waterline

waterstone INSOLVENCY

EDITION 8

INSIDE:

Are we too trusting?

Are we too trusting?

In 1866 the New Zealand colonial administration introduced death duties. To evade death duties citizens simply gifted their estates prior to their death.

It took 19 years for the state to respond by introducing gift duties in 1885, but they created a loophole; minor bequests would not be taxed.

There began a constant struggle between the wealthy wishing to evade death duties and the various forms of government revenue collectors who wished to lay claim to the assets of the recently dead.

The recently dead won. Those with assets gifted their wealth in small amounts over time to a trust. By the time they departed for Valhalla they hoped to have successfully disposed themselves of all their worldly possessions.

Parliament threw in the towel in 1993 and abolished death duties, but gift duties remained. What followed was one of the most remarkable acts of collective inertia in our nation's history.

Despite there being no death duties, hundreds of thousands of kiwis continued to gift their assets to a trust, an entirely pointless exercise to avoid a tax that had been abolished.

When considering the effects of the abolition of gift duties, the Treasury amassed the following estimates:

Number of trusts in NZ:	*400,000*
Number of trusts per head in NZ:	*10*
Number of trusts per head in Australia:	*38*
Number of trusts per head in Canada:	*148*
Costs of complying with gifting programmes:	*$70m per annum*
Amount of revenue raised by gift taxes:	*$1.1m per annum*

When pushed, trust lawyers will give a number of reasons for having a trust but most of them do not withstand scrutiny.

Tax Advantages:

Until very recently there was a lower marginal rate of tax on trust income than existed for individuals, but this advantage was only of benefit for people who had income earning trust assets and these are the great minority of individuals.

Attempts to smooth income from labour, as Penny and Hopper tried to do, was only ever going to work as long as the IRD did not investigate the tax payers affairs.

Means Tested Care:

It is possible to shield a person's assets using trusts so that the state will not discover them when it comes time to means test them for state support. Ignoring the ethical implications of attempting to cheat the state, parliament has given the bureaucrats wide leeway in dealing with just such a scenario:

Section 147A of the Social Security Act states:

> *"If the Chief Executive is satisfied that a person who has applied for a means assessment... has... deprived himself or herself of any income or property... the Chief Executive may... conduct the means test as if the deprivation had not occurred."*

This does not mean that the custodians of the social welfare budget cannot be hoodwinked by clever arrangements of a person's affairs but it means that the only truly effective way to defeat the intent of this legislation is to play a long and creative game, and it is probable that most people who set out to avoid paying for their own care when they are elderly either have enough money to be looked after privately or rush headlong into the long-goodnight without worrying about years of state-paid decrepitude.

Asset Protection:

This is the most common and most sustainable reason for setting up a trust, the ability to separate the actions of an individual from their assets; allowing them to behave recklessly in their personal affairs whilst remaining prudent in their financial ones.

There is no doubt some benefit from just such arrangements but these people are a very small minority.

The reality is those who have been careful and prudent in establishing cast-iron trusts are also careful and prudent in their business affairs. Those who mishandle their business affairs so badly that they fall into bankruptcy usually have no assets to be protected.

It is also, in our experience, that despite carefully putting their assets in trust, business people will wring every last cent from every source to throw at their dying enterprises before conceding defeat; begging the question why establish a trust in the first place?

This is not to say that trusts cannot be effective and powerful tools but that for most people there is little benefit from having one. Trusts are not free. Paying to establish one should be seen as a form of insurance. If you are a director of a finance company it would seem a good investment. If you are a government salary man it probably is not.

After avoiding death duties, a restful eternity.

Construction Contracts Act

By Ekta Raniga

The Construction Contracts Act (CCA) interacts with the insolvency profession in a number of ways but none is more interesting than in the issues of payment claims.

The CCA was designed to protect builders from dodgy developers, and specifically removing the pernicious effects of pay-if-paid contracts.

The Payment Claim

The core of the CCA is the Payment Claim. Here the builder issues an invoice in the specific form of the Act. The key requirements are; that the invoice be in writing, make reference to the CCA, detail how the invoice was determined and how much is due and when it is due.

The Payment Schedule

The developer, once in receipt of a Payment Claim, has twenty working days to respond by issuing a Payment Schedule. A Payment Schedule details what the developer is going to pay. If it is less than the Payment Claim the developer must detail why.

Critically, if the developer does not issue a Payment Schedule they are liable for the amount of the Payment Claim.

Alternatively, the parties can go to adjudication under the CCA if there is no response to the payment claim or the payee disagrees with the reasons given for the amount being less than they claimed.

Pay now, argue later

The CCA has an elegant section, 79, that prevents the use of set-offs or counter claims to be used when settling debts, unless those counter claims are undisputed or are court judgements. This has important implications when it comes to the use of statutory demands and the enforcement of debts as the two cases below demonstrate.

Adjudication

For disputes regarding a construction contract, the parties may start adjudication by serving a notice of adjudication. The adjudicator must decide the dispute within the tight time frames and an adjudicator's determination is binding on the parties and is enforceable in the courts as a debt due.

The Act also allows that an adjudicator's determination is binding and continues to be of effect even though a party has applied for judicial review of the determination or any other proceeding relating to the dispute between the parties has been commenced.

Payment Claims and Section 310

Section 310 of the Companies Act specifies that if you owe money to a company in liquidation, you can net-off anything that the company owes you, so long as this debt is over six months old.

This conflicts with Section 79 of the CCA, which does not allow such netting off. When builders first went to court to enforce unsatisfied payment claims the High Court was sympathetic to the developers argument that the 310 net-off should by logical extension be considered when bringing liquidation proceedings.

Section 79 should only apply when debt collection measures were being employed, and some legal beagles believe that a statutory demand should not be used for debt collection.

The Court of Appeal made short work of this argument, declaring what everyone knows; statutory demands are a means of debt collection, and therefore an unpaid payment claim can be used to liquidate a company.

The two cases illustrate this.

Canam gets a lift

Canam was engaged to build some lifts, which it did, for Ormiston Hospital. In September 2009 it issues a payment claim for $130,000. Ormiston responded with a payment schedule showing payment due of only $124,000.

Canam was willing to accept this lower amount but no payment was forthcoming, so Canam issued a statutory demand.

Ormiston claimed it had found defects in the lift and wanted to claim deductions of $78,000 for remedial work done to make the lifts operational. Ormiston went to court to prevent the advertising of the liquidation and, effectively, force Canam into either arbitration or trial on the amount owing.

The High Court dismissed Ormiston's attempt. Once a payment claim had been issued and no dispute raised by a Payment Schedule, the debt was due. A statutory demand can be issued and the developer liquidated or bankrupted.

Ormiston may well have a valid claim against Canam, but the principal of pay now, argue later applied. Ormiston would need to pay the money to Canam and then sue for the $78,000.

Sefton

Sefton Construction was the builder and Macennovy Trust Limited the developer. Sefton had issued a payment claim, it had not been met with a payment schedule so Sefton issued a statutory demand.

Macennovy went to court to have the statutory demand overturned. They were successful, as Sefton was unrepresented. Sefton was circling the drain at this point and was due to be liquidated on the day it was meant to be defending its statutory demand.

Once a liquidator was in office Sefton sought to recall the decision to strike out the statutory demand. Here Macennovy made the argument that now that Sefton was in liquidation they were entitled to the protection of section 310 and had a right of set-off.

The judge dismissed this argument and went further, declaring that a company in liquidation was entitled to rely on unpaid payment claims and liquidate developers even if the developers had net-off arguments that fell under section 310.

That specific argument has yet to be tried in court but in this author's view the argument in Sefton would prevail.

Ekta is a lawyer working for Waterstone Recovery.

The power of section 261

By Jane Pendarovska

It has been said that those who seek insolvency as a profession sometimes lack the people skills to become an accountant or sufficient personal hygiene to be admitted to the bar so it is not surprising that parliament had to legislate to force people to talk to us.

A liquidator stands in the shoes of the liquidated company so has access to all of the company's books, banking records, emails, lawyers files and anything else that the company may have had legitimate access to. In addition we can interview shareholders and directors *under oath*! This means that lying to a liquidator is committing perjury and this power is contained in section 261 of the Companies Act. Sending a notice seeking information is often called a *261 Notice*.

This power is not limited to shareholders and directors. It includes staff, bankers, lawyers, accountants and "other people whom may have knowledge of the affairs of the company".

It has been thought that this power did not extend to the company's creditors but under a recent judgement, Managh and Currie, a creditor was compelled to submit to a liquidator and be interviewed under oath.

Managh was the liquidator of Titan Building. He suspected that there had been voidable payments from Titan to a firm controlled by Currie in the last months prior to liquidation. The liquidator had sent out 261 notices and made requests, all of which had been rebuffed.

The liquidator was largely concerned with the payment of $16,833.38 just two months before liquidation. According to the liquidator it was essential to find out why the payment in question was made; whether it was for goods or services in fact supplied; what, if any, taxation consequences there were or might be; and whether or not there were any related parties involved.

Section 266 of the Companies Act allows for application to the Court by a liquidator seeking enforcement of a 261 notice, but the orders under 266 are only available against persons to whom 261 is applicable.

This case raises an important issue for liquidators faced with a lack of records from the subject company; as to whether they can compel production of and explanations for relevant documents from a recipient of company money under suspicious circumstances?

The liquidator's position here is that the payment of $16,833.38 may have been a payment for the debts of the company other than Titan Buildings, that other company being one controlled by Titan's director, Mr Hasselman. Managh points out that there is no evidence from Currie, and also no documentary evidence, that Currie's firm was a creditor of Titan Buildings.

Currie, on the other hand, submitted that he did not have the requisite knowledge of the affairs of Titan Building because he was a "mere recipient of money".

Having regards to the purpose of s261, which is to provide liquidators with critical and detailed information needed in the discharge of their duties, the judge came to the conclusion that knowledge of the nature of the payments from Titan to Currie's company is relevant knowledge of the company's affairs. It was directly material to the liquidator's concerns. Currie must be assumed to know why the payment was made, and more particularly whether it was made in exchange for goods or services.

The application was successful. Currie must comply with the requirements of the liquidator under s261 and must bring documents in accordance with the notice served.

This is an important judgement as it means that a liquidator's power extends to firms that potentially have exposure to a liquidator for a claim under section 292, the voidable transaction section of the Act. If someone is being interviewed under oath by a liquidator, they do not have the right to silence. This means that they must tell the liquidator what he wants to know even if by doing so the person is incriminating themselves. However, anything that a person tells a liquidator cannot be used in a criminal trial.

Jane is an Insolvency Officer at Waterstone.

ITM gets a hosing

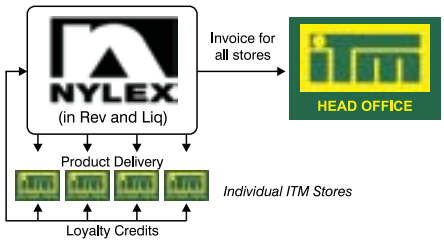
The right to set off debt owed is a fundamental feature of contract law. You cannot enforce a debt owed to you if you also owe the other party more.

This right is protected in a liquidation under Section 310.

In an interesting case last year the receivers of Nylex (the company was also in liquidation) sought to recover money owed to it by ITM.

ITM was a shareholder arrangement. The individual stores held shares in the main company. The individual stores would place orders with Nylex but the payments came from the ITM Head Office.

The loyalty credits, for typical goodies like travel and high quality loofahs, accrued to the individual stores.



When Nylex fell into receivership the receivers came looking for $181k. ITM baulked, knowing that their claim for loofahs were now likely to remain unsatisfied.

Did ITM Head Office have a right to off-set credits due to different but clearly related parties?

There were two issues. The first was the right to net-off, the second was those rights after liquidation.

Normally there is a clear right to net-off debts between trading parties but this right is limited in liquidation. If you owe money to a company in liquidation you can only net-off money owed to you that arose six months prior to the liquidation of the company.

However, the loyalty benefits appeared to have accrued over a longer time, so ITM Head Office had an automatic right of net-off if it was found that the loyalty benefits could be taken into account.

If Nylex was not in liquidation ITM's position would have been stronger but the rights to net-off in liquidation are covered by the narrow working of Section 310 and the critical wording for ITM was *mutual*.

The court found that the loyalty benefits accrued to the individual stores, there was no mutuality, so no automatic set-off right.

Nathan Finance: Enabled by Eunuchs

The Nathan Finance trial was an eye opening insight into the murky world of our lamented and recently departed second tier finance industry and the professionals who enabled it.

Justice Heath's 156 page deconstruction of Nathan Finance makes for an interesting and at times entertaining read.

Nathan Finance was a subsidiary of VTL, a firm developing vending technology products. Nathan raised money from the public, ostensibly for lending to third parties but most of its lending, 181m of it, was to VTL and almost all was lost.

The highest profile character in the dysfunctional circus that was Nathan Finance was John Hotchin. One witnesses characterised him as being 'aggressively commercial', a description Heath suspected Hotchin "... would wear as a badge of honour."

Some of Hotchin's emails are illuminating. Referring to a draft investment prospectus he types in frustration to his fellow directors:

> *"I strongly urge that the RISK section is changed as if this is going to market NO cash will come in.*
>
> *This is totally none commercial and I dought that any other company would give such indephth details as this, this is simply not commercial.*
>
> *I AM NOT HAPPY WITH THE RISK SECTION, IT NEEDS MODIFICATION URGENTLY."*

Spelling and emphasis are Hotchin's own.

But the real failure of Nathan Finance is that the very institutions that we expect to protect us from such disasters, the trustees, auditors and the Securities Commission totally failed in their duties.

The Securities Commission is defunct but there is merit in looking at how this institution failed to act quicker. In March 2006 the Commission wrote the following to Nathan Finance:

> *"We understand... Nathans was originally established to finance the activities of the VTL Group, and that it has since expanded into other commercial lending but is still significantly exposed to VTL. We query whether there is sufficient information given about this relationship to enable investors to properly assess the associated risks....*
>
> *It appears that, at least to some extent, Nathans acts as a funding vehicle or conduit issuer for VTL. Have you considered whether VTL might itself be an issuer of the debt securities offered by Nathans?"*

Criticising the Securities Commission for its failings is easy in hindsight. Had the Commission moved aggressively against Nathans it would have been hugely controversial. Nonetheless an objective analysis would indicate that the Commission failed to detect what was an unsustainable business model. This is disappointing because the legislation gave the Commission more than enough power to investigate the affairs of Nathans.

The Trustee, Perpetual, does not emerge with clean hands either. The trust deed placed all of the obligations on the directors to report to the Trustee. This means that the directors could have provided the trustee with complete nonsense and the trustee had little obligation to investigate further. The directors are therefore liable but it raises the question of what is the value in having a trustee? Waterstone has made our views on the uselessness of some trustees known before, so there is no need to labour the point. Their failure in this case is yet another disappointing example.

The auditors perhaps come out of this debacle the worst. A medium sized Hamilton based firm were attempting to audit what was a large, international and complex finance house. The Institute of Chartered Accountants have chastised the audit partner concerned and the receivers of Nathan Finance, PwC have indicated in their last report that they are suing the auditors for $73m.

There is, however, a small codicil to the Nathan Finance train wreck that has slipped below the radar, and that is the commercial disgrace that is Chancery Finance.

This was a sister company of Nathan Finance. It was owned also by VTL and it raised $17m from the public. It will come as no surprise to learn that this money was paid to VTL and was of course all lost.

What is stunning about Chancery however were the details of its liquidation. According to liquidator Bernie Montgomerie, investors were warned:

> *The Trustee has no power to enforce payment of the Bonds, even when Chancery and/or VTL group Limited was in breach of a provision of the Trust Deed.*
>
> *The Trustee could only take action to enforce repayment of the Bonds following the commencement of liquidation of Chancery and/or VTL group and then only after certain other events took place.*

The trustee was Covenant. It is hard to imagine more impotent commercial relationship. The trustee purports to represent the interests of investors but signs up a toothless trust deed.

This is perhaps apt. Men in power have long valued the impotence of eunuchs.

In perhaps the best part of the judgement Heath colourfully gives his own version of how the prospectus should have read:

The Original

The Company provides significant financial accommodation to its parent company and to VTL subsidiaries. These advances make up a significant proportion of the Company's current assets and are secured. Advances to VTL and its subsidiaries have been made on a commercial arms length basis...

Justice Heath's Version

The main purpose of the offer is to provide working capital to Nathan's parent company, VTL, and its subsidiaries. While loans to those company s take the form of revolving credit contracts made on usual commercial terms ,... credit processes used for other borrowers do not apply to them, Decisions about renewals of the loans are based on VTL's needs....

But I was secured, the section 305 dilemma

By Alan Preston

A liquidator has a powerful tool in section 305 of the Companies Act.

A section 305 notice compels a secured creditor to make a decision, within twenty working days, how they want to deal with their security:

The can either:

(a) realise property
ie: recover the asset. The creditor can still claim in the liquidation for any shortfall but must account to the liquidator for any surplus.

(b) value the property
The creditor must declare what the asset is worth. If their debt is greater they can claimed as an unsecured creditor for the balance. The liquidator is not obliged to accept the valuation.

(c) surrender the charge;
Walk away from the security and claim and claim as an unsecured creditor for the whole debt.

These first two options are not mutually exclusive, and a secured creditor who is not confident of a quick sale would be wise to have a valuation done in order to register the debts with the liquidator. This may mean that they are paid out quicker. However there is a trade-off. In electing to do both a creditor rules out their ability to adjust their unsecured claim at the time of realising the asset. There is a balance that should be sought here, as a liquidator could take advantage of a low valuation, and provided the creditor has not realised the asset pay out the value. This would release the security giving the liquidator full rights to realise the true value of the asset.

Our mascot Prudence waiting to see the Pope at Saint Peter's Square.

If a liquidator gives notice under section 305 then they are requiring the creditor to elect which one of the three options they are going to take, and to do so within twenty working days. If (b) or (c) are elected then those rights must be exercised in the same twenty day period. If the creditor remains silent they have therefore elected to forego their security.

Section 305 can be the thief that robs the king of his crown. It is the reason that secured parties need to remain vigilant and informed of their rights and duties with regard to their security. I have noticed that some liquidators are including a 305 notice in their first liquidator's reports, effectively vacating all securities.

There is however a small glimmer of hope hidden within subsection 10 which allows for a creditor who has let the twenty days lapse to re-establish their security with either the liquidator or the court allowing them to do so. Nonetheless, it is unlikely that any liquidator will allow a security to be reinstated, as this raises the bar in that they have to realise over and above that security before they can cover their fees.

The idea of this article is to establish some awareness about securities and the fact that it is not a safety blanket that guarantees you are kept warm regardless of circumstance. Creditors holding securities should know that they must reply to liquidators and elect their chosen course of action. Furthermore, they may also have to exercise their rights within this twenty day period. Creditors should be aware of this and should not sit by as their only source of warmth and security is slipping through their idle hands.

There is very little case law on this section but one case in particular is interesting. The liquidated company was called Boutique. The secured creditor, Consolidated, was a developer and contracted Boutique to build a subdivision at Gulf Harbour. Boutique went into liquidation and PKF Howarth was appointed liquidator.

Consolidated held security over Boutique so the liquidator sent Consolidated a 305 notice, asking them to elect option A, B or C above. Consolidated sought further information before making the election, wanting to know the value of the other unsecured creditors. The liquidator was unable to provide the desired clarity and Consolidated was deemed to have not responded.

The liquidator considered the charge surrendered, assigned the assets of Boutique to his liquidation firm and proceeded to realise the assets for the benefit of unsecured creditors, including possibly Consolidated although this was a further matter of debate.

Consolidated then went to court seeking to have the Court reinstate its security, which is specifically allowed in section 305. This may have been the first such time a secured creditor has done this.

Consolidated's position was further complicated by the assignment because the liquidator had effectively removed the assets outside of Boutiques' control.

This forced Consolidated to challenge both the assignment as well as asking the court to reinstate their security.

The High Court did both: setting aside the assignment which vested Boutique's assets back with the liquidation and reinstated Consolidated's security.

The Court went further. Consolidated was instructed to make their election twenty days after the liquidator provided to Consolidated the details of the other creditors.

Section 305 is a powerful tool in the hands of a liquidator, but the Boutique case demonstrates that liquidators have a requirement to be as helpful as possible to secured creditors seeking information prior to making their election.

This case also brings into question the practice of issuing a blanket 305 notice in a liquidator's report. This seems a dubious practice and one which, given the Consolidated case (2006) may not supported by the Courts.

Consolidated Technologies Development (NZ) Ltd v McCullagh

Alan is an Insolvency Officer at Waterstone.

Voluntary Administration: a rare success

By David See

Independent Magazine Distributors Limited (IMD) was a magazine distribution company with titles like *Inspire* and *Idealog* in its stable. In 2009 it sold its business in a complex deal that included delayed payment terms depending on the value of the assets acquired.

Unfortunately for IMD the upfront sale price was insufficient to clear the firm's current creditors and worse, there was a risk that the final sale price may fall short of IMD's expectations causing the firm to be insolvent.

Seeing the writing on the wall the board intervened and placed the company into Voluntary Administration, placing Waterstone in charge in January 2010.

Two issues confronted the Administrators. The first was the uncertainty of the actual level of creditors. The nature of the business meant that retailers could return magazines many months after they had received them and they would be entitled to a credit.

The second was managing and monitoring the retail performance of magazines that were now being managed by the purchaser as this determined the final sale price.

It is in these uncertain environments that Voluntary Administration proves itself a powerful tool.

As in liquidation creditors have a limited time frame to declare themselves. If they fail to do so they are ineligible for any distributions that the Administrators undertake. If they claim late they are limited to returns from subsequent distributions.

This is enormously helpful as it allows administrators to collect the firm's assets and pay them out in a systematic fashion and in the moratorium protection of Voluntary Administration the firm has time to collect its assets and collects its debts without ongoing creditor's pressure.

The DOCA prepared for IMD was straight forward. Waterstone would collect the money from the sale of the business, plus any other assets and debtors, and pay them out on a pari-passu basis to creditors who had submitted a claim.

The first payment was made within several months of our appointment, although it took over a year to collect sufficient funds to make the second distribution. When we did, however, we were able to clear all creditors out in full. 100c in the dollar, $1.2m was paid to the unsecured creditors.

Under prevailing case law the preferential status of the IRD's debt for GST and PAYE must be protected, which was done in this case, although the actual level of the debt was very small.

The company is now back in the hands of the board. I believe that IMD is New Zealand's largest successful DOCA and the first to pay creditors 100c in the dollar.

David is Waterstone's Financial Accoutant.

Werewolf Productivity

There has been much ado recently about differences in productivity. Being an insolvency firm we have no real understanding of productivity, we bill by the hour. Productivity seems an anathema, frankly.

However, not withstanding this we wish to wade into this heated and fraught area by confronting a difficult issue head on.

Werewolves. We know from the Twilight series and watching Anna Pacquin that these creatures are amongst us, and if they are amongst us then they are in our workplaces.

For werewolves, the morning after a transformation can be difficult.

Vampires are not a problem because they sleep during the day but Werewolves are indistinguishable from the rest of us, at least most of the time, so what implication does it have for the work place if you have a werewolf on staff?

Of course, werewolves have some remarkable qualities. They have excellent attention spans, unparalleled focus and an incredible sense of smell. However, and there is no easy way to say this and we do not wish to be prejudiced against werewolves but, once a month they get a little freaky. Each full moon they go from being polite, considerate, attentive and helpful members of staff into hairy rabid monsters ripping at the flesh of any poor creature that passes by.

During these difficult times werewolves need time off work and can be a little tense in the days leading up to, and the days after, their transformation. If the transformation has been especially difficult, the werewolf may have family or personal issues that they will need to deal with.

It is common for werewolves to wish to hide their true selves from other members of the business. This is understandable but a prudent HR officer should be attuned to the probable presence of a werewolf on staff and take precautions. Noting when the moon is full it is inadvisable to have a probable werewolf on a plane, giving a presentation, or involved in childcare.

On balance, werewolves can be productive members of any organisation but given their absences from work and occasional sudden mood swings it is natural for some employers to wish to pay them less than other employees.

This is an extremely foolish idea. Although placid enough when safely in human form werewolves retain their natural canine instincts and will attack in merciless pack formation if they feel threatened. Their blood lust will not be sated until the focus of their anger is dispatched.

Unfortunately, there is no mechanism for detecting a werewolf during the employment process. All that can be done once you have one on staff is tread carefully, plan ahead and maintain wage parity.

Beaten by the shell game

As liquidators one of our more frustrating tasks is chasing money and assets that directors move between entities.

Usually we lose, frankly. The law moves a lot slower than internet banking.

The difficulty we face was illustrated recently by the challenged faced by Deloitte in the following case.

The facts are this:

The 100, Eden Crescent, First City and Gore Street were all companies controlled either directly or indirectly by a Mr Godfrey.

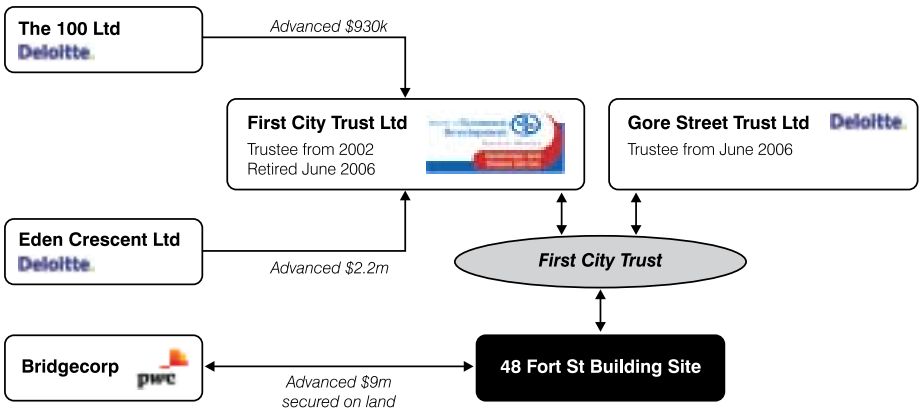
The 100 Limited and Eden Crescent were development entities that advanced unsecured funds to First City. At the time of the hearing they were both in liquidation with Deloitte.

First City Limited was a trustee of the First City Trust, that was developing land in Fort Street. In 2006 it was retired as trustee and replaced as trustee by the Gore Street Trust Limited.

Gore Street Trust was in liquidation, handled by the Official Assignee.

Sitting behind all of this was Bridgecorp, now in receivership, being looked after by PwC.

Deloitte wanted to have First City and Gore Street treated as one legal entity for the purposes of the liquidation. This made sense because funds from two other Godfrey companies, The 100 and Eden Crescent, were owed over three million dollars by First City but nothing by Gore Street.



What we have here is a shell game within a shell game.

The actual trading entity was a trading trust, the First City Trust. First City Limited was merely a trustee. Cash was moved from The 100 Limited and Eden Crescent Limited to First City Limited, presumably for the benefit of First City Trust.

Then, the First City Trust replaced its trustee, First City Limited, with Gore Street Limited. Now, First City Limited has an indemnity against the assets of the trust (even though the trust deed in question sought to limit this).

Deloitte were having none of this. This was one business, First City Limited and Gore Street Limited were the same, a pooling order should be made. The receivers of Bridgecorp, PwC, disagreed.

The relevant section of the Act is Section 271 and 272.

Section 271 allows for the court to order that two liquidated companies be treated as one if they are related entities.

Section 272 advises the court the issues to consider, and in summary they are:

- Degree of management co-ordination
- Conduct towards creditors
- The degree that the businesses were combined

In this case the court found that although clearly connected, the companies were not related for the purposes of the Act because they were not in business contemporaneously.

There was no real intermingling of the companies affairs. Because one followed another and the court felt that they could not be held to be related. There would have been no confusion between the those dealing with the two entities.

Business Interruption Insurance – Get It Right

By Steven Khov

Since the recent Canterbury earthquakes Business Interruption Insurance has been a popular topic in the region.

There are some pitfalls emerging with this product however, and one of the underwriters, Western Pacific, has fallen into liquidation leaving some policy holders without cover.

The main trick emerging is underwriters arguing 'Depopulation', the value of a business has fallen not due to the earthquake but because of depopulation due to people staying away from the affected area. There have been various instances of this in Christchurch, particularly in the CBD where access continues to be restricted.

Commercial landlords can claim for loss of rent. However, evaluating the reduction of rent may be more complicated than it seems. For example, if insurance proceeds from total building loss is used to pay out the mortgage on the property, the savings in interest may be deducted in the calculations.

Firms seeking to claim under Business Interruption need to estimate their reduction in sales, deduct from this the reduction in their cost of sales, and then add in any additional costs such as temporary premises and claim preparation costs to work out their entitlement.

Steven is the General Manager at Waterstone.