IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2011-404-5022
[2012] NZHC 3089

UNDER	the Companies Act 1993
IN THE MATTER OF	SHAFTSPRY LIMITED (IN LIQUIDATION)
BETWEEN	CHRISTOPHER HORTON AS LIQUIDATOR OF SHAFTSPRY LIMITED (IN LIQ) Applicant
AND	BRIAN PATRICK COWLEY AND GARTH WILLIAM COWLEY AS TRUSTEES OF THE RENTALENGTH TRUST First Respondents
AND	CALVIN BLAKLEY WEST Second Respondent

Hearing: 26 June, 23 October and 6 November 2012

Counsel: K T Glover for Applicant
E J Werry for First, Third and Fourth Respondents
R S Pidgeon for Second Respondent

Judgment: 23 November 2012

INTERIM JUDGMENT OF ASSOCIATE JUDGE BELL

This interim judgment was delivered by me on ***23 November 2012*** *at* ***4:30pm*** *pursuant to Rule 11.5 of the High Court Rules.*

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Registrar/Deputy Registrar

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Introduction

[1] In late 2009 Brian and Garth Cowley sold a 13 ha property at 26 Paddy Road, Te Kauwhata for $895,000 plus GST. Shaftspry Ltd owned the property. The company was in liquidation. The Cowleys had a registered first mortgage over the property and sold the property as mortgagees.

[2] The dispute in this case is about the distribution of the proceeds of sale. The Cowleys say that after paying GST and the costs of sale, the proceeds of sale are to be paid to them as first mortgagees, and to Brian Cowley and Calvin West under a second mortgage. After those payments, there is nothing left for Shaftspry Ltd, the mortgagor. They say that that is a distribution under s 185 of the Property Law Act 2007.

[3] Christopher Horton, the liquidator of Shaftspry Ltd, challenges that distribution. He accepts that there is a registered first mortgage in favour of the Cowleys securing the principal sum of $400,000 and a registered second mortgage securing the principal sum of $200,000 ($100,000 to Brian Cowley and $100,000 to Calvin West), but he says that after allowing for those principal amounts, GST and the costs of sale, the balance of the funds should be paid to the company to be distributed according to the liquidation provisions of the Companies Act 1993.

[4] He attacks:

(a) a shareholders' resolution of 8 May 2008 which provided, amongst other things, for the company to pay interest on mortgages registered over the Paddy Road property; and

(b) four term loan contracts and an agreement to mortgage dated 22 July 2008. Under the term loan contracts, Shaftspry Ltd agreed to pay Brian Cowley and Brian Cowley Surveying Ltd for advances, expenses paid and services provided to the company. The agreement to mortgage gave security for payment under the term loan contracts.

[5] Mr Horton says:

(a) The shareholders' resolution was not effective to vary the mortgages, which were originally interest free. The mortgagees are accountable under s 305 of the Companies Act for the sums they have retained for interest on the mortgages.

(b) Alternatively, the resolution does not allow for interest to be backdated, so that the mortgagees can only keep money for interest running from the date of the resolution.

(c) The shareholders' resolution of May 2008, the term loan contracts and the agreement to mortgage of July 2008 are voidable under ss 292 and 293 of the Companies Act.

(d) The security given for payment of interest on the mortgages in the shareholders' resolution of May 2008, and the agreement to mortgage of July 2008, should be set aside under s 299 of the Companies Act.

[6] Calvin West, the second respondent, generally supports Mr Horton, but adds further arguments:

(a) The shareholders' resolution did not bind the company; and

(b) The court should order Brian Cowley to pay the liquidator's remuneration.

[7] Brian Cowley represents the Cowley interests, who are:

(a) he and Garth Cowley, as mortgagees (the first respondents);

(b) himself as lender under three of the term loan agreements of July 2008 (the third respondent); and

(c) Brian Cowley Surveying Ltd as lender under the fourth term loan agreement of July 2008 (the fourth respondent).

[8] As well as opposing the other parties, Mr Cowley says:

(a) Mr West and the Cowley interests are the only creditors of the company. Accordingly, there is no point in the liquidator's attack on the transactions, because any money paid to the company would have to be paid back to Mr West and the Cowley interests;

(b) Alternatively, if there are preferential creditors, he would pay an amount to clear them; and

(c) He takes issue with Mr Horton's conduct of the liquidation and his remuneration.

[9] The case raises these questions:

(a) Can Mr Horton require the mortgagees to account for sums retained for interest on the mortgages under s 305 of the Companies Act?

(b) Was Shaftspry Ltd able to pay its due debts on 8 May 2008?

(c) Was Shaftspry Ltd able to pay its due debts on 22 July 2008?

(d) Are the charges given by the shareholders' resolution of May 2008 and the agreement to mortgage of July 2008 voidable under s 293 of the Companies Act?

(e) Are the shareholders' resolution, the term loan contracts and the agreement to mortgage voidable transactions under s 292 of the Companies Act?

(f) Should the shareholders' resolution be set aside under s 299 of the Companies Act?

(g) Does Mr Cowley have good grounds to challenge the conduct of the liquidation and Mr Horton's remuneration?

(h) Can Mr Cowley be ordered to pay the remuneration and expenses of the liquidator?

[10] There are some matters that I do not decide:

(a) In written submissions, Mr Werry set out arguments as to running account under s 292(4B) and set-off under s 310 of the Companies Act, but at the hearing did not pursue them. I am not required to address them.

(b) Mr Cowley has an interest in Black Beagle Property Ltd, the company that bought the Paddy Road property under the mortgagee's sale. However, the other parties do not contest the validity of the sale; pragmatically so. They accept that the sale price was reasonable. On the evidence of a valuation that Mr Horton obtained, the price was likely more than current market value. For this case, the sale was valid and effective. I do not have to inquire further.

(c) There are continuing differences between Mr Cowley and Mr West going back to 2006. There are other proceedings between them. In particular, Mr West has started a proceeding under s 174 of the Companies Act. The company is not a party to that proceeding, but Mr Cowley is a defendant. The differences between Mr Cowley and Mr West are part of the background to this case, but I am not required to rule on the rights and wrongs of their disputes, except the next matter.

(d) One of the differences between Mr Cowley and Mr West is whether Mr West was effectively removed as a director of the company in early 2007. There was no evidence or argument on that issue.

Although the issue is relevant under s 299 of the Companies Act, I cannot decide it.

Background facts

[11] Shaftspry Ltd was incorporated in December 2004. It initially had three equal shareholders— Brian Cowley, Calvin West and Shirley van der Kley. They were all directors, but Ms van der Kley resigned 5 October 2005. She sold her shares to Mr Cowley on 16 May 2008.[1]

[12] The company bought the Paddy Road property in 2004. The property was used for a vineyard/winery and was purchased as an investment. Shaftspry Restaurant Ltd ran a restaurant operation on the property, and Cooks Landing Wines Ltd operated the vineyard and winery. Mr Cowley, Mr West and Ms van der Kley were also the shareholders of Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd.[2]

[13] In May 2005, Shaftspry Ltd gave two mortgages over the property: both were registered. The first was to Brian and Garth Cowley. The mortgage is for a fixed sum of $400,000, repayable on demand. The mortgage states that there is no interest payable.

[14] The second mortgage is in favour of Mr Cowley, Mr West and Ms van der Kley. It is also a fixed sum mortgage. It secures $300,000 repayable on demand. This mortgage also states that there is no interest payable. It is accepted that Ms van der Kley has been repaid for her interest in the mortgage and that Mr Cowley and Mr West are owed $100,000 each as the principal sums secured.

[15] While she was associated with the company, Ms van der Kley provided administrative and accounting services. Mr Cowley says that Mr West did not contribute any capital. Mr West's contribution to shareholders' funds was his labour,

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1 Under the agreement, she sold him her shares in Shaftspry Ltd and two related companies, Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd for $130,000.

2 Those companies are also in liquidation now, but Mr Horton is not the liquidator.

which Mr West apparently called "sweat equity". Mr West ran the restaurant business and the vineyard business.

[16] Mr Cowley's professional skills are in surveying. Through his surveying company, he did surveying work for the company and subdivided its excess land, creating additional sections which were sold for $528,000. Mr Cowley says that those funds were used to pay out Mrs van der Kley. The company was left with 13.8ha of land.

[17] Mr Cowley has been the primary funder of Shaftspry Ltd. In addition to the sums secured under the mortgages, he put other funds into the company and met company expenses. Until July 2008, there was no formal agreement between him and the company for repayment of his advances to the company.

[18] Mr West and Mr Cowley fell out. Mr Cowley accuses Mr West of mismanagement. Mr Cowley says that at the end of 2006 it came to light that Mr West had mismanaged the winery and restaurant businesses. He had allegedly used company funds to pay for personal expenses without authority. Mr Cowley purported to remove Mr West as director of all three companies in early 2007. Mr West complains that Mr Cowley unlawfully removed him as director. He also asserts claims against the company.

[19] Mr Cowley says that it later came to light that Mr West had filed inaccurate excise returns with the New Zealand Customs Service. Customs found this out when it carried out an audit. According to Mr Cowley, under Mr West's management, wine had been removed without excise duty having been paid. Shaftspry Ltd was liable for non-compliance with the bonding requirements of customs law, even though it was the winemaking business run by Cooks Landing Wines Ltd that had the wine. Mr Cowley also says that Mr West did not account for the wine that had been removed.

[20] On 8 January 2008, New Zealand Customs served a statutory demand on the company for the unpaid excise duty. Customs began liquidation proceedings on

8 February 2008. Mr Cowley paid Customs $22,566.82 in May 2008 to clear the unpaid duty, penalties, interest and costs.

[21] Mr Cowley says that the shareholders had an agreement that they would be repaid their loans only when land was sold. He says that Mr West went against this agreement by issuing a statutory demand. The company in turn applied under s 290 of the Companies Act to set aside the statutory demand. This proceeding led to the shareholders' resolution of 8 May 2008. It was intended to settle the statutory demand and the setting aside application, and to provide for an orderly winding up of the company.

[22] The written resolution is expressed to be a special resolution of shareholders under ss 106, 122 and 129 of the Companies Act. Mr West signed it. Mr Cowley signed it twice, once for himself and once as proxy for Ms van der Kley.

[23] In general, the resolution provides:

(a) for the Paddy Road property to be sold;

(b) for the company to recover unpaid debts;

(c) following the sale of the land, for payment of debts in a specified order: mortgages with interest, taxes and customs duty, costs of sale, certain undisputed creditors, other creditors (once it was resolved that they were creditors of the company), shareholders' loans plus interest, and any balance was to be paid pro rata to shareholders;

(d) procedures to deal with questioned debts;

(e) for shareholders' loans not to be paid until creditors are sorted out or three months of sale of Paddy Road;

(f) for assets of Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd to be sold; and

(g) for both the statutory demand and the setting aside application to be abandoned.

[24] The part of the resolution Mr Horton challenges is the start of (c) above:

> Following the sale of its land, the company pay in this order:
>
> (a) The total indebtedness together with interest at 10 per cent per annum (capitalised) as secured by mortgages registered over 26 Paddy Road, Te Kauwhata.

[25] At the time of the resolution, the liquidation application by Customs was still pending, but shortly afterwards, on 16 May 2008, Mr Cowley paid the Customs debt.

[26] In June, Mr West applied to be substituted as plaintiff in the Customs liquidation application. While this step was inconsistent with what he had agreed to in the shareholders' resolution, he says that Mr Cowley had himself breached the agreement and that then released him from complying with it. Apparently the alleged breach had something to do with the way Mr Cowley went about marketing the Paddy Road property.

[27] On 22 July 2008, the company entered into four term loan agreements and an agreement to mortgage:

(a) A term loan agreement with Mr Cowley for repayment of $169,270.78 for expenses Mr Cowley had met on behalf of the company together with interest, backdated to 21 November 2006. Mr Cowley signed the contract on behalf of the company.

(b) A term loan agreement for the payment of $142,640.35 payable to Brian Cowley, with interest backdated from 18 January 2006 to cover expenses of the company met by Mr Cowley.

(c) A term loan agreement with Mr Brian Cowley for $22,566.82 with interest backdated to 16 May 2008, for repayment of the Customs debt that Mr Cowley had paid.

(d) A term loan agreement for $73,731.94 with Brian Cowley Surveying Ltd to cover payment of advances made and expenses paid by Mr Cowley's surveying company. Interest was backdated to 28 January 2007.

[28] Mr Cowley signed the agreements for both lenders and borrower. No-one else signed them. Security for payment under all these term loan contracts was given under the agreement to mortgage, again signed only by Mr Cowley. That agreement was the basis for a caveat lodged against the title to Paddy Road. Mr Cowley did not tell Mr West about these agreements.

[29] In December 2008, the Cowleys served notices under s 119 of the Property Law Act on Shaftspry Ltd. The first notice alleged a default in paying the principal under the registered first mortgage for $400,000. The second notice alleged a default in paying interest amounting to $132,400. The company did not comply with either of those notices.

[30] On 3 February 2009, Mr West's application for the company to be put into liquidation was heard. His case was that the company was not able to pay its due debts and that it was just and equitable for the company to be put into liquidation. The company opposed. In her decision of 3 April 2009, Associate Judge Sargisson ordered that the company be put into liquidation. Judge Sargisson accepted that the company was insolvent. In fact, at that stage, insolvency was no longer in dispute. Judge Sargisson did not have to decide the just and equitable ground, but noted the collapse in the relationship between Mr Cowley and Mr West. The application had been opposed in the hope that, if granted more time, the Paddy Road property could be sold. Judge Sargisson held it was no longer appropriate to allow further time. She accepted that Mr West was a creditor of the company, but noted that the amount of his debt was in dispute.

[31] Mr Horton was appointed liquidator. At that stage he was in practice with Mr John Price, another insolvency practitioner. Shortly afterwards, Mr Price ceased practice with Mr Horton and Mr Price resigned as liquidator. Mr Horton has had effective charge of the liquidation throughout.

[32] Mr Horton put the Paddy Road property up for tender. Just before the date for tenders closed, the Cowleys advised that they had sold the Paddy Road property as mortgagees to Black Beagle Property Ltd. The sale price was $895,000 plus GST or $1,006,875. The sale settled in December 2009.

[33] Mr Horton says that from the proceeds of sale the mortgagees were entitled to retain or disburse $715,579.17, being:

(a) GST from the sale price: $111,875;

(b) Costs of the mortgagee sale: $3,704.17 (including rates);

(c) The first mortgage of $400,000 to Garth and Brian Cowley; and

(d) The second mortgage of $200,000 to Brian Cowley and Calvin West.

[34] Mr Horton says that the balance of the proceeds of sale, on my calculation $291,295.83, should be paid to him as liquidator. Instead, he says that the funds have been paid out as follows:

(a) $189,558.07 has been paid to the Cowleys as interest on the first mortgage;

(b) $54,914.24 has been paid to Mr Cowley as interest due to him on the second mortgage;

(c) $57,446.27, representing interest to Mr West, has been held in the trust account of the solicitors for the Cowleys, pending this court's determination of this proceeding.[3]

[35] This balance of the proceeds of sale has been applied wholly to interest on the first and second mortgages. The basis for claiming interest is the shareholders' resolution of 8 May 2008. None of the sale proceeds has gone in reduction of the

[3] These amounts total $301,918.58. The increase from $291,295.83 is apparently for interest earned on the proceeds of sale.

term loans of July 2008. However, to be able to recover these sums, Mr Horton needs to get rid of both the shareholders' resolution and the July agreement to mortgage. If only the shareholders' resolution is set aside, but the agreement to mortgage remains in force, the Cowley interests would take the balance of the proceeds of sale under the July 2008 transactions.

[36] In September 2010, Mr Horton issued two notices under s 294 of the Companies Act. The first one was directed at charges under s 293 of the Companies Act:

(a) the first and second mortgages, insofar as they created a charge for the payment of interest; and

(b) the charge created by the agreement to mortgage of 22 July 2008.

[37] The second notice, directed at voidable transactions under s 292, seeks to set aside the special resolution of 8 May 2008 for the payment of interest on the mortgages and the agreement to mortgage of 22 July 2008 to secure the payments under the four term loan agreements of 22 July 2008.

[38] The Cowley interests gave a notice of opposition under s 294(3).

[39] So far in the liquidation, Mr Horton has sold chattels (which were not subject to the charge under the mortgages) for about $13,000 and has received some grazing fees, but these have not been enough to cover his costs.

[40] Between the sale of Paddy Road and the start of this proceeding, correspondence passed between the parties. Mr Horton required the Cowley interests to account for what he saw to be the surplus from the proceeds of sale. Letters sent on his behalf spelt out clearly the case for the shareholders' resolution and the agreement to mortgage to be voidable. On the other hand, the Cowley interests pointed out that they and Mr West were the only creditors of the company. There could not be much difference between the actual distribution and a distribution under the Companies Act. If they had to account to the liquidator, the money would

be paid back to them and Mr West as creditors and shareholders. They were interested in an arrangement under which Mr Horton could be paid for his services as liquidator, without requiring further payments. Mr Horton was not prepared to consider such an arrangement.

Creditors

[41] Under s 304(3) of the Companies Act a liquidator must as soon as possible admit or reject a creditor's claim in whole or in part. It is now more than three and a half years since the liquidation order. However, Mr Horton has not yet decided which claims to admit or reject. He says that there is no particular reason for not deciding. Determining the creditors of the company is relevant to the question of preference under s 292(2)(b) and the extent of any relief ordered under s 295. From the outset the Cowley interests have maintained that they and Mr West are the only creditors of the company to support their arguments that there was no preference or that relief should be moulded to reflect the limited extent of any preference.

[42] Because Mr Horton has not made decisions under s 304(3), only a provisional view of creditors can be given.

Secured creditors

[43] Mr Horton accepts that the Cowley interests and Mr West are secured creditors only for the principal sums secured under the first and second mortgages. In this proceeding he challenges the claims of the Cowley interests to be secured for interest on the mortgages and under the agreement to mortgage. There are no other secured creditors.

Preferential creditors

[44] Mr Horton is a preferential creditor for his remuneration and expenses.

[45] At the start of the liquidation, Mr Cowley and Mr West paid Mr Horton $2,500 to cover his initial expenses. Mr Horton recognises that claim as preferential under the 7th Schedule as part of his liquidator's expenses.[4]

[46] Mr West is a preferential creditor for $9,187.00 for costs on the liquidation order.[5]

[47] Mr Horton recognises that Mr Cowley has a subrogation claim under cl 4 of the 7th Schedule of the Companies Act for the payment of $22,566.82 to Customs and to that extent is a preferential creditor.

Unsecured creditors

[48] Mr Horton says that there was a small ACC claim, but he believed that it had fallen by the wayside. Claims had been received from a White partnership and from the liquidator of Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd, but he says that Mr Cowley has given good reasons for rejecting those claims.

[49] There is uncertainty as to income tax. The Commissioner has not made a claim, although Mr Horton has written to the Inland Revenue. The company apparently made taxable gains on the sale of subdivided lots, but after liquidation an accountant, apparently instructed by Mr Cowley, filed a return on behalf of the company claiming an offset for losses by Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd, as the three companies were group companies under the relevant income tax legislation. Mr Horton notes that he did not authorise that return to be filed. There is a difference of opinion whether the claimed offset comes within the legislation. Mr Horton proposes to write to the Inland Revenue again to see if there are outstanding issues.

[50] Mr West does not claim interest on the second mortgage under the shareholders' resolution of May 2008. His case is that the shareholders' resolution is ineffective to bind the company. Mr Horton says that Mr West is an unsecured creditor for $3,710 for expenses he paid for the company. Mr West may not accept

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4 Companies Act 1993, sch 7, cl 1(1)(a).
5 Companies Act 1993, sch 7, cl 1(1)(c).

that his claim is limited to that. He had made a claim for $150,000, but Mr Horton has noted that this had to be confirmed. Mr West had brought a personal grievance claim in the Employment Relations Authority, but that was out of time under s 114 of the Employment Relations Act 2000. He apparently claims wages, but Mr Cowley rejects that, saying that Mr West's work for Shaftspry Ltd was the sweat equity contribution, for which he has been paid under the second mortgage. Any claim for wages would be in the liquidation of Shaftspry Restaurant Ltd and of Cooks Landing Wines Ltd, but not of this company. Mr Cowley also notes that Shaftspry Ltd has claims against Mr West that might be applied under the insolvency set-off provisions of s 310 of the Companies Act. It is not certain that an inquiry into all these matters is required, as Mr West now seems to accept that regardless of the outcome of this proceeding he would not receive anything as an unsecured creditor of the company. Instead he has started a separate proceeding under s 174 of the Companies Act. The company is not a defendant, but he has sued Mr Cowley.

[51] The Cowley interests have taken part in this proceeding as a group. They assert that there are only two creditors, themselves and Mr West. That suggests that they do not draw any distinction as to their various claims. However, it is still necessary to note their different claims. The claims do not all have the same ranking and that goes to the question of preference. While they might regard themselves as a group, the liquidator and the court are required to deal with their claims separately. The Cowleys, as first mortgagees, are trustees of the Rentalength Trust. They are secured for the principal sum under the first mortgage, but their claims to interest on the mortgage and to have security for the interest are both challenged. Mr Cowley as second mortgagee also has contested claims for interest and whether it is secured. He is the same person as the lender under three of the term loan contracts, but he is not the same person as the lender in the fourth contract, Brian Cowley Surveying Ltd.

[52] Mr Horton says that there are no other creditors of significance that he is aware of.

Can Mr Horton require the mortgagees to account for sums retained for interest on the mortgages under s 305 of the Companies Act?

[53] As secured creditors of Paddy Road who had given notices under s 119 of the Property Law Act (which are not challenged), the Cowleys were entitled to realise their security after the company went into liquidation.[6] Secured creditors who suffer a shortfall after realising their charges may claim as unsecured creditors in the liquidation.[7] They must also account to the liquidator for any surplus under s 305(3)(b):

> (3) A secured creditor who realises property subject to a charge —
>
> ...
>
> (b) must account to the liquidator for any surplus remaining from the net amount realised after satisfaction of the debt, including interest payable in respect of that debt up to the time of its satisfaction, and after making any proper payments to the holder of any other charge over the property subject to the charge.

[54] A secured creditor may be accountable if the liquidator can show that the secured creditor has retained more than he is entitled to under his charge. A liquidator may successfully challenge the validity of the charge. The liquidator may invoke particular provisions of the Companies Act aimed at protecting the interests of creditors, such as the voidable transaction provisions, but he may also raise arguments under the general law. This part of the decision deals only with claims under the general law.

[55] Claims under the general law for the Cowleys to account for the sums they retained as interest for themselves and Mr West are made on three grounds:

(a) The shareholders' resolution of 8 May 2008 did not bind the company;

(b) The shareholders' resolution was ineffective as a variation of mortgage under ss 85 and 86 of the Property Law Act; and

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6 Companies Act, s 305(1)(a).
7 Companies Act, s 305(3)(a).

(c) On its true construction, the shareholders' resolution did not provide for back-dated interest.

[56] There was also an attack on the term loan contracts of July 2008 and the agreement to mortgage as transactions in which Mr Cowley as director was interested. However, Mr Glover for Mr Horton accepted that under s 141 of the Companies Act, it was now too late for the company to avoid those transactions.

Did the shareholders' resolution bind the company?

[57] For Mr West, it was submitted that the shareholders' resolution was not enforceable because it was not a contract with the company. He characterised it as only a shareholders' agreement and as such it did not bind the company. He relied on the Court of Appeal's decision in *Wairau Energy Centre Ltd v First Fishing Co Ltd*.[8] There, Hardie Boys J said:[9]

> A company is a distinct personality from its members. A contract by its members is not a contract by the company.

[58] In that case there was a contract between shareholders and an outsider for the sale of shares. The company was not a party to the agreement, did not purport to enter into any covenant, and no-one purported to sign the agreement on its behalf. It was held that the company was not bound by the agreement.

[59] This case is different. The shareholders' resolution is expressly stated to be pursuant ss 106, 122 and 129 of the Companies Act and to be a special resolution. The company is identified as Shaftspry Ltd. The resolution was signed by or on behalf of all shareholders. The assent of all members is effective to bind the company, even if there is a failure to comply with other formalities. This is sometimes termed the *Duomatic* principle, but the principle goes back further than that case.[10] In *Salomon v Salomon & Co Ltd*, Lord Davey said:[11]

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8 *Wairau Energy Centre Ltd v First Fishing Co Ltd* (1991) 5 NZCLC 67,379 (CA).
9 At 67,383.
10 *Re Duomatic Ltd* [1969] 2 Ch 365.
11 *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL) at 57.

> The company is bound in a matter intra vires by the unanimous agreement of its members.

In *Meridian Global Funds Management Asia Ltd v Securities Commission* Lord Hoffmann cited accepted authority[12] that:[13]

> The unanimous decision of all the shareholders in a solvent company about anything which the company under its memorandum of association has power to do shall be the decision of the company.

The Court of Appeal's decision in *Westpac Securities Ltd v Kensington*[14] is to similar effect.

[60] As the shareholders made their resolution under s 129, they must have contemplated that there could be a major transaction under the section. Such a transaction can only be approved by special resolution of the members. There was no submission whether the section applied, but there can be no doubt that the resolution was intended to and was effective to bind the company.

[61] Under the resolution, Mr West agreed not to rely on his statutory demand. The shareholders agreed that their loans would not be paid until creditors had been resolved or until after settlement of the sale of Paddy Road. Under these provisions, which are set out like contractual terms, the shareholders gave undertakings to the company. The shareholders signed the resolution so as to bind themselves as well. The resolution not only bound the company, but was also an agreement between it and its shareholders.

Did the shareholders' resolution effectively vary the registered mortgages?

[62] For Mr Horton, Mr Glover says that the resolution of May 2008 is ineffective as a variation of mortgage under ss 85 and 86 of the Property Law Act. To repeat, the relevant part of the resolution is:

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[12] *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258.

[13] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 3 NZLR 7 (PC) at 12.

[14] *Westpac Securities Ltd v Kensington* [1994] 2 NZLR 555 (CA) at 562–563.

Following the sale of its land, the company pay in this order:

(a) The total indebtedness together with interest at 10 per cent per annum (capitalised) as secured by mortgages registered over 26 Paddy Road, Te Kauwhata.

The intended variation of the mortgages is for payment of interest, when the mortgages until then provided that interest was not charged. There were no further documents to give effect to the resolution.

[63] Sections 85 and 86 relevantly provide:

85 Variation of mortgage

...

(2) The rate of interest payable under a mortgage over property may be reduced or increased by an instrument that—

(a) complies with subsection (5); and

(b) is executed,—

(i) in the case of a reduction, by the mortgagee; or

(ii) in the case of an increase, by the current mortgagor; and

(c) states that the rate of interest payable under the mortgage is reduced or increased, as the case may be, to the rate or sum or in the manner specified in the instrument, or words to that effect.

...

(5) For the purposes of subsections (1) to (4), a mortgage variation instrument must—

(a) be endorsed on, or attached to, the mortgage instrument, or have its existence recorded on or with the mortgage instrument; and

(b) be executed in the same manner as a deed is required to be executed.

(6) A mortgage over land under the Land Transfer Act 1952 may also be varied by a mortgage variation instrument that is registered under that Act.

86 Effect of mortgage variation instrument

A mortgage variation instrument that is duly executed under section 85(1) to (5) or registered under section 85(6)—

(a) operates as if it were a deed; and

(b) varies the mortgage in accordance with the terms of the instrument.

[64] Mr Horton's case is that the shareholders' resolution does not meet the requirements as to form in s 85(5) and no instrument has been registered under s 85(6). Accordingly, the resolution cannot have the effect provided under s 86.

[65] However, it is possible for a mortgagor and a mortgagee to enter into an agreement to vary a mortgage. If the agreement is legally enforceable, then despite form and registration requirements, equity will treat the parties' rights as modified in terms of the parties' agreement so as to hold the parties to their bargain. This is based on two principles of equity: first, equity looks on that as done which ought to be done, which has been applied in a property law context to enforce agreements despite strict form requirements.[15] Second, equity will not allow a statute to facilitate unconscionable conduct, so that if one party has already provided consideration for or done something in performance of an otherwise enforceable contract, the other party cannot rely on a form requirement to deny that party the benefit of the contract.[16] So, it has been held that although requirements as to form must be met to give rise to a legal interest or estate, they are not necessarily needed to create an equitable interest, such as an equitable variation of mortgage.[17]

[66] For this agreement to create an equitable variation of mortgage, it is sufficient that there is a contract purporting to create a charge on a property that, while insufficient to bring about a legal variation, shows the parties' intention to create a security and is supported by valuable consideration.[18]

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[15] See *Walsh v Lonsdale* (1882) 21 Ch D 9; in a contract variation context, see Wylie J's recent comments in *MacDonald v C1 Gloucester Street Ltd* [2012] NZHC 2842.

[16] See Tipping J's comments in *T A Dellaca Ltd v PDL Industries Ltd* [1992] 3 NZLR 88 (HC) at 99–100.

[17] See for example *Target Holdings Ltd v Priestley* (2000) 79 P & CR 305 (Ch). For further discussion of variation of mortgages at equity, see Wayne Clark *Fisher and Lightwood's Law of Mortgage* (13th ed, LexisNexis, London, 2010) at [10.2], which states that there is "nothing in [the form requirements of the English Land Registration Rules] to nullify the contractual effect in equity of an otherwise valid variation effected in writing ..."

[18] Wayne Clark (ed) *Fisher and Lightwood's Law of Mortgage* (13th ed, LexisNexis, London, 2001)

[67] Here, both mortgages were repayable upon demand. But, under the shareholders' resolution, they were repayable only after the Paddy Road property had been sold. Conversely, although there was no interest payable for the principal, the shareholders' resolution provided that the company was to pay interest on the principal secured under the mortgage. The shareholders' resolution shows that there was consideration given for the obligation to pay interest on the principal because the mortgagors surrendered their right to make immediate demand. It is not contended that Mr Cowley did not have authority to bind Garth Cowley, his co-mortgagee. The shareholders' resolution is a valid agreement between the mortgagor and the mortgagees to vary the interest terms of the mortgages at equity, despite form requirements not being met.

[68] There is still Mr Horton's argument that lack of registration under s 85(6) means that the agreement is unenforceable. In dealing with the equivalent Australian provision, the Supreme Court of New South Wales in *Torre v Jonamill* held that:[19]

> The lack of Real Property Act registration of an instrument of variation is relevant only to issues going to indefeasibility of estate or interest as distinct from the content or effect of covenants.

[69] This principle also makes sense in the New Zealand context. Registration becomes an issue only when indefeasibility questions arise. So, the fact that the resolution was not registered in accordance with s 85(6) of the Property Law Act does not bar the mortgagees from holding the company to the agreement.

Does the shareholders' resolution provide for backdated interest?

[70] The shareholders' resolution does not state when interest starts from. The Cowleys say that they are entitled to recover interest starting from when the advances were made. Mr Glover submitted that interest runs only from the date of the resolution.

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at [1.20]

[19] *Torre v Jonamill* [2002] NSWSC 152, applying Kirby P's comments in *Mercantile Mutual Life Insurance Co Ltd v Gosper* (1991) 25 NSWLR 32 and Giles J's comments in *PT Ltd v Maradona Pty Ltd* (1992) 25 NSWLR 643.

[71] Ordinarily, when parties vary a contract, they intend to set out how they will perform the contract from then on. If they intend a variation to have retrospective effect, that intention is likely to be expressly stated or to follow as a matter of necessary inference. In this case, interest was to be paid in the future. Again, ordinarily in a contract varying a loan, a change in interest rate takes effect from the time of the variation or later. If the change in interest rate is to run from a date before the variation, such a departure from the normal course would be expressly stated or would follow as a necessary inference.

[72] In this case, the two mortgages were interest free and repayable on demand. There is no evidence that the mortgagees had made demand. Mr West had served a statutory demand, but there is no evidence that in that demand he sought payment of the sum secured under the second mortgage. However, the parties knew in May 2008 that if demands under the mortgages were made, the company would not be able to meet them immediately. The mortgagees' rights to make demand were replaced by a provision for payment after sale. In return, the mortgagees were to be paid interest. Those circumstances do not point to any intention that interest should be backdated. Allowing interest to run only from the date of the resolution is consistent with an intention to compensate the mortgagees for being held out of their money only while they were no longer able to make demand under the mortgages.

[73] A further consideration is the risk of invalidity if interest is to be backdated. If the parties had agreed at the time of the original advances that the loans were to be interest free, but that if the company defaulted when demand for payment was made, interest would run from the date of advance, the provision would be a penalty and would not be enforceable. Colman J explained the position at common law and equity in *Lordsvale Finance plc v Bank of Zambia*:[20]

> It is clear that, if a loan agreement were to provide that upon the happening of a default in payment by the borrower the rate of interest were to be increased with retrospective effect, that which would be payable on default would be a sum in addition to the amount of principal and interest outstanding which would be calculated by reference to a period of time during which the borrower was entitled to the use of the principal and which might vary in length depending upon when the default in payment occurred in relation to the period of borrowing. Moreover, the amount of interest

[20] *Lordsvale Finance plc v Bank of Zambia* [1996] QB 752 at 763.

> which would be payable would be unrelated to the extent of default. If therefore default in payment triggered a retrospective increase in the rate of interest, it would be impossible to say in advance how much extra interest would become payable and what arithmetical relationship it would have to the amount of time during which the principal was outstanding. Moreover, assuming that any increase in the rate of interest was to continue into the future, the period of time during which the default was continuing would be compensated by the continuing increased rate, but also by the accumulated increase in the interest derived from the period before default. Such a provision would therefore have all the indicia of a penalty.
>
> Where, however, the loan agreement provides that the rate of interest will only increase prospectively from the time of default in payment, a rather different picture emerges. The additional amount payable is ex hypothesi directly proportional to the period of time during which the default in payment continues. Moreover, the borrower in default is not the same credit risk as the prospective borrower with whom the loan agreement was first negotiated. Merely for the pre-existing rate of interest to continue to accrue on the outstanding amount of the debt would not reflect the fact that the borrower no longer has a clean record. Given that money is more expensive for a less good credit risk than for a good credit risk, there would in principle seem to be no reason to deduce that a small rateable increase in interest charged prospectively upon default would have the dominant purpose of deterring default. That is not because there is in any real sense a genuine pre-estimate of loss, but because there is a good commercial reason for deducing that deterrence of breach is not the dominant contractual purpose of the term.

[74] New Zealand statute law also recognises the difference. Section 40(2) of the Credit Contracts Act 1981 provided that a credit contract could contain a term to the effect that if a debtor fails to comply with a term of the contract, the finance rate could be increased, provided that the increase took effect no earlier than 14 days after default. That act has now been repealed,[21] but the repeal does not revive any earlier rule of law invalidating default interest provisions as penal.[22] Section 40(2) of the Credit Contracts and Consumer Finance Act 2003 provides that a consumer credit contract may provide for a differential interest rate if the higher rate is imposed only in the event of default and while the default continues or while a credit limit is exceeded. That is, the provision for default interest cannot operate retrospectively. Section 40(3) saves other rules of law limiting default interest charges. Both statutes allow prospective increases in interest upon default, but not backdated default interest.

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[21] Credit Contracts and Consumer Finance Act 2003, s 140.
[22] Interpretation Act 1999, s 17(2)(a).

[75] In this case, the parties negotiated knowing that the company could not comply with a demand for repayment under the mortgages. For the parties to vary the mortgages so as to backdate interest risks imposing a penalty. The parties are more likely to have contracted so as not to run risks of interest provisions being struck down.

[76] For the Cowleys, Mr Werry relied on "capitalised" in the resolution and the parties' subsequent conduct to allow the mortgagees to claim back-dated interest. Neither assists.

[77] In the resolution "capitalised" suggests that interest will be paid as a lump sum following the sale of Paddy Road, instead of at regular intervals. The word cannot be effective to change the treatment of the interest provision for accounting or taxation purposes. The word does not help with fixing the time from which interest starts. Interest may be "capitalised" under the resolution, whether it runs from the date of the resolution or earlier.

[78] For subsequent conduct, Mr Werry referred to:

(a) A letter of 18 June 2009 to the liquidator by an earlier barrister instructed for the Cowley interests;

(b) A provisional, without prejudice schedule prepared by Mr Horton in December 2009 to show an indicative distribution under the Companies Act; and

(c) A settlement statement dated 7 December 2009 by the Cowleys' solicitors sent to the Cowleys, a copy of which was sent to Mr West's lawyer on 19 February 2010.

[79] Mr Werry relies on *Gibbons Holdings Ltd v Wholesale Distributors Ltd*[23] as the basis for using these documents to ascertain the meaning of the resolution. Four judges in the Supreme Court accepted that subsequent conduct could be taken into

[23] *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37, [2008] 1 NZLR 277.

account in interpreting contracts. Blanchard J reserved the point.[24] There are differences within the four whether subsequent conduct must be shared or mutual to be taken into account. Tipping J said:

> [60] ... The focus must still be on objective conduct rather than expressions of subjective intention or understanding. But if the parties have *together conducted themselves in the performance of their contract* in a way that is relevant to the meaning of the disputed provision, the court should be able to take that into account...
>
> [61] ... It can fairly be said that when the issue is examined as at the date of the court hearing, *the shared conduct of the parties in the performance of their contract* is a part of the surrounding circumstances...
>
> ...
>
> [63] Even if the meaning suggested by the post-contract conduct is not the most immediately obvious objective meaning, *the parties' shared conduct* will be helpful in identifying what they themselves intended the words to mean. That, after all, must be the ultimate determinant. If the court can be confident from their subsequent conduct what both parties intended their words to mean, and the words are capable of bearing that meaning, it would be inappropriate to presume that they meant something else.
>
> (*Emphasis added*)

[80] Anderson J said:

> [73] ... A party seeking to rely on post-contract conduct would have to show conduct on the part of all the contracting parties in order to demonstrate a shared and not merely an individually held meaning ...

[81] On the other hand, Thomas J rejected any requirement to show shared conduct in the performance of the contract.[25] His approach was:

> [136] Providing that the evidence is relevant to the question of interpretation before the court, it should be sufficient that, following the completion of the contract, the party concerned has acted inconsistently with the meaning it now asserts in court ...

[82] Reflecting this difference in approach, Tipping and Anderson JJ did not have regard to subsequent conduct in that case. Thomas J did. Elias CJ did not find it necessary to have regard to subsequent conduct of the parties to decide the case.

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[24] At [27].
[25] At [134]–[136].

However, she agreed with Thomas J that the subsequent conduct of *one* of the parties was consistent with the meaning of the contract she had found. While that part of her judgment may be obiter, she can be taken to have accepted his approach rather than that of Tipping and Anderson JJ.[26] Accordingly, opinion within the Supreme Court was evenly divided on the issue.

[83] In *Vector Gas Ltd v Bay of Plenty Energy Ltd*[27] Tipping J referred to his approach in *Gibbons Holdings Ltd v Wholesale Distributors Ltd*, noting that he saw the limitation to evidence of shared or mutual conduct as necessary to exclude evidence as to a party's subjective understanding of the meaning.[28] On the other hand, Wilson J, who had been counsel for the successful respondent in *Gibbons Holdings Ltd v Wholesale Distributors Ltd*, said that the fact that subsequent conduct was not mutual went to weight, not to admissibility.[29] The other judgments in *Vector Gas Ltd* did not address the issue. It is still unresolved in the Supreme Court.

[84] In *Open Country Cheese Co Ltd v Fonterra Co-operative Group Ltd*[30] Courtney J rejected evidence of subsequent conduct because it was not shared or mutual. It does not appear from the judgment that she was invited to follow the approach of Elias CJ and Thomas J.

[85] For Mr Horton, Mr Glover relied on the approach of Tipping and Anderson JJ to submit that the evidence the Cowleys rely on is not shared or mutual. However, as it is not clear that that is the correct test, I also consider the evidence in the light of the approach of Thomas J. Under his test, the focus is on whether a party has acted inconsistently with the meaning it contends for in court.

[86] The letter of 18 June 2009 by the barrister to Mr Horton sets out how the Cowleys proposed to deal with their security. While they reserved their rights to realise the security, the barrister said that they wished to retain the property for $855,178.00, a sum that would clear sums owing under the first and second

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[26] At [7].
[27] *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444.
[28] At [30].
[29] At [122].
[30] *Open Country Cheese Co Ltd v Fonterra Co-operative Group Ltd* HC Auckland CIV-2008-404-727, 11 December 2009 at [8].

mortgages. That sum took into account interest on the first and second mortgages on a backdated basis. Mr Horton did not accept the proposal. The letter is not evidence of shared or mutual conduct in the performance of an agreement. It is not relevant under the approach of Thomas J, as there is no inconsistency between the position of the Cowleys as to backdating of interest in the letter and their position in the hearing.

[87] Mr Horton's schedule, "Proposed Liquidation Distributions", is noted "Without Prejudice" and "E & O E". It sets out a scheme for distribution in the liquidation. While figures are rounded out, Mr Horton has applied backdated interest to the claims for interest under the first and second mortgages. He has treated those claims as unsecured. The document is clearly provisional. In using "Without Prejudice" and "E & OE", Mr Horton was clearly reserving his right to make changes later. He was not committing himself to a particular interpretation of the shareholders' resolution. The document cannot be relied on as evidence of the parties' intentions under the shareholders' resolution. It simply set out a proposed position, in much the same way as the barrister's letter. It is not evidence of shared conduct in the performance of the shareholders' resolution. The Cowleys object to the proposed distribution, especially the treatment of their interest under the mortgages as unsecured. Under Thomas J's approach, the document is not evidence of the parties' intention at the time of contract. It is at best an attempt by a liquidator to set out an indicative distribution, but as such it is not relevant to the meaning of the shareholders' resolution.

[88] The solicitors' settlement statement of 7 December 2009 sent to the Cowleys on the mortgagee's sale shows a sum set aside for Mr West as second mortgagee, including an amount for interest. The Cowleys' barrister sent a copy to Mr West's solicitor on 19 February 2010. In his reply of 22 February 2010, the solicitor challenged parts of the barrister's letter, but seems to have accepted that Mr West was entitled to interest on his share of the second mortgage, but still had questions. However, the company was in liquidation. Mr West's solicitor was not acting for the company. Neither letter is evidence of shared conduct by the company in performance of the shareholders' resolution. The correspondence is consistent with the parties stating positions for resolving the liquidation of the company, but does not help in ascertaining the parties' intentions in the resolution. Under Thomas J's test,

the letters do not show any inconsistency between the position of the Cowleys then and now. The letters were not sent by the liquidator and do not bind him or the company.

[89] Mr Werry's arguments do not persuade me that the shareholders' resolution allows the mortgagees to recover backdated interest. Interest runs only from the date of the resolution. Following the sale under the first mortgage, the Cowleys were entitled to hold back interest only from 8 May 2008 to the date of settlement of the sale (the applicable date under s 305(3)(b) of the Companies Act). Similarly, interest payable to Mr West is also to run only for the same period. Under s 305(3)(b), the mortgagees must account to Mr Horton for sums retained for backdated interest.

Was Shaftspry Ltd able to pay its due debts on 8 May 2008?

[90] Shaftspry Ltd's ability to pay its due debts is relevant to both insolvent transactions under s 292(2)(a) and insolvent charges under s 293(1)(b) of the Companies Act. Under s 292, the inquiry is at the time of the transaction. Under s 293 it is immediately after the charge is given, but for this case, there is no significance in the difference. The sections have corresponding provisions defining a restricted period and providing a rebuttable presumption that the company is unable to pay its debts in that period.[31] Customs had filed its liquidation application earlier in 2008. Mr West was substituted as plaintiff in June. It was that application on which the liquidation was made. All parties accept that 8 May 2008 is within the restricted periods under s 292(6)(b) and s 293(7)(b) and that the Cowleys have the burden of proving that the company could pay its due debts.

[91] In considering whether a company was able to pay its due debts at the time of a transaction, it is standard[32] to refer to the principles stated by Richardson J in *Re Northridge Properties Ltd (In Liq)*:[33]

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[31] Companies Act, ss 292(4) and (6), 293 (2) and (7).

[32] See for example *TR Group Ltd v Blanchett* HC Hamilton CIV-2003-419-300, 15 May 2003 at [11].

[33] *Re Northridge Properties Ltd (In Liq)* SC Auckland M46/75, 13 December 1977.

(a) The ability of the company to pay debts is concerned with the position of the debtor at the time when the charge or payment is made or other specified act took place. The concern is with the present.

(b) In considering the present position regard may properly be had to the recent past — relevant to this is whether the debtor has in recent weeks been unable to pay debts as they become due;

(c) In determining the ability to meet debts as they become due, account must be taken of outstanding debts;

(d) The words "as they become due" mean, as they legally become due;

(e) The reference to "payment from his own money" has not been interpreted strictly to require a debtor to keep sufficient cash on hand at all times for that purpose. It is a matter of striking a balance. It is not a matter of simply measuring assets against liabilities, and it is not a matter of whether given sufficient time assets could be realised and debts paid;

(f) The section is concerned with solvency, so there must be a substantial element of immediacy in the ability to provide cash from non cash assets;

(g) If, as is well established, convertibility to cash from non-cash assets on hand may be taken into account in determining solvency, so too must debts becoming due while that conversion takes place. Moreover, the words "as they become due" involve consideration of a debtor's position over a period not an instant of time;

(h) The test of insolvency is an objective one.

[92] The legislation in that case said "payment from its own money". "From its own money" does not appear in s 292. Even under the old legislation the company

was not required to keep cash in hand.[34] The courts have recognised that a company may maintain solvency by recourse to borrowed funds, provided that the borrowing is on deferred terms or that the lender is not a creditor whose debt cannot be repaid when it becomes due and payable.[35]

[93] At 8 May 2008, Mr West had served a statutory demand on the company, but the company had applied to set aside the demand. Under the shareholders' resolution, payment of debts to Mr West was deferred until after the sale of Paddy Road. As the company was not required to pay his debts then (being the time of the transaction and immediately after the charge was given), any debts he claimed were not due debts.

[94] The shareholders' resolution sets out schedules of debts to be addressed. Mr Cowley's evidence is that these were in fact debts of Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd. He was cross-examined on that aspect. I accept his evidence. It is supported by Mr Horton's informal acceptance that they were not debts of this company. The debts listed in the resolution are not relevant.

[95] Mr Cowley and Brian Cowley Surveying Ltd had paid money, met expenses and provided services, for which they had not been paid. However, at 8 May 2008 their advances were not due debts. They were prepared to wait until Paddy Road was sold before demanding payment. Company financial statements had recorded these liabilities as long term.

[96] There was a possible liability to the Inland Revenue for tax on profits on sales of land. No demand had been made. The Cowleys' case is that that liability could be managed by using losses in Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd, so that payment would not have to be made. Mr Horton's response is that for that to be effective would give rise to other liabilities to Shaftspry Restaurant Ltd and Cooks Landing Wines Ltd for subvention payments. However, those companies had common shareholdings and directors with Shaftspry Ltd. That could allow the debts to be managed so that repayment was not required immediately.

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[34] *Bank of Australasia v Hall* (1907) 4 CLR 1,514 at 1,543.
[35] *Lewis v Doran* [2005] NSWCA 243, (2005) 219 ALR 555 at [107]–[109].

[97] So far the Cowleys' case is that there were no due debts as at 8 May 2008 and that any debts could be managed by paying them out of the proceeds of sale of Paddy Road. However, there was the unpaid excise duty. Customs had served a statutory demand and followed with a liquidation application. As at 8 May, the debt had not been paid. Mr Cowley's case is that while he had not been able to deal with that debt until the shareholders' resolution (because of differences with Mr West), after the resolution he paid the debt for the company.

[98] Mr Cowley says that he was the company's funder. As long as he was prepared to keep funding the company, it was able to pay its due debts. He was still willing to invest in the company and to fund it. He points to his purchase of Ms van der Kley's shares on 16 May 2008 and his payment to Customs Service on that date as evidence of his willingness to keep funding the company. The company may not have been able to pay its due debts later, but that stage had not been reached on 8 May.

[99] However, for Mr Cowley's argument to work, the company has to be able to repay its lender when the lender's debt becomes due and payable: *Lewis v Doran.*[36] If it cannot, it is unable to pay its due debts at the relevant times under ss 292 and 293. For this case, that means finding out whether all creditors could be paid out of the proceeds of sale of Paddy Road. It is to that extent that the balance sheet limb of the insolvency test applies.

[100] The liabilities of the company at 8 May 2008 included these:

(a)	Principal under 1st and 2nd mortgages	$600,000
(b)	Excise duty	$22,566
(c)	Advances by Brian Cowley Surveying Ltd	$58,662[37]
(d)	Advances by B Cowley, 1st term loan	$169,270[38]

[36] Above n 31.
[37] Excludes advances to Cooks Landing Wines Ltd and expenses paid.
[38] The figures are taken from the term loan contracts of July 2008.

(e)	Advances by B Cowley, 2nd term loan	$142,640
(f)	C West	$3,710
Total		**$996,848**

Some allowance should also be made for a potential tax liability of about $75,000 or for subvention payments to Shaftspry Restaurant Ltd and to Cooks Landing Wines Ltd.

[101] The Cowleys need to show that these debts would all be paid in full from the proceeds of a notional sale of Paddy Road. The time of sale would be sometime between May 2008 and the actual sale in December 2009. In December 2008 the Cowleys served their notices under s 119 of the Property Law Act. That showed that they regarded the time for payment as having arrived. That factor points to a sale being more likely following service of the notice.

[102] Two valuations of the land are in evidence: a valuation by Seagar & Partners of April 2009 for $1,000,000 exclusive of GST (prepared for Mr Cowley), and a valuation by Curnow Tizard of July 2009 for $765,000 exclusive of GST (prepared for Mr Horton). Mr Cowley also referred to earlier valuations in 2005 which showed higher values, but these were not in evidence. In any event they could not be helpful, as they were made well before the relevant notional sale period. Similarly the book value of the property in the March 2006 financial statements is not relevant. Paddy Road was sold to Black Beagle Property Ltd, in which Mr Cowley has an interest. There is a suggestion that the price of $895,000 may have been set so as to clear the registered mortgages with backdated interest in full, but to leave nothing else for other creditors.

[103] The property had been marketed since 2008. The only evidence of any market interest in the property at a price above what it was sold for is an offer at $1.3 million. Mr Horton points out that the offer was subject to a resource consent being obtained. The company had applied for the consent but it had not been granted. The consent application later lapsed. That offer does not help establish the value without

the consent. Notwithstanding the related party aspects of the sale to Black Beagle Property Ltd, the price is helpful as a possible ceiling for the value of the property. It suggests caution in applying the valuation by Seagar & Partners.

[104] Even if the valuation by Seagar & Partners were adopted, there is no assurance that there would be enough funds to clear all the debts of the company after paying rates, insurance and costs of sale. As the sale price is more likely to be less, it becomes all the clearer that creditors would suffer a shortfall. Accordingly I find that the Cowleys have not proved that the company was able to pay its due debts in May 2008.

Was Shaftspry Ltd able to pay its due debts on 22 July 2008?

[105] 22 July 2008 is the date of the term loan contracts and the agreement to mortgage. The inquiry as to the company's ability to pay its due debts on that date follows the same path as for 8 May 2008. Perhaps the only difference is that by that date, a small amount of interest on the first and second mortgages had accrued, but that does not change the result. Applying the same approach, I find that the Cowleys have not proved that the company was able to pay its due debts on 22 July 2008.

Are the charges given by the shareholders' resolution of May 2008 and the agreement to mortgage of July 2008 voidable under s 293 of the Companies Act?

[106] The definition of "charge" in the Companies Act is:[39]

> **charge**
>
> includes a right or interest in relation to property owned by a company, by virtue of which a creditor of the company is entitled to claim payment in priority to creditors entitled to be paid under section 313 of this Act; but does not include a charge under a charging order issued by a court in favour of a judgment creditor:

[107] Under the shareholders' resolution, interest on the mortgages was to be secured. The resolution created a charge, in that the obligation to pay interest was secured by mortgage and entitled the mortgagees to be paid in priority to unsecured

[39] Companies Act, s 2.

creditors. Under the agreement to mortgage the company covenanted to give and execute in favour of the creditors a registrable mortgage securing the sums payable under the term loan contracts. The agreement is also a charge.

[108] Section 293 says:

> **293 Voidable charges**
>
> (1) A charge over any property or undertaking of a company is voidable by the liquidator if—
>
> (a) the charge was given within the specified period; and
>
> (b) immediately after the charge was given, the company was unable to pay its due debts.
>
> (1A) Subsection (1) does not apply if—
>
> (a) the charge secures money actually advanced or paid, or the actual price or value of property sold or supplied to the company, or any other valuable consideration given in good faith by the grantee of the charge at the time of, or at any time after, the giving of the charge; or
>
> (b) the charge is in substitution for a charge given before the specified period...

[109] The charges were given within the relevant two year specified period under s 293(7)(b). Indeed, they were given while a liquidation application was pending.

[110] Under the shareholders' resolution, a charge was created for interest falling due after 8 May 2008. The mortgagees gave consideration for payment of the interest in giving away their right to demand payment under the mortgages. Accordingly, s 293(1A) applies. The shareholders' resolution is not voidable under s 293.

[111] The term loan contracts provided for payment of debts Shaftspry Ltd already owed to Mr Cowley and Brian Cowley Surveying Ltd. The agreement to mortgage created a charge for existing debts, rather than for new indebtedness under s 293(1A). To that extent, the agreement to mortgage is voidable under s 293. Further, under the term loan contract with Brian Cowley Surveying Ltd, Shaftspry Ltd undertook to pay $15,070.02 for loans to and expenses of Cooks Landing Wines

Ltd and Shaftspry Restaurant Ltd. There does not appear to be any consideration under subsection (1A) given for that obligation. Accordingly, the charge given for that part of the loan is also voidable. There is no part of the agreement within s 293(1A). The agreement to mortgage is voidable under s 293.

Are the shareholders' resolution, the term loan contracts and the agreement to mortgage voidable transactions under s 292?

Can the term loan contracts be set aside in this proceeding?

[112] The term loan contracts cannot be considered for setting aside, because they are not the subject of a notice under s 294. Mr Horton's notice to set aside under s 292 specifies the shareholders' resolution and the agreement to mortgage, but not the term loan contracts. The first originating application did not seek orders setting aside the term loan contracts, but the amended application did. However, it is the notice under s 294 which must identify the transactions to be set aside. Section 294 says:

> 294 Procedure for setting aside transactions and charges
>
> (1) A liquidator who wishes to set aside a transaction or charge that is voidable under section 292 or 293 must—
>
> (a) file a notice with the Court that meets the requirements set out in subsection (2); and
>
> (b) serve the notice as soon as practicable on—
>
> (i) the other party to the transaction or the charge holder, as the case may be; and
>
> (ii) any other party from whom the liquidator intends to recover.
>
> (2) The liquidator's notice must—
>
> ...
>
> (c) specify the transaction or charge to be set aside;...
>
> (3) The transaction or charge is automatically set aside as against the person on whom the liquidator has served the liquidator's notice, if that person has not objected by sending to the liquidator a written notice of objection that is received by the liquidator at his or her postal, email, or street address within 20 working days after the liquidator's notice has been served on that person.

...

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

[113] The scheme of the section is that a liquidator must issue a notice under s 294(2); the creditor has the opportunity to object within s 294(3); in the absence of objection, the transaction is set aside; and where there is an objection the liquidator can seek a setting aside order from the court. The application to court comes at the end after the liquidator has first given his notice. Section 294(5) does not give an independent means of challenging a transaction or charge without first giving a setting aside notice. That follows from the words, "A transaction or charge that is not automatically set aside..." which show that the creditor must be first given the opportunity to object to a notice, before facing court proceedings. That is reinforced by the mandatory terms of s 294(1) that a liquidator wishing to set aside must give a notice under subsection (2).

[114] The notice must specify the transaction or charge to be set aside. Again the language is mandatory. A transaction or charge that is not specified in the notice cannot be set aside under the section. Because they were not specified in the liquidator's notice, the term loan contracts cannot be set aside in this proceeding as voidable under s 292.

Are the shareholders' resolution and the agreement to mortgage transactions under section 292(3)?

[115] Under s 292(3) a transaction includes creating a charge over property and incurring an obligation. As explained above, the shareholders' resolution and the agreement to mortgage created charges. Under the shareholders' resolution, the company incurred fresh obligations—to pay interest on the debts secured by the mortgages. These are transaction under s 292. As under s 293, these transactions were within the relevant two year specified period under s 292(6)(b).

Did the transactions enable the Cowleys to receive more towards satisfaction of a debt owed than would be received in the liquidation?

[116] I summarise matters so far. Under the s 305 decision above, the mortgagees are accountable under the general law to Mr Horton for backdated interest under the shareholders' resolution, but not for interest running from the date of the resolution. Under s 293 the agreement to mortgage is set aside but the shareholders' resolution is not. The term loan contracts of July 2008 are not in issue under s 292. The matter remaining for decision under s 292 is the shareholders' resolution, being both an obligation incurred by the company (to pay interest prospectively and in a lump sum on existing mortgages) and a charge given to secure that obligation. The promise to pay interest was new—the mortgages had been interest free until then. There was consideration for the promise—the mortgagees undertook not to demand repayment until after the sale of Paddy Road.

[117] I also quantify the sums in issue. This calculation is provisional. The liquidator is seeking to set aside under s 292 the retention of interest at 10 per cent from 8 May 2008 to 7 December 2009, the apparent date of sale of Paddy Road.[40] On a principal of $600,000, the interest is in the order of $95,010. Correspondingly, the amount to be accounted for under s 305 alone is in the order of $196,285.[41]

[118] The paradigm for a voidable transaction is a payment by an insolvent company to a creditor who receives more by that payment than he would receive in the liquidation. That includes creditors who supply cash on delivery. They do not supply unless they are paid at the same time. By the cash payment they receive more than they might receive in the liquidation. If a creditor agrees to take security for a supply instead of taking a cash payment, the security may also enable the creditor to be paid in full, instead of taking a reduced pro rata payment as an unsecured creditor in the liquidation. In principle then, a security taken for a debt created under the same transaction may be preferential under s 292(2)(b). Section 292 allows for this by providing that both charges and new obligations are transactions under the section. Charges under s 292 are not limited to charges for past debt, as they are in s 293.

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[40] The date of a settlement statement of Brian and Garth Cowley's solicitors.
[41] The balance after the prospective interest is deducted from $291,295.83.

[119] Mr Horton's case is that the security given for payment of the interest under the shareholders' resolution by making it part of the secured debt under the mortgages enables the mortgagees to receive more for their interest than if they were unsecured and claimed for the interest in the liquidation.

[120] Mr Cowley does not object to the principle, but he says that it does not apply on the facts. He says that there has not been any preference because Mr West and he are the only creditors. If the mortgagees are required to pay amounts for the interest they retained, it will be recycled to them as there are no other creditors. Alternatively, any relief ordered should be limited to redress any preference but no more, so as to avoid the need to recycle money through the liquidator.

[121] As to that, certain matters are to be noted. First, Mr Cowley treats the Cowley interests as one person. They cannot be treated that way under s 292. The Cowleys as first mortgagees are trustees of the Rentalength Trust. Any money they retain for interest under the first mortgage will be held for the trust. It will not necessarily be available for other parts of the Cowley interests. Mr Cowley is a second mortgagee, but not for the term loan agreements because the agreement to mortgage is set aside. He is a preferential creditor for the payment to Customs. He is not the same person as the creditor in the fourth contract, Brian Cowley Surveying Ltd. On Mr Cowley's argument, within the Cowley interests some will be preferred ahead of others. If the interest is retained, most of it would go to the first mortgagees, some to Brian Cowley as second mortgagee, and none for the remaining Cowley interests. If the interest goes to the liquidator, there will be a preferential payment to Brian Cowley for his subrogation claim for excise duty, and any balance will be shared rateably among the remaining interests.

[122] Second, the argument ignores that Mr West is a preferential creditor for costs on the liquidation order. For that debt he ranks behind the liquidation expenses and the liquidator's remuneration, but ahead of other unsecured creditors. If the interest from the mortgages is paid to the liquidator, Mr West would receive payment of his costs order ahead of other creditors. That would reduce the funds available to other creditors, including the Cowleys. Mr Cowley has not shown that if Mr West is paid his order for costs, the Cowleys would receive just as much as by retaining the

interest on the mortgages. Mr West is also an unsecured creditor, although perhaps for only a modest amount. Any distribution among unsecured creditors in the liquidation would include his debt, whereas it is taken out of account if the mortgagees retain their interest.

[123] Third, the argument ignores the liquidator's priority under the 7th Schedule. For Mr Cowley it was submitted that the liquidator's right to remuneration and to payment of fees and expenses cannot be taken into account under s 292(2)(b). The argument ran that the date of ascertaining whether there was a preference is the date of liquidation. The liquidator's remuneration could not be considered, because at that time the liquidator was not a creditor. Besides, if liquidator's costs were considered, no transaction would survive under s 292(2)(b). As to the last point, I note that there may be cases where transactions could pass s 292, even if liquidator's costs are taken into account. Those are cases where a company goes into liquidation for cashflow insolvency, but the liquidator is successful in obtaining enough to pay off all creditors and leave a surplus for shareholders. In that case, there could not be any preferential transaction under s 292. But in the general run of cases in an insolvent liquidation, the costs of liquidation, including the remuneration of the liquidator, impact on the distribution to creditors, who invariably rank lower. That applies in this case. The Cowleys will receive less as unsecured creditors than as mortgagees because of the impact of the liquidator's remuneration and expenses, as well as other preferential claims.

[124] Fourth, Mr Cowley's argument assumes that there are no other creditors. But that has still to be established. The problem here is that Mr Horton has not yet accepted or rejected claims under s 304, so as to confirm the creditors in the liquidation. For Mr Cowley, it was submitted that the court should assume that there are no other creditors. It would not be safe to do so. It is the liquidator's job to accept or reject claims. His decisions under s 304 may be challenged under s 284(1)(b). It is an unacceptable shortcut to decide the case on the basis that Mr West and the Cowley interests are the only creditors when the class of creditors has not been closed.

[125] Fifth, the mortgagees are required to pay Mr Horton backdated interest under s 305. Mr Cowley's submissions had not allowed for this. The amount is in the order of $196,000. The funds to be paid under s 305 will be available for distribution under s 312, s 313 and the 7th Schedule. They would go first to preferential creditors. For reasons given below, the amount of Mr Horton's remuneration and expenses is in contention. If his claims for his remuneration and expenses are upheld in full, it is unlikely any preference under s 292(2)(b) will be completely eliminated. But if the only creditors are Mr West and the Cowley interests, then the extent of preference may be relatively limited. If so, relief under s 295 might be moulded to fit the case. The Cowley interests may be able to agree among themselves how to address any preference. It would then be a case of assessing to what extent the other creditor has been prejudiced. I assume that there will be no agreement between Mr Cowley and Mr West, but once the amounts of claims are fixed, it may be possible to calculate the amount of any monetary adjustment required to eliminate any preference without an order for payment to the liquidator of all the interest retained.

[126] At this stage it is not possible to make a final decision as to preference under s 292 and as to the extent of any relief ordered under s 295 on that account. As a matter of impression, it appears that the retention of prospective interest of about $95,010 under the shareholders' resolution has had a preferential effect, but that will only become known once three matters are cleared up:

(a) The impact of the backdated interest ordered under s 305;

(b) The number and value of creditors, in particular, whether Mr West and the Cowley interests are the only creditors; and

(c) The amount of Mr Horton's remuneration and expenses.

Should the shareholders' resolution be set aside under s 299?

[127] Section 299 of the Companies Act relevantly says:

299 Court may set aside certain securities and charges

(1) Subject to subsection (2) of this section, if a company that is in liquidation is unable to meet all its debts, the Court, on the application of the liquidator, may order that a security or charge, or part of it, created by the company over any of its property or undertaking in favour of—

(a) A person who was, at the time the security or charge was created, a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(b) A person, or a relative of a person, who, at the time when the security or charge was created, had control of the company; or

(c) Another company that was, when the security or charge was created, controlled by a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(d) Another company, that at the time when the security or charge was created, was a related company,—

shall, so far as any security on the property or undertaking is conferred, be set aside as against the liquidator of the company, if the Court considers that, having regard to the circumstances in which the security or charge was created, the conduct of the person, relative, company, or related company, as the case may be, in relation to the affairs of the company, and any other relevant circumstances, it is just and equitable to make the order.

...

(3) The Court may make such other orders as it thinks proper for the purpose of giving effect to an order under this section.

...

(5) The provisions of section 7 of this Act apply with such modifications as may be necessary to determine control of a company.

[128] Section 299 provides a discretionary power to set aside a security or charge. If a charge is already invalid or it has been set aside under some other rule of law, such as under s 292, it is not necessary to consider s 299. It is therefore not necessary to consider the agreement to mortgage, as that has already been set aside under s 293. It has not yet been possible to decide finally whether the shareholders' resolution should be set aside under s 292 and, if so, the extent of relief. Ordinarily any decision under s 299 ought to wait until the voidable transaction questions under ss 292, 294 and 295 have been answered. So the question here is whether the court

should decide the s 299 application now ahead of a final decision on voidable transaction under s 292.

[129] Under s 299 the Cowleys and Mr West may be treated differently. Mr Cowley was a director of the company at the time of the shareholders' resolution. Garth Cowley, his co-mortgagee, is his relative. However, it is not clear whether Mr West was a director then. Mr Horton did not present evidence or argument that he was. Mr Cowley says that he had been removed as director, but Mr West contests that. Mr West did not have control of the company under s 7 and s 299(5). If Mr West does not come within s 299(1) (and it has not been shown that he does), then there is a difficulty in exercising the discretion under the section. The court has to be satisfied that it is just and equitable to set aside a security to an insider. Here the shareholders' resolution benefited the Cowleys and Mr West rateably according to the principal amounts of their secured advances. It would not be just and equitable to set aside the shareholders' resolution to the extent that it benefits the Cowleys but not set it aside in respect of Mr West. I appreciate that in this case Mr West generally supports Mr Horton, but I am not sure that I can translate that general support into a waiver of his rights under the shareholders' resolution in the circumstances where s 299 does not apply to him, but invoking the section would allow him to get one up on Mr Cowley. Any decision to set aside the shareholders' resolution should treat the Cowleys and Mr West equally. Until it is known whether Mr West was a director in May 2008, something I was not asked to decide, it would not be safe to make a decision under s 299.

Does Mr Cowley have good grounds to challenge the conduct of the liquidation and Mr Horton's remuneration?

[130] The context for Mr Cowley's challenge to the conduct of the liquidation is Mr Horton's fees and expenses. At 6 August 2012 the value of his recorded work on a time/cost basis was $62,820 plus GST. In addition there are miscellaneous disbursements of $17,049, as well as legal fees. He breaks the $62,820 down into:

(a) $6,450 for the attempted sale of Paddy Road by tender in 2009

(b) $17,310 for administration of the liquidation

(c) $39,060 for work on recovering part of the proceeds of sale of Paddy Road, including this proceeding.

[131] Legal fees, exclusive of GST, he has incurred came to $115,869, broken down as follows:

(a) $7,648 from the start of the liquidation to the sale of Paddy Road

(b) $52,496 from the sale of the property to the start of this proceeding

(c) $55,725 from the start of the proceeding to August 2012.

[132] All up, the costs of the liquidation up to August 2012 are over $200,000, of which about three quarters have gone on the recovery of part of the proceeds of sale of Paddy Road.

[133] Mr Horton has of course done more work and incurred more legal fees since August this year. And he will have ongoing work. The decision in this case will not bring the work on the liquidation to an end. Apart from the proceeds of sale of chattels, grazing fees and $2,500 contributed by Mr West and Mr Cowley, Mr Horton has not had funds to meet outgoings on the liquidation. He has covered those himself.

[134] Mr Cowley's case is that this proceeding has not been necessary. The Cowley interests and Mr West are the only creditors. While there might be minor adjustments between the actual distributions to them from the proceeds of sale and a distribution according to the requirements of the Companies Act, it was not efficient to bring this proceeding to achieve a distribution under the Companies Act.

[135] His argument is that a liquidator is not required to carry out any duty or to exercise any power in relation to property subject to a charge and that a liquidator is required to carry out his functions in a reasonable and efficient manner. He relies on ss 253 and 254:

253 Principal duty of liquidator

Subject to section 254 of this Act, the principal duty of a liquidator of a company is—

(a) To take possession of, protect, realise, and distribute the assets, or the proceeds of the realisation of the assets, of the company to its creditors in accordance with this Act; and

(b) If there are surplus assets remaining, to distribute them, or the proceeds of the realisation of the surplus assets, in accordance with section 313(4) of this Act—

in a reasonable and efficient manner.

254 Liquidator not required to act in certain cases

Notwithstanding any other provisions of this Part of this Act,—

(a) Except where the charge is surrendered or taken to be surrendered or redeemed under section 305 of this Act, a liquidator may, but is not required to, carry out any duty or exercise any power in relation to property that is subject to a charge: ...

[136] Mr Dalton, an insolvency practitioner, gave opinion evidence for Mr Cowley. He had not been provided with copies of Mr Horton's work records or a full breakdown of the time and costs spent on the job, so could not comment in detail on those aspects. His evidence is at a more general level. If liquidator, he would have done matters differently. He notes that there were only two assets, land and chattels at Paddy Road. They would be identified and secured. He would have identified and contacted the creditors. He assumes that there were only two, the Cowley interests and Mr West. As the land was mortgaged and the valuation obtained by Mr Horton showed that the land was worth less than the amounts the mortgagees said were due to them, he would not have put the property up for tender, as Mr Horton had. It was better to leave the mortgagees to sell the property themselves. He would have disclaimed Paddy Road as onerous under s 269 of the Companies Act. That meant that only the proceeds of sale of the chattels and grazing fees would be available to meet the costs of liquidation. If all mortgagees had agreed to the liquidator selling Paddy Road, he would have negotiated with them for payment for his work in selling the property. Even if Mr Horton is correct that the interest under the mortgages is recoverable, he would not have taken proceedings to recover the interest from the mortgagees, as no other creditors were prejudiced. As a minor

point, he noted that his practice would not have engaged lawyers to prepare tender documents. In a second affidavit, he noted that by the time of the sale to Black Beagle Property Ltd, the costs of liquidation (including legal fees) were $28,586.67 plus GST and disbursements. While he queried the need to carry out all the work, those costs were not completely unreasonable. He notes that Mr Cowley was offering to top up the liquidator's fees. He regarded this proceeding as an unnecessary exercise in recovering funds from creditors only to return it to them again.

[137] The efficiency of this proceeding can be assessed by considering alternative distributions, the actual distribution on sale and an indicative one which a liquidator would consider in deciding whether to undertake proceedings. The indicative one is necessarily hypothetical and involves estimates. There is a range of potential outcomes, which vary with the assumptions made at the outset.

[138] Under the first, the pool is the sum of $301,918.58 in [34] above. Mr West receives $57,446 at the time of sale and the Cowley interests take the rest. There is nothing available for other creditors.

[139] Under the second, the pool is the sum likely to be available for creditors on the successful completion of the litigation after legal costs and the costs of the liquidation have been paid. I take the sum of $200,000. This is an estimate, maybe an overestimate. It allows for a judgment of about $300,000 plus interest at 5% per annum for three years and an order for costs, but deducts likely legal and liquidation costs for the recovery proceeding. It assumes complete success in the proceeding and that the respondents will be good for the judgment. It makes no allowance for risk. The preferential creditors will be Mr West and Mr Cowley for $2,500 paid at the start of the liquidation, Mr West for $9,187 for the costs order, $22,566 for Mr Cowley for his subrogation claim—a total of $34,253. The remaining $165,747 will be available for unsecured creditors. They are:

(a) Advances by Brian Cowley Surveying Ltd $58,662

(b) Advances by B Cowley, 1st term loan $169,270

(c)	Advances by B Cowley, 2nd term loan	$142,640
(d)	C West	$3,710
(e)	Mortgage interest	$95,010[42]
	Total	**$469,292**

[140] The dividend for unsecured creditors is $0.35. Under this indicative distribution, Mr West receives:

Half share of $2,500	$1,250
Court costs	$9,187
Dividend as unsecured creditor	$6,840[43]
Total	**$17,277**

[141] Mr West fares worse under the second distribution. A similar analysis would show that the Cowley interests would also receive less as a group. Even if the assumptions are changed for the initial pool on account of other potential judgment amounts and variations in legal and liquidation costs, they are not likely to change the fact that creditors will receive markedly less than under the first distribution.

[142] The comparison assumes that there are no other unsecured creditors. Mr Horton and the Cowleys were of that view in 2009–2010. Mr Horton had not accepted or rejected creditors' claims at the time, but it is something he ought to have done early in the liquidation. If there are other unsecured creditors, they stand to receive a dividend under the second distribution, but not under the first.

[143] In 2009 and 2010 the parties exchanged correspondence about Mr Horton's demands for payment of the proceeds of sale of Paddy Road, after allowing for the

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[42] The prospective interest under the shareholders' resolution.

[43] Mr West is an unsecured creditor not only for $3,710 but also for a sixth share of the mortgage interest—$15,833.

sums in [33]. Mr Cowley's lawyer made the case that it was pointless to require the Cowleys to pay the funds over. He inquired as to Mr Horton's remuneration with a view to resolving the matter on the basis that Mr Horton could be paid a reasonable amount for his work.

[144] Mr Horton's position has remained largely unchanged. He was appointed by the court to get in the assets of the company and to distribute them under the Companies Act. He says that Mr Cowley was not entitled to retain the funds and he should hand them over. Mr Cowley was trying to be some sort of de facto liquidator by insisting on distributing the funds his way. Mr Cowley had not co-operated by responding properly to notices under s 261. Mr Cowley had not given notice of his intention to sell Paddy Road, so that he had incurred unnecessary costs in putting the property up for tender. Mr Cowley was gaming by stalling on handing over the proceeds of sale. His remuneration was not up for negotiation. It was for the court to determine his remuneration at the end of the liquidation. He would not discuss it with Mr Cowley's lawyer. He was not prepared to consider any arrangement whereby he would be paid only a sum to cover his unpaid work on the liquidation. The correspondence is consistent with his acceptance that the only creditors to be considered were the Cowley interests and Mr West, and that as between the Cowley interests and Mr West a distribution under the Companies Act would not depart much from the actual disposal of the proceeds of sale. He did not address the matter of efficiency.

[145] Another insolvency practitioner, Mr Vague, gave supporting evidence for Mr Horton, but it did not show much in the way of independent analysis. I did not find his evidence helpful on this part of the case.

[146] I do not accept the allegation that Mr Cowley was gaming. He opposed this proceeding in good faith and with arguable grounds. The fact that his arguments did not prevail does not mean that Mr Horton can shift the entire responsibility for the costs of the proceeding on to Mr Cowley (that is, leaving aside any costs ordered under Part 14 of the High Court Rules). It was foreseeable from the outset that this proceeding would be opposed and that costs would impact on the funds available for creditors.

[147] It was not helpful that Mr Horton was not prepared to discuss his remuneration when Mr Cowley was looking to resolve matters. It was sensible for Mr Cowley to look for pragmatic solutions. The costs of liquidation would have a major impact on any distribution to creditors under the Companies Act. While it is correct that the court has powers to review a liquidator's remuneration under s 276 and s 284(1)(f), those powers are given to fill a gap. In most cases fees charged by professionals can be fixed by negotiation. But in liquidations, creditors often do not have the ability or opportunity or means to negotiate with a liquidator as to his remuneration. The court's power of supervision is a substitute. But when Mr Cowley raised the issue of remuneration with a view to seeing Mr Horton paid, Mr Horton did not have to turn that down as a matter to be decided by the court instead. For Mr Horton the point was made that the Cowley side seemed to have niggardly view of what he should be paid, but that is not to say that the parties could not have reached agreement.

[148] When he was considering whether to bring this proceeding, Mr Horton had to decide whether the litigation could improve the position of creditors. He did not have to be assured that the litigation would be successful. Any litigation has risks. The findings under ss 305, 293 and 292 vindicate his decision as to the strength of his claims. But he had to consider whether creditors would be better off if the litigation was successful. After the sale of Paddy Road, the Cowley interests and Mr West had received payments. Parts of those payments could be recovered from them to be distributed under the Companies Act instead of under the Property Law Act. But if the creditors would not receive more under a Companies Act distribution than they would receive under a Property Law Act distribution, there was no benefit to be obtained in starting this proceeding. A liquidator is not required to take a proceeding to ensure a distribution according to the letter of the Companies Act if the result will be that all creditors will receive less. Under s 254 he had the option not to take a proceeding in respect of the proceeds of sale of Paddy Road. If he does take proceedings, under s 253 he is required to act in a reasonable and efficient manner.

[149] Mr Horton had to consider the matter from the point of view of the creditors. It would have been a mistake for him to take proceedings as an opportunity to put

through more work on the file (and I record that there is no evidence that that was his motivation). As Hammond J said in *Re Galdonost Dynamics (NZ) Ltd*:[44]

> Liquidations are not a bottomless well from which insolvency practitioners may drink ...

He also noted that remuneration may be reduced for demonstrated misconduct or incompetence.

[150] Mr Horton needed to know who the creditors were to know what the effects of the proceedings would be. He seems to have gone along with the Cowley view that only they and Mr West were creditors. He should have decided what claims to admit or reject. If there were other creditors then there was a possible advantage in the proceeding. But with only the Cowleys and Mr West as creditors, the proceeding would not be of any benefit. It was inefficient not to resolve creditors early in the liquidation.

[151] Mr Horton's fees at the time of sale were about $28,000 plus GST and disbursements at the time of the sale of Paddy Road. The realisations to date did not cover his costs. It is quite understandable that he would look for ways for recovering payment. However, his refusal to consider an arrangement under which he received a payment from the creditors seems odd. He had room to negotiate. In his provisional schedule of distributions, he had allowed $75,000 for the costs of liquidation.

[152] I find inefficiency on the part of Mr Horton. He did not decide creditors early in the liquidation. If there are no other creditors, there was further inefficiency in taking this proceeding. There was also inefficiency in the proceeding, as the first day of hearing was wasted, because Mr Horton's pleadings were not in order. Although there was an order for costs to the creditors, that does not compensate them for the liquidator's costs of that hearing with its associated preparation charged to the liquidation.

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[44] *Re Galdonost Dynamics (NZ) Ltd In Liq)* (1994) 7 NZCLC 260,499 (HC) at 260,503.

Can Mr Cowley be ordered to pay the remuneration and expenses of the liquidator?

[153] Mr West's proposal to deal with the high costs of the liquidation is to shift those costs entirely on to Mr Cowley. He seeks an order for Mr Cowley to pay Mr Horton's remuneration, expenses and fees. Broadly, the basis for the argument is that Mr Cowley should pay by reason of alleged breaches as director of the company. Submissions referred to the duties under s 131–138 of the Companies Act, breaches of fiduciary duties at equity, the power to award costs against non-parties, and the right to seek compensation under s 301 of the Companies Act. Directors' duties were alleged to run after liquidation (notwithstanding s 248(1)(b)), although the focus of the attack on Mr Cowley's conduct was mainly on the transactions of July 2008. It was argued that these matters could all be put together to confer a power to order payment of the liquidator's remuneration and expenses.

[154] Under s 278:

> The expenses and remuneration of the liquidator are payable out of the assets of the company.

[155] Under s 312 and the 7th Schedule, the expenses and remuneration of the liquidator are a preferential claim and rank above all other claims. Under s 253, the liquidator has the duty to take possession of, protect, realise and distribute the assets of the company. The liquidator's powers in the 6th Schedule enable the liquidator to carry out his duty under s 253. These provisions allow the liquidator to recover his remuneration from the company. The Companies Act does not contain any provision under which the court can directly substitute another person to pay for the liquidator. However, s 301 allows a liquidator or creditor to apply for relief against a director for alleged breach of a duty owed to the company. On any such application, any relief granted would go to the pool available for distribution and would therefore go towards a liquidator's remuneration and expenses. Through such an application a former director might be required to pay towards the liquidator's remuneration.

[156] However, this case has not been run as a claim under s 301. Mr Horton's pleadings do not rely on s 301. Mr West's only documents are affidavits. He did not cross-apply for relief under s 301 or file any other pleading seeking orders for

payment of liquidator's remuneration. While Mr West's written submissions for the hearing on 23 October did refer to the costs of the liquidation being ordered against Mr Cowley, the matter was not fully developed until the hearing on 6 November. A claim for breach of director's duties under s 301 is quite outside the scope of the issues raised in the pleadings. It would be wrong to make any findings on that matter when Mr Cowley was not on notice that Mr West would raise that issue.

Result

[157] It is not possible to make a final decision on all questions. The outstanding matters are:

(a) Who are the creditors in the liquidation and what are the amounts of their claims?

(b) What adjustments, if any, should be made to Mr Horton's remuneration on account of the inefficiency findings?

(c) Was Mr West a director at the time of the shareholders' resolution?

[158] The first goes to the question of preference under s 292, to relief under s 295 and the exercise of the discretion under s 299; the second goes to ss 292 and 295; and the third to s 299. Until these matters are resolved, orders cannot be made under these sections. A further hearing seems necessary.

[159] On the other hand, orders can be made on other parts of the case. Mr Horton is entitled to relief under s 305. In this decision I have estimated the amount payable, but that will need to be made certain.

[160] I make these orders:

(a) Mr Horton has judgment for backdated interest on the first and second mortgages, that is, from the dates of advance until 8 May 2008. The amount has still to be fixed. If the parties cannot agree on the amount, memoranda may be filed. The respondents will be severally liable

under the judgment in these shares: the first respondents two-thirds, Mr West one sixth and Mr Cowley one sixth. Mr West's share may be met from the funds held in the Cowleys' solicitors trust account in his name.

(b) Mr Horton recovers interest at 5% per annum on that judgment sum from the date of settlement of the sale of Paddy Road to the date of this judgment. The Cowleys are directed to provide Mr Horton with all information he reasonably requires to establish the date of settlement of the sale. I have applied that interest rate throughout the period, as interest rates have generally not moved markedly over that time.

(c) The agreement to mortgage of 22 July 2008 is set aside as voidable under s 293 of the Companies Act.

(d) The application to set aside the term loan agreements of 22 July 2008 is dismissed for lack of a notice under s 294, but that does not prevent the liquidator from issuing a notice under s 294 for those agreements.

(e) Mr Horton is directed to admit or reject all claims under s 304(5) as soon as possible. Once he has done that and advised the registrar, there is to be a conference for directions to determine the outstanding issues.

(f) Costs are reserved until the outstanding issues are determined.

(g) Leave is reserved to apply for further directions.

.....

R M Bell
Associate Judge