

**IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY**

**CIV-2012-488-000385
[2012] NZHC 2881**

UNDER the Companies Act 1993

IN THE MATTER OF the liquidation of Manukau Road 380
Limited (in liquidation)

BETWEEN DAVID STUART VANCE AND VIVIEN
JUDITH MADSEN-RIES AS
LIQUIDATORS OF MANUKAU ROAD
380 LIMITED (IN LIQUIDATION)
Applicants

AND SUMNERS APPLIANCE LIMITED
Respondent

Hearing: 29 October 2012

Appearances: N H Malarao and W N Fotherby for the Applicants
A G Stuart for the Respondent

Judgment: 1 November 2012

JUDGMENT OF ASSOCIATE JUDGE MATTHEWS

*This judgment was delivered by me on 01.11.12 at 3.00 pm,
pursuant to Rule 11.5 of the High Court Rules.*

Registrar/Deputy Registrar

Date

Solicitors:

Meredith Connell, Auckland – nick.malarao@meredithconnell.co.nz
Webster Malcolm & Kilpatrick, Warkworth – a.stuart@wmklaw.co.nz

DAVID STUART VANCE AND VIVIEN JUDITH MADSEN-RIES AS LIQUIDATORS OF MANUKAU
ROAD 380 LIMITED (IN LIQUIDATION) V SUMNERS APPLIANCE LIMITED HC AK CIV-2012-488-
000385 [1 November 2012]

[1] The applicants are the liquidators of Manukau Road 380 Limited. On 26 November 2008 Manukau Road 380 Limited paid \$30,500 to Sumners Appliance Limited by way of arrears of rental due under its lease of a property owned by that company. The next day the Commissioner of Inland Revenue applied to the High Court for appointment of a liquidator of Manukau Road 380 Limited. The liquidators were appointed on 9 February 2009. On 28 January 2011 they issued a notice under s 292 of the Companies Act 1993 to set aside this payment. As Manukau Road 380 Limited opposed the notice, the liquidators then applied for an order, which Manukau Road 380 Limited opposes.

Relevant provisions of the Companies Act 1993

[2] Section 292 of the Companies Act 1993 provides, to the extent relevant:

292 Insolvent transaction voidable

- (1) A transaction by a company is voidable by the liquidator if it –
 - (a) is an insolvent transaction; and
 - (b) is entered into within the specified period.
 - (2) An **insolvent transaction** is a transaction by a company that –
 - (a) is entered into at a time when the company is unable to pay its due debts; and
 - (b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.
 - (3) In this section, **transaction** means any of the following steps by the company:
 - (a) conveying or transferring the company's property:...
 - (4A) A transaction that is entered into within the restricted period is presumed, unless the contrary is proved, to be entered into at a time when the company is unable to pay its due debts.
- ...

(6) For the purposes of subsection (4A), **restricted period** means—

- (a) The period of 6 months before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

- (b) In the case of a company that was put into liquidation by the court, the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order of the court was made;

(The restricted period is within the period described as the specified period).

[3] Section 294(5) says:

Procedure for setting aside transactions and charges

...

- (5) A transaction or charge that is not automatically set aside may still be set aside by the court on the liquidator's application.

[4] Section 296(3) provides:

Additional provisions relating to setting aside transactions and charges

...

- (3) A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or in equity, if the person from whom recovery is sought (**A**) proves that when A received the property—
 - (a) A acted in good faith; and
 - (b) a reasonable person in A's position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and
 - (c) A gave value for the property or altered A's position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

Issues to be decided

[5] The liquidators say that the payment to Sumners Appliance Limited was a transaction in terms of s 292(3)(a), and was an insolvent transaction in terms of s292(2), as it was entered at a time when Manukau Road 380 Limited was unable to pay its due debts, and it enabled Sumners Appliance Limited to receive more towards satisfaction of arrears of rent than Sumners Appliance Limited would have received or would have been likely to receive in the liquidation of Manukau Road 380 Limited. The liquidators say the payment was made during the restricted period defined in s 292(6), and seek an order setting aside the payment under s 294(5).

[6] Sumners Appliance Limited accepts that the payment was a transaction in terms of s 292(3), and that the payment was made within the restricted period, so Manukau Road 380 Limited is presumed, unless the contrary is proved, to have been at that time unable to pay its due debts. It says, however:

- (a) The payment did not enable Sumners Appliance Limited to receive more towards satisfaction of a debt owed to it by Manukau Road 380 Limited than it would have received, or would have been likely to receive, in the company's liquidation.
- (b) The defence under s 296(3) is available to it as it has proved each of the elements of that defence listed in that subsection.

[7] Accordingly the issues in this case are:

- (a) Did the payment enable Sumners Appliance Limited to receive more towards satisfaction of the arrears of rent owed by Manukau Road 380 Limited than it would have received, or would have been likely to receive in Manukau's liquidation?
- (b) Are the three elements in s 296(3) established?

Relevant facts

[8] Manukau Road 380 Limited leased premises from Sumners Appliance Limited under a deed of lease. The lease provided for payment of rent and a portion of outgoings on the building, on a monthly basis. It also provided that the lease could not be assigned without the consent of the landlord, which was to be given if certain conditions were met, one of which was that all rent and other monies payable under the lease had been paid.

[9] From July 2006 until March 2007 Manukau Road 380 Limited fell into arrears with payments. By 12 April 2007, \$24,041.33 was overdue. For a period of three months current instalments were met, and from July 2007 until July 2008 payments were also made on account of arrears so that by the latter date the sum outstanding was \$17,926.78. Manukau Road 380 Limited paid \$12,457.19 in the

period to November 2008. Ongoing rental and outgoings, together with interest, exceeded that sum, and by 26 November the debt was \$31,571.59. The business was sold in November 2008. Sumners Appliance Limited gave consent to assignment of the lease to the purchaser on condition that rental arrears were paid, and after a small discount (said by Mr Sumner to be for goodwill) the company received \$30,500 on 26 November 2008.

[10] At various times arrangements were made to catch up with arrears by paying additional monthly instalments of \$300, but between February 2007 and November 2008 seven payments on account of arrears were dishonoured.

[11] Ms Madsen-Ries produced a graph of arrears by date, which shows that from about the beginning of 2007 onwards there were arrears of varying sums, all greater than approximately \$17,000. In September 2007 the solicitor for Sumners Appliance Limited wrote to the solicitor for Manukau Road 380 Limited referring to an agreement to repay outstanding sums at \$500 per week, which had only been honoured once, and indicating that if these payments were regularly made then Sumners Appliance Limited would accept repayment of the debt means until the business was sold, and the remaining debt could be paid from the sale proceeds. In May 2008 Sumners Appliance Limited's solicitors wrote again in relation to the outstanding debt and advised that their client would have no option but to exercise its remedies under the lease and re-enter the premises "unless something very positive is forthcoming very quickly". On 21 October they issued a formal notice under the Property Law Act requiring the remedying of specified defaults in relation to rent within 12 working days, failing which Sumners Appliance Limited may exercise its remedies under the lease.

[12] Mr Sumner was aware that arrears may be paid from a sale of the business in 2007. By October 2008 a prospective sale of the business was in the wind. Sumners Appliance Limited decided not to take any further steps to terminate the lease. Mr Sumner was conscious of the value of the lease in the sale process not only because it provided the premises from which the business operated, but also because of its relevance to gaming machine licences and the liquor licence, held by the

business. He therefore arranged with a director of Manukau Road 380 Limited that arrears of rent would be paid from the proceeds of sale of the business.

[13] The applicant for appointment of liquidators was the Inland Revenue Department. It was owed significant sums for GST, PAYE and student loan deductions. Manukau Road 380 Limited did not pay any GST from July 2006, and made only three payments for PAYE from October 2005 onwards. It did not make payment of any required student loan deductions, from October 2005 onwards. Arrears at the date of liquidation in these three categories amounted to just over \$78,000 including penalties and interest.

[14] A list of creditors produced by the liquidators shows total preferential and unsecured creditors of \$162,006.71. Had the debt to Sumners Appliance Limited been on the list, the total would have been some \$193,000, the three largest creditors being the Inland Revenue Department, one of the shareholders, and Sumners Appliance Limited. Other unsecured creditors are owed relatively small amounts.

[15] Correspondence from the solicitor for Sumners Appliance Limited refers to that company being frustrated by the difficulties in achieving payment of arrears of rental, and a notation on an account from the firm refers to a letter to Manukau Road 380 Limited's solicitors offering to settle arrears of rental by accepting a transfer of the fittings in the building.

FIRST ISSUE – was the payment of \$30,500 an insolvent transaction?

[16] Mr Stuart argues that the payment to his client was not an insolvent transaction because it did not enable that company to receive more towards satisfaction of Manukau Road 380 Limited's debt than it would have received in the company's liquidation. He says that had the payment not been made, Sumners Appliance Limited would not have consented to assignment of the lease (a decision it was entitled to make under the deed of lease) with the result that the company would not have received \$140,000 for the business. Mr Stuart submits that although the balance of that sum after costs went to secured creditors, it inevitably improved the prospects of unsecured creditors being paid.

[17] Mr Stuart draws attention to the difference between s 292(2)(b) of the New Zealand Companies Act and the equivalent provision of the Corporations Act 2001 in Australia, and submits that as the amendments to the Companies Act in 2006, which brought into force s 292 in its present form, broadly mirror those in Australia but do not, in this section, the New Zealand section must have a meaning which is different from the meaning ascribed to the Australian section.

[18] Mr Stuart notes the decision in *Hardley v Fatupaito*.¹ In that case, liquidators placed a company's business on the market and on arranging a sale sought a landlord's consent to assignment of the lease. The landlord required payment of arrears of rent and outgoings. The liquidators maintained that making a payment as required would give preference to the landlord over other unsecured creditors. The liquidators accepted that they were able to obtain a better price for the asset of the company as a going concern, which required assignment of the lease, so payment of the arrears brought a benefit to the company. On that basis the Court found that the liquidators would not be in breach of their obligations under the Companies Act if they accepted the condition requiring the company to pay the arrears of rent. They would be ensuring the company realised the maximum value for the lease, to the benefit and not to the detriment of the creditors as a whole.

[19] Mr Stuart argues that the wording of s 292 is sufficiently broad to permit the Court to apply a similar reasoning in respect of a payment made before the liquidation. He submits that had the liquidators been approached with a requirement to pay the arrears of rent in order to complete a sale at \$140,000, the liquidators would have been entitled to make the payment to Sumners Appliance Limited. That, he argues, would have been a payment in the company's liquidation equalling the payment that it in fact received before the liquidation and thus, in the events that happened, Sumners Appliance Limited did not receive more towards satisfaction of its debt than it would have received in the liquidation.

[20] Mr Stuart called Ms Madsen-Ries for cross-examination. He suggested to her that had the business not been sold and the sum of \$140,000 received by the

¹ *Hardley v Fatupaito* [2009] 3 NZLR 676 (HC).

company before the liquidation, then the position of the unsecured creditors would have been worse than it is as matters stand. Ms Madsen-Ries said that it would be difficult for her to speculate on what might have happened in that event, or the impact it would have had on creditors. She was then asked whether in her experience as a liquidator, but with her knowledge about the state of the company, she would have continued to operate the business. After indicating that the liquidators had not needed to consider that possibility, she said that where appointed as liquidator of a business which is still trading, or has recently been trading, a decision on the steps to be taken would be based on a number of factors, directed at deciding whether continuing to trade, and selling the business, or ceasing trading and selling the assets *in situ*, would produce a better result for creditors.

[21] When re-examined on the point Ms Madsen-Ries said that in the course of considering this the liquidators would talk to employees and key suppliers including the landlord, as well as creditors whose interests would be affected by their decision.

[22] Ms Madsen-Ries was not prepared to be drawn into speculating on what the position might have been in the subject liquidation had the sale not been effected, and the liquidators had been required to deal with a company which was trading. This is entirely understandable. Plainly the liquidators did not turn their minds to it because they didn't have to. The explanation of the way a decision on the course of the liquidation would be made showed that facts would be gathered and assessed, and decisions made. This demonstrates the difficulty facing the Court in accepting the submission of Mr Stuart that his client would have received, or would be likely to have received, the same amount in the liquidation as it received in November 2008. Certainly it may have, but that is as high as I can put it. Ms Madsen-Ries was not prepared to speculate on what may have happened to the business, and nor can I.

[23] The test in s292(2) requires the Court not only to consider what the payee would have received in the liquidation, but also what it would have been likely to receive. Even so, in my view the evidence goes no further than to raise the possibility of Sumners Appliance Limited receiving a payment, on the basis that the liquidators may have elected to attempt to sell the business as a going concern, with an assignment of lease, may have located a suitable purchaser, and may have

negotiated with Sumners Appliance Limited's payment of a sum by way of arrears of rent equal to that which was in fact paid. This falls well short, in my judgment, of establishing a material degree of likelihood.

[24] Not only is the evidence on what may have happened scant at best, but also the financial results of Manukau Road 380 Limited scarcely establish fundamental financial elements of a viable business which might have been offered for sale. As noted, outstanding rent and revenue payments totalled around \$110,000, and apart from a shareholder advance the company had in fact been using money contractually owing to the landlord, and monies received on behalf of the Inland Revenue Department, as its working capital for a number of years. That is as far as I can take this point, as Ms Madsen-Ries was not specifically asked about the relevance of the company's financial position in any decision that the liquidators might have made had the company still owned the business at the date of liquidation. However, in my view, it is realistic to assume that at least one factor that might be taken into account in assessing the viability of endeavouring to achieve a sale would be the financial strength or otherwise of the business. I note that marketing the business appears, on the evidence of Mr Sumner, to have been in prospect from some point in 2007, yet was not achieved until late 2008.

[25] Unsecured creditors in the liquidation are highly unlikely to receive any payment on account of their debts. Sumners Appliance Limited received \$30,500 in the restricted period. On the face of it, this is a sum well in excess of the amount it would otherwise have received, or been likely to receive, in the liquidation. The prospect that it would have received the same amount had the liquidator sold the business is not made out.

[26] I have considered carefully the discussion of issues similar to those argued in this case in *Hardley v Fatupaito*. I note that his Honour said:

[74] ... I do not necessarily disagree with counsel for the liquidators when he submits that, if the company had paid the arrears of rent shortly before it went into liquidation, that payment would prima facie constitute a voidable transaction that the liquidators could subsequently set aside. ...

[27] And further:

[77] ... The voidable transaction regime is based on the premise that those in control of an insolvent company may be motivated to treat creditors in an unequal manner. The regime is therefore designed to enable a liquidator to recover assets where they have been distributed unevenly between creditors at a time when the company is deemed to be insolvent. The onus in such a situation is on those who deal with the company in such circumstances to demonstrate that they have acted in good faith and that it would be inequitable to order recovery.

[28] The references in the final sentence are to the tests then applying under s 296(3). I turn to those now. In relation to s 292(2) I find that the payment to Sumners Appliance Limited was an insolvent transaction.

SECOND ISSUE – has Sumners Appliance Limited established a defence under s 296(3)?

[29] For the prohibition under s296(3) to apply, Sumners Appliance Limited must establish each of the three factual propositions set out.

[30] The first element to be establish is that Sumners Appliance Limited acted in good faith. In *Levin v Market Square Trust*,² the Court said:

[54] ... The first matter the trust must establish, therefore, is that it “received the property in good faith”. The test of “good faith” has been clearly established by this Court. The recipient of the property or money must show that he or she honestly believed that the transaction would not involve any element of undue preference either to himself or herself or to any guarantor: *Re Orbit Electronics Auckland Ltd (in liq)*, *W H Jones & Co (London) Ltd v Rea* (1989) 4 NZCLC 65,170, approved in *Re Number One Men Ltd (in liq)*, *Meltzer v Axiom International Ltd* (2001) 9 NZCLC 262,671. The cases show that a creditor is likely to fail this test where he or she has actual or implied knowledge of the company’s financial difficulties, due to the company’s cheques being dishonoured, its failure to pay its debts on time, or other circumstances indicating serious cashflow problems: *Howes & Ors, Brookers Company and Securities Law* (looseleaf ed), at CA296.03(1).

² *Levin v Market Square Trust* [2007] 3 NZLR 591 (CA).

[31] Although the phrase in the section at the time that case was decided referred to receiving the property in good faith, whereas the section now refers to acting in good faith, this does not in my opinion have a bearing on the meaning of good faith, which is determined by examination of the elements described in this citation, rather than by reference to the payee acting in good faith as distinct from receiving property in good faith. The focus is on the recipient's state of mind.

[32] Mr Stuart argues that although Sumners Appliance Limited knew of the arrears and kept pressure on Manukau Road 380 Limited for payment, this did not suggest to Sumners Appliance Limited that the company was insolvent. He says that Sumners Appliance Limited was prepared to be patient, to give the company an opportunity to sell its business so that it could realise its full value, and that it received the payment in good faith. He says that had the payment not been agreed to, Sumners Appliance Limited would have re-entered and terminated the lease, so by consenting to the assignment Sumners Appliance Limited gave value for the payment of arrears. He says it would be unfair if the company were now able to recover the payment, having had the benefit of the assignment and thus the ability to maximise the value of the business on sale.

[33] Mr Stuart relies on *Hardley v Fatupaito* where Lang J said:

[76] It is not difficult to envisage situations in which recovery might be denied to a liquidator in such circumstances. A lessor may often elect not to re-enter and terminate a lease notwithstanding the fact that the lessee is in arrears with rent and is exhibiting symptoms of insolvency. The lessor may refrain from exercising those rights in order to give the lessee the opportunity to find a new tenant. In such circumstances the lessor may be able to persuade the court that it has acted in good faith throughout, and that it has also altered its position to its detriment. It may also be able to convince the court that it would be inequitable to order recovery, or at least recovery in full. That could occur, for example, where the lessor has refrained from terminating the lease in order to enable the company to sell its business for a price that it could never have obtained if the lessor had terminated the lease.

[34] Whilst these comments were acknowledged by the Judge to be obiter, Mr Stuart says they recognise that a respondent's ability to satisfy the criteria in s 296(3) will be dependent on the facts; the issue is one of equity or fairness. Mr Stuart submits that s 296(3) does not preclude the Court from deciding that a

creditor should not be required to repay all or any of the proceeds of a voidable transaction. He says that the section provides that a Court must not order payment if the criteria are fulfilled, but does not provide that the Court must order repayment unless they are satisfied. Mr Stuart notes that s 294(5) provides that a transaction that is not automatically set aside (by failure to file an opposition) may still be set aside by the Court on the liquidator's application – but the subsection does not say that it must be.

[35] In his affidavit Mr Sumner gave evidence of what he described as Manukau Road 380 Limited's "history of rent arrears" which began when the company missed payments in June and July 2006, and then payments later in early 2007. I have already set out the position with arrears of rent and outgoings, which established a hardcore debt in excess of \$17,000 from early 2007. Mr Sumner expressed the view, based on his experience with previous tenants, that the business was capable of running profitably and he wished to give the company the opportunity to receive a return on the significant investment it had made in setting up its business at the premises. Mr Sumner agreed to an arrangement to enable Manukau Road 380 Limited to pay current rent and outgoings and regular payments in reduction of arrears, and although he noted that there was often a need to keep pressure on the company to keep up with payments, by July 2008 the arrears had reduced from \$24,041.33 to \$17,926.78. He noted, however, that this amount still included arrears in rent carried forward from February to April 2007, with accumulated interest on those arrears.

[36] Mr Sumner became aware that the business was on the market during 2007, with a view to paying any remaining arrears owing to him from the proceeds of sale. In 2008 Mr Sumner became aware that there were prospects of sale and although he continued to press for payment he appears to have reached the view that the only way he was actually going to receive the arrears owing was if the business was sold. He kept pressure on Manukau Road 380 Limited through his solicitors and by the issuing of a notice under the Property Law Act.

[37] Mr Sumner says that apart from knowing of the rent arrears he was not aware of the financial situation of the business. He thought the company was gradually

paying off the arrears and generally keeping up to date with current rent and outgoings under the lease. On that basis he says he had no reason to think that the company was not paying other creditors. All he knew about the company's financial situation "was what I assumed from my own dealings with the company, and what I was told by others". He did not elaborate on the latter.

[38] Mr Sumner was not cross-examined on the state of his knowledge so I proceed on the basis of the evidence he has given, in the context of the known facts about the financial affairs of the company. This must be confined to the facts of which Mr Sumner, as director of his company, had knowledge. I accept that he did not know of the company's failure to make payments to the Inland Revenue Department, which I have summarised.

[39] As noted in *Levin v Market Square Trust*, a payee is unlikely to establish that it acted in good faith, and that a reasonable person in its position would not have suspected (and the payee did not have reasonable grounds for suspecting) that the company was or would become insolvent, where, by one means or another, the company has actual knowledge of due payments being missed.

[40] In this case the poor history of payments started in July 2006, just nine months after the lease commenced. It continued until the business was sold in November 2008. A hard core debt was established. Although attempts were made to pay arrears these were irregular, and payments were frequently dishonoured. Sumners Appliance Limited had to continually keep pressure on for payment, to invoke the services of its solicitors, to issue a notice under the Property Law Act, to consider taking ownership of assets in lieu of rent, and finally to accept that it would only be paid its arrears when the business was sold, which is of course a resort to the capital worth of the business to meet an expense which should have been met on a current basis. Mr Sumner continued to give Manukau Road 380 Limited every opportunity to continue to trade; no criticism could be levelled at him for acting unfairly or harshly. However, it is well-established that Sumners Appliance Limited had actual knowledge of the company's financial difficulties. I am unable to find that it acted in good faith, in terms of s296(3)(a), or that a reasonable person in its position would not have suspected that Manukau Road 380 Limited was or would

become insolvent. Further, I find that Sumners Appliance Limited did have reasonable grounds for suspecting that the company was or would become insolvent.

[41] It follows that the first two elements of s296(3) are not established. As the three elements must all be established it is not necessary to consider the third element. All I need say is that even if Sumners Appliance Limited believed that the payment it received was valid and would not be set aside, holding that belief was not, in my view, reasonable in the circumstances I have discussed.

[42] For these reasons the defence in s296(3) to the liquidators' application is not made out.

Outcome

[43] Mr Stuart submitted that even if the prohibition in s296(3) is not made out, nonetheless the Court has a discretion not to direct that the payment be set aside, as s294(5) provides that it may be set aside, not that it must be. This point was not argued on behalf of the liquidators and on the view of the facts which I have reached I do not need to determine it, as I would not in any event exercise a discretion in favour of Sumners Appliance Limited. Even if there is a discretion, it would have to be exercised, in my opinion, in a manner consistent with the scheme of ss292-301 of the Companies Act 1993. Relevant again in this context is the observation of Lang J in *Hardley v Fatupaito*:

[77] ... The voidable transaction regime is based on the premise that those in control of an insolvent company may be motivated to treat creditors in an unequal manner. The regime is therefore designed to enable a liquidator to recover assets where they have been distributed unevenly between creditors at a time when the company is deemed to be insolvent.

[44] His Honour went on to note that a liquidator can be expected to act in accordance with the obligations imposed by the Act, and must also act in the interest of the creditors. I agree with all these observations. Whilst I accept that Mr Sumner treated Manukau Road 380 Limited with tolerance in a situation where for a considerable period others might not have done so, I do not think this is sufficient to allow the payment to remain in his company's hands. Section 296(3) is enacted to

give relief against a harsh result which might ensue in the circumstances described in that subsection. To then read s294(5) in such a way that relief could be given to a payee on the basis that it has acted fairly and reasonably would, in my opinion, diminish the balanced approach to competing rights which the legislation establishes. It is trite to note that if s294(5) conferred a broad discretion, s296(3) would not be required. All these factors point away from there being a discretion, but if there is, in my view cases where it will be exercised to relieve a payee of an obligation to reply will be rare.

[45] Pursuant to s294(5) I order that the payment of \$30,500 by Manukau Road 380 Limited to Sumners Appliance Limited is set aside.

[46] The liquidators are entitled to costs; these will be paid on a 2B basis plus disbursements fixed by the Registrar.

J G Matthews
Associate Judge