

A Practical Session on Insolvent Transactions

July 2011



Agenda

A) The Law

Key Components

Common Examples

Calculating Your Voidable Claim

Creditor's Statutory Defence

B) Lessons from recent voidable cases

Taupo Paving & More Limited

Western Clothing Limited

Jouer Money Limited

C) Trends

D) Procedural points

Key Components of Section 292

Is it a “transaction”

Is the transaction “voidable”

- Within 2 years
- Unable to pay due debts
- Preference

Is it part of a “Running Account”

- Transaction for commercial purposes
- Net indebtedness fluctuates as a result of a series of transactions

Common Examples

Voidable	Not Voidable
Payment of historic debt	Payment when supplier has a security interest
Payment of judgment debt	Payment of Company debt by a third party including a guarantor
Non-cash payment	Set off – s310 CA93
Payment as a guarantor	Entitlement to specific performance
Payment of a regular supplier – running account	

Calculating your Voidable Claim

Transaction	Supply Made	Payment made by debtor Company	Total Debt
1	\$150		\$150
2		\$40	\$110
3	\$50		\$160
4		\$50	\$110
5	\$100		\$210
6		\$100	\$110
7	\$50		\$160
8		\$40	\$120
9	\$50		\$170
10		\$60	\$110
Liquidation			

Calculating Your Voidable Claim

#1	No running account	Sum of all payments	\$290
#2	Simple running account	Opening balance – closing balance	\$40
#3	Peak indebtedness rule	Point of peak indebtedness – closing balance	\$100

Creditor's Statutory Defence

Section 296 CA93

- Creditor received payment in good faith
- Reasonable person in creditor's position would not have suspected, and creditor did not have reasonable grounds for suspecting, the Company was, or would become, insolvent
- Creditor gave consideration for transaction or altered their position in reasonably held belief that transaction would not be set aside

Taupo Paving & More Ltd



Facts

- TPML hired equipment from McEntee Hire (MH)
- TPML placed into liquidation on 8/12/08 by AML Limited
- MH submitted a claim in the liquidation for \$2,214.34
- Liquidators sought to set aside payments to MH totalling \$21,384.35 from 31/01/08 – 12/06/08

Issues

- Service of notice “as soon as practicable”
- Did the liquidator prove that the Company was insolvent? Was the presumption soundly based?
- Can MHL prove it did not suspect the Company was insolvent?
- Were TPML & MHL in a continuing business relationship?

Discussion

Did the liquidators fail to comply with their statutory obligation to serve their notice to set aside on MH as soon as practicable?

Judgment

Section 294(1)(b) requires a liquidator “to serve the notice as soon as practicable”

Held: Only relates to service of notice after it has been filed, not the issuing of the notice in the first place

The Limitation Act otherwise governs

Discussion

Did the liquidators prove that the Company was insolvent? Was the presumption soundly based?

Judgment

MHL argued that:

There was no direct evidence of insolvency late in 2008. Until then the bank was willing to extend lending facilities

TPML's statement of profit and loss (provided by liquidators) recorded a trading surplus in the financial year ended 31 March 2008 of \$40,321

MHL's faith in this statement as a measure of profit rather than insolvency is misplaced as the financial statements showed that the Company earned \$27k and paid out \$100k"... "There is clear evidence of the Company's insolvency"

Discussion

Can MHL prove it did not suspect the Company was insolvent?

Judgment

Suspicion test in S296(3)(b): applies Kitto J's analysis from *Queensland Bacon PTY Ltd V Rees*

Two parts to the test

Wholly or mostly objective

Enquiry as to subjective state of knowledge

Question of looking at commercial circumstances at the time, not with hindsight

Undue weight should not be placed on late payment, since solvent persons often do not pay debts on time

MH defence failed as they had issued a stop credit notice and had referred the debt to a debt collector

Taupo Paving & More Ltd

Discussion

Was TPML & MHL in a continuing business relationship?

Judgment

Running account

The Court looked to Australian authority –

Principles for running account

“the payments must continue to have mutual purpose of inducing further supply and not to be subordinated to the predominate purpose of recovering past indebtedness”

The judgment does not answer whether knowledge or suspicion of insolvency will terminate the running account

Discusses the peak indebtedness rule: *“liquidators ought to be able to cherry pick a date that best suits the general body of creditors...s292(4B) does not limit a liquidators ability to do so”*

Western Clothing Limited

Facts

- Payments totalling \$38,783 paid by company to third parties

Issues

- Were the loans in substance payments to the creditor?

Western Clothing Limited

HELD

- Two payments to third parties were *in substance* payments to creditor
- Insufficient evidence for remainder of payments
- Liquidators should use powers to fill evidential gaps if necessary
- Old law applies to s292; new law applies to s296

Jouer Money Limited (“JML”) - Facts

- Property developer
- May 2009, net proceeds of \$177k from sale paid to the director/sole shareholder via the solicitor’s trust account
- JML put into liquidation on 23 November 2009
- At 9.45 a.m, prior to the adjudication, the director’s parents registered a GSA

Liquidators claimed to set aside the payment of \$177k under s292 and the registered GSA as a voidable security under s293

Discussion – voidable payment

Director sought to argue that the payment was not made for his personal benefit but was in fact a repayment of money to his parents

Held:

“the belated averment in the affidavit that the \$177k was a ‘repayment’ to his parents as I see the position is wholly inconsistent with the undisputed contemporary documentation before the Court”

Key components – Voidable charge

S293 – a charge is voidable if:

- a) Given within 2 years of the liquidation
- b) After the charge was given, the Company unable to pay due debts

The exceptions (s293(1A)):

- a) It secures money advanced at the time (or after) of the giving of the charge
- b) Its in substitution for an earlier charge

Discussion

The parents' GSA was executed on 6 November 2009 which they contended was in substitution for some earlier "oral agreement" that a security would be granted to the parents.

Held:

The advances were past advances

It was another company that advanced the money

"There is still no warrant to take an alleged security, which even on the parents best case scenario would be unregistered, unperfected, and unattached, and convert it into an effective one. The exception in s293(1A)(b) of the Act still does not include an unregistered charge (much less a vague and unspecified "oral agreement")"

Lessons

- Try to obtain the documentation that went with the payment in question at the time it occurred
- The security document itself was clearly voidable as it was executed almost a year after the last advance – make sure you get the security document
- An oral security is unlikely to be enforceable against a liquidator in a section 293 scenario

Trends in recent voidable cases

- Overall sense of caution from Courts
- Some indications that Court will try to “tone down regime”
- Interest being applied from varying dates

Procedural points

New procedure

- Less Risk for liquidators issuing notices
- Easier, less expensive for creditors to object
- Obligation to produce all relevant information/evidence, but see *Blanchett v The Roofing Specialists Ltd*

Remember....

Gather as many facts and evidence of the creditor's behaviour

- Initial interview
- Bank statements
- Proof of debt
- Statements
- Emails
- Telephone conversations with creditors
- Bank diary notes

Further information will come to light.....be prepared

In obtaining the information consider whether the creditor knew the company was insolvent

It's not just trade creditors: look out for payments to directors, shareholders, trusts, vendors, and banks

Presenters



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