

Inder Lynch

LAWYERS

WHAT'S NEW

BUSINESS LAW UPDATE

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No Setting Aside of Statutory Demands Based on Payment Claims Under the Construction Contracts Act

In two recent decisions, the High Court has refused to set aside Statutory Demands for unpaid payment claims issued under the Construction Contracts Act 2002 holding that the demands could not be set aside on the grounds of there being a substantial dispute or a set off if the appropriate steps had not been taken to dispute liability by the service of the appropriate payment schedules within the time frames permitted by the Construction Contracts Act.

Valuation Not Necessary to Discharge Mortgagee's Duty

The High Court has recently held that a mortgagee conducting a sale of a property by way of a mortgagee sale had complied with its obligation under Section 176 of the Property Law Act 2007 to take reasonable care to obtain the best price reasonably obtainable at the time of sale even though no independent valuation had been obtained by the mortgagee prior to the sale. The Court noted that the mortgagee had complied with its duty by engaging reputable, professional real estate agents who then conducted an active and open marketing campaign. The Court found that the "real" assessment of market value (which is what a valuation is intended to provide) was the price the property achieved when sold on the market following such a campaign.

Misdescriptions in Advertisements Insufficient to Prevent Mortgagee Sales

The High Court has recently set aside an interim injunction that had earlier been granted to prevent settlement of a mortgagee sale of an apartment. The High Court held that whilst there were misdescriptions in the advertising that preceded the sale (relating the number of bedrooms in the apartment and the floor in the building on which the apartment was situated) it was nevertheless unlikely to have resulted in the apartment being sold at an undervalue. The evidence was that the sale price ultimately achieved was what could have been expected for the apartment had it been correctly described in a forced sale situation. Furthermore, the mortgagor was in a dire financial situation and as such delaying the sale would prejudice the mortgagee (due to ongoing arrears accruing). Furthermore the granting of an injunction would have prejudiced the interests of an innocent third party purchaser.

PHOENIX COMPANIES

How they may affect you



By Greg Stringer

Greg is a Partner of our firm leading our Commercial Litigation team.

What are phoenix companies?

"Phoenix companies" is a colloquial term that has come to mean companies that are established or used, often with common directors and/or shareholders, to take on the assets and business of a failed company, using a similar name, or one which has an association with the failed company. The term "phoenix

companies" has now been enshrined in recent amendments to the Companies Act 1993 which now provides remedies where illegitimate phoenix activity has taken place.

A "phoenix company" is defined as a company that either before, or within a five-year period after, insolvent liquidation of a failed company, is

known by a name by which the failed company was either known at any time in the 12 months before its liquidation, (and this includes any trading name by which the failed company was known) or known by a name that is so similar to the pre liquidation name of a failed company as to suggest an association with that company.

Use of phoenix companies, where they are part of a legitimate arrangement for the purchase of assets or shares at market value, is not abuse, even if the sale is to former directors or shareholders. In many cases this may result in the greatest maximisation of value for creditors of the failed company. Nevertheless phoenix

company arrangements can be abused and amount to a breach of the Companies Act 1993.

What is the potential liability of directors & others for engaging in phoenix activity?

Illegitimate phoenix activity may amount to one or more breaches of directors and others' duties to the company and its creditors. Although not a complete solution to the problem, the new provisions are designed to impose liability (both criminal and civil) on directors who abuse such arrangements to the detriment of creditors. The main abuse identified by the government is that the association with the failed company will mislead creditors, and also that directors will not necessarily pay fully for the goodwill (if any remains) associated with the name.

It should be emphasised that the provisions do not prohibit or restrict such phoenix arrangements absolutely, but impose liability on directors (including shadow directors) in certain circumstances. Directors may apply for leave to continue to use a similar name to that of a failed company (for example, if the failed company's insolvency was not through any fault of the director) and there are further particular exceptions to liability. Thus, the provisions are targeted at a very specific set of circumstances, attempting to steer a careful course between permitting legitimate phoenix arrangements, and preventing and deterring their abuse.

A person who, in a 12 month period prior to liquidation of the "failed company", is a relevant director, and, unless leave of the Court is given, such person must not, for a period of five years from the date of liquidation of the failed company, be a director of, or concerned in the promotion, formation or management of, a "phoenix company". The words "concerned in" aims to catch directors who hide behind other company officers in order to avoid liability. Furthermore, the restriction extends beyond companies, to directors of a failed company who directly or indirectly carry on a business that has the same or a similar name to the failed company's pre-liquidation name.

There are certain exceptions contained


in the Companies Act 1993, and even if none of these apply, a director may apply to Court for leave to be involved in the phoenix company.

For example, one of the permitted exceptions is that legitimate phoenix arrangements are often used in so-called "hive-down" situations in insolvency, whereby an insolvency practitioner may sell shares or assets to a new company, often with some directors or shareholders common to that of the old company.

The provisions impose both criminal and civil liability on directors. The criminal penalty is up to five years in prison and up to a \$200,000 fine. The civil liability makes the director of the failed company personally liable for all the debts incurred by the phoenix company for the period during which the liability attached. Moreover, the liability extends to persons involved in the management of the phoenix company who act or are willing to act on instructions given by someone known to them to be contravening the Companies Act 1993.

The important point to emphasise about the civil liability is that it makes the director of the failed company liable for the debts of the phoenix company, rather than making them contribute to the debts of the failed company. This liability would only be triggered if the phoenix company were unable to pay its own debts, though the phoenix company does not have to be insolvent for this liability to be triggered. The justification for this is that the abuse through the phoenix company may have misled people to give it credit, and therefore the director of the failed company should be liable to the creditors who were potentially misled.

Conclusions

Both directors and creditors of companies need to be aware of the provisions relating to phoenix activity. Directors need to take careful legal advice to ensure their companies are not engaging in illegitimate phoenix activity. Also, creditors of companies who have been the victims of illegitimate phoenix activity should take legal advice, as the new provisions open up another potential avenue of liability against directors, and others who are involved in such activity. 

FOR ALL OF YOUR BUSINESS LAW NEEDS

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