insolvency but before its liquidation could be challenged by the liquidator as a voidable preference. The payments all took place in the 2 year specified period, while the company was unable to pay its due debts. It is likely that such payments would have enabled the main supplier to have received more towards its debts than it would have otherwise have received in the liquidation of the company.

The *ordinary course of business defence* is unlikely to be of help given the knowledge that the main supplier had regarding the company's financial difficulties and the way in which the company was paying its creditors during the last 6 months of its existence.

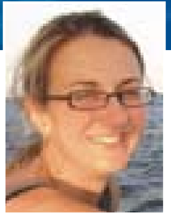
Under the new rules, the payments, even though they were in advance, were for work done during the specified period, and are safe. Only the one off payment of $10,000 was a payment for old debt, and is an insolvent transaction.

The *running account* exception is a more equitable regime and gives suppliers of insolvent firms confidence that payments they receive for work done is safe.

Bruce Wang is an Insolvency Officer at Waterstone Insolvency.

Our mascot Prudence, at the Inca Ruins of Machu Picchu, Peru.

Avoiding cash crunch



By Rebecca Hindwood

According to the Longman Business Dictionary a cash crunch is defined as being: *"when an organisation does not have enough money to operate successfully."*

Many businesses suffer significant cash drain during the Christmas and New Year period. Debtors stop paying. A substantial amount of holiday pay is paid out to staff producing no income for the business. Companies that were unable to build a cash buffer in the lead up to Christmas will be feeling the pain of cash crunch as a result of little or no cash coming in and lots of cash going out.

This crunch has a cascading effect as money ceases to cycle. Our monitoring of the causes for debtor non-payment shows a significant increase in their own collection problems being cited by respondents.

In this market, a monthly statement run and a little hope is not going to be sufficient. With Christmas and the January hiatus behind us it is time for New Zealand companies to focus on rebuilding their depleted cash balances.

A call is worth 1,000 emails

Start calling (not emailing!) your debtors immediately, and not just the overdue ones. New clients and those who have dragged their feet previously should all be called before their account falls due.

Calling in advance is a great way to avoid any nasty non-payment surprises after the 20th of the month. We recommend you get on the front foot with your debtors – place a friendly call before debts are due to check:

- have they received the invoice?
- in the debtor's view is the invoice correct and therefore payable?
- the date and method by which you can expect payment!

Asking the first question gives you the opportunity to resend the invoice if it has been "lost". Asking the second question gives you the opportunity to reissue the invoice or raise a credit note if there is any dispute about the amount owed. Question three prioritises paying you in the debtor's mind.

So, the 20th of the month has past, and your bank balance still looks grim. Don't sit and wait until next month in the hope that overdue debtors will magically materialise in your bank account. Call again. Work through the issues raised by the debtor with the aim of resolving them by the end of the phone call. If they mention cash flow issues or say they are unable to pay, take note and try to get such claims in writing (email is okay here!). Admissions of insolvency are a great weapon to have in your arsenal if you have to go legal later.

Be sympathetic. Agree with the debtor that managing cash flow can be difficult at this time of year or in the current economic environment, whatever works. Talk through their issues and encourage them to propose a payment arrangement. First try to get them to commit to paying in full by an agreed date. If that doesn't work go for half now and half next month. Or if things are really dire ask for a lump sum upfront as a sign of good faith and a weekly payment plan for the balance until the debtor's cash flow improves or the debt is fully paid.

Getting Serious

Send a demand letter to the debtor. In person if you are bold enough. If you are a bit unsure engage a debt collection agency to do it for you.

Once your debt is referred to a debt collection agency the standard approach is to send a letter demanding payment by a specified date. The letter should also warn of consequences that will follow if payment is not made.

Persistent, recurring phones calls should then follow and continue until the debtor pays, agrees to and honours a payment plan, disputes the debt, or admits that they have cash flow issues.

In some cases site visits can be a very effective strategy for a debt collection firm.

Going Legal

Going legal is often a last resort because creditors perceive it as expensive and slow. Not all legal tactics will break the bank. At Waterstone Recovery some of our favourite cost effective legal tools are the Disputes Tribunal, Statutory Demands and Deeds of Settlement.

On the 1st August 2009 the Disputes Tribunal claim limit increased from $7,500 to $15,000. If both parties agree, the Tribunal can hear claims up to $20,000 (up from $12,000). With a maximum filing fee of $100, the Disputes Tribunal is an inexpensive way to resolve a dispute. The Tribunal is not a formal court – parties must represent themselves and disputes are heard by a referee - there are no lawyers or judges involved. Having an enforceable ruling for greater than $1,000 opens the way for the issue of a Statutory Demand.

A Statutory Demand is a legal demand that a company pay a debt due within 15 days. A Statutory Demand is also a test of solvency. If you have an admission of cash flow problems or insolvency from the debtor you have strong grounds to serve a Statutory Demand.

Often the issue of a Statutory Demand or the likelihood that a creditor will commence legal proceedings brings the debtor to the negotiating table. In this situation, a Deed of Settlement that commits the debtor to an agreed payment plan and extracts a personal guarantee as consideration for taking legal proceedings off the table, extending payment terms, or both, provides the creditor with the security of recourse to both the company and the individual if the payment plan is not honoured.

In the end, successful debt recovery is all about prioritising paying you in the debtor's mind.

Rebecca Hindwood is the Manager of Waterstone Recovery Ltd.

Reckless directors:

Australian abuses of the VA regime migrating across the Tasman

By Steven Khov

It has become common practice for Australian directors to use the Voluntary Administration (VA) regime to escape exposure to a reckless trading prosecution. DOCA's are put up to unwitting creditors offering a few cents in the dollar, which they must accept or face the uncertainly of liquidation and probable zero return.

Because an Administrator cannot bring a reckless trading prosecution, but a liquidator can, passing DOCA's are seen by some Australian directors as a good insurance policy.

Some of you may recall John Elliott. A famous Australian businessman, raconteur, sometimes president of the Carlton Football Club and the Australian Liberal Party, not to mention an occasional associate of our own Alan Hawkins.

Mr Elliott was a director of an Australian business, Water Wheel Holdings Limited. The company fell into trouble and was placed in Voluntary Administration, and DOCA's duly passed in June 2000.

Alas for Mr Elliott the Australian Securities and Investments Commission (ASIC) took the view that Mr Elliott had breached his duties as a director under Section 588G of their Corporations Law, (effectively reckless trading). They succeeded, and he was found liable by Victorian courts for $1.4m of losses suffered by creditors. He was further banned as a director for four years, effectively ending his business career (but not his career, you can find Mr Elliott blogging furiously on his website www.jdereport.com.au.)

Mr Elliott fell foul of ASIC, and not a liquidator. The strategy of passing a DOCA to escape the harsh glare of a liquidator's gaze was successful. Thus the importance of the Elliott case should not be overstated. ASIC do not take many cases, and it may have had a particular axe lying in wait for Mr Elliott.

What lessons can New Zealand creditors and directors learn from the Australian experience?

We have already seen cases where a VA has been used by New Zealand company directors looking to avoid a potential reckless trading prosecution. As in Australia, a liquidator can take a reckless trading prosecution and a voluntary administrator cannot.

New Zealand has no equivalent to the Australian ASIC regime for taking prosecutions. The Registrar of Companies only has the power to ban individuals from being directors but does not have the power to bring reckless trading prosecutions. This power rests solely with a liquidator. This means that if a company enters into a DOCA, then the director will avoid being liable for reckless trading.

This creates an issue as to whether the directors appointed an administrator for the purposes of maximising the return to creditors, which is what the legislation was intended for, or to preserve the directors' position?

The objectives of voluntary administration as outlined in New Zealand legislation are to:

a. maximise the chances of the company, or as much as possible of its business, continuing in existence; or

b. result in a better return for the company's creditors and members than would result from an immediate liquidation of the company.

The question is whether the director acted in the best interests of the company in appointing an administrator as required by legislation? In the US a prerequisite to a Chapter 11 petition is a 'Good Faith' Test, whereby three branches are tested;

- is the company in financial distress;
- is administration going to maximise return to creditors;
- what is the motive behind the administration process.

However, in New Zealand and similarly in Australia, the only legislative test that is required is the solvency test before a company goes into VA.

In Australia, there is case law to suggest that the solvency test is not the only hurdle to cross when it comes to the appointment of an administrator. Therefore, a 'good faith test' is implied in the legislation. In the Australian case Kazar v Duus, the judge declared:

"...if the power to appoint an administrator is exercised for a purpose unrelated to that object but for an ulterior or extraneous purpose, then it will be invalidly exercised."

In Cadwallader v Bajco Pty Ltd, the presiding judge described the directors' powers to be a 'fiduciary power' and improper use of this power is a "breach of duty owed to the company...". This case went to the New South Wales Court of Appeal and the Court affirmed that the court is entitled to look at the situation objectively to ascertain the purpose of the exercise of power.

In New Zealand to date there is no litigation involving a case where a DOCA has been used by a director to avoid a reckless trading prosecution. However, as a creditor voting on a DOCA, an important thing to keep in mind is whether the DOCA will achieve a better return than if the company was to go into liquidation. No doubt there will be directors that will use the VA process to avoid a potential reckless trading prosecution and it will be interesting to see whether there is a move to close the gap as VA settles into New Zealand.

Steven Khov is a liquidator at Waterstone Insolvency.

The PPSA, again

By Peter Drennan

The PPSA is a boring topic. We know. Honestly, we get it. So we thought we would give you a PPSA quiz. Everyone likes a quiz.

Here is the set-up: A regional airline: Jef's Charter Airlines (JCA): owes $2,000,000 to Royal Bank of Niue. The bank has a GSA, registered in March 2004. There are five staff owed $20,000 in holiday pay and the IRD is owed $240,000 in GST.

JCA goes into liquidation in December 2009.

Question One: *Washington Air Lease, a company that specialises in leasing planes, leased a plane worth $100,000 to JCA three weeks before liquidation. They did not register a PPSR, but they only leased the plane for one month. The lease contract said that the lease would automatically renew if not terminated by the parties. Can Washington Air Lease take their plane back?*

No. Under s17(1)(b) of the PPSA leases for a term of more than one year are deemed to be a security interest. 'Leases for a term of more than 1 year' is defined in s16 as including leases with the potential to extend beyond one year in term. The fact that the lease has only been in place for a month is irrelevant, the bank GSA will extend to the plane.

Question Two: *A month before liquidation, JCA flew ten executives to Queensland. The bill of $18,000 remains unpaid. When this money is collected, will it go to the preferential creditors (staff and the IRD) or will it go the bank?*

This money will go to the preferential creditors. Upon liquidation no security will extend to accounts receivable unless they meet the exception provided by Clause 2(1)(b)(i)(C) of Schedule 7 of the Companies Act 1993. This exception basically covers specific securities taken by factoring companies over accounts receivable.

Question Three: *Six months before liquidation, a Mr Fraser Lincoln broke his ankle in an unfortunate incident in Coatesville. He was unable to fly his private jet, so he leased it to JCA for a fixed term of 13 months. He did not register his interest on the PPSR. Can he come and collect his plane?*

Yes. As an exception to the scenario provided in question one, the definition for 'lease for a term of more than 1 year' excludes a lease by a lessor who is not regularly engaged in the business of leasing goods.

Question Four: *The Water Cooler Company "Aqua Sin Gas Limited" has two water coolers at the offices of JCA. They are left at the office and billed monthly. There is no paperwork other than the monthly invoices, the coolers have been at the office for the past 18 months. Can they come and collect their coolers?*

No. These again would be caught by the 'lease of a term of more than 1 year' definition. Even though there is no defined lease period the coolers have effectively been leased by JCA for over 12 months, and Aqua Sin Gas Limited is regularly engaged in the business of leasing goods.

Question Five: *The director of JCA, Jeff Quay, brought in a couch from his home and left it in the reception in 2003. Can he remove the couch?*

Yes. As the company merely possesses the couch this does not give rise to a security interest that must be registered. As such the GSA holders security can only extend as far as the rights of the company, that being the right to possess the couch. At any point the director can require that it be returned.

Question Six: *The company purchased a Lear Jet (350) in 2002. By 2006 it was fully paid off. In 2007 the Peoples Bank of Wanaka lent JCA $300,000, using the jet as security. They registered their security on the PPSR. Can they come and collect their plane?*

No. As both the Royal Bank of Niue and the Peoples Bank of Wanaka have perfected security interests in the jet, the priority rules in s66 of the PPSA will dictate who has the highest ranking security. As the Royal Bank of Niue's security was registered first it will take precedence. The exception to this rule would be where the money lent by the Peoples Bank of Wanaka was used to buy the plane, and they had registered a PMSI (Purchase Money Security Instrument) over the plane. In this case the plane was already owned by JCA at the time the Peoples Bank of Wanaka lent JCA the money, so the Lear Jet was simply used as a security.

Question Seven: *Two days before liquidation, Saturn IT Systems Limited delivered a new server to the office. It is still in the box. Saturn IT Systems Limited has a signed terms of trade that include a Retention of Title clause. The goods are not yet paid for. Can Saturn collect their computer?*

No. This transaction creates a security interest that must be perfected (registered on the PPSR) in order to be enforceable against third parties. The third party in this case being the bank's prior ranking GSA.

Question Eight: *Welsh Atlantic, a factoring firm, advanced money to JCA after taking ownership of invoices raised to an Australian travel agent. They have registered their security interests over JCA's debtor book. Can Welch Atlantic collect the debts from the Australian travel agent?*

Yes. As per the exception raised in question two the factoring company will have rights in the accounts receivable which rank ahead of the banks GSA.

Question Nine: *Sonic Head Phones Limited, a supplier of high-end noise reduction head phones has a deal with JCA. They supply stock to JCA on consignment. At the end of each month JCA accounts for any sales made to their customers and pays Sonic Head Phones Limited. The contract clearly states that the stock held on consignment and that title rests with Sonic. Can Sonic collect their consignment stock?*

No. The Romalpha clause in this situation is irrelevant as commercial consignments are deemed security interests under s17(1)(b). As these items are inventory they will be caught by Clause 2(1)(b)(i)(B) of Schedule 7, this provision provides that any security interest in inventory must be a PMSI. This means that the preferential creditors will rank ahead of both Sonic Head Phones and the banks GSA.

Question Ten: *Sonic Head Phones Limited realise that JCA are getting into trouble and decide to stop supplying stock and to take a PMSI over the inventory that JCA still hold. Can Sonic get their stock back?*

No. Under s74 of the PPSA all PMSI's inventory must be perfected (registered) prior to the debtor taking possession of the inventory.

Trick Question: *A PPSR security only lasts for five years, but it can be renewed.*

The above set-up depends on the Royal Bank of Niue confirming the PPSR security before it expires in March 2008. If they failed to do so they would still have a GSA but their security would be unperfected.

As with all PPSA and PPSR issues, some people may take issue with my opinions. Please feel free to email me with suggestions or further examples to be worked through in the next issue of Waterline.

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