



SUPREME COURT OF NEW ZEALAND | TE KŌTI MANA NUI O AOTEAROA

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MEDIA RELEASE – FOR IMMEDIATE PUBLICATION

**VIVIEN JUDITH MADSEN-RIES AND HENRY DAVID LEVIN AS LIQUIDATORS
OF DEBUT HOMES LIMITED v LEONARD WAYNE COOPER**

(SC 29/2019) [2020] NZSC 100

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.

Debut Homes Ltd (Debut) was a residential property developer. The first respondent, Mr Cooper, is its sole director. At the end of 2012, Mr Cooper decided to wind down Debut’s operations. Existing developments would be completed but no new developments undertaken. At the time this decision was made, it was forecasted that there would be a deficit of over \$300,000 in goods and services tax (GST) once wind-down was completed. Debut was placed in liquidation on 7 March 2014 on the application of Inland Revenue/Te Tari Taake (Inland Revenue). The first appellants are Debut’s liquidators.

The main issue in this appeal is whether Mr Cooper was in breach of his directors’ duties under the Companies Act 1993 (the Act). There is also an issue as to whether a general security agreement securing advances by the L & T Cooper Family Trust (the respondent’s family trust, of which Mr and Mrs Cooper were the trustees and principal beneficiaries) should be partially set aside under s 299 of the Act and what relief, if any, should be ordered under s 301 for breach of directors’ duties.

The High Court held that Mr Cooper had breached his duties under ss 131(1), 135 and 136 of the Act. It rejected a defence under s 138 of the Act of reliance on professional advice. It ordered Mr Cooper to contribute \$280,000 towards the assets

of Debut under s 301(1)(b)(ii) of the Act. And it set aside the general security agreement under s 299 of the Act.

The Court of Appeal allowed Mr Cooper's appeal against the findings of breach of ss 131, 135 and 136 of the Act and quashed the High Court's orders.

This Court granted leave to appeal on the question of whether the Court of Appeal was correct to allow the appeal.

This Court has allowed the appeal. The High Court orders are restored.

This Court's reasoning took a schematic approach to the Companies Act. At all times, directors must comply with their duties under the Act. When a company becomes insolvent, there are statutory priorities for the distribution of funds to creditors and mechanisms to ensure these are not circumvented. There are also a number of formal mechanisms in the Act, apart from liquidation, for companies experiencing financial difficulties. While informal mechanisms for dealing with insolvency or near insolvency can be used, these must accord with the scheme of the Act and the salient features of the available formal mechanisms, such as ensuring all affected creditors are consulted and agree with the course of action proposed.

If a company reaches the point where it is clear that continued trading will result in a shortfall to creditors and the company is not salvageable, then continued trading will be in breach of s 135, unless formal or informal mechanisms in the nature set out above are used. This applies whether or not continued trading is projected to result in higher returns to some of the creditors than would be the case if the company had been immediately placed in liquidation and whether or not any overall deficit was projected to be reduced.

There will be a breach of s 136 if directors agree to debts being incurred where there are no reasonable grounds to believe the company will be able to perform its obligations when they fall due. Such obligations do not need to arise from direct contractual arrangements between the company and the creditor.

There will be no breach of s 131 if a director honestly believed they were acting in the best interests of the company. However, there will be a breach of s 131 if a director, in an insolvency or near insolvency situation, fails to consider the interests of all creditors. Such a breach may be exacerbated by a conflict of interest.

Where there have been breaches of duty, any relief ordered under s 301 must respond to and provide redress for the particular duty or combination of duties breached. Relief can be compensatory or restitutionary in nature and must take account of all of the circumstances, including the nature of the breach or breaches, the level of culpability of the director, causation, holding the director to account and reversing the harm to the company. In cases where the breach is of s 136, relief is not calculated on a net deficiency basis because limiting compensation to the net increase in amounts owing would provide directors with the perverse incentive of continuing to trade in breach of s 136 as long as they are careful to ensure that the net deficit remains constant; in other words, "robbing Peter to pay Paul".

In this case, Debut was clearly insolvent by the beginning of November 2012 and should have stopped trading at that point unless a viable formal or informal mechanism for insolvent companies was used. No such mechanism was used. Mr Cooper did not consider the interests of all creditors and involve all creditors, in particular, the Inland Revenue. At no later stage did Mr Cooper revise his strategy, even though the overall trading position was worse than the costings projected in November 2012. This was in breach of s 135. In breach of s 136, Debut incurred debts (including GST) at a time when Mr Cooper knew they would not be paid. In breach of s 131, Mr Cooper considered the interests of only some creditors, despite Debut being insolvent. This means he did not subjectively believe he was acting in the company's best interests as he failed to consider the interests of all creditors. This breach of s 131 was exacerbated by his conflict of interest, having given personal guarantees of the secured debts owed by Debut.

On s 299, this Court agreed with the High Court that it would frustrate the purpose of liquidators pursuing judgment against Mr Cooper if the Coopers as trustees of the Trust were able to reclaim the benefit of the judgment through the general security agreement and indirectly return any compensation to Mr Cooper. The High Court was correct to set aside the general security agreement to the extent that it did.

The compensation ordered by the High Court was calculated on a restitutionary basis. This was appropriate, considering the combination of the breaches involved. The deductions made were appropriate in all of the circumstances.

The formal orders of the Court are:

- The appeal is allowed.
- The High Court orders outlined at [4](a), (b) and (c) of this Court's judgment are restored.
- The respondents must pay costs of \$25,000 plus disbursements to the appellants. Costs in the Courts below are to be determined in accordance with this judgment.

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