



Supreme Court of New Zealand | Te Kōti Mana Nui o Aotearoa

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MEDIA RELEASE

YAN v MAINZEAL PROPERTY AND CONSTRUCTION LIMITED

(SC 48/2021) and (SC 52/2021)

[2023] NZSC 113

PRESS SUMMARY

This summary is provided to assist in the understanding of the Court’s judgment. It does not comprise part of the reasons for that judgment. The full judgment with reasons is the only authoritative document. The full text of the judgment and reasons can be found at Judicial Decisions of Public Interest: www.courtsofnz.govt.nz.

What this Judgment is about

The issues addressed in this judgment are of fundamental importance to the business community. They involve the scope and application of directors’ duties under sections 135 and 136 of the Companies Act 1993 (the 1993 Act) — provisions that address the interests of creditors — and, how compensation for breach of these duties should be assessed.

Mainzeal Property and Construction Ltd (Mainzeal), a major New Zealand construction company, was placed in receivership and liquidation in February 2013. By the conclusion of the receivership, the receivers had paid the secured creditor, Bank of New Zealand (BNZ), and preferential creditors in full. However, the shortfall owed to unsecured creditors in the liquidation is approximately \$110 million.

The liquidators brought claims alleging, among other things, that from January 2011, Mr Richard Yan, Dame Jenny Shipley, and Messrs Clive Tilby and Peter Gomm (the directors), as directors of Mainzeal, had agreed:

- (a) to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to creditors (in breach of s 135); and
- (b) to the company incurring obligations to creditors when they did not believe on reasonable grounds that the company would be able to perform those obligations when required to do so (in breach of s 136).

The themes of the arguments before the High Court, the Court of Appeal and this Court are the extent to which and how the 1993 Act provides protection for creditors. More specifically,

did Mainzeal's directors breach their duties under ss 135 and 136; if so, how should loss be quantified, and what orders for compensation should be made?

Background

Mainzeal was incorporated in 1987. From 1996 it was a subsidiary of companies associated with Mr Richard Yan (the Richina Pacific group). From 2005, Mainzeal was balance sheet insolvent. This was largely a consequence of substantial advances that it had made to members of the Richina Pacific group being irrecoverable. From 2008 it generated, at best, limited operating profits, and, more usually, losses.

The period that is primarily material to the case is from 2009 to 2012. In permitting Mainzeal to continue to trade during this time despite its insolvency, the directors relied on assurances of support from other companies in the Richina Pacific group. These assurances were not legally binding and often came in the form of oral assurances from Mr Yan. Such written assurances of support as were given came from a member of the Richina Pacific group that was unable to honour them from its own resources.

On 29 January 2013, Mr Yan advised that the Richina Pacific group would not support Mainzeal. On 6 February 2013, BNZ appointed receivers and Mainzeal was put into liquidation on 28 February 2013.

The liquidators pursued a number of claims in relation to the failure of Mainzeal. These included claims under the 1993 Act against the directors, alleging breaches of ss 135 and 136. The proceedings were issued in reliance on s 301 of the 1993 Act, which provides for liquidators to bring proceedings.

Lower Court judgments

The High Court dismissed the s 136 claim but upheld the s 135 claim, finding that the directors had been in breach of s 135 by no later than 31 January 2011. The Judge awarded total compensation of \$36 million against the directors, with Mr Yan liable for the full amount and the liabilities of Dame Jenny and Messrs Tilby and Gomm limited to \$6 million each (being one sixth of the total).

The directors appealed to the Court of Appeal. The liquidators cross-appealed, seeking a larger award of compensation for the breach of s 135 and against the dismissal of the s 136 claim.

The Court of Appeal agreed with the High Court that the directors had breached s 135 by no later than 31 January 2011. However, it disagreed with the approach that the High Court Judge had taken in relation to compensation, holding that the proper measure of loss for breach of s 135 in this case was the extent to which the company's financial position deteriorated between the breach date and the date of liquidation. As the company's position had not been proved to have deteriorated, it awarded no compensation for breach of s 135.

The Court of Appeal disagreed with the the High Court Judge's rejection of the s 136 claim, holding that the directors breached s 136 in relation to two categories of obligations: (a) obligations incurred in respect of four major projects Mainzeal entered into after

31 January 2011; and (b) all obligations incurred from 5 July 2012 onwards. In relation to the first category of obligations, the Court held that in light of the precarious medium to long term future of Mainzeal at 31 January 2011, the directors did not have reasonable grounds to believe that Mainzeal would be able to meet the significant obligations associated with those projects when they fell due. In relation to the second category of obligations, the Court held that from 5 July 2012 Mainzeal's financial position was such that that the directors did not have reasonable grounds to believe that any obligations entered into after that time would be met.

As to relief for the breaches of s 136, the Court held the relevant loss was the amount of the new debts incurred in breach of that section that remained unpaid at liquidation. But being of the view that it was not in a position to quantify loss calculated on this basis, the Court remitted the proceedings to the High Court to determine the amount of the loss and also whether, in the exercise of the discretion under s 301(1), compensation should be reduced and/or split differently between the directors.

Issues the Supreme Court must determine

Before this Court are appeals and a cross-appeal against the Court of Appeal judgment. The directors seek to reverse the findings of liability under ss 135 and 136. In the alternative, they argue that the liquidators have failed to establish loss for which compensation can be awarded. The liquidators seek to uphold the findings of liability. They also cross-appeal against the Court of Appeal's findings as to the approach to loss under s 135 and they invite this Court to fix compensation in respect of both claims rather than remitting this aspect of the case to the High Court.

The issues this Court must therefore determine are as follows:

- (a) Did the directors breach s 135?
- (b) Did the directors breach s 136?
- (c) If the directors were in breach of s 135 and/or s 136, how should loss be quantified?
- (d) Can loss be quantified on the information present before the Court?
- (e) If loss can be quantified, what orders for compensation should be made?

Fundamental to the determination of the first three issues is the extent to which ss 135, 136 and 301 provide for the protection of creditors' interests and how this plays out in the context of the present litigation.

Result

The Supreme Court has unanimously dismissed the directors' appeal and, in part, allowed the liquidators cross-appeal. It has found that the directors breached their duties under both ss 135 and 136 from the dates and in the manner determined by the Court of Appeal. The Court orders the directors to contribute \$39.8 million with interest to Mainzeal's assets. Mr Yan is liable for the entire amount, with the liabilities of the other directors limited to \$6.6 million each together with interest. Costs are also awarded.

Conclusions on the key issues

Protection of creditors

Prior to the 1993 Act, the courts considered that once a company is insolvent or bordering on insolvency, directors are required to have regard to the interests of creditors. Sections 135 and 136 apply that policy using language that makes it clear that their purpose is creditor protection. This is emphasised by s 301 which, as interpreted by this Court, provides for direct claims by creditors.

Did the directors breach s 135?

The Court concluded that liability under s 135 depends upon:

- (a) A manner of trading that creates a likelihood of substantial risk of serious loss to creditors. Whether or not the trading in question creates this risk is to be assessed objectively; and
- (b) Fault on the part of directors by agreeing to, allowing or causing, the company to trade in that manner in circumstances in which they either recognised, or if they had acted reasonably and diligently, would have recognised, that risk.

The Court upheld the findings of the High Court and Court of Appeal that from at least 31 January 2011 the directors were in breach of s 135. This was for reasons that included:

- (a) Mainzeal had been trading while balance sheet insolvent for many years. This was largely because significant amounts of money had been extracted from it for the benefit of the Richina Pacific group by way of advances that were not practically recoverable.
- (b) Advice was given by external advisors that additional capital was required. Such capital was not provided.
- (c) From 2008 Mainzeal generated little, if any, operating profit.
- (d) The directors were aware of the precariousness of Mainzeal's position.
- (e) The directors could not reasonably have relied on assurances of support given to them by other companies in the Richina Pacific group or Mr Yan as mitigating the risk to creditors sufficiently to ensure compliance with s 135. These assurances were neither legally nor practically enforceable.

In short, from 31 January 2011, the directors allowed Mainzeal to trade in a manner that was likely to, and did, create a serious risk of substantial loss to creditors. That Mainzeal was trading in such a manner would have appeared to the directors if they had acted with reasonable skill and diligence.

Did the directors breach s 136?

The Court rejected arguments from the directors that (1) s 136 cannot apply to a course of trading (as opposed to incurring particular obligations); and (2) liability under it depends on affirmative agreement to the incurring of particular obligations as opposed to a general agreement to continued trading and thus, by implication, to the incurring of the obligations that were the corollary of that trading.

The Court agreed with the Court of Appeal that the directors breached s 136 in respect of four major projects. Although the directors argued that these breaches had not been specifically argued or pleaded, the Court considered that this aspect of the case was squarely on the table at trial. The Court also upheld the Court of Appeal's liability findings in respect of all obligations entered into after 5 July 2012.

How should loss be quantified?

Having found the directors in breach of ss 135 and 136, the primary issue was whether quantification of loss should be based on net deterioration or new debt. Net deterioration refers to the extent, if any, that the financial position of the company (and that of its creditors as a whole) deteriorated between breach and liquidation dates. On the new debt approach, the relevant loss for the purposes of breaches of ss 135 and 136 is the gross amount of debt that (a) was taken on in breach of ss 135 and 136 and (b) remained unpaid at the date of liquidation.

In agreement with the directors, the Court has concluded that the proper approach to quantification in respect of the s 135 claim was net deterioration. This is primarily because net deterioration reflects loss to the creditors as a whole and is consistent with the language of s 135 which is directed to substantial risk of serious loss to creditors generally rather than individual creditors. Because no net deterioration had been proved, the liquidators were not entitled to an award of compensation in respect of the established breach of s 135.

For liability under s 136, the Court agreed with the liquidators that a new debt approach was the proper measure of loss in this case. In contrast to the language of s 135, s 136 is focused on losses to particular creditors including, as the Court held, groups of creditors. Given this, the most logical basis for quantification is the loss that those creditors suffered. The Court concluded that it had adequate information to quantify the losses associated with the breaches of s 136 and proceeded to do so, assessing that loss at \$39.8 million.

What orders for compensation should be made?

The Court held that the language of s 301 provides the Court with flexibility as to relief with the total assessed loss, \$39.8 million, providing both a starting point for, and the maximum that could be awarded, by way of compensation.

Applying that approach, the Court saw no reason to depart from the High Court's assessment of relative culpabilities. Accordingly, Mr Yan was held liable for the full amount while the liability of the remaining directors was limited to one sixth of that the total quantification rounded down to \$6.6 million each. Interest on these sums was also awarded.

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