IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2008-404-002891

IN THE MATTER OF the Insolvency Act 2006
AND IN THE MATTER OF the bankruptcy of STEPHEN ROBERT KELLY

BETWEEN STEPHEN ROBERT KELLY
Judgment Debtor

AND STRUCTURED FINANCE LIMITED
Judgment Creditor

CIV-2008-404-001982

AND IN THE MATTER OF the Insolvency Act 2006

AND IN THE MATTER OF the bankruptcy of Stephen Robert Kelly

BETWEEN STEPHEN ROBERT KELLY
Judgment Debtor

AND PUBLIC NOMINEES LIMITED
Judgment Creditor

CIV-2008-404-004853

AND IN THE MATTER OF the Insolvency Act 2006

AND IN THE MATTER OF a proposal to creditors by STEPHEN ROBERT KELLY

BETWEEN STEPHEN ROBERT KELLY
Insolvent

AND IN THE MATTER OF the Insolvency Act 2006

AND IN THE MATTER OF the bankruptcy of STEPHEN ROBERT KELLY

BETWEEN	STEPHEN ROBERT KELLY Judgment Debtor
AND	SOUTHLAND BUILDING SOCIETY Judgment Creditor

Hearing: 5 November 2008

Appearances: MG Locke for SR Kelly
JB Paulson for Southland Building Society
TJP Bowler for Bank of New Zealand and Davies & Co. Solicitors Nominee Company Limited
RJ Latton for Structured Finance (NZ) Limited and Public Nominees Limited

Judgment: 17 November 2008 at 4:30 pm

JUDGMENT OF ASHER J

This judgment was delivered by me on 17 November 2008 at 4:30 pm pursuant to Rule 540(4) of the High Court Rules

……..
Registrar/Deputy Registrar

……..
Date

Solicitors:
Lovegroves, PO Box 25066, St Heliers, Auckland
LeeSalmonLong, PO Box 2026, Auckland
Cavell Leitch Pringle & Boyle, PO Box 799, Christchurch
Stephens Lawyers, PO Box 10-966, Wellington
Grove Darlow & Partners, PO Box 2882, Auckland
Copy:
M Locke, Barrister, PO Box 90915, Auckland

Table of Contents

Introduction

[1] Stephen Robert Kelly has applied for approval of a proposal to creditors for the satisfaction of his debts under subpart 2 of Part 5 of the Insolvency Act 2006 ("the Act"). The application is opposed by three creditors, Southland Building Society, the Bank of New Zealand and Davies & Co. Solicitors Nominee Company Limited ("the objectors").

[2] The Court also has before it an application from Southland Building Society for an order adjudicating Mr Kelly bankrupt. The Court also has before it applications filed by two other companies, Structured Finance Limited and Public Nominees Limited, who no longer seek to have Mr Kelly adjudicated bankrupt and do not oppose the proposal. At the outset of the hearing Mr Latton for Structured Finance advised that Structured Finance had settled with Mr Kelly. He sought and was granted leave to withdraw.

[3] In addition to opposing the proposal, Southland Building Society seeks an order of immediate adjudication. Mr Kelly accepted that if his proposal is not approved, bankruptcy cannot be opposed.

[4] By his own account Mr Kelly owes unsecured creditors $3,166,959. If his contingent debts including personal guarantees are taken into account before credit is given for securities, he appears to owe in excess of $28 million. He states that his total assets amount to $15,000. Mr Kelly's apparently hopeless financial position arises from his control of or at least interest in a number of significant property developments through various companies with which he is associated. Some if not all of these property developments are stalled and face considerable problems. Very significant secured creditors have mortgages over the properties owned by the various development companies, and Mr Kelly has guaranteed these mortgages.

[5] The objectors submit that the proposal has not complied with the requirements of subpart 2 of Part 5 of the Act and is therefore not a proposal that can be properly considered and approved by the Court. They submit that the

creditors' consideration of the proposal at a creditors' meeting was significantly affected by the fact that not all creditors were given notice of the meeting and therefore did not attend. It is also submitted that the terms of the proposal were unreasonable, unclear, and not for the general benefit of creditors, and that there is no satisfactory evidence that Mr Kelly's proposal is a meaningful offer of payment. They further submit that some significant creditors who voted in favour of the proposal were trusts and other interests closely associated with Mr Kelly. Finally, it is asserted that the public interest and commercial morality require that Mr Kelly be adjudicated bankrupt and his affairs investigated.

The proposal

[6] On 30 July 2008, when Mr Kelly was facing three applications for an order adjudicating him bankrupt, he filed an application for an order "halting" the applications on the ground that he was filing a proposal to creditors. The proposal was dated 30 July 2008 and was filed the same day. Grant Bruce Reynolds, an insolvency practitioner of Auckland, filed an affidavit stating that he was willing to accept appointment as trustee in respect of the proposal.

[7] Mr Kelly's proposal was that the creditors would receive 55 cents in the dollar as assets of a "property development enterprise managed by me" sold over a six to 24-month period.

[8] After a number of adjournments the matter came before Associate Judge Faire on 21 August 2008. Clearly influenced by the delays that had already occurred, the Judge directed that a meeting of creditors to consider the proposal be held on 28 August 2008.

[9] A meeting duly took place on 28 August 2008. Mr Reynolds asserts that at the meeting eight unsecured creditors representing 82 per cent in value voted in favour of the proposal, as against three creditors representing 18 per cent in value who voted against the proposal.

Approach to approval of the proposal

[10] Section 327 of the Insolvency Act 2006 requires a proposal to satisfy an insolvent's debts to be in the prescribed form and be accompanied by a statement of affairs in the prescribed form and verified by affidavit. Under s 328 the proposal must be filed in the Court.

[11] Under s 330 the person appointed provisional trustee under the proposal is required to call a meeting of creditors "as soon as practicable after the proposal is filed". Sections 330 and 331 read:

> **330. Provisional trustee must call meeting of creditors**
>
> (1) The provisional trustee must, as soon as practicable after the proposal is filed, call a meeting of creditors by posting to every known creditor at the creditor's last known address—
>
> (a) a notice of the date, time, and place of the meeting:
>
> (b) a summary of the insolvent's assets and liabilities:
>
> (c) a copy of the proposal and particulars of any charge or guarantee:
>
> (d) a creditor's claim form:
>
> (e) a postal vote in the prescribed form.
>
> (2) A creditor who has proved a claim in the prescribed manner may vote on the proposal by sending a postal vote that reaches the provisional trustee before or at the meeting.
>
> (3) If the provisional trustee receives a postal vote before or at the meeting, the postal vote has effect as if the creditor had been present and voted at the meeting.
>
> **331. Procedure at meeting of creditors**
>
> (1) The provisional trustee is the chairperson of the meeting of creditors, unless the creditors elect their own chairperson.
>
> (2) The creditors may—
>
> (a) examine the insolvent:
>
> (b) accept the proposal with or without amendments or modification, by passing a resolution that sets out the proposal in its final form:

(c) confirm the provisional trustee as trustee, or appoint another person who is willing to act as trustee, in which case that person becomes the trustee.

(3) The resolution accepting the proposal must be decided by a majority in number and three-quarters in value of the creditors who—

(a) vote; and

(b) are personally present or are represented at the meeting by a person specified in section 332 or have voted by postal vote.

(4) If the insolvent consents, the creditors may include in the proposal teams for the supervision of the insolvent's affairs.

[12] After the proposal has been accepted by the creditors, the trustee must apply to the Court for approval of the proposal. Sections 333(1)-(3) provide:

333. Court must approve proposal

(1) After the proposal has been accepted by the creditors, the trustee must, as soon as practicable,—

(a) apply to the Court for approval of the proposal; and

(b) send notice of the hearing of the application in the prescribed form to the insolvent and to each known creditor.

(2) The Court must, before approving a proposal, hear any objection that is made by or on behalf of a creditor.

(3) The Court may refuse to approve the proposal if it considers that—

(a) the provisions of this subpart have not been complied with; or

(b) the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors; or

(c) for any reason it is not expedient that the proposal be approved.

[13] Putting a proposal into effect is therefore a three-stage process. First, a proposal must be filed and a meeting of creditors called. Second, the meeting of creditors must be held and the required creditors' acceptance secured. Third, the Court must consider and approve the accepted proposal.

[14] Section 333(3) requires the Court to consider the compliance, reasonableness and expediency of the proposal. While the Court appears to have a general

discretion to refuse approval as indicated by the word "may", the Court may only refuse approval if one or more of the trigger paragraphs in s 333(3)(a), (b) and (c) applies: *Farmer v Rowley* [1992] 2 NZLR 195 at 199.

[15] The approach to approving a proposal is that set out by Hardie Boys J in *Re Bennett's Proposal* HC CHCH B138/81 and M306/81 1 February 1982 in relation to the predecessor s 143 of the Insolvency Act 1967, quoted with approval in *Farmer v Rowley* at 205:

> I think the Court should accept the view of the creditors, or the majority of them, and grant approval unless it is apparent that one of the grounds for refusing approval exists. The Court is clearly required to exercise its independent judgment, for considerations of wider public interest are relevant, and therefore even unanimity amongst the creditors will not be predeterminative of approval. But unless it is clear that the creditors generally would fare better under a bankruptcy, approval ought normally to be given unless other special circumstances militate against it. Whilst a proposal ought not to be imposed under dissentient creditors if that would be disadvantageous to them as members of the general body of creditors their dissent should not be upheld if to do so could be prejudicial to the general body of creditors.

[16] As this statement indicates, there is no onus on the insolvent to show that the proposal should be approved. Indeed, this is indicated by the heading to s 333, which is "Court must approve proposal".

[17] A number of decisions suggest that there is an onus on creditors who oppose the proposal to show that approval should be refused: *Re Trott* AK HC B1471/88 14 April 1989, Tompkins J; *Re Hart* [1991] 2 NZLR 219 at 225. However, it is the obligation of the Court under s 333(3) to approve the proposal "if it considers" that any of the various factors referred to are made out. The phrase "if it considers" indicates the application of independent judgment. I respectfully agree with the conclusion of Robertson J in *Re Nathan* HC Whangarei B53/89 14 August 1989 that an onus on an opposing creditor would ignore the public interest factor. Rather, the Court must follow the specific words of s 333(3). It has a discretion to refuse to approve if after exercising its independent judgment it considers that one or more of the various factors referred to in that subsection are made out.

[18] I will now consider the three factors referred to in s 333(3).

Have the provisions of subpart 2 been complied with?

Creditors not properly served

[19] Under s 330(1), the provisional trustee must send a notice of the meeting together with the proposal, a summary of the insolvent's assets and liabilities, a claim form and a postal vote form to "every known creditor at the creditor's last known address". Thus to comply with subpart 2 every known creditor must be served. It would be unfair for a creditor not to receive fair notice, or not be able to attend the meeting, participate in any discussion and vote on the proposal.

[20] In fact creditors of Mr Kelly worth in excess of $10 million did not attend the meeting. The objectors submitted that this was because the provisional trustee did not, as required by s 330(1), post a copy of the proposal and other necessary information to every known creditor.

[21] The objectors have only specifically proved that three creditors were not served, namely the Bank of New Zealand, Davies & Co. Solicitors Nominee Company, and the Auckland City Council. It is common ground between the creditors and Mr Kelly that none of these three entities was served. However, Davies and Co. did in fact attend the meeting and vote. It has not argued that it was prejudiced by the lack of formal notice, so its non-service had little practical significance.

[22] Mr Kelly put forward at least a partial explanation as to why these creditors were not served in his affidavit of 29 August 2008:

> I have not included some $10 million of purely contingent and fully secured creditors about which I will say more below on the basis that they are not affected by the proposal.

[23] Mr Kelly and the provisional trustee appear to have assumed that only unsecured or partially secured creditors had to be served. This was an error. Secured creditors are entitled to vote according to the full amount owing to them: *Guest v Duffy* [1991] NZLR 183 at 186; *Whiteman v UDC Finance Ltd* [1992] 3 NZLR 684 at 687. In any event, it seems likely that the Bank of New Zealand was

not fully secured, and the Auckland City Council appears to have had no security at all.

[24] There was therefore a failure to comply with s 330(1). This failure is a matter that must be taken into account by the Court in exercising its discretion. The Bank of New Zealand is owed $1,716,000 and the Auckland City Council $550,000. The amounts are considerable. The Bank of New Zealand vigorously opposes the proposal. The details given as to who was served and was present and how they voted is unclear. However, if these two creditors had been served and had attended the meeting their contribution may well have altered the result.

[25] In addition, because it appears to have been wrongly assumed by Mr Kelly and the provisional trustee that secured creditors did not need to be served, it seems likely that some or all of the $10 million worth of secured creditors who did not attend the meeting were also not served. Mr Kelly and the provisional trustee have not given details of those creditors, save that Mr Kelly thought they were secured. Their involvement may well have contributed to a different result.

Discrepancy between the proposal filed and the proposal approved at the meeting

[26] The opposing creditors submit that there is a discrepancy between the proposal filed in Court and the proposal approved at the meeting, contrary to s 328(2). Section 328(2) provides:

> **328 Proposal must be filed in Court**
>
> …
>
> (2) The insolvent may not, while waiting for the decision of the creditors and the Court, withdraw the proposal or any charge or guarantee tendered with it, unless the insolvent obtains the permission of the Court.

[27] The proposal filed by Mr Kelly with the Court is extraordinarily brief. It comprises some six short paragraphs on one-and-a-half pages. It asserts at paragraphs 1 and 4:

> 1. That payment of my debts to the secured creditors will be made in the following manner:

> As the property development enterprise managed by me sells and develops its assets I believe that all claims by my secured and contingent secured creditors will be satisfied in full.
>
> These claims will be met as the development properties owned by the companies which form the above enterprise are developed and sold, and the secured and unsecured contingent claims are met from the proceeds of settlement.
>
> I believe that this process will occur and be completed over the period of six to 24 months from the date of filing of this proposal, as the development projects are completed and settled.

…

4. That payment of claims by my unsecured creditors will be made as follows:

   That a dividend of 55 cents in the dollar will be paid on all unsecured debts, in the same manner as under 1 above.

[28] Mr Kelly's proposal is in essence an offer to apply towards his creditors money he might receive from an unspecified property development enterprise owned by a third party.

[29] In addition to the proposal, Southland Building Society and at least some other creditors were also forwarded three further documents, being a "creditor's compromise", a "statement to accompany notice of compromise" and a document described as a "scheme of arrangement". It is unclear whether some or all of the creditors received some or all of these documents. The point is not addressed in the material before the Court.

[30] The trustee states that the proposal for which approval is sought is "essentially … a combination of both the compromise document and scheme of arrangement document", but that "the majority of the substance to the proposal is contained within [the scheme of arrangement]".

[31] The substance of the proposal actually voted on has not been identified. Mr Reynolds produced a draft of his template letter to creditors, but it makes no reference to the scheme of arrangement which he says in his affidavit contained the substance of the proposal. Clearly those creditors who voted by post did so on the

basis of the documents that they received, which included at least in some cases documents adding to and modifying the proposal.

[32] These three further documents, in particular the scheme of arrangement, amplified and made changes to the proposal. The scheme of arrangement stated that Mr Kelly had entered into management agreements with five different companies, and that he would be receiving management fees in relation to the settlement of sales of various units, townhouses and homes.

[33] The creditors' compromise document put forward a different payment proposal than that in the proposal filed with the Court. Rather than making all the 55 cents per dollar available for the unsecured debts as stated in the proposal, the creditors' compromise document stated that administration costs and professional fees and disbursements were to be deducted from the 55 cents per dollar prior to any payment to creditors. The change was significant. The discretion to deduct administration costs, legal costs and meeting expenses left creditors vulnerable to significantly reduced payments.

[34] It is a breach of s 328(2) for such changes to be made to a proposal without the Court's permission. The rationale of such a rule is to prevent creditors inadvertently accepting something different to what they thought they were agreeing to. In this case, for the reasons given, I conclude that there was a breach of s 328(2).

Resolution of creditors accepting the proposal

[35] Section 331(2)(b) states that the creditors may accept the proposal with or without amendments or modification by passing a resolution setting out the proposal in its final form. Unfortunately the documents filed by Mr Kelly, including the minutes, do not disclose the passing of a resolution setting out the proposal in its final form.

[36] Mr Reynolds did not provide a formal resolution from creditors accepting the proposal. However, he did produce minutes of the creditors' meeting. It is apparent from the minutes that there was a vote. Eight creditors who amounted to 82 per cent

in value were stated to have accepted "the proposal". It is, however, quite simply unclear what the proposal voted on was, and whether all or some of the creditors had received the three extra documents, or whether all or some were voting on the original proposal.

[37] Adding to the uncertainty, in his affidavit of 2 September 2008, which was prepared and filed after the creditors' meeting, Mr Reynolds sets out a statement of proposed payments. These did not appear in the documents sent to creditors. He would pay ten cents in the dollar 14 months after Court approval, 15 cents in the dollar 18 months after Court approval, and 30 cents in the dollar 24 months after Court approval. This statement of proposed payments was not part of any of the documents given to the creditors, but may have been put to them at the meeting.

[38] Further, at paragraph 32 of his affidavit of 29 August 2008 Mr Kelly stated that he did not propose to draw any of the $200,000 that he had suggested be allocated to him for living expenses. It is not clear how this aspect of the proposal was put to creditors at the meeting.

[39] Thus it appears that there has been some change between the proposal and what was accepted at the meeting, but it is not clear exactly what documents and therefore what terms were accepted at the creditors' meeting. The nature of the changes went to the net amounts to be received by creditors and are therefore significant. Mr Kelly and Mr Reynolds have failed to produce a clear resolution referring to a clear proposal. It therefore cannot be clear what the "final form" of the proposal apparently accepted actually was. The uncertainty reflects on the net amounts received by creditors, and was therefore significant.

Conclusion on compliance with the provisions of subpart 2

[40] I conclude that were three areas of significant non-compliance with the provisions of subpart 2. These were, first, the failure to give notice to eligible creditors in breach of s 330(1). Secondly, the proposal filed in the Court was different to that considered by the creditors in breach of s 328(2). Thirdly, it is not

clear what resolution was passed as required under s 331(2)(b) setting out the proposal in its final form.

[41] I do not consider that these failures can be in any way excused by the order of 21 August 2008 that Mr Kelly hold a meeting in relation to the proposal within seven days. He had a duty to call a meeting of creditors "as soon as practicable after the proposal is filed", which from 30 July 2008 until the hearing of 21 August 2008 he had made no effort to discharge. By 21 August 2008 he should have already filed with the Court a detailed proposal, and he should have had the creditors' meeting and the requisite notice well organised. The seven day requirement for the meeting was thus entirely appropriate.

[42] It is relevant to consider the seriousness of these failures. A Court will not place weight on minor procedural errors. For the reasons given I do not consider that the errors in relation to this proposal were serious, and meant that significant creditors did not get a fair opportunity to influence the creditors' approval process.

[43] I consider therefore that in terms of s 333(3) the court may refuse to approve the proposal because the provisions of subpart 2 have not been complied with. Whether in its discretion it should do so or not will be considered later, with other relevant matters.

Are the terms of the proposal "not reasonable" or "not calculated to benefit the general body of creditors"?

[44] The wording of this section and the reference, albeit in the alternative, to the benefit of the "general body of creditors" indicates that reasonableness is assessed from the perspective of the creditors. It would be awkward to interpret "reasonable" as importing considerations of the public interest, as to do so would require the Court to apply two different touchstones of reasonableness. Reasonableness is best assessed from one particular perspective, and in s 333(3)(b) it is more naturally the perspective of creditors rather than the public. For reasons that I will set out later in this judgment, I consider the public interest is better considered under s 333(3)(c).

[45] In considering reasonableness a Court may objectively assess whether the proposal would be acceptable to a commercially experienced prudent creditor. As was stated by Lord Esher in *Re Reed and Bowen ex p Reed and Bowen* (1886) LR 17 QBD 244 (CA) at 251 in relation to the Bankruptcy Act 1883 (UK), which was the basis for much of our present legislation:

> … this Act was passed … for the purpose of protecting the creditors against their own recklessness; [and] for the purpose of preventing a majority of creditors from dealing thus recklessly, not only with their own property, but with that of the minority …

[46] The terms of the proposal in its original form can give no comfort to a commercial experienced prudent creditor. The proposal refers to companies forming an undefined "property development enterprise", which Mr Kelly says he manages. The proposal refers to the enterprise selling and developing its "assets", which are also not defined. Mr Kelly states that he "believes" that the sale of development assets will occur over six to 24 months. He states: "I believe that all claims by my secured and contingent secured creditors will be satisfied in full." No explanation is offered as to how Mr Kelly might be able to access any of this money. It is clear he has no legal right to any funds. No reference is made as to what should happen should there be any default. The language used, in particular the phrase "I believe", is tentative. I am driven to conclude that the proposal in its original form contains no comprehensible plan to obtain funds to pay creditors.

[47] The scheme of arrangement dated 26 August 2008 gives more detail. The scheme refers to various companies carrying out various developments and refers to Mr Kelly being their manager. The scheme states that Mr Kelly has entered into management agreements with various companies. The scheme states that: "In terms of a written management agreement Kelly will be entitled to management fees".

[48] Mr Kelly in his affidavit of 6 October 2008 relied on two letters dated 25 August 2008 to assert the existence of the management agreements. They were letters from Merchant Limited and Progression Development Limited, neither of which is listed in the scheme of arrangement as the companies with whom management agreements were entered. The letters are not management agreements at all but rather proposals to enter into an agreement with Mr Kelly or his "nominee",

a company called New Oakland Properties Limited. These proposals were conditional on Mr Kelly being able to legally enter into a formal management agreement.

[49] The following further factors arise in relation to the original or modified proposal:

a) The companies forming the "property development enterprise" from which Mr Kelly would secure income are clearly under Mr Kelly's control. Indeed the letters from the companies are signed by a man called Mr Patel. In a recent affidavit Mr Patel described himself as a person employed to assist Mr Kelly in relation to the scheme of arrangement and in relation to some of the administrative details.

b) There is no evidence of any ability on the part of the companies to pay any moneys at all, and indeed no information about their solvency. They appear to be working in the troubled area of property development.

c) Under the letters relied on for the existence of the management agreements the payments do not need to be made to Mr Kelly but may be made to a company New Oakland Limited.

d) The agreement is said to be conditional upon entering into an agreement, the terms of which are not disclosed, and upon other uncertain conditions.

[50] Therefore, the proposal, even as modified, could not from an objective point of view give any assurance of payment, or indeed show that any payments were likely. For these reasons it was not commercially reasonable.

[51] Further, the original proposal and the later documents put forward a position to the creditors which was confusing and vague. It is left unclear as to what Mr Kelly is binding himself to pay and over what period. The vagueness in itself is

sufficiently acute as to make the proposal unreasonable. In *Re Hart* [1991] 2 NZLR 219 the fact that the proposal was unacceptably vague was a reason why approval of the proposal was refused. It is inherently unreasonable to expect creditors to accept an arrangement where there is no proper basis on which the details of the proposal and the basis on which it could be enforced can be determined as acceptable. Further, the vagueness leaves the Court unable accurately to assess the proposal.

[52] In summary, the offer put forward had little commercial merit and was hopelessly vague. I therefore do not consider that the terms of the proposal are reasonable or calculated to benefit the general body of creditors. This is a factor to be taken into account in terms of s 333(3)(b).

Expediency of the proposal

[53] It was presumably the predecessor to s 333(3)(c) that Hardie Boys J had in mind in *Re Bennett's Proposal* when he referred to the Court considering the wider public interest. The Court may refuse to approve a proposal if it considers that for any reason it is not expedient that the proposal be approved. The word "expedient" is capable of a broad meaning. It can mean 'practicable', but also has the wider meaning of 'suitable' or 'appropriate'. This wider view was taken in *Re West* HC HAM B5/93 23 April 1993, Penlington J. In his article "Misconduct and Public Interest under Part XV of the Insolvency Act 1967" (2005) 11 NZBLQ 132 at 153, the learned author Michael Josling suggests that such a broad definition begs the question: appropriate or suitable to what end, that while a wide meaning of expediency should be adopted, it should apply only to matters relevant to the public interest. I do not see any reason to apply such a limitation. I consider that s 333(3)(c) requires an open-ended approach, and that any attempt to focus it on a specific matter would be to impose a limitation that does not arise from the words of the subsection.

[54] A serious failure to comply with the provisions of subpart 2 as referred to in s 333(3)(a) or unreasonable terms which do not benefit creditors as referred to in s 333(3)(b) can all be relevant to expediency. I have already found that these factors arise, but as they have been already considered they can be presently put to one side.

It is matters not covered by the words of ss 333(3)(a) and (b) but which nevertheless reflect on the suitability of the proposal that arise under s 333(3)(c). Here the voting at the meeting of various entities associated with Mr Kelly is put forward as a reason not to approve the proposal. Such a matter cannot be seen as a failure to observe a procedural step, or to relate to the reasonableness of the terms. Rather, it reflects on the weight that can be given to the gross percentage of creditors' approvals, and is the sort of matter which can be considered under s 333(3)(c).

Voting by associated entities

[55] Three entities which voted in favour of the proposal had a close family association with Mr Kelly and may well have been controlled by him. They were $1.6 million in value. It is not clear from the material provided whether indeed these entities actually exist legally as companies or trusts, and whether there are genuine debts.

[56] In *Farmer v Rowley* the Court of Appeal accepted that a creditor which was a family trust associated with the insolvent was entitled to put forward a proof of debt and vote at a creditors' meeting. However, the fact that a proposal is supported by an entity closely connected with the insolvent can be taken into consideration in the Court's discretion: *Whiteman v UDC Finance Limited* [1992] 3 NZLR 604 (CA) at 689; *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145 and *Re Riddiford* HC WN B91/89 21 September 1989, Neazor J p 45.

[57] I have not found it possible to establish with any certainty whether there would have been any difference to the ultimate result if the associated creditors had not voted in favour of the proposal. I am not prepared to conclude that even if their value were deducted, those present would not have voted in favour of the proposal to the requisite 75 per cent threshold. It is possible that they might have still done so. I do, however, consider that it is relevant in the exercise of the discretion to take into account that Mr Kelly did rely on family entities of a considerable value which he controlled to vote in favour of the proposal. Those entities presumably had a role at the meeting. Their contribution may have affected the outcome.

Public interest

[58] It has been suggested that the public interest is not a matter that can be properly considered under the expediency head, or indeed at all under the predecessor to s 333: Paul Heath QC "Proposals under Part XV Insolvency Act: Is the Public Interest Relevant?" [1991] NZLJ 52. This view was contested by Michael Josling "Misconduct and Public Interest under Part XV of the Insolvency Act 1967".

[59] I have had no submissions on those two learned articles or the detailed arguments they contain, and do not seek to do justice to them. I consider however that a limited interpretation of the word "expedient" cannot be justified. It would seem artificial to exclude considerations of the public interest when considering expediency, given the wide meaning of the word. One of the consequences of bankruptcy is that s 149 applies to the bankrupt, and restricts the bankrupt's ability to enter business. This protects members of the public who might have had dealings with the insolvent person but for the bankruptcy. This protection can be seen as one of the purposes of the insolvency legislation. It would be defeated if the public interest could not be considered in relation to approval of a proposal.

[60] I have already referred to *Farmer v Rowley* and the approval of the statement of Hardie Boys J to the effect that the wider public interest is relevant in considering a proposal. The public interest was referred to as relevant in *Re Davison* HC CHCH B412/89 13 December 1989, Holland J at p 9. In *Re Trott and Joy* HC AK B1471/88 14 April Tompkins J, after referring to the expediency ground, stated at p 28:

> An insolvent's misconduct may be so irresponsible and its effects on creditors or others so devastating that a Court may conclude that it is in the public interest that the person responsible should not escape the stigma of bankruptcy. Rather, it may be in the public interest that such a person should be marked as a bankrupt and further, that he should suffer the various disqualifications that go with bankruptcy. Those disqualifications are after all designed to protect the unsuspecting community from the ravages of irresponsible financial conduct. And the stigma of bankruptcy is itself a deterrent to others from behaving in a like manner.

[61] I respectfully adopt that reasoning as it applies to the relevance of the public interest, while acknowledging that the purpose of the Act is not to punish a debtor.

[62] Tompkins J went on to distinguish between misconduct and gross misconduct, and stated that only the latter could invoke the expediency ground. I do not, with respect, consider a focus on the word "misconduct" helpful. While the word "misconduct" is a ground for not approving a composition with creditors after bankruptcy under s 315(3)(c), the word is not used in s 333(3). There is no need to specifically address the concept of misconduct in s 333(3).

[63] The public interest is best approached from the perspective of protecting the public from the insolvent debtor. The issue is not the punishment of the debtor, but avoiding the risk of further conduct to the detriment of the community, in particular in this case the commercial community.

[64] The vague and confusing nature of all the material put forward by Mr Kelly and his procedural ineptitude through the course of the proposal process cast doubt on Mr Kelly's business abilities, in particular his ability to achieve any benefits for creditors in the future. So does his lackadaisical and last minute approach to the bankruptcy proceedings.

[65] His business problems extend back before the present property slump to a time when property prices were stable or rising. A very full affidavit was filed by Gareth Abdinor, a solicitor acting for Southland Building Society. Mr Kelly appears to have sought to delay Southland Building Society from exercising its rights as mortgagee from as early as August 2006. Mr Abdinor stated that Mr Kelly had actively sought to frustrate the sale and as a result Southland Building Society was unable to settle with the purchaser. Mr Kelly in his affidavit of 30 October 2008 described Mr Abdinor's summary of these matters as "broadly correct and uncontentious for present purposes". This history indicates at least one longstanding financial problem that arose before the downturn. Mr Kelly continued trading despite those problems, and took deliberate tactical measures to avoid payments to creditors. This early problem that arose before the present downturn does not reflect well on Mr Kelly's business acumen or his attitude to financial responsibilities. It is extraordinary that Mr Kelly can now be indebted to the amount that he is, and yet only have assets of $15,000. This calls into question his commercial judgment.

[66] It is also significant that Mr Kelly has made no effort to explain to the Court the financial disaster that appears to have befallen his group of companies. The Court can have little confidence in Mr Kelly's ability to secure money in the future when he has failed so singularly to do so in the past. While there is no onus of proof on Mr Kelly in this proceeding, his failure to provide obviously relevant information can be taken into account by a Court in exercising its independent judgment.

Exercise of the discretion

[67] Ultimately the Court does not decide to refuse or approve a proposal simply because one or some of the matters referred to in that subsection are satisfied. A Court must place great weight on the views of creditors who support a proposal, particularly where, as here, some are significant commercial entities. They are in the best commercial position to evaluate a proposal. Risk is generally inherent whenever an insolvent person seeks a compromise with creditors, and a Court cannot expect perfect certainty of payment from any proposal.

[68] Nevertheless, I note that none of the creditors has independently come to the Court to express their support. They may have reached individual settlements with Mr Kelly, or they may have gone along with the proposal simply because the vague possibility of payment might be better than nothing at all.

[69] However, there are potential benefits to creditors and the public if Mr Kelly is adjudicated bankrupt. The Official Assignee will then take charge of his affairs. The chaotic situation at present indicates that the control of an independent third party is desirable to ensure that the costs of Mr Kelly's financial failures are allocated fairly and to avoid an improper shifting of consequences. There will be restrictions on his ability to trade in the marketplace, and given his very poor record this may be for the benefit of the public. Further, any past irregularities on his part are likely to be discovered, which could have a material benefit for creditors.

[70] It is my conclusion having considered the three factors that approval of the proposal should be refused. It would not be for the benefit of creditors for the proposal to be approved. I am also concerned that it is not in the public interest for

Mr Kelly to avoid bankruptcy and to be able to continue to operate without restriction in the marketplace.

[71] Mr Locke for Mr Kelly, who took a realistic approach towards the procedural and substantive defects in the proposal, suggested that it might be appropriate to adjourn the bankruptcy petition so that a new proposal could be formulated, circulated and voted on. He referred by way of example to the case of *Re Chambers* HC AK B1222/92 30 May 1993, where Blanchard J imposed a strict timetable for an amended proposal to be filed in the Court and a meeting of creditors to be held.

[72] However, that case provides an instructive example of a proposal which on examination had substance and merit. Mr Chambers had a written employment contract for a three-year term, and the amount that he was to pay on a weekly basis appeared to be realistic and acceptable to creditors: at p 11. He appeared to have faced up to his obligations: at p 12.

[73] These are not features of Mr Kelly's proposal. There is no sure or indeed identified income stream from which payments could be made. Its inherent weaknesses and the serious nature of the procedural failures to date persuade me that giving Mr Kelly more time would not be in the interests of creditors or the public.

[74] As I have refused to approve Mr Kelly's approval, there is no reason why Mr Kelly should not be adjudicated bankrupt. Indeed his counsel has not suggested otherwise. He is clearly insolvent.

Result

[75] The application to approve the proposal is refused.

[76] The debtor is adjudicated bankrupt.

……..

Asher J