

News Release

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High Court orders director to make landmark payment in reckless trading case

A former director of Christchurch based South Pacific Shipping Ltd (SPS) has been found liable by the High Court for reckless trading and ordered to pay what is thought to be the highest award of its kind in New Zealand. The director, Klaus Löwer, has been declared personally responsible for \$7 million of the company's debts and ordered to make payment to the company's liquidators, Gary Traveller and John Waller of PricewaterhouseCoopers.

SPS was formed in January 1992 and went into liquidation, hopelessly insolvent, just over six years later in February 1998. For most of the life of SPS, Mr Löwer was its dominant shareholder and director. The liquidators maintained that he conducted the company's affairs in a reckless manner and should be held to account.

SPS operated a cargo shipping line, plying the Pacific Islands and primarily the trans-Tasman trade. From 1992 to 1998 it chartered and operated up to 11 German owned cargo vessels. Mr Löwer had ownership interests in eight of these vessels. They were bareboat chartered to SPS through Antigua and Dutch companies in which he was also a significant shareholder.

By June 1993, after its first 18 months of operation, SPS had accumulated losses of \$7.8 million. An increase in the share capital to \$6.25 million mopped up a significant part of these losses and the directors were projecting profits for the following year to 30 June 1994. In fact, the company incurred a loss in that year of \$6 million and it carried on incurring similar losses in each of the following years.

"It should have been apparent to the directors from late 1993 and early 1994 that the company was incurring further losses, that the projections of profit were hopelessly adrift and that the trading environment was becoming increasingly difficult," said Gary Traveller. "This is when the company should have stopped trading." Instead the directors decided to steam ahead. In April 1994, they committed SPS to the charter of three additional ships and two months later they decided it would assume about \$1 million of liabilities of a related company. "These actions, and others, were severely criticised by Justice Young who describes them as reckless given the company's financial position," said Mr Traveller.

Justice Young commented that the potential for Löwer to derive “substantial collateral advantages” from his involvement with the vessel ownership and charter arrangements “encouraged him to gamble with the funds of his creditors” [para 174 of judgment]. He described the governance style adopted by the directors of SPS as “lamentable” [150] and concluded that the decisions taken by the directors were not legitimate business risks.

“In those circumstances, I think that Mr Löwer can fairly be regarded as having forfeited the protection of limited liability for what followed. Given his wish to permit SPS to continue to trade despite insolvency, the hostile business environment, his unwillingness or inability to implement orthodox governance practices, and the proven unreliability of management reporting, he ought to have been prepared to put his own money up by capitalising the company to an extent that was appropriate given the risks he was taking with creditors’ money. His behaviour departed so markedly from orthodox business practice and involved such extensive and unusual risks to the creditors that it can fairly be stigmatised as reckless.” [151]

“The expansion in the business and the non-payment of ever-increasing amounts of related party debt owed under charter arrangements to the Antiguan and Dutch companies allowed the company to continue trading but eventually reality set in”, said Mr Traveller.

Following the liquidation in February 1998, creditors’ claims amounted to over \$41 million and realisable assets were only \$4 million. However Mr Traveller noted some \$22 million is owed to related parties of which \$17.271 million is subordinated and won’t rank for payment.

“We are pleased with the decision”, said Mr Traveller. “It is a vindication of the action and provides a measure of justice for the creditors.”

Counsel for the liquidators, Mark O’Brien of Bell Gully, said “whilst the sum awarded is large, it is appropriate. The Judge accepted that the risks taken were substantial and also illegitimate given the company’s financial position and other circumstances. The judgment underscores the need for good governance and for particular caution when a company’s solvency is in issue. However, it does not impose any new requirements on directors - it applies the law to what was an extreme set of facts”.

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