

Meltzer Mason Heath

Chartered Accountants practising as insolvency specialists

Refer to: Mike Lamacraft

No. of Company: 1035776

Liquidators' Further Report

Ehomes Limited (In Liquidation)

For the period 29 June 2010 to 28 December 2010

Introduction

Ehomes Limited was placed into voluntary liquidation in Auckland on 29 June 2010 and Jeffrey Philip Meltzer and Michael Lamacraft were appointed joint and several Liquidators.

In accordance with section 255 of the Companies Act 1993 the Liquidators are obliged to report to all creditors and shareholders on the conduct of the liquidation during the preceding six months. This report covers the period 29 June 2010 to 28 December 2010.

Schedule of Receipts and Payments

A schedule recording all transactions is attached.

Asset Realisations

The major asset being the show home, was sold following an extensive marketing and tender process. Fixed assets were sold by private treaty and a settlement was achieved in respect of the only outstanding debtor.

Dividends

Preferential claims were paid in full and a dividend of 11.42% was paid to unsecured creditors.

Liquidators' Investigations

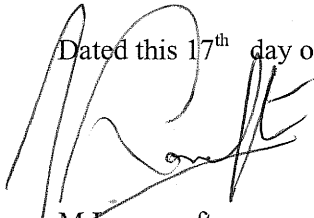
A copy of the report to creditors dated 12 October 2010 is attached to this report.

Outstanding Matters

Once the company's GST position is finalised the liquidation will be closed.

Please contact Mike Lamacraft of this office should you require any further information.

Dated this 17th day of January 2011


M Lamacraft
Liquidator

Jeff Meltzer

Karen Mason

Arron Heath



Ehomes Limited (In Liquidation)

Receipts and Payments

For the period 29 June 2010 to 28 December 2010

	\$
Receipts	
Debtors	31,111.11
Petty Cash	47.90
Sale of Show Home	133,333.33
Dividend Received	320.00
Bond Refund	1,250.00
Proceeds of Bank Account	40,330.37
Furniture Realisation	2,916.66
Motor Vehicle Realisation	5,111.11
IBD Interest	494.62
GST Income	22,469.00
	<u>237,384.10</u>
Payments	
Liquidators' Remuneration	55,953.00
Liquidators' Disbursements	3,196.19
Advertising	221.33
Bank Fees	26.25
Computer Services	208.00
Contractor	825.00
Inland Revenue – Preferential Claim	7,232.90
Insurance	1,127.06
Power	128.36
Rent	4,000.00
Legal Fees	6,331.70
Mail Redirection	111.11
Professional Fees	2,421.43
Water Rates	37.33
Liquidation Wages	1,362.88
PAYE	3,832.47
Preferential Wages & Holiday Pay	9,344.96
Unsecured Creditors	114,707.71
Secured Creditors	1,049.88
GST Expense	24,070.61
	<u>236,188.17</u>
Funds on Hand	<u><u>1,195.93</u></u>

Notes: The funds held are subject to further costs of winding up.

Meltzer Mason Heath

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12 October 2010

Dear Sir / Madam

Ehomes Limited (In Liquidation) "Ehomes"

Following our appointment as Liquidators we received several complaints from creditors (comprising trade suppliers and clients) expressing concern at the conduct of the directors. The view of these creditors was that the directors must (or ought to) have known that Ehomes was in financial difficulty and therefore should not have accepted goods from suppliers or money from clients in the period at the end of June before Liquidation. In particular, as regards clients, the question was raised as to whether the directors should have ensured that funds paid by them were applied solely and exclusively to payments for supplies under the clients' contracts with Ehomes.

Our review has incorporated the following elements:

1. A review of the relevant company records
2. Inquiry and discussion with certain creditors and clients
3. Inquiry of the directors and consideration of the written responses received
4. Consideration by the Liquidators of all the available relevant information and related literature
5. Obtaining a legal opinion on the available evidence.

We have considered the following areas as regards the conduct of the directors

- Section 135 and Section 136 of the Companies Act 1993 ("S135")("S136")

Section 135 says:

"A director of a company must not –

(a) Agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or

(b) Cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors."

If directors are held to be guilty of reckless trading the Court can require them to contribute a sum to the liquidation. In determining an appropriate sum the Court will consider the director's actions after the time they knew or ought to have known that their company was in financial difficulty.

Section 136 says:

A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligations when it is required to do so.

- Did the Directors owe a specific statutory or fiduciary duty to clients?
- Fair Trading Act.

Jeff Meltzer

Karen Mason

Arron Heath



CHARTERED
ACCOUNTANTS



General Facts

- Ehomes has never been profitable. Financial statements for the year ended 31 March 2008 record that the company was insolvent on a balance sheet basis. Losses up to that date were funded by shareholder loans. At the time of Liquidation payments to creditors were largely up to date.

The trade creditor position as at 29 June 2010 (the date the Liquidators were appointed) can be analysed as follows:

90 days +	Due May 20	Due June 20	Due July 20
\$137,776	\$4,699	\$36,449	\$250,519

The 90 days+ balance comprises related party advances or debt of \$44,341 and accounts relating to the construction of the Takanini show home of \$107,987. Accounts relating to the show home were not payable until the show home was sold.

Therefore the bulk of debt to suppliers was incurred in June.

- Every month different clients would make payments that were due under their specific contracts with Ehomes. These payments were received into Ehomes trading bank account and were not held separately and funds received from a specific client were not applied against the liability to suppliers for that client's product (there was no such requirement in the contract).
- Shareholder conflict meant that Ehomes lost the use of the show home in Kumeu in the third quarter of 2009. This resulted in a loss of sales. The construction of the Takanini show home was completed in December 2009 but given the time of year was not fully functioning in terms of producing sales until February 2010. No new sales were achieved between the loss of the Kumeu show home and the availability of the Takanini show home.

Matt Taylor left his role as Managing Director of Ehomes early in 2010 and at this stage Lindsay Aitken became more involved in the operation of the business. An experienced sales manager was recruited in March. Recognising that Ehomes could not survive without new funding or a restructure Mr Aitken put together a proposal to restructure the company's affairs. This was submitted to the other shareholders and this proposal was still seen as a possibility by Mr Aitken throughout May and June 2010. At the end of June when it was clear that shareholder agreement could not be achieved all parties accepted that the only alternative was to place the company in to Liquidation.

Directors Explanation

As noted above when considering whether directors have traded recklessly the Court will take into account the actions of the directors to assess whether steps taken to protect the interests of creditors were appropriate and reasonable. When a company is insolvent the directors must act in the best interests of the creditors.

We wrote to the directors, Matt Taylor and Lindsay Aitken, requesting their explanation of events and the steps taken to protect the interests of creditors. A summary of their views is below:

- the new show home was expected to generate sales, coupled with the recruitments of the Sales Manager
- long term finance was arranged with suppliers of product for the new show home such that payment was not due to suppliers until the show home was sold
- a sale and lease back of the new show home was explored as a means of easing cash flow
- entities owned by Mr Aitken provided ongoing financial support for certain running costs
- the restructuring of Ehomes was actively pursued whereby Mr Aitken would acquire the shareholding of the other shareholders, assume liability for Ehomes debts, source an equity injection and continue to trade on the basis that the other shareholders were prepared to write off their loans as part of the restructuring.
- Mr Aitken advises that in the expectation that the restructuring would proceed Ehomes continued to trade in the ordinary course of business in May and June.

- Mr Aitken had expected this restructuring to go forward and it was not until June 24 that he accepted it would not succeed. He then immediately took legal and accounting advice resulting in the Liquidation of Ehomes on 29 June.

Section 301 of the Companies Act 1993 (“S301”)

If it is determined that the directors have breached the requirements of S135 and S136 the next step is to determine whether proceedings pursuant to S301 are appropriate. In basic terms S301 provides that if the Court determines that directors did trade a company recklessly from a specific date (i.e. the date when the Court determines the directors knew or ought to have known the company was insolvent), then the directors can be required to contribute to the assets of the Liquidation. The Court takes the increase in liabilities from the deemed date of insolvency to the date of Liquidation and the directors will be ordered to pay all or a percentage of that increase. The Court will have regard to the directors’ actions in trying to save the business and any sums loaned or advanced to the company by them. In Ehomes case, despite the balance sheet position, the company was generally paying trade creditors as and when they fell due so it is difficult to expect that the Court would determine a date much before (say) 31 March. The trading records for Ehomes indicate that trade liabilities were fairly consistent month on month, (\$379,000 at 31 March; \$429,000 at 29 June – increase of \$50,000).

However, funds received from clients in March were some \$90,000 against a June figure of \$208,000. We would expect that the loss to clients would involve a factor of perhaps 100% allowing for the re-ordering of goods already paid for and other costs. If (as a fairly crude example to assist you) the date of 31 March was used to determine insolvency the Court might assess the maximum increase in liability for which the directors could be responsible would be

	\$
Increase in Trade Creditors say (429,000 – 379,000)	50,000
Increase in client loss say (416,000 - 180,000)	236,000
	<u>\$286,000</u>

As explained the Court will take into account the directors’ actions in determining a fair contribution to the assets of the Liquidation. Given the attempts to restructure the business and funding provided to Ehomes, the Liquidators believe that it is unlikely that the maximum sum (\$286,000.00 in the above example) would be ordered to be contributed to the Liquidation. The Liquidators also feel compelled to make the point that it is often extremely difficult to identify the precise point in time when a company’s position is such that the directors should obviously have taken steps to ensure that they would not act in breach of ss135-136. Whilst the Liquidators have chosen 31st March as a date for the above example, the date could be held to be much later.

Summary as regards S135/S136

Having regard to the legal advice received our current view is that the directors may have a case to answer in terms of S135 and S136. However, it is by no means clear cut. To take S301 proceedings would involve considerable cost, time and risk to the funds in hand that would otherwise be available to unsecured creditors by way of dividend.

The cost of bringing proceedings against one or more directors varies from case to case, depending upon the number of directors involved and the complexity of the issues. A rough estimate of an average cost would be \$100,000.00 (plus GST). If successful, an award of costs may be made of, say, up to 40% (\$40,000.00), which would mean that the net cost would be approximately \$60,000.00 (plus GST). That assumes that any director found to have breached their duty has the money to pay all sums awarded against them.

In general terms (in any given case), there is the risk that if any such proceedings brought by any liquidators were to be unsuccessful, an award of costs against the liquidators could be made. Should that occur, the liquidators would be entitled to an indemnity from the assets of the company. However, should there be insufficient unsecured assets to cover all possible cost, the liquidators would not usually be prepared to embark upon litigation without full funding (including coverage of any possible costs award against the liquidators) being provided by the creditors or by a third party funder.

In the present circumstances, we would have to satisfy the Court that the directors allowed the business to carry on in a manner that created an unreasonable risk of serious loss to the creditors. There is evidence that efforts to restructure were genuine and the Court will certainly take this into account. Accordingly, there is some risk that even if one or more directors is found to have breached either or both of ss135-136, the directors may not be ordered to make a substantial contribution (such as to make proceedings worthwhile).

Based on our assessment we do not consider that funds in hand should be used for litigation. We have not received claims from many clients as yet but based on the information available a dividend of 10 cents on the dollar may be possible in due course.

However, any creditor can either bring S301 proceedings on their own or provide funds to the Liquidators for them to commence proceedings. Pursuant to the Seventh Schedule of the Companies Act 1993 any creditor who provides funds to the Liquidators would have preferential status.

Fiduciary Duty to Clients

Understandably clients have expressed concern that funds were accepted from them in June when the directors knew that Ehomes future was in the balance. Therefore we have researched whether proceedings might be available on any specific or additional obligation of the directors to protect the interests of clients.

The basic position is that director's fiduciary duties are owed to the company as a whole and not to individual shareholders, creditors, employees or community.

In the circumstances, it is the Liquidators' view that Ehomes clients would not enjoy any rights over and above that of the general body of creditors of which they form a part and therefore Ehomes directors did not owe any special duties directly to Ehomes clients. However, as the Liquidators are required to act in the interests of the Company (and therefore, its creditors), the Liquidators cannot consider the position of Ehomes clients beyond the extent to which any breach by any director of any duties owed by the director to the Company impacts on the recovery of sums owed to creditors. Should any Ehomes client wish to know whether the directors owed (and breached) any duties owed specifically to Ehomes clients, they would have to seek their own legal advice.

Section 9 Fair Trading Act 1986 "FTA"

If the Court determines that any of the directors of a company have engaged in misleading or deceptive conduct they could be ordered by the Court to make some form of payment to the aggrieved party. In addition the creditor could lay a complaint with the Commerce Commission to see whether any action would be taken. (This would not result in any financial compensation for the creditor.)

It is not open to the Liquidators to take action under the FTA as regards client losses. This would be a matter to be pursued by any aggrieved client based on their own legal advice.

The creditor would have to establish that Ehomes conduct was misleading or deceptive or was likely to be misleading or deceptive.

12 October 2010

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Conclusion

While the Liquidators consider there is an arguable case against the Ehomes' directors for reckless trading they do not consider that commencing proceedings would be justified. In our view, the likely recovery for creditors from the successful outcome of any proceedings taken against the directors is likely to be significantly reduced by non-recoverable costs and mitigation arising from the directors' attempts to restructure Ehomes.

Given this risk, the likely protracted nature of any proceedings commenced and the probability that funds on hand would not be sufficient to cover the costs of going to trial, the Liquidators do not believe it is in the best interests of creditors to initiate legal proceedings against the directors.

In the circumstances we propose to commence the process of agreeing claims with a view to paying a dividend as quickly as possible. Accordingly, we request that all creditors who have not yet already done so, submit details of their claims against Ehomes to the Liquidators as soon as possible.

Yours faithfully
For and on behalf of
Ehomes Limited
(In Liquidation)

A handwritten signature in black ink, appearing to read 'M Lamacraft', with a stylized flourish at the end.

M Lamacraft
Liquidator