IN THE SUPREME COURT OF NEW ZEALAND

I TE KŌTI MANA NUI

SC 76/2021
[2021] NZSC 121

BETWEEN		ANTONY IVO ARNERICH Applicant
AND		DHC ASSETS LIMITED Respondent

Court: William Young, O'Regan and Ellen France JJ

Counsel: J D McBride and A J Steel for Applicant
F J Thorp and L J Turner for Respondent

Judgment: 20 September 2021

JUDGMENT OF THE COURT

A The application for leave to appeal is dismissed.

B The applicant must pay the respondent costs of $2,500.

REASONS

The application

[1] In the High Court, Paul Davison J found the applicant, Antony Arnerich, liable to DHC Assets Ltd (DHC) under ss 131 and 301 of the Companies Act 1993.[1] On appeal and cross-appeal to the Court of Appeal, Mr Arnerich was substantially unsuccessful.[2] He now seeks leave to appeal to this Court against the judgment of the Court of Appeal.

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1 *DHC Assets Ltd v Arnerich* [2019] NZHC 1695 [HC judgment].
2 *Arnerich v DHC Assets Ltd* [2021] NZCA 225 (Goddard, Duffy and Nation JJ) [CA judgment].

Background

[2] Vaco Investments (Lincoln Road) Ltd (Vaco), as trustee for Vaco Investments (Lincoln Road) Trust, developed a property on Lincoln Road, Auckland. This involved the construction of a commercial building. Vaco Investments (Lincoln Road) Trust is a discretionary trust, the beneficiaries of which are (ultimately) Mr Arnerich and members of his family. Mr Arnerich was the only director of Vaco and controlled its sole shareholder. The respondent, DHC, was the builder. The development was funded by ANZ Bank.

[3] The building was substantially completed in late 2012, with practical completion as at 21 November 2012 later being certified on behalf of the engineer to the contract. By this stage there were disputes between DHC and Vaco in respect of a significant number of issues. As well, and unknown to DHC, Vaco had entered into an agreement on 7 November 2012 to sell the building for $8.4 million with settlement in April 2013.

[4] The sale was completed on 3 April 2013. Within days of the settlement, the bulk of the difference between the sale price and what was required to discharge the amount owing to ANZ Bank was paid out to Mr Arnerich, his family members or related family interests in two payments: one $1,175,000 (on 8 April) and the other $1,036,131 (on 9 April). And between May and October 2013, virtually all remaining funds of Vaco were paid out; this to meet obligations or for the benefit of Mr Arnerich, his family or family interests.

[5] On 1 July 2014, a shareholder's resolution of Vaco appointed a liquidator.

[6] The procedural history of what followed is convoluted but the key elements are as follows:

(a) In adjudication proceedings under the Construction Contracts Act 2002, the adjudicator:

(i) determined that Vaco was required to pay DHC $300,763.12 together with interest at a daily rate until payment; but

(ii) rejected claims for approximately $200,000 for time-related and P&G costs, and

(iii) after all other allowances, including for costs, held that DHC was entitled to a total of $367,768.12.

(b) Judgment for this sum was entered in the District Court on 11 May 2017.

(c) DHC referred to arbitration those aspects of its claim (time-related and P&G costs) on which it had been unsuccessful before the adjudicator.

(d) DHC sued Mr Arnerich under ss 131 and 301 of the Companies Act.

(e) The arbitration claim did not proceed as it was seen as superseded by the claim under ss 131 and 301.

The High Court judgment

[7] The High Court Judge found that he did not have jurisdiction to determine Vaco's liability to DHC under the building contract given the dispute resolution procedures in it, but that DHC had established a debt owed to it by Vaco of $367,768.12 as determined by the adjudicator.[3] He concluded that when Vaco was distributing the surplus funds generated by the sale, DHC was a contingent creditor. Mr Arnerich knew that DHC had not abandoned its claims. His duties as a director required him to have regard to its interests when distributing Vaco's assets.[4] The High Court Judge concluded that when these distributions were made, Mr Arnerich did not have sufficient regard to DHC's interests and that he was accordingly not acting in good faith.[5]

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3 HC judgment, above n 1, at [259] and [268]–[269].
4 At [314].
5 At [345].

[8] The High Court Judge held that Mr Arnerich should compensate DHC directly by paying it $367,768.12 and that he was liable as well for interest on this sum at the contractual rate of 12.4 per cent, compounding monthly.[6]

The Court of Appeal judgment

[9] The Court of Appeal broadly upheld the High Court decision but differed in two respects. First, it held that DHC was not entitled to contractual penalty interest on the entire $367,768.12.[7] Secondly, it found that the High Court Judge should have assessed the full amount owed by Vaco to DHC; this because the claim by DHC against Mr Arnerich was not covered by the dispute resolution provisions in the building agreement.[8] The Court of Appeal remitted the proceedings back to the High Court to determine the award of interest and the value of DHC's unresolved time-related and P&G claims against Vaco under the construction contract.[9]

[10] The key elements of the Court of Appeal's reasoning as to s 131 are as follows:

(a) It had been open to the High Court Judge to conclude that Mr Arnerich did not believe that DHC had abandoned its claims.[10]

(b) The High Court Judge had not directly addressed the possibility that Mr Arnerich believed the claims were so lacking in merit that there was no need to retain funds to cover them. On the assessment of the Court of Appeal, Mr Arnerich believed that the risk of a successful claim was very low.[11]

(c) Therefore, if the test under s 131 was purely subjective, Mr Arnerich would have a "respectable argument" for the view that he could

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6 At [347]–[350] and [353].
7 CA judgment, above n 2, at [186].
8 At [145]–[151].
9 At [190]–[191].
10 At [162].
11 At [163].

disregard the risk of claims by Vaco in excess of a provision for retentions.[12]

(d) But the four "riders" to the subjective approach to s 131 summarised in *Madsen-Ries v Cooper* (*Debut Homes*) were material.[13] In particular:

(i) There was no benefit to Vaco in distributing funds ahead of determination of the claims by DHC,[14] but there was a clear disadvantage to Vaco in doing so.[15]

(ii) There was no evidence that Mr Arnerich turned his mind to Vaco's best interests.[16]

(iii) A rational director who was considering whether payment was in the best interests of Vaco would, at the very least, identify all potential liabilities that Vaco might face in its capacity as trustee of the Vaco trust, and ensure that Vaco retained access to funds sufficient to meet that maximum liability if it materialised. There was no evidence that Mr Arnerich did this.[17]

(iv) "The irresistible inference is that Mr Arnerich was acting throughout in the best interests of himself and his family, and did not genuinely turn his mind to the interests of Vaco as a separate entity, or seek to pursue those interests."[18]

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12 At [164]. ANZ initially advised Vaco's solicitors on 27 March 2013 that, in addition to the amount required to repay the principal and accrued interest of the project finance facility, it would retain a total sum of $641,674 to be held on term deposit to cover retentions and the outstanding costs of completion of the project. Of that amount, $515,076 was to be retained to cover the construction costs to complete and $80,559 would be retained as contractor retentions. Following settlement, ANZ only retained $561,115 to cover the costs to complete: $80,559 (the contractor retentions) was instead paid directly to Vaco's ANZ bank account. Then, in May 2013, ANZ agreed to release to Vaco the full balance of the costs to complete amount it was holding on term deposit.

13 *Madsen-Ries v Cooper* [2020] NZSC 100, (2020) 29 NZTC ¶24-088.

14 CA judgment, above n 2, at [168].

15 At [169].

16 At [171].

17 At [170]–[171].

18 At [172].

(v) The effect of the distributions was that Vaco became insolvent or near insolvent.[19]

(vi) In those circumstances, three and probably all four of the *Debut Homes* riders applied, albeit that one had not been pleaded.[20]

[11] The key elements of the reasoning on s 301 and quantum were:

(a) If Vaco had sued Mr Arnerich for breach of fiduciary duty it would have recovered the lesser of the full amount of the liability to DHC or the amount that ought properly to have been retained.[21]

(b) Mr Arnerich did not set out to show that some distributions could have been made consistently with his fiduciary duty and in particular the need to protect Vaco as trustee.[22]

(c) Accordingly, Vaco could have recovered against Mr Arnerich the full amount of the liability to DHC and there is no reason why DHC should not be able to do the same.[23]

(d) Vaco took no steps to challenge the determination of the adjudicator against it in respect of the $367,768.12.[24]

(e) But for Mr Arnerich's breaches, Vaco could have met this liability.[25]

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19 At [174].
20 At [173]–[174].
21 At [175].
22 At [175].
23 At [176]–[178].
24 At [179].
25 At [179].

The proposed appeal

[12] The submissions in support of leave propose the following arguments:

(a) The Court of Appeal applied (wrongly) an "entity primacy" model and imposed a duty to provide for "maximum conceivable liabilities".

(b) The Court of Appeal wrongly applied the *Debut Homes* "riders"; a submission premised on the contentions that:

(i) Mr Arnerich was entitled to consider his own interests, this given that he controlled the sole shareholder of Vaco; and

(ii) applying the riders, the test should come down to whether DHC's claims could objectively be regarded as being without merit and whether the provision initially made was irrational.

(c) The liability of Mr Arnerich should have been based on an assessment by the Court of Appeal of how much should have been retained to cover the claim.

(d) The High Court should not have accepted the adjudication and District Court judgment as establishing liability of Vaco to DHC.

Discussion

[13] The arguments that Mr Arnerich wishes to advance face a number of major difficulties.

[14] First, at the time it distributed its assets, Vaco was no longer in trade, balancing the risks of its activities against likely rewards. Instead, it was a trustee holding assets and the issue it had to address was whether to distribute them despite the claim by DHC. There would be no reason for an orthodox and solvent trustee in the position of Vaco to distribute all its funds without having first resolved (or at least capped) the claim against it by DHC, or alternatively, obtained a bankable indemnity from Mr Arnerich.

[15] Secondly, on the findings of fact in both Courts, the reason why Vaco did distribute all its funds was because this was in the best interests of Mr Arnerich. Although Mr Arnerich may have believed that the prospects of a successful claim were low, it is difficult to see how he could have believed that it was in the best interests of Vaco that it divest itself of its assets ahead of a determination or agreement as to how much was owed to DHC. On the same findings, the decisions made by Mr Arnerich did not involve a balancing of risk and reward for Vaco. For Vaco, there was only risk. All the upside was for Mr Arnerich and his family. Given the insolvency of Vaco consequent on this divestment, the wishes of Vaco's shareholder were not controlling. We see no error apparent in relation to these findings.

[16] Thirdly, against these findings, the conclusions that Mr Arnerich did not make an honest attempt to consider the best interests of Vaco and that he was in breach of s 131 are not susceptible to easy challenge.

[17] Fourthly, and as to quantum, on the findings of fact a counter-factual based on what an honest and conscientious director might have retained by way of a provision for claims would not be easy to argue for. In large measure this is for the reason given by the Court Appeal: Mr Arnerich did not set out to establish what such a provision should be. Indeed, given the way an orthodox trustee would have behaved, it is difficult to see how, in the absence of an indemnity, provision for what was owed to DHC would not have included the full amount claimed.

[18] Finally, and also in respect of quantum, the adjudication, to the extent to which it was favourable to DHC, not having been challenged, and the District Court judgment itself creating a debt, there are distinctly slim prospects of a successful challenge to the conclusions reached by both Courts.

Disposition

[19] For the reasons just given, we do not see the proposed appeal as raising any issue of general or public importance and there is no appearance of a miscarriage of

justice.[26] The application is accordingly dismissed. Mr Arnerich is to pay DHC costs of $2,500.

Solicitors:
Doug Cowan Barristers & Solicitors, Auckland for Applicant
Duthie Whyte, Auckland for Respondent

[26] Senior Courts Act 2016, s 74(2)(a) and (b); and *Junior Farms Ltd v Hampton Securities Ltd (in liq)* [2006] NZSC 60, (2006) 18 PRNZ 369 at [4]–[5].