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Insolvency – latest news from the courts and legislators

Liquidator duties: first court ruling of its type

Consolidated Technologies Development (NZ) Limited v Anthony John McCullagh is the first case in which a court has ordered a liquidator to comply with duties under s286 of the Companies Act 1993.

Consolidated was a property developer which had contracted with company Boutique to build houses. Before the project was complete, Boutique went into liquidation and a liquidator was appointed.

Consolidated claimed that it was both a secured and unsecured creditor of Boutique. On the secured creditor claim, the liquidator served a notice on Consolidated requiring it to elect whether to:

- realise the property subject to its security;
- value that property and claim in the liquidation as an unsecured creditor for the balance; or
- surrender its security.

When Consolidated did not make an election within the 20 days required under the notice, the liquidator treated its security as surrendered and entered into a deed which assigned all of the assets of Boutique to Horwath Corporate (Auckland) Limited, an

accounting practice of which the liquidator was a director.

Breach of duties

Consolidated alleged that by entering into the deed the liquidator failed to comply with his duties and that he had breached:

- regulation 31 of the Liquidation Regulations 1994;
- the duty not profit from office;
- the duty to control proceedings; and
- the duty to act impartially and for a proper purpose.

Liquidation Regulations 1994

Regulation 31 of these regulations prohibits the direct or indirect purchase of the assets of a company in liquidation by a liquidator of that company. The court accepted that by entering into the deed the liquidator indirectly became a purchaser of Boutique's assets, and as a result, breached regulation 31.

The liquidator's contention that the deed was necessary to stop Consolidated from using its security to shield itself from any claim which could be brought against it by Boutique was rejected by the court.

“The court accepted that in entering into the deed, the liquidator breached his duty to act impartially and for a proper purpose.”

While the liquidator’s power to bring a claim on behalf of Boutique against Consolidated was subject to Consolidated’s right to realise the assets subject to its security interest, if Consolidated failed to take these steps it could not rely upon its security to prevent the liquidator from bringing a claim on behalf of Boutique.

Duty not to profit

The court accepted that by entering into the deed, the liquidator obtained benefits that he would not otherwise have received, including interest on unpaid fees and the use of funds. There was a further potential benefit in that Horwath Corporate may have recovered fees at a higher level than the liquidator could have reasonably recovered under ss276 and 277 of the Act.

Duty to control proceedings

The court also accepted Consolidated’s claim that the liquidator had improperly transferred his duties to control any proceedings which may be brought by purporting to assign the claims which he had available to him.

The court drew an important distinction between property vested in Boutique when it went into liquidation and the rights of a liquidator to pursue causes of action which arise after the liquidation. The latter was not an asset of Boutique and the liquidator had no ability to assign it pursuant to his power to sell or otherwise dispose of Boutique’s property.

In this case, the deed transferred all of the liquidator’s rights, title and interest in the Boutique’s charged property, and also irrevocably appointed Horwath Corporate as his attorney to conduct legal proceedings over the charged property. The deed therefore improperly gave Horwath Corporate ultimate control of any causes of action vested in Boutique.

Duty to act impartially and for a proper purpose

Finally, the court also accepted that in entering into the deed, the liquidator breached his duty to act impartially and for a proper purpose. Under s305 of the Act, Consolidated could apply to withdraw any surrender of its security which resulted from a failure to make an election pursuant to the Notice within 20 days, provided that the assets subject to the security had not already been sold. The court held that by entering into the deed the liquidator attempted to foil Consolidated’s ability to make such an application. In doing so, the liquidator failed to act impartially and for a proper purpose.

What the judgment means

The effect of the decision for the liquidator is potentially serious. Under s286 of the Act, if he again fails to comply with his duties in relation to the same or any other liquidation, the court could make an order prohibiting him from acting as a liquidator for up to five years.

Article 2:

Serving voidable transaction notices

The methods a liquidator can use in serving a voidable transaction notice on an individual have been clarified in a significant court ruling.

The High Court has confirmed that where the addressee of a voidable transaction notice, issued under s294 of the Companies Act 1993, is an individual, personal service is not required.

In *Right Point Investments Limited (In Liquidation) & Anor v Mottram*, the liquidators alleged that certain payments made by the company in liquidation to Mr Mottram were voidable. A voidable transaction notice was served on Mr



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Mottram by delivery to his letterbox. The validity of this method was questioned.

Liquidation Regulations

The starting point for serving a voidable transaction notice is regulation 40 of the Companies Act 1993 Liquidation Regulations 1994. It provides that service of a document in a legal proceeding must be effected either in accordance with the Companies Act, or the High Court Rules. The Companies Act provides for service of a document in a legal proceeding on a company, not individuals. The court therefore considered whether service of a voidable transaction notice was required to be effected under the High Court Rules.

The court accepted that a voidable transaction notice was “a document in a legal proceeding” for the purpose of regulation 40(1). With this conclusion, counsel for Mr Mottram argued that the voidable transaction notice was required to be served in accordance with the High Court Rules. In particular, counsel argued that rule 192, which requires personal service, must be complied with.

The court rejected this argument, noting that rule 192 states that it only applies to “service of a document that is required by these rules to be served”. A voidable transaction notice is not a document required to be served by these rules because a voidable transaction notice does not fall within the rules’ definition of “proceeding”.

As the court held that serving a voidable transaction notice on an individual was not provided for by either the Act or the High Court Rules, service was required in accordance with s391 of the Act. This allows for methods including facsimile and post. The liquidators had therefore validly served the voidable transaction notice on Mr Mottram by leaving it in his letterbox.

What the judgment means

The consequences of the decision are significant. It confirms that the regime for service of a voidable transaction notice on a company is more strict than that for an individual. Potentially, a voidable transaction notice could be validly served on an individual, but not come to his or her attention until after the 20 day period provided for in the notice during which action must be taken. For example, an individual on holiday may return to find a voidable transaction notice in their letterbox requiring them to action by a date which has already passed. There is no ability to extend the timeframe for taking action under a voidable transaction notice in such circumstances. As a result the recipient of a voidable transaction notice may be required to repay monies referred to in a notice, despite the fact that he or she had a valid basis for saying that the payments in question were not voidable.

Article 3:

Updating financing statements

Four years on from the Personal Property Securities Act 1999 (the PPSA) coming into force, creditors now appear to appreciate the significance of registering security interests on the Personal Property Securities Register (the PPSR). Creditors seem less aware, however, that there are circumstances in which they are required to update their financing statements. A creditor who fails to update a financing statement when required to do so could lose priority to creditors with competing security interests.

One of the most common threats to a party’s security interest results from a simple change in a debtor’s name. Section 90 of the PPSA requires that if a secured creditor becomes aware that a debtor has changed its name, it must either register a financing change statement recording the change of name or take possession of the collateral. This must be done taken within 15 days of the secured party becoming aware of the

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change of name.

The reason for requiring a secured creditor to take such action is to protect the integrity of the PPSR. If a debtor changes its name but a creditor does not update its financing statement to reflect this, anybody who subsequently carries out a search of the PPSR in the debtor's new name will not be alerted to the prior registered security interest of the secured creditor.

Requiring a secured creditor to update its financing statement reduces the risk of a prior registered security interest not being revealed. Requiring the update is balanced, however, against the fact that a secured creditor is only required to register a financing change statement where it is aware of a change in the debtor's name. A secured creditor cannot be penalised for something it was not aware of.

The effect of failing to register a financing change statement where a creditor is aware that a debtor has changed its name is significant. The secured creditor will lose priority to a creditor who registers a competing security interest after the 15 day period provided for by s90 of the PPSA but before the original secured creditor has updated its financing statement.

Article 4:

Registering a security interest

In a recent case under the Personal Property Securities Act 1999, the High Court was asked to determine whether a retention of title clause created a security interest for the purposes of the PPSA, and if so, whether that security interest had been perfected by a financing statement which was said to be seriously misleading.

The critical issue in the case was whether

the description of collateral in the financing statement registered covered the description of goods which the company held a security interest in; and, if not, whether the inaccurate description was "seriously misleading".

There are key lessons to be learned from the case – in particular that it is better to register a financing statement which is overly broad in its description of collateral, rather than register a financing statement which too narrowly describes the collateral.

You can find more details of this case at:
http://www.bellgully.com/newsletters/12financial/courts_Supply_on_retention.asp

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