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IN THE SUPREME COURT OF NEW ZEALAND
I TE KŌTI MANA NUI

SC 48/2021

[2022] NZSC Trans 6

BETWEEN **RICHARD CILIANG YAN**
Appellant

AND **MAINZEAL PROPERTY AND CONSTRUCTION LIMITED (in liquidation)**
First Respondent

KING FAÇADE LIMITED (PREVIOUSLY KNOWN AS RICHINA LAND LIMITED) (in liquidation)
Second Respondent

MAINZEAL GROUP LIMITED (in liquidation)
Third Respondent

ANDREW JAMES BETHELL AND BRIAN MAYO-SMITH
Fourth Respondents

PETER GOMM
Fifth Respondent

JENNIFER MARY SHIPLEY
Sixth Respondent

CLIVE WILLIAM CHARLES TILBY
Seventh Respondent

PAUL DAVID COLLINS
Eighth Respondent

RICHINA GLOBAL REAL ESTATE LIMITED
(in liquidation)
Ninth Respondent

SC 52/2021

BETWEEN **PETER GOMM**
First Appellant

JENNIFER MARY SHIPLEY
Second Appellant

CLIVE WILLIAM CHARLES TILBY
Third Appellant

AND **MAINZEAL PROPERTY AND CONSTRUCTION LIMITED (in liquidation)**
First Respondent

ANDREW JAMES BETHELL AND BRIAN MAYO-SMITH
Second Respondents

RICHARD CILIANG YAN
Third Respondent

Hearing: 7-11 March 2022

Coram: Winkelmann CJ
William Young J
Glazebrook J
O'Regan J
Ellen France J

Appearances: D J Chisholm QC, T P Mullins and T Hu for Mr Yan
J E Hodder QC, M D Arthur and J Marcetic for Mr Gomm, Dame Jenny Shipley and Mr Tilby
M D O'Brien QC, Z G Kennedy and M D Pascariu for Mainzeal Property and Construction Ltd and

Messrs Bethell and Mayo-Smith
No appearance by or for King Façade Ltd,
Mainzeal Group Limited, Paul David Collins and
Richina Global Real Estate Limited (in liquidation)

CIVIL APPEAL AND CROSS-APPEAL

MR CHISHOLM QC:

May it please your Honours. Chisholm and Mullins and Hu for the appellant Mr Yan.

WINKELMANN CJ:

Tēnā koutou.

MR HODDER QC:

May it please the Court. Hodder with my learned friend Mr Marcetic and Mr Arthur in the other order, in fact for the 52/2021 appellant, Gomm, Shipley and Tilbey. We also have present Ms Holtz, who was intended to be a driver. She is not of counsel, but there is a driving Holtz for technological reasons I understand, and it was understood that she would be doing it for both sets of appellants, and I understand our friends have no objection to that, but I need the leave of the Court.

WINKELMANN CJ:

We'll get the technological people down, Kodum I think they're called, to work out what the issue is at the morning tea break. We thought we'd just press on and we can just access our documents.

MR HODDER QC:

Understood your Honour.

WINKELMANN CJ:

Thank you Mr Hodder.

MR O'BRIEN QC:

Yes, may it please the Court. O'Brien, Kennedy and Pascariu for the Mainzeal company and liquidator respondents.

WINKELMANN CJ:

Tēnā koutou. Now Mr Hodder, who is first up?

MR HODDER QC:

Your Honour, I am first up. I don't believe that the Court has formally responded to the joint memorandum of counsel about the allocation of time, but in memorandum number 2 of 3 March we indicated what that agreed allocation was.

WINKELMANN CJ:

So 2.25 days combined for counsel for the appellants?

MR HODDER QC:

Correct your Honour, and those were maxima obviously, not…

WINKELMANN CJ:

Not a target.

MR HODDER QC:

So the expectation is between the two sets of appellants, as it were, is that I would go first. I expect to take probably a day and a bit more. My learned friend will then follow. Our overall expectation it maybe less than two days for both of us, in which case there should be ample time to complete the case comfortably, but we'll see how we go. That's our current anticipation in relation to those matters.

So the Court will have received more than enough material for any case, although this is an important case, but in particular I want to commence by referring to some preliminary matters, or background matters, before I turn to the outline of oral argument which I hope got to the Court earlier today, which

has been provided to our friends, and so after some background material I'll get into that. That is really in three parts. Much of the first three pages or so is about legal framework and various aspects of the law. We say that's important because we think the legal analysis shapes the factual approach, or the approach to the facts. There's then a discussion about was the writing on the wall in January 2011, or July 2012, which is effectively the essential findings in the Courts below, or the Court of Appeal, and then that's, in a sense, directed to questions of liability to a large extent, then the last section deals with if they're wrong on liability then the question about quantum, the approach to quantum under 135, 136 and 301 in terms of the discretion, that's the plan of approach to that, and then I will probably conclude by reviewing what I understand to be the major issues in the case in a sort of a sweeping exercise. Those issues are many. We listed some of them in our submissions but on reflection there's probably about a dozen major issues of general importance before dealing with the specific facts of this case, which is why it is a significant case.

Can I just check that I am being heard both through the muffling effect of the mask and with the microphone?

WINKELMANN CJ:

I can hear you perfectly clearly.

MR HODDER QC:

Excellent, thank you. Can I also say that in the materials, the bundle of authorities, there is a wide range of materials shall I say. For the purposes of most of what I am going to be talking about to start with, I will be referring in the old fashioned way to a copy of the Companies Act, and an even more old fashioned way, of a hard copy of the Law Commission's Report No. 9 from 1990. There are extracts from those, the Law Commission Report is document number 130 but it's number 130 on the list of authorities. That list of authorities is slightly hard to navigate in the sense that some of the non-case names are alphabetised by reference to the first name of the author,

rather than the surname, which involves a degree of challenge, but I imagine the Court has become familiar with that and will work its way around it.

So companies. In 2012, and I can provide references to this if there's any doubt, but we've tackled these through public records where there's, they're not in the evidence. There were 550,000 companies registered in New Zealand under the 1993 Act. So each of those companies by definition had to have at least one director to be a valid company. About 41,000 company were removed in that year, that's about 7.5%, which I mention simply that there's a churn in companies, that's kind of what happens, and as the Law Commission commented, and that's in it's first report at paragraph 222B, the objective is to provide a form for carrying on business for anybody ranging from a corner dairy to the largest of industrial conglomerates, and at the time the Law Commission prepared that report in 1989, in fact, the first one, it referred to the fact of 150,000 companies. So there have been an increasing number of those and it has become the standard modus operandi for carrying on commercial activities in this country, and virtually all of those have limited liability and that, we say, is a matter of common knowledge. It's not possible to carry on business in New Zealand, we suggest, without understanding that companies, among other things, will normally have limited liability. Again, a point that the Law Commission contemplated at paragraph 227.

As the Court well understands, one of those companies was Mainzeal Property and Construction Limited and it was related to others in the Richina Pacific Group. Most of those companies were either in New Zealand or limited partnerships. But the ultimate shareholders in both what can be described as a China stream and a New Zealand stream were more widespread. The group structure is put out in a sort of a slightly minute version in the Court of Appeal judgment and the Court finds the group structure as at December 2009 at page 101.00691. 691 is the beginning of the defendant's statement of defence, that's my client's statement of defence, and at page 715 schedule A sets out that particular chart, as it were, the corporate structure for that period.

I can't see how far the Court's got, but if the Court had it, it would note that the top of this begins with –

WINKELMANN CJ:
Are you referring us to your statement of defence, Mr Hodder?

MR HODDER QC:
Yes, I am. I'm just wondering whether I should have said 102 rather 101.00691. Indeed I should. That reference should be 102.00691, and the page reference is 00715.

One of the points of taking the Court to this at this stage is simply to indicate that to get from the common shareholders who were shareholders in both streams, one goes to the right down through Richina BVI and then turning left down to Richina (NZ) LP and then below that RGREL Richina Land (NZ) but best known as RGREL, and then below that a series of companies, the left-hand one of which is shaded and is the Mainzeal company which is the centre of attention in this case.

On the left-hand side where one has the RPL (Bermuda) and down to what's called the CHC, the China holding company, that is, as the Court will have no doubt gleaned from the work its done so far, including reading the judgments below, that is the one that holds the assets in China, including the Shanghai assets, which were mentioned in various parts of the judgments and in evidence.

The common shareholders were – Mr Yan's position in relation to those was understood to be largely representative of those, but that can be spoken about more by my learned friends who are representing him, but certainly our clients understood that Mr Yan had authority to speak really on behalf of the group and that was the approach also taken by Mr Walker, whose name will have been noticed, who was the New York lawyer who was chairman of one of the upstream organisations.

So those assets in Shanghai were suggested in one document which was an EY paper in 2011 to be worth maybe 245 million US in 2001. I won't go there at the moment. That reference is 317.10337 at 317.10353. It's the Project Citron paper that again reference is made to in the judgments.

Now there's some debate and uncertainty about what the assets were but certainly it was understood again by my clients that those assets were very substantial and that they went to the question of support.

Again, important by way of overall background for this appeal, we say Mainzeal was a trading company. It was carrying on major construction works in New Zealand. Its business origins went back to the late 1960s, if one traces the building enterprise, and in 2011 its revenue was around about $380 million and employees were 450 at that time. Those figures fluctuated year by year, but they were of that order, approaching $400 million of revenue and somewhere north of 400 employees. So it was a major trading enterprise and all the kind of associated expectations, obligations, that went with that.

The accounts for the financial year ended 31 December 2010, the company had an end of year, end of calendar year balance date, the audit of the accounts, which are at 316.09333, show an operating loss of about $1.02 million, that's about .03% of turnover of $340 million. The assets on the balance sheet were around about $116 million and of those about $44.5 million were related party receivables. Again, the issue that's at the heart of these cases.

WINKELMANN CJ:
So the assets on the balance sheet were?

GLAZEBROOK J:
Slow down slightly when you're giving figures. I like to take them down.

MR HODDER QC:

Certainly, your Honour. What I might do is, if the Court can go to those numbers, they're not very long set of accounts at 316.09333.

WILLIAM YOUNG J:
316.09?

MR HODDER QC:
333. And you should find the operating loss at page .9335.

GLAZEBROOK J:
Sorry, I've lost the number again?

MR HODDER QC:
316.09333, your Honour. And the assets and related party receivables are referred to at .9336. And then to follow those through, one would go to footnote 6 which is at page 9342 and then footnote 14 which is at 9344. And then the audit opinion from Ernst Young is at 9346. And the Court will see at the bottom of this unqualified but immediately before that there is something called an "Emphasis of Matter" which goes back to the matters dealt with in footnote 14 and footnote 6. That's at the bottom of 9346.

In terms of support, there is a letter of support that relates to that set of accounts at 316.09352 and that's a forward-looking letter of support signed by Mr Yan on behalf of the Richina (NZ) LP. And the Court probably understands that one of the different position points on this is that it is said that the LP had insufficient assets to meet the liabilities on the related party receivables, the contrary view was Mr Yan spoke for the group as a whole, irrespective of which letterhead he was writing on when talking about providing support.

WINKELMANN CJ:
Sorry, that's your position?

MR HODDER QC:

The latter one is our position, the first one is the liquidator's position, that is to say that that company had no assets, not assets to meet those liabilities if they were called upon to pay the related party receivables. As it happens, the audit fees paid in 2011 were $135,000. The director's fees paid for the financial year 2011 were $97,500. After Mainzeal went into liquidation in February 2013, then in 2015 the liquidators claimed $75 million from the directors and it's probably useful to go to the pleadings for a couple of minutes, so I would like the Court to go to 103.01299. It's the merge pleading document. The first cause of action –

WINKELMANN CJ:
Just pause for a moment.

MR HODDER QC:
Sorry, your Honour, 103.01299.

WINKELMANN CJ:
Yes.

MR HODDER QC:
Your Honours have got it. Thank you. The first cause of action starts at page 01332. That cause of action against the directors first, second, third and fourth defendants versus Mr Yan. The second, third and fourth were my clients was based on section 136 and 137. I have to say 137 was barely heard of at any point in this process, but it's a 136 claim and at paragraph 59(a) you will see the reference to the statutory duty by reference to section 136: "A duty not to agree to Mainzeal incurring obligations unless they, the directors, believed at that time on reasonable grounds that Mainzeal be able to meet those obligations."

Paragraph 60 then sets a number of dates at which they were under a duty to consider the interests of creditors. (a) was at all times after the end of 2008. That got some mention, but most of the focus in the judgments is not on that but on the alternatives that we find on the next page paragraphs 60(b) and (c).

(b) is: “At all times from January 2011, at which point it was or should have been apparent to the directors that there was significant uncertainty about the collectability of related party debts and that structural and governance issues added further risk.”

And then (c): “Alternatively, from 31 July 2011, by reference to the matters pleaded in paragraph 33,” and paragraph 33 can be found back at page 01314. There is a series of matters said to go to the question of risk factors going to the company and that led to the claims that we find at page 01335 and paragraph 62 says the obligations incurred to creditors after 31 January 2011 were about 75 million plus, or if you took the 31 July 2011 date, it was 69.4 million plus a bit. Now that’s in terms of incurring obligations.

The second cause of action that starts, and those are the sums that were being claimed in the prayer for relief that is to be found on page 1336 which is also the page where the second cause of action commences under section 135, and if we proceed through to the end of page 40, sorry, page 01338, paragraph 69 is an alternative about incurring obligations and so in the relief that’s sought at the top of 01339, there’s a cascade, firstly $75 million or $69 million as per what was quantified in the previous cause of action, paragraph 62, or $44 million or $32 million which were related to the then liquidator’s then belief in terms of net deterioration. As the Court will know, the High Court and Court of Appeal were both of the view there was no net deterioration, but those are the numbers that were based on that. But the 135 claim the headline number was the obligations numbers of 75 million and 69 million.

At the moment, as the Court knows from the liquidator’s submissions, the number that’s being sought is at the moment, or could be $45 million minimum plus interest. So the number remains very large and we would say eye-opening compared to the rewards the directors earned as such.

WINKELMANN CJ:

How is that relevant though?

MR HODDER QC:

I'm sorry, your Honour?

WINKELMANN CJ:

I said, "How is that relevant?"

MR HODDER QC:

It's relevant because one of the points that I make in the submissions, both in the written submissions or I make orally, is that the Companies Act is about a balance between encouraging directors to take on the role and engage in entrepreneurial activity, at the same time as there being protection against abuse of management powers by primarily directors. So risk and reward need to be taken into account. Now, one of the things that we say in this case is that the approach taken by the courts below means that the rewards are inadequate, the overall exercise of having these massive liabilities on uncertain situations is one that defeats the purposes of the Companies Act. It gets the balance wrong.

WINKELMANN CJ:

I suppose you'll take us back to where you say there's any kind of principle in the Companies Act that said the balance is between the amount that they get paid and the –

MR HODDER QC:

No, your Honour, I'm adding a pragmatic gloss, so if we want to have a Companies Act that achieves the things that business enterprise, taking risks is supposed to achieve, you need to have directors. If there are directors they need to have some comfort that it's worth while taking on the role. I'm simply pointing to those two things in juxtaposition as pointing out that there is a massive gap between those matters. I don't, I'm not taking the matter any further than that. I'm not saying there's a principle in the company law that if you earn low director's fees you have low liabilities, I'm simply pointing out that the balance in matters.

I make that point because, unlike most cases that the courts see in relation to companies that go insolvent, there is in relation to my clients no question of self-interest or no material question of self-interest. They, yes. And so, the High Court held that my clients were not conflicted, if I can just give the Court some references to that judgment, just the paragraph numbers that was at paragraph 283. It also concluded that they acted in good faith and honestly, that was at paragraph 431. That they had breached their duty under section 135 in terms of carrying on the business of the company, but the High Court rejected the claims under the first cause of action, section 136. And the end result of that was that on the High Court's total liability focus, they were ordered to pay, that's my clients jointly with Mr Yan, $6 million each and Mr Yan was ordered to pay an additional $18 million, that's the summary is at paragraph 461 of the High Court.

So things got turned upside down in the Court of Appeal, the Court of Appeal held that there was no valid claim for a section 135 breach on pleadings grounds and no net deterioration, which was a valid approach to be taken, not the one the High Court had taken, but held that the directors were liable for breach of section 136 which meant that quantum should be redetermined by going back to the High Court where the High Court will apply a new debt rather than net deterioration approach.

In the essence of what the Court of Appeal found was that Mainzeal should not have entered into new construction contracts and associated subcontracts after 31 January 2011. That's the essential finding at paragraph 469 and there should have been no contracts at all, that is no trading actively in kind from July 2012. That's the point we find at paragraph 475: "Unless," said the Court, "Mainzeal have obtained legally enforceable guarantees or repayments of group receivables".

So the case for the directors that comes to this Court is that the Courts were profoundly wrong. They have created a minefield for directors and it's unnecessary. The Act can be interpreted in accordance with the long title

without requiring the conclusions that the Courts below reached and to come back to the point that I was discussing with the Chief Justice, it undermines the likelihood of well-advised independent persons taking on the role of direction and undertaking responsible entrepreneurialism and so I repeat the point I made earlier, unlike almost all cases that one finds in the reports about insolvency cases, no contract acting in good faith and honestly in what they believe was the company's best interests, but the Court says notwithstanding that, we think, having looked at all the material we've got, that they had no reasonable basis for carrying on the way that they did. So, we say that that reduces dramatically the significance of the explicit reference in the long title to the wide discretion in matters of business judgment and it expands the focus on the long title's reference to abusive management powers to cover the conduct of honest, diligent and experienced persons who are making judgment calls and we say these were judgment calls.

Could assurances from the leaders of the wider group be relied on? Could carefully worked through financial operation forecasts be relied on? Was Mainzeal a going concern? Was a group restructuring plan to improve Mainzeal's balance sheet over about three years credible? We say those are all matters of judgment. They are all matters on which the directors formed a judgment. We'd have to see a different judgment to the one that the Court of Appeal came to.

O'REGAN J:
But in the end, the Court has to make a decision about where the duties have been breached. It can't be that the Court just says: "If the directors thought it was fine, it is"?

MR HODDER QC:
The question that I'm going to be spending a bit of time on your Honour is whether or not there was a rational basis for the views that the directors had and we say that if there was, that is sufficient. That does get the balance right. Whereas here, among other things, we would say that what the Court of

Appeal did is it took on a substitutionary approach as opposed to saying were there rational grounds for believing the position that there was.

O'REGAN J:
Well, in the end, the Court just has to assess whether the duty has been complied with or not. It's not a judicial review.

MR HODDER QC:
Well, in a sense, we say that is the question. It's obviously not a standard judicial review, but taking away the public law connotations in the sense it is an exercise in judicially reviewing what happened, we say that the appropriate approach to take is if we're going to give a wide discretion of business judgment, that does encourage the idea that there is something edging towards the idea of judicial review in that sense rather than simply saying: "Well, we can substitute our opinion having looked at all materials." That would be a simple second guessing which we suggest isn't what is contemplated and isn't helpful to the balance that the Court is concerned with.

So what we will be attempting to take this Court to are materials which indicate that there were grounds for belief that there could be a restoration of material profitability, that there could be an improvement and return to having a credible balance sheet, and that the contrary view taken by the Court of Appeal on section 136, where the liability currently rests, involved a misbalancing which then, that approach we've just been discussing with Justice O'Regan, rather dictates what happens with the liability and breach conclusions. So we are asking this court to explicitly improve the balance between those aspects of the long title so that there can be proper recognition that directors of solvent or salvageable companies who make honest and informed decisions that they rationally believe are in the best interests of the company are lawful, acting lawfully, and they're protected against claims such as those which are being pursued against these directors since 2015.

GLAZEBROOK J:

Can I just, I certainly accept where said, I think, in the authorities that salvageable companies don't come within this, but the question is, what does that mean and what – so are you really saying if there's some minor possibility, and some – well perhaps just explain what you mean by rational basis for that view that the company is salvageable.

MR HODDER QC:

Well, perhaps I can start at the other end with your Honour's question, but the word "salvageable" is obviously one that's focused on the Court's decision in *Debut Homes*. So taking *Debut Homes* as treating unsalvageable as hopeless, absolutely no chance of being –

GLAZEBROOK J:

Well that was the situation in *Debut Homes*, yes.

MR HODDER QC:

Then there's the category of imminently solvent companies, we're not concerned about, and then somewhere in the middle there's a, includes a marginal territory, or the twilight zone as people describe it in some of the literature. So we're talking about what happens in the twilight zone and we say that in the twilight zone if you have honest and good faith decisions by people who have been diligent and who have knowledge, then int hose circumstances you would not be expecting to find the Court saying, no, we disagree, we're going to subset our own view.

GLAZEBROOK J:

Can you slow down a bit. Honest decisions by persons with due diligence, is that right?

MR HODDER QC:

Honesty, good faith, due diligence and relevant experience, which is what we say occurs here. If that happens then we say it's surprising if a decision on matters of judgment is set aside and substituted by a court. One of the

reasons I say that, and I'll come later on, at least in passing, to the evidence of Mr Tilby who was one of the clients and he was an independent director, and to Mr Gomm, who was the chief executive and a director. Between them they had the thick end of 70 years' experience in the construction industry, in very senior roles. So if they say we think we can get this company into a profitable decision, then we say that is something that is of real significance in relation to the contrasts with the position the Court is in.

O'REGAN J:
But the problem wasn't the operation of the construction company. It was the receivables from companies in China wasn't it?

MR HODDER QC:
Yes.

O'REGAN J:
That had nothing to do with being experienced in the construction industry.

MR HODDER QC:
Well there's two – the Court of Appeal makes the point of both, that's why I'm responding to the point about the profitability of the company, and on the balance sheet, I'll come to this, but the Project Citron report, the EY report, discusses the proposal to move to the pre-purchase agreement, which was intended to reduce the balance sheet deficit as it were, particularly on those particular matters to something like $2.5 million by the end of the financial year 2013, from a very substantial reduction of that sum. So that was an exercise that had been worked through with Ernst & Young, approved by the board, developed with the group, and that was one of the ways in which the intention was to deal with the balance sheet problem. It wasn't being ignored, although that's a suggestion that seems to be made in a number of points in the Court of Appeal's judgment. That was a proposal in place and the agreement was entered into. No it didn't go as perfectly as it was hoped to go, but in terms of the expectation, in terms of the decisions to do something, and to address the issue specifically, they had done that on both the capital

and on the profitability side, and again because the pre-purchase agreement did include the use of materials for construction, we would say that the experience of Mr Tilby and Mr Gomm wasn't irrelevant to that either.

WINKELMANN CJ:

Can I just ask you, does your test as you've formulated it which has as part of it the relevant, the experience of the director, does – would that mean that different directors with different experience could face different liability in the same circumstances?

MR HODDER QC:

It wasn't part of my argument particularly. I've largely been thinking of the board's decisions as collective, but collectively they incorporated that experience.

WINKELMANN CJ:

Well, same thing. Same, different boards. I mean surely –

MR HODDER QC:

Well, if a board has no experience about construction, is running a construction company, then there might be a greater justification for a second-guessing exercise.

WINKELMANN CJ:

So the Courts will be more intrusive on the business decisions, depending on the experience of the board?

MR HODDER QC:

Yes.

WINKELMANN CJ:

Would be justified in being more intrusive on the business decisions depending on the experience of the board?

MR HODDER QC:

Yes, I am reluctant to get into concepts of “difference” knowing how that word is somewhat polarising in jurisprudential terms, but yes, I could contemplate it for your Honours, the question, I could contemplate a situation where a board that had absolutely no experience wanting to come to somebody and explain they had a rational basis for doing something would have more difficulty than a board that had lots of experience in that matter and said, and particularly when it comes to questions of judgment: “What’s your judgement based on?” Well, if your judgement’s based on 70 years of construction experience that’s one thing. If it’s based on one year of construction experience it’s something different.

WINKELMANN CJ:

That might have the strange result that people who’ve got more experience and are therefore more likely to be highly paid will end up having lesser standards demanded of them than people who are in smaller companies, you know, not such glamorous figures in the corporate world.

MR HODDER QC:

Well, the ultimate question is going to come down there was a rational basis, but in terms of assuming everybody is acting in good faith and honestly for these purposes and without self-interest then to the extent that experience and knowledge is relevant and being properly informed then one of the ways in which the proper information aspect comes through is the fact the experience provides background information that lack of experience doesn’t. I don’t think we can take that point any more than that.

ELLEN FRANCE J:

How does that fit in with duties to take legal or other advice?

MR HODDER QC:

I’m not aware –

ELLEN FRANCE J:

Well, the logic of your approach is you might have less of a requirement to take advice if you've got all your own experience. Is that where that leads you?

MR HODDER QC:

I hadn't seen the two as being on the same territory in a sense, your Honour. The experience I'm talking about relates to the operation of the business, that's the constructions experience, and whether it could achieve profitability. Legal advice, with respect to our profession, doesn't seem to me to be likely to bear a great deal on the profitability question. It may bear on a whole series of other things but not that one, and relatedly I hadn't apprehended there was a duty to take legal advice as a stand-alone duty. It's simply part of an exercise –

ELLEN FRANCE J:

No, no, that's not well expressed on my part. I was just trying to understand how you saw this experience factoring into the assessment of liability.

MR HODDER QC:

Well, if I can perhaps try and restate it and hopefully not contradict or confuse anybody in the process, I'm really saying that when questions of business judgement arise, and the Act contemplates that there'll be a wide discretion for those, and, as Justice O'Regan says, at some point the Court gets confronted with having to make a decision, then all I'm saying is that a significant factor at the time of the decision-making is whether or not that was a decision that was well-founded on, in particular, experience about profitability to the extent that's relevant and whether the company had a valid future.

So in a sense, the Court of Appeal has various phrases but one of them is, I think it's "wilful blindness" and "unwarranted optimism" and phrases of that kind, we say in terms of the operation of a construction company and its ability to perform the contracts and its ability to be profitable, those are matters

where experience of the directors or the managers, but here the directors, in particular, is relevant.

So when one is assessing whether there are rational grounds or reasonable grounds or, conversely, no reasonable grounds or no rational grounds, then when these directors are part of a board which makes a decision that says: "This is the way we're going forward and we believe we can restore the company to profitability," then that is relevant.

Now, the results turn out are not ideal. They're not perfect in obviously 2011 or 2012. Partly, there is still an aftermath of the GFC. Partly there is impact of the Christchurch, Canterbury earthquakes going on and various other things, including the leaky building crisis. All of those things are issues that affect a range of players. It's not a company specific exercise. So the environment is affected by those three factors.

But in effect, what I am resisting is what might be seen as an implication at least of the Court of Appeal judgment that this exercise was hopeless, they just should've given up because they couldn't run a construction company, or possibly no construction company was going to be particularly successful in this environment.

O'REGAN J:
Well, it wasn't just a construction company, it was a construction company that didn't have any shareholders' funds.

MR HODDER QC:
Well again, I guess I'm predominantly and what I've been saying is redressing the profitability point. As I say, in terms of the funds that, the balance sheet funds that were in the background, or the material that was coming in from, expected coming from the group, I see that as being sort of a somewhat discrete issue and then there's a whole series of material about that. It says there was support coming in and did come in albeit in a sort of less than perfect scenario because it didn't arrive in a lump sum in the form of shares or

a guarantee or something of that kind, but funds did come in. Quite substantial funds came in.

WINKELMANN CJ:

So you dealt, and I say this without any sort of no pejorative sense very glibly with this notion that Mr Yan, when he wrote on one letterhead, could be taken for all purposes to be speaking for all companies. Are you going to take us back to that because it is a critical part of the liquidators' case, but doesn't seem to be a focus on your appeal that these, the support that they had was not from the asset rich, was not legally enforceable and even if it was legally enforceable or something you could depend upon, it wasn't from the asset rich branch, left-hand side of the diagram that you took us to?

MR HODDER QC:

That's not in dispute though, your Honour. It's following through a strictly legal ability to enforce. On the right-hand side there would be assets to enforce those receivables by Mainzeal.

WINKELMANN CJ:

What's not in dispute, Mr Hodder?

MR HODDER QC:

I'm sorry?

WINKELMANN CJ:

Can you just re-state what's not in dispute?

MR HODDER QC:

That there were not assets immediately available in the companies on the right-hand side as your Honour has used the phrase of that diagram to pay the receivables as it were on demand. There would have to be assets from the wider group. That's the full amount. What was then done was because the group operated, and this is the evidence from Mr Yan and Mr Walker, was that they were looking to use the group's resources as a whole, including the

left-hand side as a basis on which they could provide support. Now, that turned out not to be straight forward, but that was the representation that was made. That was the belief that the directors had and they carried on. It was the reason they carried on and then the issue, one of the issues was the absence of a legally enforceable guarantee or an injection of cash to the value of those receivables and the essential prerequisite to carrying on business. Obviously that's the position we say it wasn't.

GLAZEBROOK J:
Even assuming that's right, what level of comfort do you then say is required in those circumstances?

MR HODDER QC:
Action was what we would say was, well it gave a level of comfort and so there's evidence, and I will come to this a little later on, but there's evidence that there had been support for the company in the past. At the time there were some issues around the Vector Arena construction exercise. The evidence was there had been a support I think of something in the order of a couple of million dollars had come in to work through that process. All of this has to be seen in the context of a group we would submit to the Court. Sir Paul Collins' evidence describes this, but Mr Yan also discusses it. The idea was that they would have what they call a centralised treasury and so money would go where it was needed when it was needed and the rest of it, in a sense, was not what drove the operations. So it wasn't a formalistic approach to the money involved, but when money was required it was provided, and in 2010, 2011, 2012, money was provided. Again, in kind of in various stages and different forms. So the money being provided in various forms is part of the answer to Justice Glazebrook's question, but the real point I think I wanted to make by way of answer –

GLAZEBROOK J:
I was just wanting the test.

MR HODDER QC:

The test is, was there a plan to address the issue and the answer is, yes, there was a plan to address the issue. Now that came in two forms, the first form was the pre-purchase agreement that I referred to and which is described in the Citron Report which was intended to reduce the balance involved in the receivables dramatically over a period of about three years. And secondly, there was the strengthening of the New Zealand balance sheet by putting on assets, the Mainzeal House, the vineyard, the various other things that created a New Zealand asset base.

GLAZEBROOK J:

I was really asking what the test was in respect of the, for want of a better word, the letter of - or the comfort letter.

MR HODDER QC:

I suspect that has to be done in terms of reasonableness, your Honour. That, I think, is what the cases to date had said, that was there a reasonable basis for thinking that the support would be provided.

GLAZEBROOK J:

Thank you, so it's reasonable, not rational at this stage then? Because you'd said rational before.

MR HODDER QC:

I'm quoting what the cases have said in the past. For myself, I would say again, rational is an appropriate test.

GLAZEBROOK J:

Well, is it rational or reasonable?

MR HODDER QC:

As your Honour's cornering me on that, I'll say, I'm happy to say rational.

GLAZEBROOK J:

Or do you say they're the same thing?

WINKELMANN CJ:

So you're saying rational, not reasonable?

MR HODDER QC:

Yes.

WILLIAM YOUNG J:

Is there a difference?

WINKELMANN CJ:

Okay, all right.

MR HODDER QC:

I mean, I'm not sure there's a substantial difference between those concepts for these purposes.

GLAZEBROOK J:

That's what I was just asking you, you saying it's a sort of Wednesbury reasonable.

MR HODDER QC:

Yes, yes. If you had a reason which is coherent and intelligible, then it's rational and it's reasonable, that's, it's no more than that and no less than that.

ELLEN FRANCE J:

A coherent reason which is what?

MR HODDER QC:

Coherent and intelligible. But maybe, that may be an overlap in that concept.

WINKELMANN CJ:

Even if it's wildly optimistic? Where would you put the optimism, you know, what quotient of optimism do you allow in this?

MR HODDER QC:

Well I'd start with the proposition that all business is optimistic, and then you have to kind of frame what you're talking about within that scenario.

GLAZEBROOK J:

I'm not sure about that, businesses that don't operate on optimism, they operate on quite conservative projections.

WINKELMANN CJ:

Capital.

MR HODDER QC:

I think the point I was seeking to make is that, you wouldn't be going into business unless you some optimism about being able to return better than the risk free rate of return, if I can put it that way. But that's the underlying point of the exercise in most cases. So, in terms of the Chief Justice's question about wild optimism –

WINKELMANN CJ:

Because I'm just taking you back to your language, that you were attacking a Court of Appeal judgment.

MR HODDER QC:

If there is, on what I'm describing as rational in the way I've described it, reasons there, then optimism is beside the point. What matters is there are rational reasons for taking the commercial steps that are being taken. In this case, trading on.

WINKELMANN CJ:

And where does the language of section 135 come into that?

MR HODDER QC:

Well, section 135 is in terms of carrying on the business. And in particular, it's the carrying on of a business in way that isn't going to create a substantial risk

of serious loss, well substantial risk of serious loss to creditors means the company's in liquidation and insolvent otherwise creditors can enforce their rights by contract. So the question becomes one of, carrying on a business in a way that isn't going to create or compound an insolvent liquidation.

So relating it back to my rational point. If you have, as we say, a rational belief that you can restore the asset position of a balance sheet to a respectable state and you can run the operation profitably, then you don't think you're carrying on a business in a way that's going to create an insolvent liquidation.

GLAZEBROOK J:
And how long a timeframe do you have to do that, because most, well, certainly the cases to date have suggested a relatively short one if you're actually insolvent?

MR HODDER QC:
There's no simple answer to that apart from saying it has to be looked at as a plan as to one that can work in the circumstances. So I'm conscious that in *Re South Pacific Shipping Ltd (in liq); Traveller v Löwer* (2004) 9 NZCLC 263,570 (HC) I think it was Justice Young had in mind a relatively short period, a matter of months rather than years. In this case we – but there's no necessary reason why it has to be that period, as long as it's foreseeable and it is credible.

GLAZEBROOK J:
What about the view that the Companies Act has a whole lot of mechanisms for dealing with companies in that situation and that the scheme of the Act is that those mechanisms should be used rather than the directors who may not be self-interested but would certainly have an interest in the particular company just in terms of reputation or even being slightly blind as to what the actual effect might be, so in fact you should use those mechanisms?

MR HODDER QC:

Those mechanisms, we would say, are – primarily liquidation would be the obvious one where the company is doomed, it's not salvageable, and so there's no dispute from us that if the company is not salvageable then it shouldn't keep trading. The question we're talking about is in the twilight zone and as –

GLAZEBROOK J:

Well, involving creditors, involving receivers.

MR HODDER QC:

Well, I'm not – your Honour's question is about don't formal mechanisms click in at some point in the twilight zone? In our submission, no, not necessarily. The responsibility of directors is to carry on the business of the company. If there is – in the marginal zone, they're required to have regard to the interests of creditors as well as anybody else, and perhaps more than anybody else. They're not required to exclude everybody else's interests. The idea that they are required to give up their responsibilities and put the company into voluntary administration, although that seems to be barely used in the experience of it, or into liquidation, we'd suggest is not a requirement of directors.

Underpinning all of this is the idea, and it particularly affects the facts as I'll come to in more detail later, but when there is a trading operation of some scale then the value involved or the difference in value between a going concern and a company that is no longer a going concern is massive, and that's they the authorities have recognised that there is a major dilemma if you have a company which is at the margin and whether you carry on trading on the basis that there is a rational belief that you can get to a point of sustainable solvency versus what can be described as a guaranteed train wreck if you put the company into liquidation and probably voluntary administration because reputation in the market will suffer and people who deal with the company will try not to deal with the company and all sorts of things. I mean this is a matter that was discussed in the evidence and I think

the basic consensus that came through from, for example, the governance experts on all sides, both sides, was that there was no soft landing, and so that's a factor that's relevant as well.

So in broad terms, your Honour, I'm suggesting that in a marginal trading scenario, a marginal profitability, marginal trading scenario, marginal solvency scenario, the directors are entitled to carry on provided they have a rational basis for believing that they can get their company into a state of solvency. If they don't, they shouldn't be trading.

GLAZEBROOK J:
And what was the answer about the timeframe?

MR HODDER QC:
The timeframe is it has to be within a – it's hard to avoid words like "reasonable" and "credible". There is no – one can't define it.

GLAZEBROOK J:
No, that's fine. I just wanted to know what your answer was. So within a reasonable timeframe?

MR HODDER QC:
Yes, in the general circumstances. Now, your Honours, if it is convenient I will pick up my outline or oral argument and start working my way through that no doubt with various rifts on my own part and possibly on the part of the Court through questions, but the starting point which probably should be before my 1.1 is that company's operate in the wider general law, as do directors and that perhaps goes to the point about core company law. The Law Commission's 1989 report is clear that it was designed to focus on core company law. If there were additional requirements required because you were dealing with the public and were raising funds in the securities markets, then those are dealt with by securities legislation and that deals with a wide range of people who might be providing loan capital or otherwise in those markets. But the company will be operating, and the directors will be

operating in the general law of negligent mis-statement, fair trading, environmental requirements, all those sorts of things. That isn't dealt with by the Act. What the Act is designed to deal with we suggest is about establishing the concept of limited liability for companies and the position of shareholders who are the owners of the company including the agency issues that arise where the shareholders are not also the managers of the company. That's the broad thrust of what I am contending for in these submissions.

So, like I said, 1.1, the first purpose of the Act is to facilitate the establishment of companies and their use to create wealth which is the essential point being made in the long title. As I have said, it is about core company law. It's not trying to fix all the world's problems in company law. Some things will be dealt with otherwise, whether it's fraud or its environmental issues, or its industrial relations and then there's also a question of clarity and accessibility which was one of the things that the Act was designed to do because in the preceding legislation, or the preceding legal regime lacked clarity and lacked accessibility for most people, probably including lawyers.

Going back to striking the balance, that is as the Court has already heard me say the key part of what we are contending for, that the balance is one that needs to be useful for the present purposes. The question of balance is put in various ways and I have given some references in the right-hand column to some points of that. There's no real, I would've thought there's not very much doubt about they argue that there is meant to be balance. The question is whether the balance struck by the Court of Appeal in particular is one that is consistent with the kind of idea that is behind the drafting of the long title.

Now, there are a number of references to the Law Commission here and I probably should say we accept of course that the Companies Act 1955 in the form it now sits and the form it was enacted is not the way it was drafted by the Law Commission in various places, including sections 135 and 136, but what does survive from the Law Commission's drafting is the long title. There's no change whatsoever to that and so we suggest to the Court that it is entitled to have regard to what the Law Commission says about the balance it

was seeking. There are a number of places in that report, that's the 1989 report number 9 which makes it clear that the Act should be designed to achieve a balance which doesn't overly deter those who want to become directors.

Because I only went back to it yesterday and it's not in the bundle, but can I just mention this and see if the Court will put it into the bundle, but the Law Commission wrote two reports as some of the Court may remember. The first report was the main report which is report number 9 from 1989. The second report in 1990 was called *Transition and Revision* and it had a lot of time spent on how do you get from where we were then to where we are meant to be now, which is a question of re-regulation and a whole series of other extraneous matters such as flat and office owning companies or mining companies or profit of companies. But in the 1990 report, in the preface of report number 16, there was in the preface was the discussion of director's duties, which if I may just mention that. And what it said was: "The topic of director's duties is central to company law. Opinion on the way in which those duties should be defined vary widely. Any legislation reform will contract considerable interest. The Law Commission was satisfied of the need to strive to achieve a balance between assuring accountability and making the position of director so onerous that people with appropriate skills are dissuaded from retaining or taking up directorships. The Commission is aware that there's already evident a trend for professionals to refuse to accept directorships, this cannot assist in improving the quality of corporate management." Now that passage adds to the references I've given from report 9.

WINKELMANN CJ:

Is that report the 1991 in your authorities?

MR HODDER QC:

No, it's not. I came across it and I revisited it yesterday, but we'll put it in if it's helpful for the Court. In the online version, I'm reading from page 14. But it

may be that it's essential we put it into the authorities, so the Court has access to it or it helps.

While mentioning that, the other thing I should say is that that report, like the 1989 report, makes clear that there was and had been a lot of attention paid to North American company law, principles and legislation, and on page 8 of the online version, there was reference to the fact that: "The Commission's draft is not based on the 1955 Act, nor is it based on any one overseas model although the US Model Business Corporations Act has been of great assistance, as with the work of the Dickerson report which preceded the Canada Business Corporations Act. And I make that point only because I come to this point, but there was, we submit, on the face of the reports, an understanding of the way in which the business judgement rule was being developed and understood in the North American jurisdictions and that exercise is what lies behind paragraph D of the long title. "Allowing directors a wide discretion in matters of business judgment while, at the same time, providing protection for shareholders and creditors against the abuse of management power."

O'REGAN J:
There is the problem though that the Commission's provisions relating to director's duties, which presumably were intended to give effect to the long titles were then rejected in the reform process and we came up with something completely different.

MR HODDER QC:
Well, they were certainly transformed in marked ways, I'm not, as I think I said earlier, I'm not claiming a direct line of descent, as it were, from the Law Commission's views about insolvent trading to what we find in the statute book. My case is that when one has the language of sections 135 and 136, the range of possible literal interpretations is quite broad. The question then is what is the purpose of approach which the Interpretation Act 1999 requires of us and we say in that basis it goes back to the long title unchanged from the Law Commission's drafting and says if we are looking for a balance that

achieves the objectives in the way that is described in both the number 9 and number 16 reports, one would approach sections 135 and 136 to enable a meaningful wide discretion of matters of business judgment and our complaint to the Court by way of appeal is that the Court of Appeal hasn't done that. But absolutely no question that the Law Commission isn't the definitive travaux préparatoires for the Companies Act, and particularly in the detailed drafting.

Can I just say a couple of things about my 1.2, that the companies, the enabling aspect, the revision of, this is about shareholders. It's shareholders who are the direct beneficiaries of limited liability and we adhere to the point that it is not a privilege, which has been suggested I think maybe in the *Mountford v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104 (HC) case, but it's a statutory right. There's no pre-qualifications on it and that in part comes from the *BTI 2014 LLC v Sequana* SA [2019] EWCA Civ 112; [2019] 2 All ER 784 reference I've given in the box on the right of 1.2 which is the Court of Appeal decision.

The other point of that 1.2 is about ultimate control. So, the shareholders can if they choose put the company in liquidation whenever they want to, or seek to do that and ultimately, they appoint directors, ultimately the make decisions, a whole range of things subject to the safeguards that the Act provides and that reserve power as it were, or ultimate power, is important in terms of what the Companies Act is and is not designed to do.

I've probably said as much as I need to say about 1.3.

The point we make at 1.4, in some ways it's easy to say, well any decision is made on the basis of hindsight. That's the nature of many decisions certainly made by courts. It's inevitable because there's a recreation of history required in almost all cases, but we say that there is sound reason to believe that hindsight risks were one of the reasons why the North American jurisdictions in particular developed a business judgment rule because it was such a problem and we've identified various places where that's discussed.

Nobody is going to vote for hindsight as being a good thing. The question is how much credit you give to it and how seriously it's applied in the particular circumstances.

WILLIAM YOUNG J:

I suppose there, I mean obviously there is a hindsight bias, everything with hindsight, everything that happened looks as though it was inevitable and should have been seen so from much earlier in the piece. There is also some confirmation bias where people often believe what they want to believe?

MR HODDER QC:

Yes.

WILLIAM YOUNG J:

And are prepared to put off an evil day in the hope of something else, so that's probably an issue with the business judgment rule, isn't it?

MR HODDER QC:

We would suggest that in fact that the business judgment rule amounts to a vote for confirmation bias and against hindsight bias in a sense. That's the point of it. If you're going to give people a wide discretion of business judgment and they are the decision makers, even if they are subject to confirmation bias, the scales have been tipped in that way and conversely, what that material I've cited to the Court in 1.4 is about is really about the idea that it's the Court or those who are wishing to pursue the directors who are the ones who have to explain away if they can that they are not relying on some degree of hindsight bias. The classic phrase that we get in the Court of Appeal judgment which we've used in the headings on the next couple of pages is: "The writing was on the wall in January 2011." The writing was on the wall in a sense because the company went into liquidation in February 2013. Now, various witnesses among the directors, all the directors and Sir Paul Collins who was a director at the time thought the company was able to work its way into a situation where it would be profitable and successful up

until the events of January and February 2013. So the writing was on the wall in January 2011. The company carries on for two years.

WINKELMANN CJ:

So, the writing was on the wall in January 2011 and the directors were extremely worried about the letter of support arrangement?

MR HODDER QC:

And they were taking steps to make things happen and things did happen.

WINKELMANN CJ:

And they were extremely worried about the solvency of the company and then the letter of support arrangements effectively, ultimately, were the undoing of the company when Mr Yan made his decision and communicated it?

MR HODDER QC:

Well, he said he wasn't prepared to give the support undertaking the BNZ was looking for. He did that on one day and then it was reversed about two days later, but it was too late by then, the BNZ had lost faith.

WINKELMANN CJ:

Had become concerned about whether this was really a chimera really I suppose?

MR HODDER QC:

Well again, that's the question that a Court is inevitably placed in and what we've been discussing for a large extent this morning is about what approach and where what prism the Court comes to that question with and so when the Court says: "We think that in January 2011 the writing was on the wall," that is, it was doomed to insolvency and so it should not have taken on any new construction contracts. That actually means the end of the Mainzeal business.

WINKELMANN CJ:

That's not really the language of the section though, is it?

MR HODDER QC:

No, but it's the Court of Appeal's approach is quite fairly we say reflected in that.

WINKELMANN CJ:

No, no, I'm saying your approach really which means you really putting your case unless no one could rationally think this wasn't go to be an inevitably insolvent company, unless no one could rationally think it was irretrievable, unless no one could think it was retrievable, then the directors have to be allowed their business judgment. You're pitching it very high. You're pitching it very high is what I'm saying. You're pitching section 135 very high in terms of the deference.

MR HODDER QC:

I'm not sure that I can assess –

WINKELMANN CJ:

Or you can tell me I'm wrong.

MR HODDER QC:

Well, I'll obviously contemplate on that over the rest of the day in various ways.

WINKELMANN CJ:

Yes.

MR HODDER QC:

But am I putting very high? I had thought that it was no more than saying that if there is a question of business judgement about whether the way the company is carrying on business is going to cause insolvent liquidation, and there is a rational basis for carrying on on the basis that there is expected to

be the avoidance of that and the creation of profitability and solvency, if that is putting it high then I guess this is has to be described that way.

WINKELMANN CJ:

Can I ask you a follow-up question? Do you accept there's any different approach required of directors once they actually enter the area of insolvency, so they know that their – and they've got a balance-sheet insolvency? I mean they're effectively in difficult circumstances. Is the Court entitled to expect – is it enough in those circumstances for a court to sit back and say: "Oh, well, that was their judgement and they're experienced"?

MR HODDER QC:

Every situation is going to depend on its facts, your Honour, but what we're talking about is a marginal case where the directors – and the question is whether the directors have a rational basis for not putting the company into liquidation. That's effectively what we're talking about and we say the answer should be that that will be the case if there is something plausible. I'm –

WINKELMANN CJ:

So you're saying the test remains the same really whether they've a rational basis for what they're doing and considering that they're not going to become unsalvageably –

MR HODDER QC:

The test will be the same. The test has to be – there's an objective aspect to it. We accept that for 135 and that means that there has to be a rational basis for the carrying on trading, and the flip side of that is the alternative is not carrying on trading which means insolvent liquidation, which means loss of value and jobs, et cetera.

WINKELMANN CJ:

But you kind of close out the objectivity aspect of that by saying it's their view of a rational basis, we should – if they think it's a rational basis.

MR HODDER QC:

I suppose I'm saying no more than *Wednesbury* has an objective analysis or maybe it's a combination of subjective/objective which I know is some of the language used in the jurisprudence. It can't be outside a zone of rationality. Within the zone of rationality it can be there and rationality comes back to what I was discussing with the Court before in terms of what is something that is credible and intelligible. If you lack those then you can't survive a claim under this provision, but if you do have them then we say that – and those are matters of business judgement that underpin those reasons – so they are matters of business judgement and they're a rational basis for those judgements, then yes, we are saying that that's a point where the Court should be extremely cautious before it concludes that the directors were completely wrong which is what happens in this case.

I'm still probably at my 1.4 but these matters are kind of fundamental to the case so as long as the Court's happy I'm happy to develop them a little further.

1.4(a) and (b), of course there are going to be risk factors in any business enterprise of scale, and what is required to deal with those risk factors? Well, we say the answer, given by the long title itself, is business judgement and that goes to the question of are those risk factors likely to materialise? How important are they? How are you going to respond? How successful will the response be? Those are matters of business judgment.

GLAZEBROOK J:

So is business judgement to how – so you do a full analysis and it comes out that there's a probability of a 10% return to profitability and a 90% non-return, so how does business judgement work there?

MR HODDER QC:

We would say that that is sufficient to justify carrying on.

GLAZEBROOK J:

So wildly optimistic is fine?

MR HODDER QC:

Yes, the – I mean it depends where you've –

GLAZEBROOK J:

Because that sounds wildly optimistic to me. There's a 10% chance of returning to solvency and a 90% chance we're doomed. That sounds like: "I'll take the 10%, not the 90%, in my business judgement." Well, it's difficult to quite see a rational basis for that.

MR HODDER QC:

It's hard to quantify this, your Honour, and the question is where does the 90% come from and how do you get there, because they are judgements –

GLAZEBROOK J:

Well, you've done a full analysis. You've taken your risks. You've done a proper cash flow, future cash flow analysis taking all those things into account.

MR HODDER QC:

But that's going to give you one answer, not a range of answers. It's going to give you the answer that you are going to get to a – you can get to a profitability, not "are", you can get to a profitability point, but you're still talking about the future, and as somebody famously said, you are subject to events and you may not get there, but if the proposition is, and we will say these are what the documents in 2011 and 2012 show, that there is a path to get to solvency and profitability then that's what you want to know, that there is a path to get there.

GLAZEBROOK J:

So however unlikely that path might be, if the directors think if there's some rational basis for even a very unlikely path to profitability that suffices, is that the submission?

MR HODDER QC:

Well, it's subject to the point I was making before that that rationality has to be credible and intelligible. If there is a credible and intelligible path to profitability, the answer to your questions –

GLAZEBROOK J:

However unlikely that is?

MR HODDER QC:

Well, I'm not sure, with respect, how unlikely adds to credibility and intelligibility.

GLAZEBROOK J:

Well, there can be a – well, I can't put it any differently. There can be a path to profitability that's very, very unlikely but it can still be credible and intelligible if all the ducks are in a row to get you to that point.

MR HODDER QC:

Yes, I think that must be right, your Honour, and in those circumstances –

GLAZEBROOK J:

Okay, so however unlikely, if it's rational and credible, that's sufficient.

MR HODDER QC:

Well, in the real world, in the real judicial world, if it's that unlikely then a court's going to be struggling to get to the idea that it's rational and it's credible.

GLAZEBROOK J:

Then what is the submission? I'm sorry, I'm just having difficulty.

MR HODDER QC:

The submission is largely that it's a question of – starting with a presumption, it's a business judgement being exercised by the relevant decision-maker, the directors, and unless it's shown that it's not rational, that is to say it's not

intelligible and it's not credible, then it stands. It isn't to be deemed as unlawful and to be a foundation for liability.

O'REGAN J:
On your test do you envisage that it would ever be possible that a director was liable in circumstances where there hadn't been any misconduct, lack of good faith, personal interest, et cetera?

MR HODDER QC:
It should be extremely rare because all the normal things that you're concerned about haven't occurred. What you have is a question of different judgements and hindsight is going to affect the view you take of the judgement after the event.

O'REGAN J:
But there's nothing in section 135 that mentions those factors. It just talks about a "serious loss", a serious risk of loss, doesn't it?

MR HODDER QC:
I'm sorry?

O'REGAN J:
It just talks about a serious risk of loss to creditors. It doesn't talk about any improprieties on the part of directors.

MR HODDER QC:
Well, that part of the section as we apprehend it is defining the outcome. The question is whether you can avoid the outcome and kind of the degree of rationality that has. But the result would be insolvent liquidation. That's what happens at that point, and we would say that the language of –

O'REGAN J:
Well, would you accept that if the Court reached a view that a company was unsalvageable, as it did in *Debut Homes*, for example, at a point in time and

that the director kept on trading in the face of the evidence that was available at that time to that effect, that that director could be liable notwithstanding lack of, you know, or absence of bad faith, et cetera?

MR HODDER QC:

It's conceivable, your Honour. We accept once you're into unquestionably unsalvageable, so if allowing for the experience, discounting for hindsight, all those things, you finish up with a proposition that this was unsalvageable, then the flip side of that is there wasn't a rational or credible or intelligible basis for carrying on. In those circumstances –

WILLIAM YOUNG J:

Does it have to be unsalvageable? Can't there be – I mean the problem with this is that the risks are all one way. When there's a borderline salvageability issue, the risks of the company continuing to trade fall entirely on the creditors. The benefit, if it turns out well, is entirely to the credit of the shareholders of the company, and I mean this is this whole business that goes back, probably earlier, but it goes back to *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA), possibly earlier, but you get to a point where it's not really just a business judgement in terms of your own personal interests or the personal interests of the shareholders, it's a judgement that has to be made having regard to the interests of all, to use a horrible word, stakeholders in the company and they include current and future shareholders.

MR HODDER QC:

Well, I was going to come back to the question of creditor's interests later on and I will but the immediate response to your Honour's question is that if an insolvent liquidation obviously dooms the shareholders but it also causes havoc for most, or many creditors. So –

O'REGAN J:

It's not a problem for new creditors.

GLAZEBROOK J:

The existing creditors but not the new ones that have come into being without any idea that they're dealing with a possibly insolvent company.

WINKELMANN CJ:

Because, Mr Hodder, there's this added detail here, isn't there, that in fact, they weren't trading on capital, they were trading on the money of their sub-contractors, you know, the timing issue. They were actually using –

MR HODDER QC:

It was a timing issue, that was a feature of the construction industry, that's true.

WINKELMANN CJ:

Yes, so effectively using creditor's money to stay cash-flow solvent.

MR HODDER QC:

Well, I'll come back to that, but I mean, we would say that most companies use creditor's money, that's what companies do. They're a combination of debt and equity capital and funding and a cash flow that happens. In terms of –

GLAZEBROOK J:

But most of the, well, when people are trading on debt, they're usually trading on people who know they are providing debt, not people who think they're providing –

WINKELMANN CJ:

Trade creditors.

MR HODDER QC:

Well, I'm going to come to that, I mean, Permakraft says something in a sense to the contrary. Justice Cooke says, well, if you, you know, you take an ordinary limited liability company the way you find it. But getting back to

Justice Young's question about, isn't all the loss on the creditors and none on the shareholders, if the company succeeds that's a benefit to the shareholders.

WILLIAM YOUNG J:
That's a benefit, of course, linked to the current shareholders, not the future – sorry, the current creditors, not future creditors.

MR HODDER QC:
Now, Justice Glazebrook says that's – to the creditors. And again, the Court will appreciate that in our argument dividing shareholders into new and existing – creditors into, creditors into new –

GLAZEBROOK J:
Do you mean shareholders or creditors?

WILLIAM YOUNG J:
We mean creditors.

MR HODDER QC:
Creditors into new and existing isn't something the Companies Act contemplates. If the question is something about misleading conduct, then that's a different issue. If it's fraud, that's a different issue. If, indeed, there's self-interest in some reason because the shareholders are desperately trying to save their own skin, and the shareholdings up, that's a different issue. But I think the postulate that is being discussed here is where none of those are present. This is really all about the creditors taking all the risk and getting none of the up-side. In our submission that isn't right, creditors are getting some of the up-side. And creditors don't all have the same interests. So, there will be a range of creditors. There's the bank, there's the bondsman, there's the very astute member with a guarantee, there's those less astute, and then there's the sort the person that provides the newspaper facility or whatever it might be.

WINKELMANN CJ:

You've been inviting us to look at the philosophy of the Companies Act. You say there's nothing it the Companies Act that divides creditors into new and existing, but actually you could say the philosophy that flows out of section 136 is to divide creditors into new and existing.

MR HODDER QC:

Again, we would say that, well, 136 is essentially describing another way of getting to the point where there is a problem. In this case, it's getting, for example but only for example, you're taking a company from solvency to insolvency, that's a problem for shareholders as well as creditors. And that's why shareholders, for example, can get an injunction under section 164 if they wind of it earlier enough. We deal with this a bit later on, but to take, for example, a guarantee by one company of a say a related company's large debt, then that's a problem for shareholders as well as, or may be a problem for shareholders as well as creditors. So I think we resist the proposition that this is all the question where shareholders get all the up-side and creditors are the ones taking all the risks.

Now, I think, your Honours, it looks like it's 11.30 according to this clock and I'm probably at the end of 1.4, so it may be a convenient point if your Honours care to take an adjournment.

WINKELMANN CJ:

Yes, we'll do that.

COURT ADJOURNS: 11.29 AM

COURT RESUMES: 11.49 AM

MR HODDER QC:

Just one footnote as it were to my response to Justice Young's question from before the break about shareholders and creditors, I will come to this a bit later on, but what I should have said, immediate response was the position of employees who on one level are creditors, on the other level they have a strong interest in the continuation of trading and in an enterprise such as this, it's very real. It was a very real factor.

So at 1.5 of the road map and we've covered a number of these matters in the exchanges from before the morning adjournment and the companion part of the balance is about abuse of management power and again, the Court understands our submission is that in addressing that, then what can be done and should be done by way of purpose of interpretation is to focus on what abuse means. It's not protection. It's a protection per se. It's protection against abuse.

One of the things that the Law Commission can be seen to have done in its approach was to address specific problem areas in the law. It says that in the preface to the second report at page 14, but it's manifest in the way in which it approaches various issues and the principal problem is self-dealing conduct. That's the concern that limited liability is somehow abused to the benefit of the directors. That's the paradigm issue and so the Act, as the Court knows, has a range of provisions that try and limit that exercise in various ways.

There is also a concern about assets being put beyond the scope of creditors in a liquidation and that's why we have a whole lot of detailed provisions about no distributions without satisfying the solvency test, no share buybacks and also a range of clawing back of preferences, the whole series of specific mechanisms that deal with particular problems and again we say that justifies a purpose of approach which does give strong weight to the discretion and

gives a narrower approach to the concept of abuse. That's just the way the Act is structured and deliberately so.

That leads to the formulation of what we are saying in the beginning of 1.5 that there should be regulation to the extent that it minimises a possibility or abuse of a company form. That is to say, the corporate structure and/or limited liability and as we have said in those paragraphs, one of the Law Commission's points was that the main risk to creditors was limited liability itself. Now that's sort of a paradigm feature, or the principal feature of the Act and so that is, it's a reality of the structure, not a risk as such, although it is recognised as being the principal risk to creditors. In the end of the day, you can't sue the individual you're dealing with because they're trading as a company and they have limited liability and the whole logic of the Act is that that is an acceptable state of affairs for the wider wealth creation benefits and, as we say, in terms of that concern about assets being outside, that's where the solvency test with its two limbs, balance sheet and cash flow, comes in so that there isn't a transfer out to shareholders and away from the corporate entity without being satisfied on both those points and we say it is significant that when you get to liquidation, part 16 of the Act, what gets to the commencement of litigation is the question of cash flow solvency, unable to pay debts.

The other aspect we mention at the end of 1.5 at (c) is that there was a concern there and we say it is to be found in section 136, in particular the idea that you were trying to protect that scenario where something moves from being solvent, insolvent as a result of directors' decisions, sometimes described as being the big bet problem. I think it's also described as one of those perverse incentives that you take the big gamble because you might just score a big windfall for the shareholders. The obvious thing of course to say here, that isn't this case, but in terms of protecting the change from a solvent company to an insolvent company, then that is what one gets. We say that's one of the reasons for section 136 to be framed as it is and we also suggest that that's not just about creditors and indeed, the protections in this Act are for shareholders and creditors both, not just for creditors. If I can offer

a gentle criticism of the Court of Appeal judgment, in a sense, there's a question of this being a creditor centric judgment whereas the Act isn't creditor centric and so balance, if I can perhaps, if we can on the Law Commission.

WINKELMANN CJ:
Well, you could say it's creditor centric once you enter into the realms of the insolvency regime of course.

MR HODDER QC:
In liquidation, it is undoubtedly more creditor centric, although it's focused on the efficient administration of realising and distributing the debts that one could call that creditor centric. It's the end game being run efficiently and the end game is pari passu distribution after you have taken care of secured and preferred debts.

WINKELMANN CJ:
But one issue for us is how the creditor figures in all of this in that twilight zone you identified.

MR HODDER QC:
Yes, and the Court will know from our written submissions that we say that creditors are understood as a body in the structure of admin. That's the logic of pari passu. If the creditors are treated equally and have no specific rights other than to pari passu distribution out of an efficiently run liquidation, then the idea that they could be subdivided into subclasses and those subclasses then drive the interpretation of the Act is a proposition that we resist.

GLAZEBROOK J:
I'm sorry, what do you mean by that? You just mean new and old creditors, is that, because obviously they are going to be differences between creditors in terms of whether they are secured or otherwise?

MR HODDER QC:
Of course, your Honour. I'm talking about kind of the –

GLAZEBROOK J:

New and old?

MR HODDER QC:

– the residual unsecured creditors who will be being treated on a pari passu basis and what is being identified in the Court of Appeal judgment and the way the liquidators have approached this case is there was a distinction, or a concern to be drawn on behalf of new creditors because they have said to have been potentially misled by dealing with the company at a time when there was a question mark about solvency and we say that draws a distinction between the group of unsecured creditors who are treated as a whole and equally whether they're existing or new and sometimes of course they're both.

WINKELMANN CJ:

So the Court of Appeal actually says I think that at a time when the directors took risks that they found fell foul of the section 135 threshold, then it is appropriate to look at new categories, new creditors in a different way. So it's not just per se and when there is a question mark about solvency, it's in a particular set of circumstances?

MR HODDER QC:

Yes and again we say it wasn't necessary to get into that distinction. It's taken on a life of its own with respect to those who developed it. Probably the intellectual source appears to be Mr Moss QC in terms of this idea that there is something terrible being done to new creditors as opposed to existing creditors when there is some form of trading while insolvent. Again, I think, I read his article again over the weekend, I think he is largely contemplating a, in terms of *Debut Homes* an unsalvageable company, at least in terms of the way the English legislation is framed. But our respectful submission is that you don't need to have that distinction at all for any purpose. Either the company is unsalvageable or it's not and if it is, then drawing a distinction between new creditors, existing creditors we say is not justified.

GLAZEBROOK J:

Well, it is to an extent in that if existing creditors became creditors, we would find there was no issue about solvency of the company, then 135 can't really have any bite on them, or 136 whereas if people become creditors at a time when it is insolvent, then 135 and 136 bites surely?

MR HODDER QC:

Well again the question is –

GLAZEBROOK J:

It's not a distinction between creditors as such, it's just a distinction between the facts at the time they became creditors.

MR HODDER QC:

Well again I think your Honour we have to go back to that distinction between perhaps three categories of company. If it's unsalvageable, then there should be no trading or creditors affected by whatever happens. If there is no problem with solvency because the company is fine, it doesn't matter to anybody. We're back into the marginal zone and in the marginal zone, the question is whether or not there's a difference between new creditors and existing creditors who might finish up in the unsecured ranks, and we say there doesn't need to be one. The question is, what, for the benefits, I get to this in a moment or two, and I'll return to the –

GLAZEBROOK J:

We're really – the main thing here is going to be the facts, isn't it, as to what, where there's this company lies? Even if you're distinction is right, was it unsalvageable, if it was salvageable how rational was the view that it could be salvageable?

MR HODDER QC:

Correct. That will be the ultimate test on this case, but there is no – I go back one step. We say that the approach of the Court of Appeal within terms of what happens in that middle category as to whether –

GLAZEBROOK J:

You have to assume it's in the middle category first and, so that will be the first thing you've got to do on the facts.

MR HODDER QC:

I do.

GLAZEBROOK J:

Is to show that it's a middle category.

MR HODDER QC:

There's a chicken and egg scenario about how I deal with that, your Honour, but at the moment I'm dealing with the law as to what that means around that category and how we get to there, but clearly enough, when I come to what I've headed "Was the Writing on the Wall?" that's where I address the facts in some particular detail.

GLAZEBROOK J:

It just seems long way down to me, that's all.

MR HODDER QC:

I understand, your Honour. And I will –

GLAZEBROOK J:

And it's slightly difficult looking at the law divorced from the facts in this particular case, but –

MR HODDER QC:

I'm agreeing, but I'm understanding also your Honour is generally familiar with the case we're putting forward. That is to say that this is a most unusual case. It's a trading company and so not trading has quite profound consequences for a range of people, not least the creditors such as the employees. And it's a case in which there's no suggestion of conflict of interest, no suggestion of self-dealing. There's no suggestion of negligence in attention to duties.

The question is one of having got it wrong on whether the company should keep trading, and so we say that in those circumstances the approach that the Court should be taking should be one that's extremely careful and in the terms I was describing earlier. And what I am partly doing is exploring whether the Court of Appeal's approach, which is not that approach by a longshot, is sound. That's the reason why I was spending a bit of time on this.

GLAZEBROOK J:
Yes, I suppose you've got to convince me that that was the Court of Appeal's approach rather than treating it as an unsalvageable company.

MR HODDER QC:
Right, I understand that.

WINKELMANN CJ:
In any case, press on Mr Hodder. Where are you at in your outline?

GLAZEBROOK J:
But that's for later, I'm just –

MR HODDER QC:
Sure. Understood.

WINKELMANN CJ:
Where are you at now in your outline?

MR HODDER QC:
I'm at 1.6, your Honour.

WINKELMANN CJ:
1.6, thanks.

MR HODDER QC:

Of my road map. There is typographical error in that the word “today” should not be in the second line. I’m sure it was meant to be another word, but I can't remember what it was. So if you just delete “today” and we’ll carry on, on that basis. But the main point is that in the Court of Appeal’s judgment it seemed to pay particular attention to perverse incentives and those perverse incentives are what are set out in paragraph 231 and 232 and you have 231 on your screen at the moment. But 231, so they’re perverse incentives in relation to risk taking.

ELLEN FRANCE J:
Bigger?

MR HODDER QC:
I’m sorry?

GLAZEBROOK J:
If we could get these a bit bigger on the screen?

WINKELMANN CJ:
They’re microscopic.

ELLEN FRANCE J:
Yes, thank you.

MR HODDER QC:
Yes, that’s good, thank you. This in part comes back to Justice Young’s question before the break about, isn't this going back to the down-side risk being borne by creditors, not shareholders. But the up-side if the risk pays off is that it’s enjoyed by the shareholders and our, the two things we say about that. Firstly, it’s over-simplified because the range of creditors who may well want to have the company carry on. They won't all have the same incentives, they’re not in the same position. And secondly, that isn't this case. There’s no suggestion here that there was an attempt to carry on because they were wanting to benefit the shareholders. They wanted to have a

successful enterprise, of course, but that wasn't particularly to benefit, or wasn't essentially or solely to benefit the shareholders. It was to make sure that the enterprise survived and that meant that the business carried on, jobs were maintained, and contracts were completed.

232 talks about directors being personally liable for guarantees and again, that wasn't this case as far as my clients are concerned. So those, the reason I mention that is that, we respectfully say, when reading the judgment these pervasive centres feature more than once as the judgment's reasoning unfold, and in fact they really don't take us anywhere in this particular case.

The last point at 1.6 is one I perhaps haven't touched on to any great extent yet, which is whether a company is insolvent when it's in the twilight zone or not is extraordinary difficult to determine in many cases and we say this is one of them. Certainly the directors had no belief that there was any issue about solvency in January –

WILLIAM YOUNG J:
Well they must have thought there was an issue about solvency, because it's been referred to in documents that the Court of Appeal identified.

MR HODDER QC:
Later. So in – I was about to say I'm talking about January 2011.

WILLIAM YOUNG J:
But there had been issues raised about solvency in 2010 had there not?

MR HODDER QC:
There's a question about going concern is raised in the audit reports on a regular basis and the board considers that topic, and that's done –

WILLIAM YOUNG J:
What's the date of the one say negative 10 million. Is that the beginning of 2010?

MR HODDER QC:

I think that'll be in the first EY report about governance, which I will come to later on.

In terms of the company being unable to continue as the High Court found nobody thought there was a candidate for liquidation in January 2011, including the High Court. At least nobody in the directors' line did, and the High Court effectively accepted that that was the case. The Court of Appeal took a different view and said that the writing is on the wall and said that there should be no new contracts entered into, and absent anything else happening that meant the end of Mainzeal, because without getting new construction contracts, it couldn't carry on. No construction company can carry on if it's not getting new contracts. So that's a kind of a key aspect of this. Now probably the Court understands this but I should make the point that as the pleading indicated the focus in the arguments and in the evidence in the High Court was very much on 2011. That's because it was pleaded that way. The date of – and so the Court of Appeal focuses on 2011 and says well at that stage in effect Mainzeal should have stopped, which is contrary to the High Court conclusion. Then goes on to say by July 2012 it shouldn't have been entering into any minor contracts either, which in our view is rather superfluous because the company couldn't have carried on in a counterfactual from January 2011 if it wasn't taking on new contracts.

WINKELMANN CJ:

You said that no one has suggested it was insolvent by 2011, is that what you said?

MR HODDER QC:

The evidence – sorry. None of the directors or anybody else on the Mainzeal side thought there was an issue. They thought the company was in good shape, and the High Court comes to the conclusion that there was no reason to put them into liquidation in 2011.

WINKELMANN CJ:

But I think some people did suggest it was insolvent, didn't they? I mean even just in the narrative of facts, Ernst & Young's accounts were –

MR HODDER QC:

They were unqualified but with a matter of emphasis –

WINKELMANN CJ:

Noting apart, apart from a matter of emphasis, which was a letter of support.

MR HODDER QC:

Yes.

WINKELMANN CJ:

Which was reasonably unexplored by Ernst & Young.

MR HODDER QC:

Well that's not quite right. The evidence seems to be that Ernst & Young had to be satisfied on that before they signed off in relation to those matters, and I'll come to the evidence on that. So Dame Jenny –

WILLIAM YOUNG J:

Coming back to the point, the date, at para 87 of the Court of Appeal judgment. So this is, that was at a board meeting on 22 January 2010, the CEO's report said balance sheet, "[n]egative, circa US $10m".

MR HODDER QC:

Yes, and that is the issue in relation to, as 88 says, that's an issue in relation to the receivables from the group, which then brings you back into the question of group support.

WINKELMANN CJ:

Which is 88, so the continuing issue about the support.

MR HODDER QC:

Yes. So that's understood, that was an issue, that's why there was a change –

WILLIAM YOUNG J:

I mean there was an issue with the solvency.

MR HODDER QC:

Sorry?

WILLIAM YOUNG J:

There was an issue as to solvency.

MR HODDER QC:

With balance sheet solvency.

WILLIAMS J:

Yes. I thought you were saying something to the contrary. I may be wrong. I may have misheard you.

WINKELMANN CJ:

I think you were saying there was no issue, Mr Hodder.

MR HODDER QC:

I think I should have used the phrase "going concern". So what the directors considered year by year was whether the company was a going concern and they believed it was a going concern when they went through and did each of their four projections as they were doing the audit work for the previous year and they believed it was a going concern as at January 2011 and that there was no basis at all on which they should have been thinking about liquidation and essentially the High Court has the same view. The Court of Appeal takes a different view and that's the one that we are having to address before this Court.

O'REGAN J:

But shouldn't PricewaterhouseCoopers also give advice in 2009 about the doubt about it being a going concern?

MR HODDER QC:

In relation to the balance sheet there are always, well not always. For your Honours both Justice O'Regan and Justice Young and the rest of you are right to say and to recall that there is a problem being raised about how these, whether these are recoverable or not. It's raised by the auditors. The auditors don't qualify the accounts. They have an emphasis of matter. So it depends on whether or not the matters described in the footnotes that I briefly mentioned before are sound. That is to say, whether there is a proper basis to expect support from the company. The directors did expect support from the company at that time and they expected that support on the basis of a range of topics which are largely discussed I think schedule A of your main appeal submissions. But, by the time we get to the end of 2010 and the beginning of 2011, there is the proposal which is discussed in the Citron report about how to reduce that by transferring it into a different form of providing that capital. There are issues, or there were issues, in relation to a simple transfer of assets from the China assets into the New Zealand balance sheet. That's not in dispute. The question was whether that amounts to a basis on which they were no longer a going concern.

WINKELMANN CJ:

So it would be correct to say then really was that from at least 2009 its solvency, its ability to be a going concern, depended upon the ongoing support that it is understood to have, itself to have?

MR HODDER QC:

Yes and each year there is a letter of support provided by Mr Yan on one or other of the letterheads. Now, there's a restructuring that removes, creates a difference between the left-hand side of the wiring diagram and the right-hand side of the wiring diagram that severs the direct legal connection between the left-hand side assets and the right-hand side Mainzeal. Now the question is

what happens after that? We say what's happening after that? Is there a plan to restructure, to create a different capital base in New Zealand and to achieve an improvement of the balance sheet in some proportions by way of the pre-purchase agreement? It's not being ignored. It's not being looked at on that basis and throughout this, as my clients say, they were receiving repeated assurances from Mr Yan who was perceived to speak for the, kind of the upstream part of their enterprise. That would happen and they were also receiving similar assurances from Mr Walker who was the chair.

That comes back to another question of business judgment. One of the questions about the business judgment that we refer to in the written submissions is how much weight do you place on what people you are dealing with say they will do and we say, our directors were entitled to put weight on what they were told by Mr Yan and by Mr Walker. That is to say that there would be support when required and support did come in when required. What they weren't being told was we're going to pay this money as a lump sum back to you. that's part of the overall group structure that the cash was being used elsewhere.

O'REGAN J:
And there wasn't support and that's why it went under.

MR HODDER QC:
In the end, yes. In the end. In terms of foresight, that wasn't expected, nor was it expected to go under.

O'REGAN J:
But it was completely avoidable by having legally enforceable obligations or share capital or something which took away that risk.

MR HODDER QC:
No, we say the proposition is was there a reasonable basis for thinking that support would come when it was required and the fact that cash came in when it was required at various points, was in answer to that.

O'REGAN J:

Yes, but it's like saying basically the capital structure was just dependent on the grace and favour of Mr Yan and Mr Walker and that's a pretty dodgy way to run a $400 million business.

MR HODDER QC:

And there was a change in progress. What wasn't happening wasn't happening immediately.

WINKELMANN CJ:

And the alternate view is that it's not reasonable for directors to take the risks of this size without having some sort of comfort that these assurances had some sort of enforceability, question mark that, (b) had something behind them.

MR HODDER QC:

Well, if the argument is enforceability then we lose. It's as simple as that. But we say it's not as simple as that.

WINKELMANN CJ:

And there's also something behind them.

MR HODDER QC:

Yes. Well, the expectation of all those who were directors at the time, particularly through into 2012 where Sir Paul Collins joins the board, is that there are substantial assets and that that means that, in the overall group, and that those assets will be made available. Now it turns out that that gets hard in 2012 but a substantial amount of assets were made available.

ELLEN FRANCE J:

Just going back, Mr Hodder, you said the letters of support come in every year but that's not right, is it, in the sense that there's the year when there's the debate about whether the letters are actually signed? I'm looking at –

MR HODDER QC:

I'll have to check that, your Honour. I was under the impression that each, in 2010, 2011, 2012, there were letters signed by Mr Yan and that –

WINKELMANN CJ:

Yes, but they didn't come in from the asset-rich companies. One year they discuss it and there's the factual finding that there was no letter of support, no support from the asset-rich branch –

MR HODDER QC:

Yes. So that's what I meant when I said a couple of minutes ago that they came in on different letterheads.

ELLEN FRANCE J:

No, I was referring to the discussion at 126, 127, of the Court of Appeal judgment, was trying to get the timing of that right.

MR HODDER QC:

That was a question of a resolution by one of the upstream companies or possibly by CHC about providing – I think by the CHC to provide support. What I was talking about were letters signed by Mr Yan on behalf of companies on the right-hand side which were the letters that were required before the audits were signed off. Each year what happened is that Ernst & Young would produce an audit report, and we'll see some of these shortly, and one of the conditions of them signing off was that there would be a letter of support. Those letters of support were signed by Mr Yan on various letterheads, as I recall it, across those years, and they were there. That's why then Ernst & Young gave the unqualified opinion each year but pointing out that the value of the shareholder support depended on the assessment of the directors and that they, Ernst & Young, weren't expressing an opinion on that, although they did, as I recall it, there's evidence that they did go and look at the China assets as part of their satisfaction about various aspects of the order. But that's not the same –

WINKELMANN CJ:

Isn't the narrative –

GLAZEBROOK J:

But there weren't any assets to support it, is that right?

WINKELMANN CJ:

Isn't the narrative that there was a group restructuring and after the group restructuring the support was limited to the asset-poor right-hand side?

MR HODDER QC:

The legally enforceable support was limited to that, yes.

WINKELMANN CJ:

Yes, but before the restructuring they actually had not legally – none of it was probably legally enforceable but the more direct representation was…

MR HODDER QC:

Yes, your Honour is right.

WINKELMANN CJ:

The more direct representation, before the restructuring more direct representation would have allowed them access to the assets of the group. After the restructuring the direct – not legally enforceable but might have given them cause to believe they had access.

MR HODDER QC:

And that was what I was referring to, that there were representations on a repeated basis in which my clients took comfort from Mr Yan and Mr Walker that the assets of the group, including the CHC, would be made available if required. What Justice France was drawing attention to at 125 and 126 is where there was a question about whether that was going to be formalised in a detailed way and it wasn't. In the end, there's some confusion about what actually did and didn't happen but we have to accept it didn't get formalised.

But it's at that point that then there is the discussion that takes place which leads to the restructuring arrangement or the restructuring of the receivables in terms of the pre-purchase agreement which is the one that's discussed in the Citron report.

WINKELMANN CJ:

So it seemed to me implicit in the High Court and the Court of Appeal findings, if not explicit, is that there was, the directors should have paid attention to that restructuring and the change and the support lines, support offering. That there was significance in the fact that after the group restructuring, these documents were not coming from the asset rich side; they were only coming from the right-hand side.

MR HODDER QC:

And we say that the evidence is that they did pay attention to that. That's why Dame Jenny wrote to –

WINKELMANN CJ:

Yes but I am saying to you, is that a finding; asking you is that a finding against you in that regard? Are you fighting against a factual finding on that, that there was significance to it? Well not a finding, that there was significance to it.

MR HODDER QC:

Well I don't think there is a dispute that it was significant, but I am not quite sure how far the factual finding goes beyond that. There was a restructuring, they did severe a connection, a more direct connection with the actual CHC assets. But what carried on was a series and continuing representations by Mr Yan and Mr Walker that the full assets of the group would be used.

WINKELMANN CJ:

So a simple way of me asking this question is what does the Court of Appeal say about that? Your account that the directors believed that, notwithstanding

this development had occurred, they could carry on acting as if the whole group was supporting them.

MR HODDER QC:

Their general approach was to say really in the context of the discussion at 135. The informal assurance, this is probably around paragraph 445 of the Court of Appeal judgment. They say: "Informal assurances were unreasonable to rely on." And "There was no reason to think solvency could be restored" at 456. But 445 is probably where the Court of Appeal where it states its conclusion. So 445, at the bottom of the page: "In some cases it would be reasonable for directors to rely on informal assurances of support." We agree. And we disagree with the next part: "In this case it was not a reasonable approach in light of the following factors" and they go on to explain what those factors are. And in particular paragraphs (d) and (e). And so (e) as it is on the next page.

WINKELMANN CJ:

So you are asking us to take a different view of those assurances?

MR HODDER QC:

Yes. We are saying the approach to the assurances is one which is in effect forming a different judgment from the judgment the directors had taken. So when the Court says at the top of the next page: "They could not reasonably proceed on the basis that Mainzeal would not encounter significant cashflow issues or significant legacy liabilities". "It was not reasonable for directors to proceed on the basis that there would always be new projects and revenue in excess of expenditure, to enable existing obligations to be met." They really are describing carrying on business. They are saying it wasn't reasonable normal business. And we say that was a matter of judgment, the matter of judgment was a different one made by the directors.

ELLEN FRANCE J:

And do you say the same about (b)?

MR HODDER QC:

That was (b) Your Honour?

ELLEN FRANCE J:

Yes.

MR HODDER QC:

Well that goes to the question of the assurances that were being repeatedly given throughout this process. That was understood. And two things were related to that that we can rely on. Firstly there were these continued assurances by the people who understood to effectively control the group as a whole, that the group's assets wouldn't be made available if required. The second was that there was, commencing from late 2010 and going into 2011 through to in fact to the end of 2012, the changing of the asset base to deal with those issues. So you had the development of the New Zealand asset based in various ways and you had the changing of the receivable into the pre-purchase agreement obligations, which was with the CHC.

ELLEN FRANCE J:

Well are you saying (b) is a matter of business judgment?

MR HODDER QC:

(b) yes. Well it is stating it as it were a fact in relation to, well apart from the adjectives. It is staying a fact that there had been a restructuring which had the effect that's been discussed in the last few minutes. That's not in dispute. The question is, what else was going on and that's what I have been describing to your Honour. That wasn't the whole picture in isolation.

GLAZEBROOK J:

So is the submission that what was going would have fixed this up within a short period, is that the – or within a reasonable period?

MR HODDER QC:
Yes.

GLAZEBROOK J:
So you need to take us to why that would be the case then.

MR HODDER QC:
Yes, there are perhaps two aspects, your Honour. The previous point is the directors weren't this ignoring this issue. They were conscious of it. That's why they firstly go to Mr Walker and say: "We want some assurances." That doesn't produce any particularly brilliant outcome and they then focus on a restructuring that gets them into a different position, and that restructuring has two components: the pre-purchase agreement which is the asset-rich entity and the second aspect is the developing of assets in New Zealand which support the New Zealand operations, including Mainzeal, which weren't there before.

WINKELMANN CJ:
And you're going to take us to the thunder-clouds that gather on top of all this, are you, which is leaky homes litigation, the Siemens situation?

MR HODDER QC:
Yes, I am. But we think it's unfair to say at (c) there was a failure to engage squarely with the issue. There was an engagement with the issue, and if what is engage squarely with the issue is get back to the suggestion in the High Court and in the Court of Appeal what the directors should have done was threaten to resign and then resigned, then we say that for various reasons that we've said in our written submissions that wasn't an obligation on the directors. They were entitled to say that the better approach was the more gradual approach that they believe was taking place.

So the Court has heard me on this but just to finish off on that point, in a sense what we are saying is that as far as the capital position is concerned they had continuing assurances, not legally enforceable, but from the people

who controlled the group, that the group's assets which were reasonably believed to be very substantial would be available if required, and on the operational side they believed that they had credible business plans which would achieve profitability, and in the light of those, sorry, in relation to those, there were difficulties in the industry. That's true. There were leaky buildings which were affecting the industry, there was the GFC which had affected the industry, and there was the Christchurch earthquake or series of earthquakes which had caused problems in one of the major areas of work.

So in terms of the questions that are being asked of me by various members of the Court, at the end of 446 there were a couple of sentences there in the Court of Appeal's judgment that said: "There was no reason to think that solvency could be restored." We say that finding is one we squarely take issue with because it depends on what your approach is to these questions and how much margin you give to business discretion. The judgement of the directors in fact was that there was reason to think that solvency could be restored.

So finishing off on the top of the second page of this road map, I note that there's reference to the Jenkins report, the English report that led, I think, to the Companies Act 1948 there, but what is the focus of that is directors who know the company to be hopelessly insolvent, it isn't this case, and who then act in a reckless manner and we say that what the directors do in this case can't fairly be called reckless and that that is what section 135 is driving at. Nowhere, with respect, do we find any discussion in the Court of Appeal judgment about the balance. There's an acknowledgement of the long title in the Court of Appeal's judgment but nowhere does it wrestle with the idea of balance that I have been emphasising to the Court thus far.

So just on paragraph 1.7, I mention that there are two issues that arise in relation to the idea that the directors are only dealing with creditors' money. The first is, is that correct as a matter of law and analysis, and on that I refer to Peter Watts QC's 2021 piece, and his analysis and the Court may be familiar with that, but its –

WINKELMANN CJ:

What point are we at on your thing?

MR HODDER QC:

The proposition is that, it isn't sound to say that directors are dealing with creditor's money when they're in a marginal insolvency scenario.

O'REGAN J:

1.7.

WINKELMANN CJ:

We're at 1.7? Thanks.

MR HODDER QC:

And this is discussed, so this is the last point in 1.7. The point in 1.7. And it's discussed in Professor Watt's, Mr Watt's piece and that second paragraph, or the whole section is there, but in the second paragraph he says: "It is not accurate, neither legally nor morally (nor as I suggest as a matter of economics) to say that once a company becomes insolvent, its assets are the creditors."

WILLIAM YOUNG J:

Who was this? Who's writing?

WINKELMANN CJ:

Peter Watts.

MR HODDER QC:

Yes. And I won't read it in court, you can read it, but those two paragraphs capture the point that he's making, that it isn't sound to say that you're dealing with creditor's money, the directors have control of the company and its assets, they are the company's assets, not the creditors assets. And as he cites –

WILLIAM YOUNG J:

I think it's a metaphor though, isn't it?

MR HODDER QC:

It is a metaphor, but when you're driven to the metaphor, it doesn't have a robust basis to it. He cites the *Re Sarflax* (1979) Ch 592; [1979] 1 All ER 529 case which is an English case, a decision by Justice Oliver. That in turn is based on, I think a House of Laws decision from the 1870s, but the basic point is that until insolvency, the directors are entitled to pay debts in the order they chose. It doesn't give creditors any right to interfere with that kind of activity by a director.

The second, point, and that's the reason I have given the reference on the right to the Maslen-Stannage article which isn't in our bundle but it would be sensible we add it, if we're going to add the second Law Commission extract, is that that article has a few pages that deal with the question about, well, if we're saying that creditors, which creditors and do they all have the same interests? And she relays the question quite well, in our submission, about well, is the position of all those people the same? And the answer is no, it isn't. And how are you supposed to tell which is the right position? You can't make an assumption that there's a kind of a constant and unified view of creditors as a whole. There will be different creditors with different positions including those who are optimistic about carrying on, so if you are employee or a small trade person dealing with Mainzeal, you probably want the company to carry on because that's the best economic outcome for you. If you're pessimistic you may think, well, I'd better give up now and I'll take my chances in a liquidation.

GLAZEBROOK J:

But there are facilities for asking creditors.

MR HODDER QC:

By creditors –

GLAZEBROOK J:

So they make the decision.

MR HODDER QC:

Well, the basic proposition I think that we say in relation to that is that, every person who deals with a limited liability company does take it as they find it. They know it has limited liability. They know they don't know very much about the creditor status of it. And so whether you're an existing creditor or a new creditor, when you enter into a transaction with a company you don't, if you're unsecured and haven't made inquiries, you're simply taking the company as you find it.

WINKELMANN CJ:

Yes, but are you taking the company as you find it, assuming that it's operating within the legal constraints imposed by the Companies Act regime. So that's why how you pitch section 135 is pretty critical, isn't it?

MR HODDER QC:

Yes, your Honour, there's a slight, if I suggest, a slight circulatory in terms of the way one has to approach that, that, yes, but all – but that's true at any point.

WINKELMANN CJ:

And that's why companies get higher profile directors. The creditors can have comfort that these are people who are reputable and will be taking care, et cetera, make sure they comply with their legal obligations. And making good business judgements, as you say.

MR HODDER QC:

Well, we haven't got any evidence about that, but in general terms we'd say, yes. It's an indication the company has honest, non-self-interest, and diligent directors. And they did.

WINKELMANN CJ:

Well, I don't think we need evidence because you've been giving us your views about the general philosophical underpinnings of the evidence, it's just –

MR HODDER QC:

No, no, in terms of why people put or seek to have people on boards, none of the experts address that question, it simply wasn't raised, it simply wasn't raised as an issue whereas the question about policy that's raised by the Law Commission is what I've been relying on. I haven't been – I mean, yes, it may sound as if I'm making statements from the Bar and, of course, I am, but I'm trying to found those on the Law Commission's analysis of the policy issues. So, who is to say that those pieces are helpful in putting into a wider perspective the question about "creditors' money" and the Court of Appeal doesn't deal with either of those points and that undermines its overall approach.

WINKELMANN CJ:

But the point must be right that I make Mr Hodder that the creditors are entitled to assume that the requirements of the Act have been complied with when they make their – they're not ultimate risk takers. They're not just crazy fools who are throwing their money onto the pyre embers companies that may or may not being doing whatever. They're entitled to assume that the Act is being complied with and therefore, it is quite important where that threshold is set.

MR HODDER QC:

Well, there is a duty under the Act to comply with the Act, it's true. That's section –

WINKELMANN CJ:

So the answer is yes?

MR HODDER QC:

Well, the question is whether there is a representation or an assumption. There can be an assumption.

WINKELMANN CJ:

Well, I didn't say representation.

MR HODDER QC:

And I understand that.

WINKELMANN CJ:

Although one might say that there is in fact a representation when one goes out to do business that you're actually complying with the Act, but I didn't say that. I'm just saying the creditors are entitled to assume that the directors are complying with their obligations under the Act. All it is, is that it means it is quite important where you pitch these tests, isn't it?

MR HODDER QC:

Yes, I agree with that proposition, your Honour. In general terms I accept the proposition that there is a working assumption that the company is carrying on and complying with the Act, but exactly what that translates to I'm not sure that it takes us very far.

WINKELMANN CJ:

I was simply responding to your suggestion that creditors were these ultimate risk takers and I'm saying yes, they're risk takers, but it's qualified by the assurances the Act gives them. Simply a radical proposition.

MR HODDER QC:

And I don't need to descend from it, your Honour, for present purposes. 1.8 sounds trite, but it is fundamental. We say that the directors' powers should be read as a whole. So, you look at all the directors' powers and you see what the general expectations are and we say that in terms of this case, that's what the directors were doing. They're not ever required to act

otherwise in the best interests as they see it for the company as a whole. The directors' duties are owed to the company. That's clear enough from the sections in the Act and they're not designed as an exception to limited liability or a guarantee for creditors, which is effectively what the approach that the Court of Appeal judgment finishes up with.

O'REGAN J:
Limited liability is for shareholders, so it's got nothing to do with limited liability making directors liable, is it?

MR HODDER QC:
In a formal sense that's trust, but the general point about limited liabilities, if you're dealing with a company, then absent a clear wrongdoing, then that's is, you can't get anymore. Your credit can't be pursued beyond that. Now, this is a pursuit beyond that.

O'REGAN J:
This is all just circular though. I mean absent, when you say absent wrongdoing, that's absent a failure of directors to comply with their duty. That's question begging really.

MR HODDER QC:
That's fair, it is to a degree of circular, but there is, well, it comes back to expectations and I'm in no position to make propositions of expectations. What we say is that the structure of the Act, the expectations around the balance are not ones in which there is intended for directors to act as a guarantee, for directors to act as a guarantor for creditors except in clear abuse circumstances. This isn't one of them.

All those issues are in the Oesterle piece, but if we can bring that up and go to the last page. Is that the Oesterle piece? It should be pieces 37, 38. I've given a series of what I think are a series of references to this, but there's a useful discussion we say about the overall aspect of this from

Professor Oesterle's perspective at the beginning of this which is pages 19 through 21. The question of –

WINKELMANN CJ:
I think this article by Professor Dale Oesterle, what year is it?

MR HODDER QC:
2000.

WINKELMANN CJ:
2000, thanks.

MR HODDER QC:
Professor Oesterle was from the University of Colorado. He was in New Zealand I think a couple of times including for a conference or work that led to this paper.

WINKELMANN CJ:
I think he lectured here for a period of time.

MR HODDER QC:
That's my recollection as well, your Honour. So I commend to the Court the general perspective he discusses in the first two or three pages 19 through 21. At pages 37 and through to 39 there's a discussion of hindsight and the risk for directors of litigation.

WINKELMANN CJ:
Is it possible to make this any larger?

MR HODDER QC:
If we focus on 37 and just down a bit. That open texture, the open texture of the test paragraph concludes and we endorse this proposition: Once a company fails, it is too easy to look back with hindsight, and find a period of time in which the directors 'should have known' or 'should have suspected' the firm's future insolvency. In other words, whenever an insolvent company must

be wound up, most directors will be put to the task of proving an affirmative defence in order to save their personal assets from execution."

Then over the page on 38 in the first full paragraph beginning: "The defences do not give a business person much solace." Obviously the Court will have its own view, but it's a robust statement of the concerns about the effect of being in a court, having to defend decisions made some time ago.

WINKELMANN CJ:
It seems a rather pessimistic view of where the courts will take the Act.

MR HODDER QC:
It is the pessimistic view that underpins the American approach to the business judgment rule.

WINKELMANN CJ:
No, but Professional Oesterle seems to say that – I'm not quite sure why you are showing us this part. Perhaps you could just make claims?

MR HODDER QC:
I am simply indicating the risk that underpins why the hindsight aspect is a real factor when one is thinking about a business judgment rule. I partly refer it to the Court because in terms of the vast amount of material the Court could potentially read, this is one of the more entertaining pieces, not least the conclusion on page 42.

So again, with respect, to the Court of Appeal judgment, if I look at Professor Oesterle's sentence: "We choose creditors as sympathetic victims and directors as villains". Then, with respect, there's an element of that that one can find in the Court of Appeal's analysis and language.

So, section 2 of this synopsis discusses the insolvent trading regime at a relatively high level. I think we've probably touched on a whole range of these so I think I can skip through reasonably clear.

Now, can I bring up *Permakraft* please, number 34. This is at 2.03 of the road map. I think they're called *Nicholson v Permakraft* and go to page 250. Thanks and blow up the top of the page. This is the passage I was alluding to earlier on about taking the company as they find it, or as it is. Short of fraud, they must be the guardians of their own interests. That's not a major point in itself, we simply say that goes to the – the validity of a distinction between new creditors and existing creditors. The position is the same with an existing creditor, giving new credit as opposed to a new creditor who has never given credit before. The same assumptions and expectations apply.

WINKELMANN CJ:
Interesting that the discussion then proceeds that the limited liability is a privilege.

MR HODDER QC:
I'm sorry, your Honour? I don't think I quite caught all that.

WINKELMANN CJ:
In line 15. I don't make – I'm not a scoring a point here, I just noticed that.

MR HODDER QC:
Yes, I noticed that and with respect –

GLAZEBROOK J:
They're making a distinction between new debt and old debt clearly in that, there is, of course, a distinction between current and future debt.

WINKELMANN CJ:
But favouring current over future.

MR HODDER QC:
Yes. But the point that was being discussed, I mean *Nicholson v Permakraft* has a number of issues which you probably don't need to spend a lot of time

on for the purposes of this appeal, but what his Honour was saying was that he would think of a requirement to have regard to the position of the existing creditors, but not to new creditors. Whereas the Court of Appeal's judgment in this case is putting particular emphasis on new creditors, not existing creditors.

WINKELMANN CJ:

Different statutory framework, of course, though.

MR HODDER QC:

Correct, and that statutory framework, and without, this predates both the Law Commission report and the 1993 Act, so in terms of your Honour the Chief Justice's reference to the limited liability as a privilege, we would say you can't find that anywhere in either the long title or anywhere else in the Act. It just simply is.

WINKELMANN CJ:

You couldn't in the 1955 Act though either, could you?

MR HODDER QC:

No. But it's an idea that kind of has a hold, I think Justice Baragwanath *Mountfort* decision, there's something similar in it that again we resisted, the basic proposition is that it is a right to set up a company under the 1993 Act, it's not a privilege. Originally there was concern back to the 19th, maybe early 20th century that it was regarded as a privilege. The point about the 1993 Act is there is simply no room to argue that that's what it is, we submit.

GLAZEBROOK J:

Well, it is described as a privilege here.

MR HODDER QC:

I'm sorry, your Honour, I didn't quite catch that?

WINKELMANN CJ:

I mean, I suppose there's one, another way of formulating what I put to you earlier is that there is essentially, as you say, a balance within this Act which is you get all these, you have this right to register and you have the benefit of the limited liability and the structures the Companies Act provides, but you have the obligations, so with that benefit comes this burden. And that's going back to the point I put to you earlier, that creditors are entitled to assume that the directors and shareholders who have the structural benefits of the Companies Act, are living up to the burden that they have thereby assumed.

MR HODDER QC:

Well, I think that, that's – I think I can accept almost all of that, your Honour, but it's the platform for my submission about what long title (d) is about. That gives you the platform for the propositions that are in long title (d), that's where the balance is explicitly made in the legislation, and that brings you back, not so much to broad compliance –

WINKELMANN CJ:

It brings us back to what the duties - what the content of the duty is.

MR HODDER QC:

Well, starting with the point that we're talking about abuses, is the concern. And we say that not every breach of duty is to be regarded as an abuse of limited liability.

WINKELMANN CJ:

Well, it could be an abuse when it steps outside the framework of the Act. So it all begs the question of what's the framework of the Act?

MR HODDER QC:

Well it is, but I mean, your Honour understands the submission I'm making to the Court is that –

WINKELMANN CJ:

But the word “abuse” should be colouring the – how we interpret it.

MR HODDER QC:

The way in which we approach the Act is heavily coloured in relation to directors by the way in which the balance is framed and the words are misused and –

GLAZEBROOK J:

So it has to be a bad breach before there’s any consequences rather than a breach, I really can't see that there’s anything in the Act that suggests that.

MR HODDER QC:

The proposition is that as –

GLAZEBROOK J:

Because the long title, doesn’t that just set out the structure of the Act, so the structure of the Act does that itself, and then you take the Act as it has already made that – you don’t look at…

MR HODDER QC:

I think my point –

GLAZEBROOK J:

Because it’s difficult to say, well because they say abuse in a long title it means a breach has to be a bad breach not a slight breach.

MR HODDER QC:

It’s not so much a bad breach or a slight breach, your Honour, in our submission, it is the point that –

GLAZEBROOK J:

Well it’s either a breach or it’s not, that’s what the Act says, isn't it?

WINKELMANN CJ:

I think I understood your submission to be, Mr Hodder, really it's that the word "abuse" connoted unsalvageable or dishonest conflicted –

MR HODDER QC:

It has connotations of that and it terms of the purpose of interpretation it goes to the question of how you approach the particular provisions you're dealing with. There may well breach at the end of it but in assessing both interpreting and applying the provisions, the balance is appropriately kept in account, taken into account. That is the core submission and the core follow-up submission is that that isn't the way the Court of Appeal approached it's work and the judgment that's under appeal.

I'm at 2.5 I think on the road map. Entry into a formal insolvency process. I think I probably should have said, for example, liquidation, may well involve a major destruction of the value of the company as a going concern. That's supported by a range of propositions, but can I take the Court to Continental Assurance please, which is number –

WINKELMANN CJ:

Are you stating that as a statement of fact, because I think it's a well understood outcome of insolvency.

MR HODDER QC:

Yes.

WINKELMANN CJ:

Although you have no evidence to support it, or you do have evidence in this case to support it?

MR HODDER QC:

There is evidence for this one. Mr Graham says that's what the directors say they were concerned about.

WINKELMANN CJ:

But what do you say to the Court of Appeal's proposition, which is notwithstanding that, a director has no active duty not to put the company into the insolvency, formal insolvency regime, the liquidation regime, to avoid that where they have reached the view that it's not longer prudent to continue to trade, notwithstanding it's going to destroy value.

MR HODDER QC:

Again we happily accept that, not happily, we accept that in relation to an unsalvageable company, one that is hopelessly insolvent. But in the marginal territory, which as we say this was, and I appreciate we have to come back to the facts about that, then this is a cogent factor. The Court of Appeal doesn't really address this point at all, it simply says, and it's going to come back to the factual position, it says the writing was on the wall in July 2011 and the company should not enter into new construction contracts. The implication of that is never quite addressed by the Court of Appeal, but the implication is that the company comes to an end, there is no soft landing, and you have a massive destruction of value.

WINKELMANN CJ:

I rather thought that was addressed by them because they said basically they should've said, look, we're not going to continue in this role unless we get some more capital or more formal level of support, and that would have crystallised the critical issue that was percolating away, and provide them with a proper basis to decide whether to cease trading or to carry on with their recapitalised or formalised support arrangement.

MR HODDER QC:

My reading is that they discussed the condition, which is as your Honour has just described, they say unless you manage to sort out something then you can't carry on with contracts. But the not carrying on with contracts, the consequences of that is not discussed in any detail as I can recall. That is a matter that was in 2012, as the directors say, something that they were very much conscious of. So the reason that I'm taking the Court to Justice Park's

decision in *Re Continental Assurance* is because more eloquently than I might at paragraph 281 is he describes that unenviable dilemma that directors have in marginal companies. So the concluding sentence on that about “ceasing to trade and liquidating too soon can be stigmatised as the cowards’ way out”. That’s a bit of a memorable line, and the question is, is this a case where the directors were entitled to say, particularly in 2012, liquidating too soon would be wrong. But in effect the issue also arises in 2011. So the factors the directors are considering in 2012 particularly, and the Court is probably saying they should’ve considered in 2011, would be have you got assurances for support that are reasonable. The Court of Appeal says you haven't and, if you haven't, and you can't get them, then you should stop, and the consequences will be that you should go into liquidation and you will have the loss of value that results from that.

WINKELMANN CJ:

Can I just take you back to your answer to me? I said to you that the Court of Appeal said that the directors had no duty to continue trading once they formed the view that, you know, it was insolvent and they didn’t have a clear pathway out in the face of the gathering storm clouds, and you said well whilst you accept that they are right that directors are not bound to carry on trading to avoid the consequences of liquidation in an unsalvageable company, that wasn’t the case that applied here. Can I just ask you, does that mean that you say that directors should carry on trading…

MR HODDER QC:

My case to you is that this was a marginal company not an unsalvageable company, and they were entitled to treat it as that, and entitled to keep on trading, including having regard to the consequences if they stopped trading.

WINKELMANN CJ:

But that doesn’t go to a duty to carry on trading with an insolvent company.

MR HODDER QC:

The question about your Honour's phrase, an insolvent company, in the three categories I'm talking about. If it were unquestionable an insolvent, a hopelessly insolvent company, unsalvageable, then they shouldn't be carrying on. You just have to bear the consequences. I don't shy from that. In the marginal category things are different. In the marginal categories what Justice Park is addressing, and we say that's what this case is, was.

WINKELMANN CJ:

And how are they different? I'm just asking the duty. You're not really saying they have a duty to carry on trading.

MR HODDER QC:

A duty to –

WINKELMANN CJ:

I mean because that would be, you'd be imposing, you'd be opposing a different standard on directors, a higher standards on directors, where they make the call to put it into insolvency, then you would, if they make the call, to carry on.

MR HODDER QC:

Well putting it in a different way your Honour, and I hope I'm answering your Honour's question, the directors have an ongoing duty under section 131 to do what they think is in the best interests of the company, and if their view is that they should be carrying on, then that is compliance with that duty. The question then becomes, are they in breach of some other duty, for example 135 or 136, and if it's marginal, and they have a reasonable basis for thinking that it is marginal and salvageable, then the 131 duty would carry the day, and that's what we say really what was happening here. Within the 131 duty they are entitled to have regard to the consequences of ceasing trading, being the destruction of value. So I'm hopeful that's answered your Honour's question, but I'm not entirely confident.

WINKELMANN CJ:

I think it has. It's just, you know, the way you're coming at it is an interesting formulation, so I just wanted to understand its implications.

MR HODDER QC:

Thank you. The reference I wanted to bring up is a further reference to *Re Continental Assurance* doesn't look to be right to me at the moment so I think I might come back to it after the lunch adjournment if that suits the Court.

WINKELMANN CJ:

Yes. We'll take the adjournment.

COURT ADJOURNS: 12.59 PM

COURT RESUMES: 2.18 PM

WINKELMANN CJ:

Mr Hodder. Now you were going to take us back to the right passage in *Continental Assurance* but I see we've got the Act 1993 up.

MR HODDER QC:

I think that's Ms Holtz just sort of being ready for action in any direction, but if we can go back to *Re Continental Assurance Co of London Plc (in liq) (No 4)* [2007] 2 BCLC 287 (Ch) please, that's at number 73, and the passages I was looking for, and I can't explain how 220 got there but it's irrelevant, the passages I would draw the Court's attention to are 106 to 110, and what the Court is doing in those passages is making a number of general observations about wrongful trading liability in the English context. What we say, they are relevant for our purposes as well, and that paragraph 106 notes what typical cases are which goes to a degree to kind of the question of what I've been describing or utilising the long title's use of the word "abuse" from. So the second sentence: Typically…cases in which the directors closed their eyes to the reality…and carried on trading long after it should have been obvious…that the company was insolvent and that there was no way out... In

those cases the directors had been irresponsible, and had no made any genuine attempt to grapple with the company's real position." I will go the material shortly which I will seek to persuade you that that does not describe this case.

Conversely, on the next paragraph, 107, the kind of contrast is in the centre of the paragraph: "The directors did not ignore that question… On the contrary, they considered it directly, closely and frequently…always conscious that, if Continental was insolvent, they must stop trading immediately." In the context of "going concern" as opposed to "insolvent", that's what we say the directors were doing in this case on the basis that the capital position would be covered by assurances from the group as a whole.

Then the paragraphs are relevant but I won't take the Court to the rest of them through to 110 but I draw attention to them.

In terms of prematurity of risk, which I should have perhaps mentioned at the end of 2.5, can I just draw the Court's attention to the joint governance experts report? That's at 605.00015, and if we go to page 00028. So there were three governance experts called although there was sort of a debate about whether there should be more or whether or not the directors could be regarded as experts, not least Sir Paul Collins, but in any event finished up with two experts for the liquidators and one expert for the directors. So Mr Burt and Mr Maier were the experts for the liquidators and Mr Westlake was the expert for the directors.

But the point I was drawing attention to is simply the joint agreed proposition under issue 8, the certainty of loss versus probability, number 1: "If MPC had stopped trading in 2011, it would have been an irreversible decision causing substantial loss." Then the different aspects of the high level, as it were, debate are captured in Burt and Maier's 1 and 2: "Given the issues, it was not a permissible trade-off to keep trading," and, secondly: "It was a big and difficult decision but that's not a reason not to do so," versus Westlake,

number 1, if you shut it down in January 2011 there'll be a near certainty of a $40 million loss and probably significantly more.

At a high level those governance experts were kind of, as I said, they were agreeing on the point that there was not going to be a soft landing anywhere in this process if Mainzeal stopped trading.

In terms of, finally, on this 2 section, I just draw attention to the reference I've got to *Grant v Ralls* [2016] EWHC 243 (Ch). It's paragraph 173. It could actually go back to 171. So if I can invite the Court when it's following up this issue that it should be having regard to 171 to 174. Well, it could be having regard to 171. Apart from other things, it touches on the question of subjective and objective, and then in 172 there's a reference to Justice Lewison's comment in *Re Hawkes Hill Publishing* [2007] BCC 937 (Ch) about directors not being clairvoyant, and again in 173 reference again to Justice Lewison on the question of hindsight and the problems that a court faces "picking over the bones of a dead company in a courtroom" which has a certain resonance for those of us who survive this rather long litigation journey.

2.7, I don't know it's necessarily a particular issue but there is a theme in the liquidator's submissions that there is a duty owed solely to creditors in the area of insolvency. We say that in a salvageable circumstance, yes, there's close regard to the interests of creditors but it doesn't exclude those of other stakeholders. There's a discussion of the authorities in the extract from the Goode text which we've given, but I wasn't proposing to take the Court to that.

Moving then to section 135, the Court's familiar with the text, and it's also, your Honour, familiar with my submission that it can be interpreted purposively in the light of the long title (d).

WINKELMANN CJ:
Just the Goode text.

MR HODDER QC:

I'm sorry, your Honour?

WINKELMANN CJ:

The Goode text you're not taking us to, what's the gravamen of what is said? Is it Professor Roy Goode?

MR HODDER QC:

Let's go there then. Number 127 and 14-21.

WINKELMANN CJ:

Is this Professor Roy Goode?

MR HODDER QC:

It's Professor Roy Goode's but at this point it's being edited by, I'm not sure if he's a Professor or Dr, van Zwieten who has been writing in this area as well, Kristin van Zwieten, and at 14-21 there's a discussion of the *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA) case, and at page 756 of the extract which should be there – maybe not. I thought we put it in. If I can read perhaps the sentence if we don't have it in that extract – I would have thought we'd put in extracts from chapter 14, apparently not – which will be paragraph 756. The sentence I was relying on says: "The true principle is not that directors owe duties to creditors as well as the company but that when the company is insolvent or bordering on insolvency the directors in discharging the general duties they already owe to the company must have regard predominantly to the interests of creditors who now have the primary interest in the proper application of the company's assets."

Then it goes on to discuss in footnote 135 that this requires directors to consider their impact or action on the interests of creditors ahead of but not to the exclusion of shareholders. Then there's a discussion of the UK Supreme Court decision and two different formulations used in the case of *Bilta (UK) Ltd v Nazir* (No 2) [2016] 1 AC 1; [2015] UKSC 23; *sub nom Jetivia SA v Bilta*

(UK) Ltd where Lord Toulson and Lord Hodge talk about the of: “Companies interests would embrace those of creditors.”

WINKELMANN CJ:
And did you say, was it, because we haven't got it on our screen, have we, is that duty articulated in insolvency or in insolvency and in near insolvency?

MR HODDER QC:
Insolvent or bordering on insolvency.

WINKELMANN CJ:
Insolvent, right.

MR HODDER QC:
Is what the text says. Again, I apologise, we’ll get that into the system so it can be addressed, and to some extent, that takes me into 3 and 3.2 where I’m saying pretty much the same thing. By reference to our submissions, our written submissions in support of the appeal, what I don’t refer to expressly there is, I should’ve referred to our paragraph 6.13 as well as our paragraph 6.12 of our written submissions, that is to say our appeal submissions, if we could, which is page 40 of those submissions. Just our actual written submissions from 22 November. So if we go please to paragraph 6.13. Thank you.

The point that we say is that is largely picked up by the Court of Appeal’s decision in *Mason v Lewis* [2006] 3 NZLR 225 (CA), or at least the core elements of it. And I’ve summarised those there in the form I have. I’m not sure that there’s any point in my reading it out, and as the Court will recall, in *Mason v Lewis* there was a recognition that there were concerns about taking a literal reading of sections 135 and 136 undermining the purpose of the Act, that is recognised and we suggest that in a way that we’ve summarised the judgment, it is well-reflected. Now, obviously there are kind of open language issues about what’s a “sober assessment” and what are “reasonable

assumptions" but that's part of the balancing exercise that we have been talking about.

WINKELMANN CJ:

So where is that, where's *Mason v Lewis* discussed in your submissions?

MR HODDER QC:

6.13 on page 40, your Honour.

WINKELMANN CJ:

Yes, sorry, 6.13, yes.

MR HODDER QC:

Now at 3.3 I've discussed that matter of rationality, review and correctness, as it were, that we were discussing before. I wasn't proposing to repeat in relation to that. But it all adds up to our proposition at 3.4, unless it is truly irrational or reckless or conflicted conduct, the directors must be entitled to determine whether the company is salvageable and if so, to have regard to the interests of the company generally, not limited to those of creditors although, as I said, in some creditor's case there will be different views or probably divided opinion including whether the creditor, if one takes the case of, for example, the employees.

WILLIAM YOUNG J:

Mr Hodder, is there authority that's to the effect that it's only where a company is completely unsalvageable that the directors might be expected to stop trading or do something else about it?

MR HODDER QC:

The main authority for that now would appear to be *Debut Homes*.

WILLIAM YOUNG J:

Sorry, but that's case where it wasn't salvageable.

WINKELMANN CJ:

No.

GLAZEBROOK J:

No, that just was the fact in that case.

WILLIAM YOUNG J:

Say there's a 10% chance of salvage, I know life doesn't work like that, you say that's enough?

MR HODDER QC:

I think realistically 10% probably be regarded as rational, but, I mean, that's, we're talking about an abstract concept and trying to apply numbers to judgement, and I have difficultly coming up with a clear-cut response.

WILLIAM YOUNG J:

Well, it's a bit like trying to put mathematics on beyond reasonable doubt, isn't it?

MR HODDER QC:

Yes, so it may be harder, I would suggest, but our proposition remains as I said before lunch, that if it's shown that there is a rational, coherent and intelligible reason for taking a particular position here, trading on the company, and that even if it doesn't turn out to succeed, that should be regarded as sufficient to comply with a director's duties, that's the submission. Your Honour was asking, is there a direct authority that addresses that, I'm not sure there is. The hopeless case is addressed by *Debut Homes*, that's clear. We don't contest that. If it's absolutely unsalvageable, then this Court's decision makes it clear and we don't argue to the contrary that there should be no trading notwithstanding there could be a train wreck or there will be a train wreck as a consequence of it. But that's a non-trading case, of course, compared to this one. And also marked by a whole series of concerns about a conscious decision to transfer the problem to a particular creditor, namely the IRD.

WINKELMANN CJ:

So what about the hypothetical that you know there is a very large risk that your company's insolvent unless its capital situation is addressed either by securing more funds or by securing a binding letter of comfort, and you over the course of years do not address those risks?

MR HODDER QC:

If you don't address them at all, I would suggest –

WINKELMANN CJ:

Resolve, address them through to resolution because addressing them by just thinking about them, but doing nothing, is not really addressing them, is it?

MR HODDER QC:

Yes, I think I discussed that in part before lunch, but we say that our directors not only considered them and discussed them, they actually did participate in steps with the group, remembering this is about assets and capital which the directors don't control in a group subsidiary. And so they're working with the group to change on the two fronts that I mentioned, the first front being the reduction of the sums involved in the receivables by the pre-purchase agreement. Secondly, by getting assets built up in New Zealand which were available to support the New Zealand company as a matter of directly available assets. Both those things were being done. If neither of things had been done, then I couldn't be making the submissions I'm making because there would have been an identified weakness in the balance sheet which wasn't being addressed.

WINKELMANN CJ:

So is the case really about whether the steps they took to address the identified weakness in the balance sheet were adequate?

MR HODDER QC:

Adequate in the sense, were they rational and –

GLAZEBROOK J:

Or would they have fixed the problem?

MR HODDER QC:

I think that's part of the rationality test, your Honour, yes.

GLAZEBROOK J:

Okay.

MR HODDER QC:

And again, would and could is, brings back the same issues.

GLAZEBROOK J:

Yes. I understand the distinction. So if successful, would they have fixed the problem and over what timeframe?

MR HODDER QC:

Yes, that's correct.

WINKELMANN CJ:

And the Court of Appeal's finding was that as a matter of fact they didn't, they may have thought about it, but they didn't crystallise it, they did not bring it to a head so as to fix it and in those circumstances it wasn't open to them to carry on trading.

MR HODDER QC:

The Court of Appeal operates, its reasoning operates at a different level, so the level that I've just explained and what the directors were doing, was if you might like it as a gradual approach that says, we're working with a group, the prepaid agreement will take three years to come to reduce the receivables balance and we're working to achieve a build-up of our balance on the balance sheet of assets and other enterprises in New Zealand and those assets are part of the deal. The Court of Appeal seems to be saying, unless you've got a legally enforceable coverage of the entire receivable and you

have threatened to resign and then resigned if you didn't get it, then that was, meant that you had to stop trading at that point. It doesn't, in those parts of the discussion and the judgment, address the gradualist approach, if I can put it that way, or the more gradual approach.

WILLIAM YOUNG J:
Well, they, I mean there's a fair bit of overlap between what the Court of Appeal found and what Justice Cooke found, I think, on this aspect of the case.

MR HODDER QC:
The vulnerability is the theme that both Courts find, they find that because of that weak balance sheet, and the lack of direct enforceable access to funds or access to some way of enforcing to that value, then there was a latent weakness.

WILLIAM YOUNG J:
Which could've been crystallised by saying to Mr Yan, well, put your money where your mouth is.

MR HODDER QC:
That's what the Court of Appeal effectively says.

WILLIAM YOUNG J:
Yes.

MR HODDER QC:
And it says that the amount of money that they're talking about appears to be, it's not absolutely clear, I think, but it appears to be sort of the order of all the money, where the mouth is.

WILLIAM YOUNG J:

And then the prepaid materials, the Court of Appeal says, well, that was a breach of the exchange control regime in China anyway, I think, didn't they?

MR HODDER QC:

Yes, I'm not sure that was clarified or clearly established on that. There's a problem arose at the point where the company was insolvent, or wasn't a going concern, up to that point I hadn't thought that there was a problem in the agreement itself.

ELLEN FRANCE J:

I thought they said it would be unlawful arbitrage?

WILLIAM YOUNG J:

That's the word I've got in my head too, arbitrage.

MR HODDER QC:

Right, I'll have to go back and check on that point, it's not a point that I've got at my fingertips at the moment.

WINKELMANN CJ:

They also said, it undoubtedly came with its own further storm cloud: "It undoubtedly rolled a further storm cloud into the sky of the company along with the Siemens and leaky homes storm clouds." It wasn't itself a problem for them, the prepaid arrangement?

MR HODDER QC:

Well, it wasn't anticipated to be, it was meant to be – and it was put forward as a perfectly rational scheme.

WINKELMANN CJ:

Yes, but incrementally speaking, over time it became apparent it was a problem.

MR HODDER QC:

Over time it took longer than it was hoped for, but in the process the movement of capital into New Zealand continues. There are assets being built up, there are products coming in which go towards reducing the amount of the receivables.

WILLIAM YOUNG J:

It was 11 or $12 million, wasn't it, over the last two years?

WINKELMANN CJ:

I think the point was that it gave them supply chain issues, so it just made their position more perilous, that's what the finding of the High Court judge was, I think.

MR HODDER QC:

It turned out that there were supply chain issues, I mean, they weren't anticipated as supply chain issues and any supply chain can have issues, that's ordinary course of business as opposed to a problem, inherent problem in the exercise itself.

WINKELMANN CJ:

Yes, I know you're saying it wasn't anticipated, but of course, this is an incremental kind of picture so actually they're able there in real time to see what's happening. It's happening over a course of years, isn't it? How long is that?

MR HODDER QC:

The plan is, as described in the Citron Report which we'll come to, is approximately three years to the end of the financial year 2013. And they don't get there, as the Court understands. But in terms of an incremental, yes, I mean, the evidence that one can see from the director's own evidence is that they were keeping an eye on these things, a very close eye particularly through 2012. And a kind of a minute-by-minute process or day-by-day

process, with respect, would be too complicated and too onerous. What we're talking about is, was the exercise going to work over the period of time that was contemplated, and if there were ups and downs then there would be ups and downs, it was an active, large operating business, and were they going to get over the problems? Well they thought they were going to get over the problems of the supply chain. That was a matter of the expectations that they had, and that was a judgement made by Mr Gomm and Mr Tilby in particular. They were concerned, obviously. Could they fix them? Yes they believed they could. What was that? It was a matter of judgement we say.

O'REGAN J:

The arbitrage comment in the Court of Appeal judgment in paragraph 150 where it says: "The shared view of the Chinese law experts called by the parties was that because the agreement sought to circumvent prohibitions on moving funds out of China it would be treated as 'arbitrage', which was unlawful. The Mainzeal board did not appreciate this because it did not take any independent advice on this substantial transaction."

MR HODDER QC:

Yes, I think that maybe something that can be more adequately addressed by my learned friends for Mr Yan about that aspect of the case, but my recollection – well two things about that. Firstly, our directors relied on Mr Yan because he had the China connections, he had a team working in China and it was believed to get through this issue. The question about getting a second opinion on that is one that's true, they didn't do. Then the question is, well could they rely on Mr Yan. Well he had been getting access to the funds into the Mainzeal orbit over a period of time and that continued, not without complications but it did through the exercise, or through until the end of 2012, but I will revert to the arbitrage point and, as I say, it may be a matter that Mr Yan's counsel can address more than I can, or more readily than I can.

While I think of it, I don't think I had mentioned before our chronology, which I think the Court will have got either Friday or the weekend or some such. Can we bring up the chronology if we can? So if the Court has that this is

meant to be a sort of a snapshot of what happens from the period from 1995 to 2013, and I'm prompted by Justice Young's question just to explain this. Broadly speaking the red line that goes right across about two-thirds down the page, the horizontal line, below that is sort of internal matters mostly in the Mainzeal activities associated with the board, and above that a sort of a wider range of events, but you'll see the green is the funding that was, that the evidence we say came through during that period from 2010 through to 2012 in various forms, including in the forms of materials. So not an insignificant amount of funds, but not a lump sum of $30-$40 million, that's understood and accepted.

So I'm discussing now, if the Court pleases, section 136, and it's part 4 of the road map and section 136, of course, is what the Court of Appeal finds liability on, or finds a remedy on, and as I said earlier it's approach seemed to be related to its focus on new creditors and the proposition that section 136 not be a dead letter in relation to new creditors, and we also understand it to be not limiting that to companies that unsalvageable, and if that is the correct reading of the case, then we say that it's unsound on both limbs of that proposition, or those propositions. Firstly, the focus on new creditors we say doesn't work when you have duties that are owed to the company, and you have an ultimate distribution which is based on pari passu.

GLAZEBROOK J:
What do you say it should be related to, because it's incurring of debt knowing you can't repay them. So in terms of old creditors if that wasn't the case then it won't apply to them, will it?

MR HODDER QC:
As I understood, as I read 136 your Honour, it's talking about the scenario, or two scenarios. One is where the company is solvent, and the obligation turfs it into insolvency, and the other is that it's already insolvent and the directors know that and it can't be, there can be no expectation that the obligation in turn will be met when the time comes to meet it, whether it's a week or it's a

month or a year, whatever it might be, but it would cover such things as guarantees and obligations.

GLAZEBROOK J:

All I'm saying is it can't cover debts where you, at the time you incurred them you thought on reasonable grounds you would be able to pay them. So I can't see what the point is that you're making in terms of new creditors and why that's wrong.

MR HODDER QC:

The proposition is that section – well what seems to drive the Court of Appeal's approaoch to section 136 is about new creditors. But section –

GLAZEBROOK J:

But it's only going to be those debts that you incur, that you know you can't pay, that would usually be new creditors or an added debt from existing creditors, won't it?

MR HODDER QC:

If one takes a large transaction, which turns out that it turns the company into insolvency, it's not just new creditors that are affected, it's any creditor. The status of the company is its inability to meet its obligations, that's the problem we're concerned with. How it gets there is because it incurs an obligation that can't actually be met at the time, at least in one of its scenarios. It isn't that that particular creditor is directly affected, it's the effect on all creditors of that exercise being undertaken, and all shareholders for that matter. So if you have –

GLAZEBROOK J:

Can we just have a look at what it says?

MR HODDER QC:

136, yes, the Companies Act please.

GLAZEBROOK J:

I just don't understand your submission at all, so you might want to explain it to me in terms of 136.

MR HODDER QC:

If we take the example of a guarantee –

GLAZEBROOK J:

I don't really want to take an example or anything, I just want you to explain to me in terms of 136 why the Court of Appeal approach was wrong, and what the Court of Appeal approach should have been?

MR HODDER QC:

I maybe – forgive me for repeating myself, but we have read the Court of Appeal's approach to section 136 is designed to deal with the perverse incentives it identifies in relation to new creditors. We say section 136 has got a broader role, not particularly focused on new creditors at all, it simply says that if you finish up in a scenario where an obligation, for example, drives the company to bankruptcy, then you shouldn't be doing that.

WINKELMANN CJ:

Well can you at least tell us – so you're saying that the Court of Appeal started from the wrong premises to the mischief that section 136 was directed to? So where do you say that takes it in terms of the interpretation of section 136 as against how it should be interpreted?

MR HODDER QC:

Well the problem that we have made in our written submissions, and we make again orally, is that they see section 136 as equivalent to carrying on normal trading, and we say that's not the role of 136, that's 135.

WINKELMANN CJ:

Yes, understood. When we look at the words of 136, that's what Justice Glazebrook is asking you to do, can we look at the words of 136 and say how you say it's to be interpreted.

MR HODDER QC:

I'm saying it should be interpreted in a way that doesn't have overlap with 135 and carrying on business. Has it got work to do? Well the answer we give is, yes, it does have work to do, and we deal with that in our 4.5. For example at 4.5(c) it has a material role where a company doesn't undertake any trading, but incurs an obligation that will itself likely cause insolvency. It may also cover things like serial phoenix company conduct.

WINKELMANN CJ:

So that involves reading down the words of section 136 though, doesn't it? Because the focus is on whether the company – I'm not arguing, I'm just trying to get some assistance, whether the company will be able to form the obligation under the particular, the particular obligation when it's required to do so.

MR HODDER QC:

Literally I accept and I agree with your Honour, as your Honour has just put it, literally it's an available reading. The question is, should it be the reading if you have regard to context and purpose? Our submission is no because of the –

GLAZEBROOK J:

I still don't, I still just do not understand the submission at all, that's all. I just don't understand what you say it does. You say what it doesn't do, but I still don't understand what it does.

WINKELMANN CJ:

Is your submission, Mr Hodder, that it only applies to obligations where the obligation is effectively the precipitating insolvency event because it's the thing that tips the company into not being able to pay its –

MR HODDER QC:

It certainly covers that. It may also cover situations where it compounds insolvency as well. We can't exclude that proposition. But to attempt to address Justice Glazebrook's question, what we're saying is that the Court is entitled to read that provision so it doesn't apply to ordinary trading, in the course of a company that carries on trading, and it does require reading down. The Chief Justice is correct in her assessment or analysis of what we're saying. It requires it to be read down so that section 135 does something to section 136, and the concern that underpins all this is that if 136 covers ordinary trading by a trading company, so every contract entered into –

GLAZEBROOK J:

Well, nobody suggests that it covers ordinary trading. It just covers trading where you know you can't pay, a debt that you incur.

WINKELMANN CJ:

So you're saying, but I think your point is that it doesn't just cover run-of-the-mill, every day, in-and-out kind of trade creditors who –

MR HODDER QC:

Ordinary churn of cash flow transaction.

GLAZEBROOK J:

But of course it doesn't because you don't – you know you can pay at that stage. Why would it cover ordinary trading?

WINKELMANN CJ:

And an insolvent or a near-insolvency situation.

MR HODDER QC:

That's the near insolvency which is the situation that we are – our submissions are focused on.

GLAZEBROOK J:

So you say it doesn't cover near insolvency; it just covers insolvency. Is that the submission?

MR HODDER QC:

We're going back –

GLAZEBROOK J:

Because it clearly doesn't cover ordinary trading because you're going to incur debts all the time and you know you're going to be able to pay them when you sell the goods, for instance.

MR HODDER QC:

Then we are probably using ordinary trading in a different way. I'm using ordinary trading to describe the normal process of people receiving invoices, so sending out invoices, receiving invoices, being paid and paying out. That's not even, we're talking about ordinary trading, irrespective of the solvency of the company. In the case of a –

GLAZEBROOK J:

But nobody would suggest it did because in an ordinary trading situation you know you're going to be able to pay those debts unless something catastrophic happens like a fire or something or suddenly people decide they're not going to buy your goods which was not –

WINKELMANN CJ:

So Mr Hodder –

WILLIAM YOUNG J:

The argument's sort of set out in the Court of Appeal judgment, isn't it, starting at para 456? But your case is that section 136 is looking at transactions on capital account rather than ordinary trading operations, that it implies a focus on a part of directors to a particular obligation rather than just an awareness of a particular pattern of events or continued –

MR HODDER QC:

And that applies to the company whether it's in the twilight zone or it's a healthy solvent company. It doesn't apply –

GLAZEBROOK J:

Well, is the submission it doesn't apply to trade at all but just capital, because that was rejected in *Debut* but it wasn't particularly argued.

MR HODDER QC:

No, I understand that. No, I'm not saying it's solely on capital account. Capital account I think was just – it was Professor Farrar's shorthand for something which was a more major enterprise or major transaction than a day-to-day recurring, revolving kind of what I'm calling ordinary trading but which I fear has got the wrong connotations.

WILLIAM YOUNG J:

But is it an obligation? You're saying it's an obligation to which the directors have specifically turned their mind, such as, for instance, a new construction contract, as opposed to simply saying: "We're going to keep on trading and we know that that means that in the ordinary course of events we'll be buying material and hopefully" –

WINKELMANN CJ:

Hiring our employees, paying our employees.

GLAZEBROOK J:

It's just I can't see how anyone could think it would apply to an ordinary trading position and I didn't understand the Court of Appeal to be suggesting that.

MR HODDER QC:

So for a construction company an ordinary transaction includes entering in a new construction contract and the very thing that the Court said it can't do as of January 2011 is enter into a new construction contract.

GLAZEBROOK J:

Well, no, that's because it took the view it was insolvent.

WINKELMANN CJ:

So can I just clarify. It doesn't apply to ordinary trading because?

MR HODDER QC:

Because it is performing a different role to the ordinary carrying on a trade which is what 135 deals with. That's the basic interpretive argument.

O'REGAN J:

So when you say it doesn't apply to ordinary trading, you mean ordinary trading by a company which is either insolvent or nearly insolvent?

MR HODDER QC:

Which is solvent or marginal.

O'REGAN J:

Yes.

MR HODDER QC:

It doesn't, in my submission, doesn't extend to the truly insolvent company.

O'REGAN J:

So you're saying that might end up being a breach of section 135 but it would never a breach of section 136?

MR HODDER QC:

I think I'll probably need to have that restated, sorry, your Honour.

O'REGAN J:

If a company keeps on trading in the ordinary course and incurring debts in the ordinary course when it's insolvent, that will be a breach of section 135 but it won't be a breach of section 136?

MR HODDER QC:

That's our submission, yes.

WINKELMANN CJ:

But it does apply to – can you show us what you say it does apply to?

MR HODDER QC:

The sort of things we've addressed in 4.5(c) where the company doesn't do that kind of trading. It enters into, for example, it gives a guarantee or it takes up an option, or you have something along the lines, as I say, of serial "phoenix" conduct. But it isn't the sort of thing that the company does as a matter of course and here the company as a matter of course enters into construction contracts, subcontracts, and everything else that a major enterprise does, most of which are obligations being incurred.

WINKELMANN CJ:

Earlier I said to you so is your submissions it just applies to the kind of transaction which effectively precipitates insolvency, and you said: "No," but (c) just does actually say "which will itself likely cause insolvency". What would you add to that? What's the "no" part of it?

MR HODDER QC:

Well, it's in the case of a company that isn't – well, in the company that's not trading then any particular significant transaction which can't be expected to succeed or is not going to succeed is going to cause the problem. What I can't exclude is the possibility that there may be compounding obligations that compound the position of non-performance which is why I'm reluctant to say it's solely about capital account, to use Professor Farrar's phrase. What I am seeking to do is to say it's something other than the ordinary course of business obligations because that is just carrying on trade covered by section 135. The most obvious examples are those ones that cause a company to tip from, or maybe jump from, solvency to insolvency, but I can't say it's limited to that.

WINKELMANN CJ:

Okay, and –

GLAZEBROOK J:

Why does it have to be different from 135, because a lot of these duties are overlapping and why wouldn't this one be?

MR HODDER QC:

The idea of – well, it's partly why we've cited, I think, somewhere, Bennion. The idea is that this is a scheme that these things are dealing with different matters because you finish up with, on our reading of the Court of Appeal's approach, you finish up with 135 having no useful role if you treat every obligation as being covered by it, including the obligations one incurs by doing day-to-day business.

GLAZEBROOK J:

Well, you may have situations, some, where you do believe that you'll be able to perform the obligation when you're required to do so under 136 but still be trading when insolvent under 135 because it'll be looking at particular obligations. So you may think you can pay your employees or pay the rent

but still be trading while insolvent, can't you, so not breaching 136 but breaching 135 in relation to that particular debt?

MR HODDER QC:
I think I would say that that applies to any debt.

GLAZEBROOK J:
In a rolling trade, a Ponzi-type scheme, you can pay those obligations and know you can, it's just that one day the wheel's going to stop spinning.

MR HODDER QC:
Well, if the exercise at the end of the day from carrying on business, as it were, in a repetitive, sort of ordinary course of business way, is to finish up with an insolvent liquidation then you'll finish up in section 135.

GLAZEBROOK J:
That was my point really. So you can have a situation where you're 135 but not 136. So they do look at slightly different things.

MR HODDER QC:
Well, we say they look at very different things though because the proper –

GLAZEBROOK J:
Well, you're saying if it's 135 it can't be 136, is that the submission?

MR HODDER QC:
I'm saying it shouldn't be and it doesn't make sense that it is covering 135, that 136 covers –

GLAZEBROOK J:
How do you look between the difference between ordinary trading and trading that might get you into 136?

MR HODDER QC:
Well, perhaps there are issues at the margin but the language is relatively –

GLAZEBROOK J:

Something that's unusual?

MR HODDER QC:

The language is, we would say, is helpful. "Carrying on business" is a standard expression for what a company does by way of trading. That's how it carries on its business, and the phrase "carrying on the business" features in both limbs of 135. The language of 136 is entirely different in terms of incurring an obligation, and, as the Court appreciates from our submissions, we don't accept that that should simply be read as any obligation. It should be read as obligations which are outside the scope of 135.

WINKELMANN CJ:

Can I just summarise –

GLAZEBROOK J:

Nothing is outside the scope of 135, is it? What you mean really is not the ordinary course of business is that's something outside of the ordinary course of business with that submission?

MR HODDER QC:

That is what I mean by saying that, yes.

WINKELMANN CJ:

So, all right, so can I just summarise what you've said then, Mr Hodder? You say that the Court of Appeal's approach is literally available on, you know, on a literal wording of the section and you accept your reading requires words being read in, but you still say that when you look at section 135 and 136 together, they're clearly intended to cover different headings. Section 135 just covers trading, so it covers any kind of debts you incur subject to what you can recover at the end of the day if it's an insolvency situation ultimately. But section 136 doesn't cover ordinary trading in a near insolvency or insolvency situation. It covers obligations that you enter into that either precipitate the insolvency or exacerbate the insolvency and just with Justice

Glazebrook, you said also sort of out of the ordinary course of business so substantial transactions perhaps or something like that?

MR HODDER QC:

I did and I say that because the alternative means that section 136 takes all the wind as it were out of the sails of 135. There's no role left for 135 and it becomes the dead letter that the Court was concerned about in relation to 136. But there is work to do for 136 if we take the approach that I am suggesting.

WINKELMANN CJ:

Do you also add into your argument that that reading is consistent with when you get to the remedial end of it because it's the company's claim, it's not the individual creditor's claim? So you're looking for something really that is harming the company as opposed to the individual creditor?

MR HODDER QC:

Absolutely, your Honour. We say that all these duties are owed to the company and the concern is about the state of the company at the end of the events that are contemplated by those sections.

GLAZEBROOK J:

That does go against *Debut* in terms of the restitutionary nature of remedies, so you might need to do some work on that one.

MR HODDER QC:

Yes, I think the answer is that we are challenging the *Debut Homes* proposition outside the scope of –

GLAZEBROOK J:

You probably don't. You're probably pushing a barrow uphill if you're wanting us to go back on a very recent decision.

MR HODDER QC:

Obviously we are conscious of the recentness of the decision. We also read the decision as being focused particularly on non-salvageable companies and I'm talking about twilight zone which I am treating as a category which is not hopelessly insolvent and is salvageable in a context where there is –

GLAZEBROOK J:

How does that operate in 136 territory is probably what you need to deal with then? I've understood your submissions in relation to 135. How does that operate in 136?

MR HODDER QC:

136 really is in the same position. The question is what's happened to the company so that ultimately when you get to the question about is there a deemed harm to the company because –

GLAZEBROOK J:

So you can incur a debt but you don't think you will be able to perform if you think that some time down the track that a company will be salvageable, is that the submission?

MR HODDER QC:

I think my submission is that if *Debut Homes* is outside the scope of an unsalvageable company is saying that there is a deemed harm under section 136 which affects the trading on of a marginal company, then we say that is not an analysis the Court should confirm.

WINKELMANN CJ:

So, Mr Hodder, if we go back to the part from Professor Roy Goode's text now edited by Kristin van Zwieten I think in relation to the *West Mercia* case, there they said that: "The true principle is not the directors owe duties to the creditors but rather, that if it is insolvent or bordering on insolvent, the duty to the company is predominantly formulated in terms of creditors in terms of the creditors."

MR HODDER QC:

In terms of taking into account the interest of creditors.

WINKELMANN CJ:

Yes, in terms of the interest of the creditors.

MR HODDER QC:

There is still a duty to the company that is under considerations that are taken into account in that exercise and how you think about the company cannot exclude the position of creditors.

WINKELMANN CJ:

Yes, so I suppose the argument against you is that however imperfectly this is expressed, section 136 is attempting to capture that. However imperfectly conceived the scheme is, and you yourself accept there's an imperfectly conceived executed scheme – well, no, you wouldn't accept that it was imperfectly conceived in its original form, just that other people have muddled about with it?

MR HODDER QC:

No, no. I'm not trying to defend the Law Commission's 105 draft but going back to the basics on 136. What 136 says it's a duty to the company not to get itself in a position where it can't perform its obligations, and what we say is that it's, that's the end result you're trying to avoid and the particular concern about getting there is some specific obligation, or possibly obligations, as opposed to general carrying on trade.

WINKELMANN CJ:

Yes.

MR HODDER QC:

So to the extent that 135 doesn't pick up the specific obligations because they're not in the ordinary course of business, then that's what 136 does.

WINKELMANN CJ:

I understand your submission, but the point I was making is that –

MR HODDER QC:

That's all, but it doesn't make any difference to who the duty's owed to or what the consequences are, in our submission.

WINKELMANN CJ:

Yes, but what I'm saying to you is that effect that the Court of Appeal gave to section 136, which you say is inconsistent with the remedial acts at the end of the day, which is its relief to the company, they effectively said, well the purpose of the company was as is articulated, they don't use these words, but it's that concept that the purpose is to protect creditors in this situation.

MR HODDER QC:

And particularly their focus is on new creditors.

WINKELMANN CJ:

Yes, new creditors. And they said, you know, it may all be an imperfectly conceived scheme, but this is the clear purpose and that's why we give it this effect. They actually say it's an imperfect conceived scheme, those aren't the words, but they actually articulate it in terms of the fact that there are inconsistencies and they accept that. But this is a best representation of achieving the purpose of the legislation.

MR HODDER QC:

If you start with a proposition of there being a deemed harm, that I think is the reasoning that they take. That they think they're bound by this court's decision in *Debut* to say there is a deemed harm because the creditors, and particularly the focus on new creditors, are adversely affected. We say that that interposes the concept of a division between creditors which the Act doesn't justify.

GLAZEBROOK J:

Well, it's not a division between creditors. It's the division between those creditors, or those debts that were incurred when you couldn't pay them, and the debts that were incurred when you had reasonable grounds to think they would be paid, which don't come within 136 on any wording, do they? So I incur a debt, whether in ordinary trading or not, and I'm 100% it's going to be paid, and I then incur a debt later when I'm 100% sure it's not going to be paid, well surely it only, so 136 can only, on any aspect of it, apply to the latter?

MR HODDER QC:

Well, if the debt is incurred when there's no obligation to be paid, then we say, yes, that's a breach of 135 or 136.

GLAZEBROOK J:

No, no. I incur a debt and I'm sure it's going to be repaid, and then I incur a debt 10 months later and I'm sure it's not going to be repaid, how can the first one be anything to do with 136?

MR HODDER QC:

Well, if there's no insolvency and the issue doesn't arise. If the company's – if there's no knowledge of the kind that's –

GLAZEBROOK J:

So it's the only the new debt that's incurred at a time when I know it's not going to be paid.

MR HODDER QC:

But that's the trigger for the consequence of insolvency and the ability to pay, it's not identifying the only victim for the exercise.

GLAZEBROOK J:

You must have a point, I'm sure, I just don't understand it. So maybe we move on because I don't know if you're ever going to get me to understand.

MR HODDER QC:

Let me try one more -

WINKELMANN CJ:

I think you're saying that you conceptualise section 136 as the company being the victim of the harm?

MR HODDER QC:

Yes. And the victim is the company because it's now unable to pay its debts. It's the company that's in trouble, not the individual creditor whose entry into the transaction that involves the obligation is the person who's being looked after, it's the company.

GLAZEBROOK J:

Well, I was just looking at the debts, it wasn't anything to do with the creditor.

MR HODDER QC:

But that's why the company can – if this becomes something that's visible, they give an example, if there's a plan to enter into a guarantee of, say, an unrelated company or some such, then the reason why there's an ability to seek an injunction, as a shareholder under section 164, is to stop that. It's got nothing to do with the creditor being able to do that. The creditor can't do that. That's because it's a harm to the company. If it's a harm to the company, that is what drives the entire interpretation of both 136's interpretation and the consequence that it has. There's not a deemed harm because a creditor, the individual creditor is damaged. It's a harm because the company can no longer meet its observations.

GLAZEBROOK J:

Or meet that obligation under 136. It's not its obligation, is it?

MR HODDER QC:

Well, we would say the logic of it is that the only reason it can't meet obligations is because it's an insolvent liquidation, otherwise it would meet its obligations, or be able to pay a monetary equivalent.

GLAZEBROOK J:

Well it could apply to something where you are unable to repay it for some legal reason, couldn't it, without being insolvent?

MR HODDER QC:

Possibly. I mean there is undoubtedly a wider concept of obligation than contractual debts. That obviously *Debut* focuses on that for the purpose of dealing with statutory obligations, but that doesn't change the point that the harm done to the company is it is no longer able to perform its obligations. Why is that? It's because it's going to be an insolvent liquidation and that is the general harm of a company that is in liquidation done to shareholders and to creditors at large at the moment that the liquidation takes effect subject to preferences et cetera.

GLAZEBROOK J:

Well, perhaps you can explain to me when you're talking about the facts why the Court of Appeal was wrong because it might be that I understand your point better at that stage?

WINKELMANN CJ:

So that takes you to paragraph 5, doesn't it?

MR HODDER QC:

It does. Well let me just make sure there is nothing that we haven't touched on. We've probably covered most of 4.5.

WINKELMANN CJ:

I think we've covered most of it.

ELLEN FRANCE J:
Sorry, I just wanted to check, Mr Hodder, you did acknowledge there may be compounding obligations?

MR HODDER QC:
Yes.

ELLEN FRANCE J:
What would be an illustration of what you mean by that?

MR HODDER QC:
I'm thinking of cumulative obligations. So if the company is already in the position where it's facing an inability to perform an obligation and a fresh obligation is taken on board, that would be a compounding obligation as opposed to a creating obligation.

I'm conscious that your Honour the Chief Justice is keen to see me move off section 4, but I think I do need to deal briefly with 4.5(g).

WINKELMANN CJ:
No, that's all right Mr Hodder. I was throwing you a lifeline really.

MR HODDER QC:
I think I should deal with 4.5(g). That's the idea of the use of uncertainty and if we go to the Court of Appeal's paragraph 287, so if we go to the Court of Appeal judgment and go to page, sorry paragraph 287. So this is in the Court's discussion of section 136 and the commencement: "In some cases a company will be so dire there is no reasonable grounds for thinking that." So that is the hopelessly insolvent unsalvageable company. "In other cases though," the Court of Appeal goes on to say, "the directors of a company may have reasonable grounds for expecting the company will be able to keep trading for the immediate future and pay debts as they fall due, but the longer term position of the company is uncertain and there is no reasonable basis for predicting that obligations will be met beyond that horizon."

So then the criteria, and this manifests itself in the way the Court approaches January 2011. It says: “From 2011 Mainzeal couldn’t take on new construction contracts.” We say uncertainty is a criteria for saying you can’t carry on is a major issue which in our submission is erroneous. That isn’t the test about whether the future of the company is uncertain. That’s an extraordinary low test. The test is whether or not, and we say it goes the other way round, the test is whether or not there is reasonable belief to think that there is an ability to carry on, not simply that there is uncertainty.

GLAZEBROOK J:
Well, it goes on to say: “There is no reasonable basis for predicting that obligations will be met beyond the next few months.” So it’s not saying it’s uncertain whether they will or they won’t.

MR HODDER QC:
It does do that.

GLAZEBROOK J:
They just say there will be no reasonable basis thinking they could.

MR HODDER QC:
In which case the word “uncertainty” carries nothing within it, it simply goes back to the same problem. But I'm assuming that they –

GLAZEBROOK J:
No, well I think probably “uncertain” is the wrong word because they’re actually saying there’s no reasonable basis for thinking they’ll be able to pay the debts after the next few months.

MR HODDER QC:
If that’s all the Court of Appeal is to be taken to meaning, then I have nothing else to say on the point. We just go back to the rational proposition but to the extent that gives rise to the question of uncertainty, and the way in which the

Court then goes to come to its conclusions, then obviously for reasons I've just given, we resist it. And not least, in this case, we're happy to endorse the approach the High Court took to this particular provision which, with respect, is a conventional proposition that said it's got to mean something other than what section 135 means, and that on the analysis of the Court of Appeal undertakes, it doesn't.

GLAZEBROOK J:

So why – because *Debut* would be against that because we didn't have that argument that it had to be something other than just a tax debt that was arising by operation of law et cetera. You don't need to answer now, you might want to think about it when you get to…

MR HODDER QC:

My reason for wanting to have a quick look at that was that I thought, well, my reading of the Court's decision obviously, I thought, beginning to a proposition in front of the Court that decided it, was that the Court made it very clear it was talking about unsalvageable companies, it does that on a number of occasions, that's what it was focused on.

WINKELMANN CJ:

Well, some say it was clear and some say it wasn't.

MR HODDER QC:

Well, I think that's unfair for the Court then in a sense that –

GLAZEBROOK J:

We think we made it absolutely clear that the fact was it was totally insolvent, and that Mr Cooper knew that.

MR HODDER QC:

And there was known to be – exactly. Well, can I respectfully, on this point, agree with that proposition that says you did make it very clear. What I was looking at was paragraph 91 where the Court largely sidesteps these issues,

as I had read it and footnote 104. It says: “No policy reason why there should be a gloss,” and that’s in relation to, in part in relation to Professor Farrer’s capital account comment which is carried through into *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA396; [2010] 2 NZLR 57. So *Peace and Glory*, which your Honour Justice Glazebrook wrote the judgement, cites Professor Farrer’s text in a discussion of the law without criticising it and it has been cited, that passage has been cited in subsequent cases as a way of indicating what the current law is. So what I understand from 104, footnote 104, is the Court hasn’t decided that that was wrong, it just says: “On the face of it, it couldn’t on the basis of the argument heard in *Debut* see there was a policy reason,” sorry: “any basis in the statutory language,” as of end of the footnote. And that then comes back to my proposition that says: “Well, actually there is a purpose of interpretation issue here which is what underpins most of the submissions I’m making to the Court.” So I hadn't understood –

GLAZEBROOK J:

So the distinction you’re making, just so I understand, is in relation to salvageable companies is that it’s still the same submission as 135, is that –

MR HODDER QC:

Yes, that applies both 135 and 136. Insofar as an unsalvageable company as defined in *Debut Homes* is concerned, there should be no trading, no obligations being incurred. It should just stop. That’s accepted. And then the argument that I’m about to move to is the one that says this company was salvageable or at least there were rational grounds for believing it was salvageable and then that is sufficient. And insofar as the Court of Appeal’s judgment is, that this case there was no basis for thinking that, then we are inviting the Court to take a different view.

GLAZEBROOK J:

Just that on my reading of *Debut Homes*, a lot of those debts that we said came within 136 were actually as a result of what could be called ordinary

trading, but ordinary trading at a time for a hopelessly insolvent company obviously.

MR HODDER QC:

Well, once it has that final phrase in there, then in a sense, and I don't have any disagreement with that, yeah, I won't take it further than that. So that brings me to section 5 and was the writing on the wall in January 2011 and that starts from the language of paragraph 462 of the Court's judgment and so at, as they say: "The Court accepts," as we see in the paragraph, "at 31 January 2011 the directors had no reason to think that the company would experience sudden failure in the coming months." "In the coming months", appears to be the kind of the Court of Appeal's own time estimate. I don't know whether it comes from anything particular in the evidence. The basic proposition for the directors was that the company was working towards, as it had been for some decades, carrying on its business into the future indefinitely. It said: "The company had managed to continue to trade despite serious balance sheet insolvency for some years." There is a question mark about that from our perspective, "and there were good reasons to think that this strategy could continue for the short term at least." Again, that's the Court of Appeal's time qualification. It points out: "The board papers for the February 2011 meeting recorded strong cash flow and a relatively positive immediate financial outlook. But the writing was on the wall." And that is the point where we say when we say the writing was on the wall, that is a phrase relevant of hindsight.

Then it goes on to list a series of matters: "Legacy obligations continued to erode the company's modest cash resources." That largely means leaky homes which was an industry problem at the time and which Mainzeal had been addressing in particular by a policy of trying to deal directly to fix things, trying to sidestep any litigation issues.

WINKELMANN CJ:

Didn't they also have a restructuring plan to address it?

MR HODDER QC:
Yes.

WINKELMANN CJ:
Isolating there?

MR JEFFRIES:
Yes, they did. They did. It was part of it. "The company's ability to generate cash flow from principals depended on incurring further obligations that would fall due in coming months." That's the nature of carrying on business. Every business that has any scale and involves contracting with other parties such as the construction business has to do that, if you don't have a pipeline you don't have a business. This is simply describing a pipeline in different language and it says: "It is a strategy that didn't resolve the underlying balance sheet," and said "it simply deferred the risk." But that, with respect, is dealing with two different topics in the same sentence.

The underlying balance sheet issue is being dealt with in the two ways I have mentioned several times and the risk of being unable to meet obligations when they fell due, which is cash flow, was being dealt with by trying to make the company profitable notwithstanding the legacy problems which they were fully engaged in doing by making various plans, doing careful assessments of what they were doing, getting advice from Ernst & Young and the like and carrying on and that's where it leaves the Court of Appeal to go on to say: "In these circumstances, we consider that where significant obligations with a longer time horizon were taken, for example, the obligations to principals under the four major contracts, there was a high risk that those obligations would not be performed."

So why would that be? Well, that would be because there would be a possibility at some point that there might be a problem such as arose with Siemens. So the risk was that Siemens would come along and cause major problems for the company and that's exactly what did happen and so it caused a great deal of difficulty and they had virtually got through it by

January 2013 when an unexpected development, Mr Yan writes his letter at the end of the month saying he can't guarantee further support from the CHC. That gets reversed by the CHC a few days later, but it's too late and so we say when you put all that together, there isn't a strong foundation for the proposition that the writing was on the wall in January 2011. That's the high level description of the case that we are advancing to the Court.

But we say these two paragraphs are particularly pivotal to the way in which the Court of Appeal analysed its visits and its concerns in relation to section 136 and the breaches that it found.

It goes on to say, for example at 468 over the page, a point we've just been discussing towards the bottom of 468, if we can blow that up please, the second last sentence on the page: "The directors agreed to these obligations being incurred: they were incurred in the ordinary course of Mainzeal's construction business." Of course they were. That was what the business of Mainzeal was, entering into major construction contracts. Without it there was no business. Without it there was no soft landing.

So the general point that we make is in our 5.4. I will be coming to specific documents, but the general proposition that I have outlined is in 5.4. The directors say that they were diligent in addressing the issues confronting Mainzeal. They applied their industry expertise and experience. They assessed audit reports carefully. They considered "going concern status" carefully, and they took external advice on how to improve their business, in particular from Ernst & Young, on several occasions, as the Court knows.

Now a great deal of detail of this is set out in schedule A to our written submissions which is replete with numerous footnotes and evidential references of the kind which at this level I don't have time to go through which is why I'm doing a selection of documents to try and cover some of the broader themes. But I've given you the references to our written submissions,

both the appeal submissions and the cross-appeal submissions, in the right-hand box at 5.4.

Then I say at (b) their view that Mainzeal could achieve a satisfactory balance sheet and profitability was reflected in the views of Sir Paul Collins, and the group's supply of cash and assets, the support of BNZ, notwithstanding very robust PwC advice in late 2012, throughout the time of the Siemens cash flow crisis.

So moving on to 5.7 and some of the documents. Perhaps before I do that, because I see we're getting close to the afternoon adjournment, assuming that's what the Court's doing, but I perhaps should enquire.

WINKELMANN CJ:
We normally finish at four.

MR HODDER QC:
There was a minute from the Court that raised the possibility of sitting in kind of the old-fashioned High Court hours but I wasn't sure what the Court was –

O'REGAN J:
I think that was if we were remote.

MR HODDER QC:
Okay. Right, in that case thank you for that clarification. Yes, so in that case let's turn to the documents at 5.7 and recording that the points – much of this material is set out in schedule A of our written submissions on appeal, so I'm not going to go into the enormous detail of it but I'm picking on some of these documents to indicate that there was work going on. Clearly, as the Court appreciates, in the size of the case on appeal, which we're not referring to more than perhaps a small percentage or even a fraction of a per cent of, there was an enormous amount of evidence about this. But the point that underpins it is that this wasn't a case of directors not paying attention. It wasn't a case of there being nobody at the wheel. It was a case in which

there was careful, regular governance activity going on. There were proper board reports being prepared for the board to consider them, or did consider them. There's no suggestion they weren't devoting sufficient time to it, and they were getting the help of external consultants to refresh their thinking and avoid the confirmation bias that was mentioned earlier in the day.

So the first document, if I can take the Court to that, is at 307.03950. So this is a December 2009 Ernst & Young report and the concept is creating capacity for growth. As the Court appreciates from repeated comments from me up to this point, what I'm looking to show is that the directors took reasonable steps through 2011 and 2012 in particular, but also going back into 2010, to deal with both the balance sheet issue and the profitability issue. Now this document is really about profitability. It's talking about the capacity for growing the business and doing so profitably. It's a lengthy report. It's about 65 pages long, and it, on page 3952, sets out some of the background. We're talking about restoring profitability and market reputation, complications by the GFC and there's a contraction in the overall market during that particular period. On the other hand, the republic private partnerships which provide some basis for optimism.

Over the page there's some discussion about the business model and organisation and it says what their analysis is, it works out analysis of what the most profitable jobs were on analysis of 2002 to 2009 and concludes at first paragraph that: "There was support for the current strategy of trying to influence the design processes early in the procurement cycle as possible," and then a series of recommendations are made in relation to that.

The next page just 3954, again there is some discussion about what can be done, to do in terms of profitability and suggesting that the analysis, this is the second paragraph: "Our analysis shows a significant opportunity for Mainzeal to improve its margins possibly with cost savings over $12 million per annum."

And then the strategy that is generally being discussed in this exercise is that of selecting the right jobs, or the right projects, trying to avoid the ones that are least profitable and there's an –

WINKELMANN CJ:
I suppose all construction companies want to do that.

MR HODDER QC:
That's true. It's true, but we respectfully say that the directors can't be criticised for trying to be the best construction company they could be, which is what this is all about and is not consistent with the approach that says they weren't concerned about restoring profitability.

GLAZEBROOK J:
Isn't the issue more here about the balance sheet issue?

MR HODDER QC:
I'm sorry, your Honour.

GLAZEBROOK J:
Well, without the balance sheet issue, I don't know that the Court of Appeal would have come to any view on the profitability issue, would it, or do you say it did and that was integral to its decision?

MR HODDER QC:
Yes, I do, your Honour. That was, and we're back at 462. The focus on the fact that legacy obligations were eroding the company's cash resources implicates the question of the company's profitability.

WINKELMANN CJ:
Well, it was never, there weren't years when it was earning an enormous amount of money was there? When you look at the history of the company, you would have no proper basis, no rational basis, for saying it's going to become an extremely profitable company suddenly when basically the same

directors are running the same company which is not many years turned much of a profit, if any at all, I suppose might be the point?

MR HODDER QC:
I will have to come back to your Honour tomorrow, but in fact somewhere I have an analysis that says actually there were some serious profits made in various years and we will see some of that in terms of the EBIT figures in documents as we get to later.

So to your Honour Justice Glazebrook, my response is that of course the balance sheet is a critical part of the equation. This document doesn't address that. The next document starts to do it and some of the other documents do so more. But both matters are not being addressed in the same document in all cases. This one is focused on profitability and that's what happens when we get, for example, at pages 3989.

So with hindsight one can always say: "Well, this looks like there is nothing particularly surprising or exciting about this," but this was a fresh view being brought in, a non, an external perspective and describing how the sources of profit were not being well understood and what could be done to improve that with the results that would be better for the company's profitability.

WINKELMANN CJ:
But Justice Glazebrook's point I think Mr Hodder, is that their business plan was not going to change the balance sheet significantly in the short term, was it, and the focus of the Court of Appeal was on the balance sheet and the need for capital or better, more binding letters of support.

MR HODDER QC:
I've read the Court of Appeal as being concerned that both the balance sheet and the profitability weren't going to be fixed and my propositions are that they were two different issues being addressed in different ways and we resist the proposition that the profitability wasn't being addressed by people who were bringing business judgment to the best way to run the company.

WINKELMANN CJ:

All right, perhaps it might be helpful just to have the references for that at some point, where they say that clearly.

GLAZEBROOK J:

It's a legacy obligation you were pointing to, wasn't it?

MR HODDER QC:

Yes.

WINKELMANN CJ:

That's the leaky homes though. It's the carrying forward –

MR HODDER QC:

But that goes directly to profitability. That's the real problem that the Chief Executive reports on month after month. They've got these legacy problems. That goes to the point that your Honour was mentioning before about whether or not they could syphon those off into a different entity in some form.

WINKELMANN CJ:

Which was part of their plan, wasn't it, I think?

MR HODDER QC:

Mmm. So just if we can leave that and move to the next document. That's at 314.08481.

WINKELMANN CJ:

I rather thought that what the Court of Appeal was saying though was that this was a vulnerable company which was being buffeted about and needed balance sheet resilience, was simply the point they were making. That's what I had understood.

MR HODDER QC:

I have – well, I'll go back and check my own notes overnight.

WINKELMANN CJ:
Find the bits, right.

MR HODDER QC:
But my apprehension in reading was that they were concerned with both.

WINKELMANN CJ:
It's quite a large judgment so pinpoint references would assist me too, thanks, Mr Hodder.

MR HODDER QC:
Shall do. So at 314.08481 we have the National Business Plan prepared by the Chief Executive about what was contemplated. I don't think I need to take the Court through it. Business plans were being produced on a regular basis. they were being, as I'll come to, Mr Tilby said he took a sceptical eye to most of these plans and critiqued them and in the end he was satisfied they were robust based on his experience.

But the point about going to this document in part is to go to the last page, 8484, and after a discussion of various matters going to profitability and strategies, then you'll see at the bottom of that page: "Value Adding Strengthening of the Balance Sheet". So part of the strategy was being contemplated through that process. Purchasing a building for head office. That was –

GLAZEBROOK J:
I'm sorry, I'm not sure we're on the right…

MR HODDER QC:
You should be at the bottom of page 08484, last page. I'm just simply pointing that the last heading on this page is covering the question of balance sheet as part of the overall plan. They weren't being divorced from one another but it's just that the Ernst & Young paper I took you to was focused on profitability.

It may be simplest, given timing issues, if I go at this point to the Citron report because that's addressing the issues rather more directly. So that's at page 317.10337. That's my 5.7(f) reference. I'll come back tomorrow to the audit issues, but in terms of this document…

WINKELMANN CJ:
Is it 317 or 307?

MR HODDER QC:
317.10337.

GLAZEBROOK J:
Mine doesn't like that either.

MR HODDER QC:
That's interesting. Volume 317.10337, but that's where you tried, isn't it?

GLAZEBROOK J:H
That's not the reference you give on your outline. You have 316.09711 on your outline.

MR HODDER QC:
Yes, I thought that was the earlier July…

WINKELMANN CJ:
That says "Project Citron: Financial Information Document".

MR HODDER QC:
Well, we now have it on the screen. But that's the document I've been looking at in hard copy, so it's encouraging it exists.

So this project, this had been developing for a while. This was the second iteration at least of the document that came from Project Citron and what EY were, among other things, doing was to assist Mainzeal to present in a form

that was useful for evaluation by potential customers and funders the way in which the company was operating and for our purposes, if we can go to 365 there's a discussion. It's a long report again. It runs to 30-odd pages, but at 365 there's a discussion of related party cash flows and interest, the very issue that we have been concerned with and what is being said is that: "As part of management's recapitalisation plan, it is intended that the debtor balance that's owed by the minor party owing the receivables were reduced as a result of expected trade sales. The cash inflow shown on the table on the left shows the impact of the recapitalisation plan as related party balance is repaid over the financial year '11 to financial year '13. The balance of related party receivables are forecast to decrease from $42 million at December 2010 to $2.6 million at December 2013." That then ties in with the table off to the left-hand side of the proposition.

That's the exercise that was being anticipated by related party receivables coming in during this period by virtue of the pre-purchase, what effectively becomes a pre-purchase agreement. That's the estimate that is given to the parties. So the directors receive this. I mean it's clearly worked up because this restructuring is being worked through between the group and Mainzeal, but what this is an indication of is that it wasn't a matter of ignoring the balance sheet position, the expectation was that over a period of two years from this point, I say two and a half years to be simple, there would be a major change in relation to the balance sheet in terms of what that receivable, related party receivables was standing for in the balance sheet itself.

WINKELMANN CJ:

Well, that's just what management wants to happen and where are the plans for it apart from the prepaid sales? This is narrating what management's plan are, isn't it?

MR HODDER QC:

Well, it's part of the recapitalisation plan. The recapitalisation plan had the two streams I mentioned. This is the part that deals with –

GLAZEBROOK J:

Well, do you want to take us to the two streams so we understand how the figures work, because that's just a figure without an indication as to how it's going to happen?

MR HODDER QC:

Yes, I can do that tomorrow. The point I am making is that this is the kind of material that the board has and the work behind it that gives it the comfort that it has a basis for thinking the balance sheet position is going to improve, not that it's ignoring it.

O'REGAN J:

Did the board vote to adopt this advice to accept this advice and do it?

MR HODDER QC:

It's received, it's endorsed, it works its way into various propositions, but there is a transforming of the recapitalisation plans. They emerge and evolve in various ways and it doesn't happen exactly like this in the end of the process, but that was the expectation. That was the way in which it was meant to be gone about and as I have been saying –

O'REGAN J:

But this is just advice to the board from an external advisor. Is there something which indicates that the board accepted the advice and was going to act on it?

MR HODDER QC:

Yes, I can take the Court to the minutes that followed the receipt.

O'REGAN J:

No, no, just a yes or no answer is fine.

MR HODDER QC:

The board accepts this as the approach to be taken.

WINKELMANN CJ:

So, can I just ask, is it actually advice because this part is simply then narrating what the management says they are going to do?

MR HODDER QC:

That's the point. It's a combination. It comes from the work being done by the group and Mainzeal management about recapitalisation plans. It's most simply summarised in this form in terms of my looking for it.

WINKELMANN CJ:

So it's not Ernst & Young say: "Yeah, do this and it's great"?

MR HODDER QC:

Well, it's Ernst & Young being brought in as an external party that helps the process.

WINKELMANN CJ:

Yes, to help them formulate the plans.

GLAZEBROOK J:

Can we go and have a look at the recapitalisation plan section, or is that not relevant?

WINKELMANN CJ:

I think Mr Hodder suggested he want to take us to it tomorrow.

MR HODDER:

I'll do that tomorrow, I think. Many of those details are in schedule A. I'm wanting to introduce to the Court the idea that it isn't a straightforward proposition to say that the directors were paying no attention to the balance sheet exercise, it wasn't being addressed. It was being addressed and, as I say, I gave the short answer to Justice O'Regan that it was picked up by the board but I'll provide a little more detail tomorrow to assist the Court on that front.

And just obviously the directors have no knowledge of the Court of Appeal judgement at this stage, of course, by definition, but this is well after January 2011, this is work being done to improve on the balance sheet at the time, it was work in progress being done because it was a sensible thing to do, and it was being worked through with the group because it was the group that was going to provide that capital and enter into those arrangements.

Related to that is the general question of how the board addressed the question of going concern and on that, going back a stage to my 5.7(d), we have the audit report for the financial year ended December 2010 at 315.09180. We'll come to Sir Paul Collins at some point, but he describes the EY auditors involved in this exercise as being "hard auditors" in his experience and –

WINKELMANN CJ:
So what was that? Right, good.

MR HODDER:
The reference is 315.09180. It's possible that it's at the end of that document, thank you. That's it. So this is April 2011. They're fairly standard format, the content changes from year to year but the format is reasonably standard. So, for example, at page 9182 it sets out the way in which they have approached it and that they contemplate issuing an unqualified audit opinion in the third paragraph. Then they address the question of going concern at page 9188 and understands that they – it sets out that they've done various procedures to assess the validity of the going concern assumption. Third paragraph: "Based on the audit work we performed, we do not believe the budget and cash flow forecast to be unreasonable," that kind of goes with that aspect of it, but then it goes on to talk about the related party balances, which it then describes. It goes on to say that: "Those are a significant factor determining whether Mainzeal continues to be a going concern," and concludes by saying there will need to be "a letter of support from the major shareholder at the time the financial statements are approved and signed.

On receipt of this letter we will still need to assess whether this entity is in a position to honour this support." As I think I mentioned earlier, there is some evidence that EY visited China to look at the assets as part of the work that they did in relation to Mainzeal audits.

Then at 09192 the outstanding matters are listed and the second item is the receipt of the parent support letter, then support for recoverability of related party balances, including repayment terms, and then receipt of the letter of representation.

The form of the draft audit opinion is at 9195 and you will have seen that effectively in the document I took you to this morning in terms of the accounts ticked off in 2011, and then the form of the letter of the representation is to be found on 9199 and that particular aspect of the going concern assumption is dealt with on the right-hand column in the third paragraph down: "We believe that the going concern assumption is appropriate for the preparation of these financial statements. Note 14…discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern," et cetera.

Then if I can, the way in which those audits were then dealt with by the board is dealt with by Dame Jenny Shipley in her brief. That's at 206.02059 at 206. That'll be in the right-hand column. If we can go, please, to page 02097 when she refers to the audit report for the financial year 2010 which is what we've just been looking at and then goes on to describe the standard pattern that was followed by the board in relation to those reports at paragraph 163 and following, and so recording in 163: "…detailed discussion about group support…very clear we were relying on the Richina group for our balance sheet. An important focus of the discussion was also Mainzeal's ability to pay debts as they fall due. Richard would explain the RPL and group position. Chinese foreign exchange regulations were often evolving, but Richard always assured us that there were avenues of support available, and worked actively to make sure that was the case," including the supply of materials and SBLCs.

"We would work through each issue raised by EY and seek management's response and/or agreement…I also ensured, at every audit, that we had a discussion (with the auditors) with Richard, and management, out of the room."

Goes on to describe the minutes, and then at 166: "In this report, EY did raise with us the treatment of payments made by Richina in China purchasing product for Mainzeal," and that was a subject of some discussion. Confirmed that could be regarded as a net off, and so on and so forth.

Then 169: "We worked closely with the auditors on matters raised in the report….status as a going concern was considered and the solvency test fully evaluated with the knowledge that we had the support of RPL. The directors of Mainzeal…requested a letter of support, as was the normal practice. EY confirmed a letter showing parent support was required," and that was provided in due course, and so she says at 170: "I was confident that that remained available."

Then the letter of support, as I think we may have looked at it before, 316.09352. That's what we looked at before and the Court will recall this is a period of 12 months from 28 April 2011. So it doesn't refer to the companies that have assets on the left-hand side of the wiring diagram, but if we come back to the Shipley brief please, and go to page 2098 we see her summary at 170 about why she remained confident that the parent company support remained available given the significant back and forth between me and John Walker and Richard at the end of 2010, as well as the formal letters of support. All our board packs are being sent to John Walker at RPL. "There was no doubt in my mind that the RPL board was fully aware of our position and that Mainzeal could continue to trade based on that support." Then considered that her board colleagues felt the same way.

That is a core aspect of the position that the directors took as they approached this issue. They knew these people. They knew that there were

assets in the group as a whole. No, they didn't seek a formal binding access to those assets, they relied on the assurances, and the question is why shouldn't they rely on the assurances.

WINKELMANN CJ:

Well they seemed to be pretty anxious about relying on them at times though, didn't they? They went back and sought better assurances and clarity to who was behind the assurances is my recollection in the narrative of facts.

MR HODDER QC:

At various points they did do that but they were, and this is the position as at 2011, the judgement that they made was that with the people who they understood to control the group as a whole, Mr Yan and Mr Walker as chair, being absolutely adamant that there would be whatever support was required for Mainzeal as it went forward, that they could rely on that, together with the fact that by this time they were working into sorts of issues that were discussed in the Citron report, and so that, together with the idea that they were going to set up a different structure in New Zealand, so New Zealand would have a stand-alone operation including the new capital assets such as Mainzeal House, work was in progress towards those issues on the balance sheet.

WINKELMANN CJ:

So that evidence is summarised differently by the Court of Appeal than you've just summarised it.

MR HODDER QC:

Well what I'm –

WINKELMANN CJ:

And by the High Court. Findings in relation to what they were told by Mr Yan are different in the High Court, in the Court of Appeal rather than your summary.

MR HODDER QC:

Well I'm referring to what Mr Yan said in his evidence, and what the directors, my directors said in their evidence.

WINKELMANN CJ:

Yes. So you're asking us to take a different view on the evidence than the courts – the High Court and –

MR HODDER QC:

Only in it was a question of judgement. There was no specific aspect to this – well I'll check, I don't know what the Court of Appeal relies on again, but in the end the question is a simple one, did you have to have something formal, or did you have to have – or could you rely on your belief that these people controlled the assets and would do all that they could to make sure that Mainzeal was supported. That's what we say these directors did, and we say they were entitled to do it. With hindsight you can say, could they have got a second opinion about Chinese regulations? Well yes, they could've done. Could they have taken earlier legal advice in New Zealand? Well yes, they could've done. Should they not have relied on Mr Yan and Mr Walker? Well perhaps they shouldn't have done. But were those not, we say, matters of business judgement of the kind that they were entitled to make, and –

WINKELMANN CJ:

So I think the – I mean one finding, for instance, is at 445(c) which you've already taken us to, which was that they say that they were insufficiently clear and definite, they were not in writing, they were informal, the parameters are unclear. Mr Yan, at least considered that they were subject to the important qualification that they only applied while Mainzeal was a going concern.

MR HODDER QC:

Mr Yan said that I think in cross-examination. I don't think that was a matter known to the directors before that, but I'll check that. That's my recollection from the trial.

WINKELMANN CJ:

So what I'm saying is, this is a really a finding which I think is concurrent in the High Court and the Court of Appeal in relation to the nature of these undertakings, and I think you're inviting us to take a different view.

MR HODDER QC:

Well again it's the approach, the proposition is they're insufficiently clear and definite, which simply means that they weren't formalised, and so the question is, is formalisation required. That's not a question of fact, that's really a question of approach.

WINKELMANN CJ:

Well that's not how I read the overall judgment I have to say. I think they go through and make the point about how there's a sort of persistent lack of clarity, notwithstanding requests for clarification.

MR HODDER QC:

At points there are clarifications which take some time to come, but the basic message from all the directors, including Mr Walker and Mr Yan was, yes, they expected to be supporting Mainzeal throughout the process, and they did so to the best of their ability through the rigours of 2012 as well as earlier.

WINKELMANN CJ:

All I'm saying is you're asking us to take a different view of the facts. You might need to give us a schedule of the references that you're relying on so we can look at them.

MR HODDER QC:

I'll do that your Honour, but I am, I'm sorry to repeat myself, but the basic proposition is that the question is really one of judgement, not of fact. The question is whether or not something formal was required. That's really what the Court of Appeal is saying.

WINKELMANN CJ:

No, I think that they're saying more than that Mr Hodder. I think they're actually saying that they were insufficiently clear and definite. That the parameters are unclear. It's not just that they're not enforceable, it's actually that even on their own terms you accept their informality, that they were informal but they're also unclear.

O'REGAN J:

Well they also came from entities that couldn't perform.

MR HODDER QC:

Well again that goes back to the nature of the group that they came from, the people who were understood to control the group including the left-hand side of the balance sheet.

O'REGAN J:

Yes, but the people are irrelevant here, it's companies. I mean we're talking about company obligations.

MR HODDER QC:

I mean it's a legitimate view to have your Honour, but the end result of that is that means that it has to be formalised, it has to be in writing.

WINKELMANN CJ:

What I'm saying is that the Court of Appeal and the High Court have done quite a thorough job on analysing these and finding deficiencies. I mean if you're asking us to take a different view then we might need some references.

MR HODDER QC:

I'll see what I can do your Honour. Thank you your Honour, I'll cogitate and return tomorrow.

COURT ADJOURNS: 4.02 PM

COURT RESUMES ON TUESDAY 8 MARCH 2022 AT 10.03 AM

MR HODDER QC:
May I please the Court. Good morning. I have discussed the question of timing with my learned friend Mr Chisholm and also with Mr Mullins. I anticipate we will be finished before midday. That will leave them they think ample time to be finished by the end of the day, so that's how I propose to use time as a target subject as always to events.

Before I return to the road map, I was at 5.7 and there were four matters that I was in effect going to follow up from yesterday. The first of those was a question of whether or not in the Court of Appeal judgment there was a focus on profitability aspects as well as balance sheet aspects in terms of the reasoning that led to the view about writing being on the wall. There are four references in the Court of Appeal judgment. I will offer two of which are the main ones, but can I just by way of –

WINKELMANN CJ:
Sorry, where there was a focus on?

MR HODDER QC:
Profitability and cash flow as distinct from balance sheet and capital position. The first and passing reference is at 190 where the Court of Appeal was discussing background. It was talking about uneven operating profit and it did that by reference to its appendix C and I may as well deal with that now. Appendix C of the judgment, at the very end of the judgment, if we can go there please. Thank you and perhaps the most useful line to look at is the operating profit at the level of EBIT which is about two-thirds of the way down the page. The first number is 12,143 in brackets and the following year describes the EBIT 12 million, 2.5, negative 2.4, 854, negative 1.02 and then two bad years in 2011 and 2012. So the position in part to that comment was directed to, and the comments generally directed to is a position up to the end of 2010 because of the Court's view about what should have happened from

January 2011 and you also see in that table where the negative 1.02 is, about two lines up from that in terms of numbers is a negative 3.7 for legal expenses and in the January 2011 board paper which is at 308.04243. We don't need to go there, but I will read the reference for the record, 308.04243. At 04246 is reference to the fact that there were legacy costs of $1.7m incurred in the 2009 number as well. So that's the reference to uneven operating profit. That's part of the process.

The main references that underpin the concern that I expressed yesterday are in paragraph 445. Paragraph 445 sets out a series of factors, but at (e) there is reference to significant cash flow issues, management forecasts had proven unreliable and the reference to the legacy issues et cetera. Now, they are part of a wider paragraph, I accept that, but they do indicate that the Court was concerned with cash flow issues which in turn goes back to the question of whether the company was viable and from an operational sense and to that extent we say that was a question of judgment.

The next reference is 462 which has the writing was on the wall line in it on the next page and the next sentence is a reference to the legacy obligations that I think we looked at yesterday.

Then the final reference I would draw attention to the Court is that in 471 and then leading on into 474 there's a discussion about the position in July 2012 which is at the point where the Siemens cash flow problems arise and they are clearly discussing, as is clear from the way the judgment is placing weight on, the operational position as at that time.

So, and just for reference, in terms of what is said in 471 and 474, we address that in our written submissions, verbal submissions at paragraph 4.33, at least in terms of the aging creditors et cetera. So those are the references I wanted to give the Court.

The second topic was the letters of support. There was a request that could I indicate to the Court where those were. The first on is at 309.05252,

3009.05252, that's given in 2010. Perhaps a little larger please on the text. Thanks. So this was given by Richina NZ to RGREL which at that time I think was the parent of Mainzeal and then if I recall rightly, there was also a back to back letter from RGREL to Mainzeal which I haven't located, but that's the text, standard text, appears to have been settled with Ernst & Young, the auditors, and becomes fairly standard for what follows and again, it's forward looking.

So, I don't know if the Court needs to see them, but the references for the 2011 letter of comfort is 316.09352. 316.09352, this one is from Richina to Mainzeal itself. The next one is for, given in 2012, that is at 326.15491.

GLAZEBROOK J:
What year was that for?

MR HODDER:
That was 2012, Ma'am, 326.15491, given for Richina Limited, and there is another one in 2012 which appears to be a re-issue dated 18 May, that is at 320.11974. Some background to those might be appropriate to mention as well, if we can go please to 207.02554, 3207.02553, in fact. 207.02553, thank you, and then 2554 – sorry, numbers right, 576, if I can read my handwriting, 576.

WINKELMANN CJ:
Is this Mr Yan's brief?

MR HODDER:
This is Mr Yan explaining why he was, at paragraph 70 on 575, he explains firstly that he was the "Legal Person" for all the China businesses and the background in relation to that, but then over on the next page, paragraph 72: "The intention to support Mainzeal was unquestioned." At paragraph 74, at the bottom he's discussing which entitles might sign it, but the passage which I draw attention to is the fourth line: "To me, it did not matter which specific entity signed the support letters because, as I represented the shareholders

and could control the China entities, I knew that we would find ways to provide support." It goes to the proposition that he elaborated on in answer to questions from me in cross-examination that he was, in effect, a benign dictator in relation to the China operations and the China assets. And that was the understanding, at least until January 2013. And that position is confirmed by Mr Walker, that is to say the taking serious of the supports, I won't take the Court to it but the reference is 207.0283 which is the brief at 02906 and it's Mr Walker's paragraphs 56 to 58.

The question that we, I think it might've been close to the end of the day yesterday, was whether the group support assurances were findings of fact and that takes us back, if we can please to the fourth paragraph, 445 of the judgment, I think we were looking at 445(c) of that document or that paragraph, 445, paragraph (c), next page please. Thank you. The Court of Appeal says: "These assurances were insufficiently clear and definite, they were not in writing and they were informal." And to the extent that they're saying that they were not formal assurances, then, of course, we're not disputing the fact that they weren't formal assurances. Our point is that they were general assurances that the group would support as and when required, subject to China currency constraints, and then on that basis we say the question is one of judgement, not –

WINKELMANN CJ:
And Mr Yan's communication which precipitates the liquidation is about him withdrawing his guarantee, is it?

MR HODDER QC:
Yes, well, being he – yes. It was a component of the BNZ package that was required, and on terms of that, the question being one of judgement and the approach that one does to that, then in a sense we finish up with the issue that we expressed concern about in our submissions, round about paragraph 2.18 of our written submissions, but it relates really to paragraph 262 of the judgment. So if we go back to 262 of the judgment, you'll see paragraph at the bottom of the page the submission for the directors

was an assessment whether a company is balance sheet solvent, likely to be able to meet its debts as they fall due, is itself a matter of business judgement. The Court wasn't prepared to accept that and on the next page says that it's an objective exercise and if it's an objective exercise it is, in a sense, substitutionary, and we say that is a kind of problematic issue for business judgement purposes and in our paragraphs 2.18 to 2.19 we quote from the *Re Caremark International* 698A 2d 959 (1996, Del Ch) from Delaware to illustrate the concern that that approach arises when there's an effective transfer of an issue from one of judgement to one of objective, in effect, substitution.

WINKELMANN CJ:
So what do you say is for the business judgement of the directors?

MR HODDER QC:
The business judgement of the directors is to decide whether or not the company was balance-sheet solvent.

WINKELMANN CJ:
Right, and able to pay their debts as they fall due.

MR HODDER QC:
And whether it was a going concern which is a topic they addressed every year at the audit time and in 2012, as their evidence shows, they were addressing it practically weekly.

WINKELMANN CJ:
Well, is it really a matter for the business judgement as to whether they're balance-sheet solvent or as to whether they can – is – as to whether they're balance-sheet solvent because isn't that actually to some extent an objective fact?

MR HODDER QC:

Well, that's the matter that's in issue, your Honour. Our submission is that it is a matter of judgement, particularly in relation to balance sheet, there's a whole series of factors to be taken into account, and I don't want to repeat the kind of exchanges we had yesterday but my position on that is that if there's a rational basis for concluding that there was balance sheet solvent then that should be acknowledged and respected in the processes that follow liquidation, including litigation.

WINKELMANN CJ:

So really that that would be – the point is really that at a certain point it may be an objective issue of fact but in this twilight zone there are judgements to be made?

MR HODDER QC:

Yes, exactly, your Honour, exactly, and if you could all forgive me for restating the point about judgement in relation to support, the question about the group and in particular the CHC having very valuable assets, I'm not sure that's in issue but it's discussed, for example, by Mr Collins at paragraph 12, I won't go there at the moment, in his brief, the fact that Mr Yan controlled the Chinese assets, I've already given you the reference to some aspects of his brief, but it's also in his cross-examination at 207.026 –

GLAZEBROOK J:

Is there anything backing up those assertions? So there's an assertion that he was in control of everything.

MR HODDER QC:

It was the assertion that was – the backup would come, in terms of the evidence, would come from the fact that Mr Walker agrees and he was the chairman of the enterprise that was –

GLAZEBROOK J:

Well, you didn't take us there so I'm not entirely sure where that comes from, what he said.

MR HODDER QC:

What Mr Walker –

GLAZEBROOK J:

So that's the only backup, Mr Walker agreeing?

MR HODDER QC:

Well, Mr Collins in – sorry, well, Sir Paul Collins and Ms Shipley take the same –

GLAZEBROOK J:

Well, did Mr Collins have independent information about the position of Mr Yan?

MR HODDER QC:

No, no, that was – well, it's the way in which it operated, but perhaps I can take you to Walker which would be most directly responsive to your Honour's question.

GLAZEBROOK J:

But nothing in terms of corporate structure or anything of that nature that you want to point us to?

MR HODDER QC:

Not in terms of documentation but if I can…

GLAZEBROOK J:

So no documentation to back that up, is there?

MR HODDER QC:

No documentation was in evidence.

WINKELMANN CJ:

Was it challenged?

MR HODDER QC:

No. Perhaps I can start though, as the point is then, as a matter of interest, can I go please to 207.02647. 207.0267 [*sic*] we get Mr Yan on the screen. We just find him please. Right, if we go then please to page 2695 in the same document. 2695. A series of questions. This sequence starts back at 2692, but the point that emerges on 2695 really is the series of questions that go through that process and at the centre of that around line 14: "It's a democratic dictatorship, as you described."

WILLIAM YOUNG J:

So, what part of the evidence is this? Is this cross-examination?

MR HODDER QC:

This is my cross-examination of Mr Yan. So his control discussion starts –

O'REGAN J:

It seems a bit of a contradiction in terms to say if it's a dictatorship how can it be democratic?

MR HODDER QC:

His discussion of how he got that control starts at the bottom of 2692 and the discussion carries on from the bottom of 2692 and the fact that it was understood by all around carries through into 2696.

WINKELMANN CJ:

It's a question of law what his control was, correct?

MR HODDER QC:

Well the issue that I'm raising in which context I am raising the question is the reasonableness of the reliance. So the reasonableness of the reliance was what was understood by the directors which was the uncontradicted position

of Mr Yan making repeated assurances on the basis he did have control of the China assets.

WINKELMANN CJ:

Yes, but Mr Hodder, this is a major trading company, so directors wouldn't reasonably just rely on one person's assertion that he has control without being satisfied that he does in fact have control and one assumes the auditors also looked at that?

MR HODDER QC:

Well, there is a history that goes back in relation to this matter. So Dame Jenny has been on the board of RPL with him for some time. Mr Tilby was on a board at a higher level at some point. Mr Collins was the overall structures. They weren't necessarily familiar with the particular format that's referred by Mr Yan at the beginning of that exercise it gave him a control. But the fact that he had it was not contradicted by anybody and the fact that he was the one in charge of getting money from China to New Zealand wasn't in doubt.

GLAZEBROOK J:

But you're trying to show the reliance was reasonable.

MR HODDER QC:

I am.

GLAZEBROOK J:

So, my question was just was there anything other than assertion and you have said no documentation available to the directors.

MR HODDER QC:

I imagine if they had asked they might have got the material he refers to on, but they didn't ask for that. They have the statements he made there. But your Honour Justice Glazebrook was asking was anybody else apart from Mr Yan saying he had control and I mentioned Mr Walker and that would take

us, if we can get directly to the page, to 207.02923. 207.02923, thank you. This is my cross-examination of Mr Walker. He was a witness as what Mr Yan called by Mr Yan of this case and you will see the question is being asked from about line 14 onwards.

WINKELMANN CJ:
So you're asking questions which are quite legally unspecific. I mean, what does it mean to have control?

MR HODDER QC:
Well, the context in which I was asking it and which I understood him to be answering it was that he could make decisions on behalf of the group for the purposes of its operations in New Zealand.

GLAZEBROOK J:
Without wishing to get into hindsight, I'm really looking at what the directors knew or enquired about at the time. So they had no documentation. They had the letters of comfort.

MR HODDER QC:
Your Honour is right, I can't take you and we didn't have any documentation at trial that touched on this issue that I can recall. I'm happy to be corrected, but I don't believe there was any documentation because it wasn't an issue, that he had this kind of control up until the point it got to January 2013. So he did assert this in his evidence.

GLAZEBROOK J:
Well, if you're saying they had a rational basis, and you're trying to overturn the Court of Appeal and the High Court findings, all I'm asking is, what did they know at the time apart from the – and what information did they have at the time that backed up what was an assertion, I assume, by signing the letter.

MR HODDER QC:

Effectively –

GLAZEBROOK J:

But there was something behind that?

MR HODDER QC:

Well, they had regular – all I can say to your Honour is that the letters were certainly letters of comfort were certainly part of it and they were issued by him on the basis that he indicated in the passage I took you to from his brief. But in addition to that, they had been working with Mr Yan for many years. It wasn't kind of a casual acquaintance who was offering a pot of money for a particular purpose, who'd come out of left field. They had been working with him and he had been committed to the Mainzeal operation for a long time. He was able to be committed to it because he had the interest in China, the nature of the interest that we're describing is what was understood by all involved at the time. But, as I say, I accept, of course, that I'm not pointing the Court of any documents.

WINKELMANN CJ:

Yes, so it says there that Mr Wu took control in late 2012, yes.

MR HODDER QC:

Yes, that's Mr, I think that's a typo for Huo, H-U-O, who was the gentleman who comes in as chief executive and causes the problem in January 2013 or late December '12, into 2013.

WINKELMANN CJ:

Huo, okay.

MR HODDER QC:

And which is what provokes the letter from Mr Yan, that then pulls the interest out.

O'REGAN J:

When support actually was provided, was that instigated by Mr Yan? I mean, was it apparent to the directors that it was Mr Yan who made that happen?

MR HODDER QC:

I don't know that anybody specifically says that, but certainly the implication from all the evidence of everybody among the directors, is that's what was going on. That was understood when, why they thought he was giving, able to provide support was, the understanding was that he was the person who would organise support from, and he did in conjunction with his, I think he had a team in Malaysia and obviously in conjunction with the CFO, but Mr Yan was a critical person in relation to this. Nobody else was.

So just to list the points that we would say on that regional list, there were very valuable assets. Mr Yan did control CHC. He did make repeated, frequent representations of support. They were supported by the evidence of Mr Walker and the group was committed and Mr Yan were committed to Mainzeal in New Zealand, both personally and by the bonds that the group was, as it were, on the hook for in relation to Mainzeal's New Zealand operation.

WINKELMANN CJ:

And the Court of Appeal saw it as relevant that this was not legally enforceable and they were effectively a fair-weather friend, just to give them working capital but it wasn't an underwrite for the solvency when the merry-go-round stopped, what do you say about that? That's their point: "Mr Yan at least considered that they were subject to the important qualification that they applied only while Mainzeal was a going concern." What do you say about that?

MR HODDER QC:

I think the Court makes the point, which paragraph are you reading from, your Honour?

WINKELMANN CJ:

At 445(c).

MR HODDER QC:

Right. He gave evidence to that effect at the trial, as I recall it. But it's the next sentence that goes to the position of my people. It appears that wasn't the understanding of the other directors, the other directors understood it was support as and when required without the qualification. And so the point that the Court makes as well, you needed to nail that down which gets back to the general approach, do you have something formal or do you have something which can be accepted as informal, but reasonable? That gets us back to the judgement versus fact point.

WINKELMANN CJ:

I suppose I'm thinking about, what I'm really asking you there is, what should they have been asking for because it wasn't the letter of support situation that precipitated the liquidation, it was Mr Yan withdrawing the guarantee. So I'm just wondering what the Court of Appeal is driving at, should they have had a letter of support that saw the creditors paid in liquidation, is my thought?

MR HODDER QC:

Well the detail about –

WINKELMANN CJ:

I'm trying to work through the logic of it.

MR HODDER QC:

I understand, I was also trying to respond to your Honour's points about what precipitated the end of Mainzeal. It was an indication, according to Mr Yan, from Mr Huo that the CHC would not, in fact, support what was being done, which led Mr Yan to say without that support he couldn't give his personal commitment to the BNZ package.

WINKELMANN CJ:

So it is casually connected?

MR HODDER QC:

Sorry?

WINKELMANN CJ:

Yes.

MR HODDER QC:

That was then addressed by Mr Walker and others and that was resulted in a reverse position by Mr Huo, after he was talked through it line by line through a translator, and the support from CHC was then provided. This was for $10 million in two stages in 2013. That's often but by that stage it's too late because the bank has decided not to proceed after it became aware of Mr Yan's letter saying he wasn't going to participate. Mr Yan supported that change of position after his damaging letter, but it was too late, and the point that Mr Walker makes is that until Mr Huo came onto the scene in about December 2012, Mr Walker had no question that, but that Mr Yan did control in effect the CHC, which is where the money was.

The Court understands the submission, I'm sure, there's a long period of time, there's a history here, and one of the points about judgement goes to the question of, do you trust people, do you think they are reliable. One way of dealing with all those issues is insisting on some legally enforceable document in relation to these matters, and obviously with hindsight that would have been an excellent idea. The question though is without that was it still a rational thing to do, to assume that this support would be coming, given the understanding of the size of the assets in the CHC, and the understanding that Mr Yan controlled it, and the understanding that he could work his way through the Chinese bureaucracy and regulations to get funds out as and when required.

That's a bit longer than I was anticipating but in any event the last point I was going to come to was the question I had from Justice O'Regan about what happened with Project Citron after the Ernst & Young Citron report itself and if I can just briefly indicate what happened. It went to, it was tabled at a July 2011 board meeting. There are actually two versions of it. There's a first draft and this is what it's called draft, is the second raft. So between the first draft in early July and the second draft in 24 August, it's tabled at the 2011 board meeting. That's referred to in Mr Tilby's brief of evidence at paragraphs 158 to 165. I don't know that I need to take the Court there but if the Court is happy with that then those are the references. Then it comes back to the board on 24 August 2011, and that is the same date as this document.

So if we go please to 317.10085. so these are the minutes of the meeting of 29 August 2011, and at item 3, if we could below up the last third of the page please, there's the discussion about the EY report, and various bullet points are recorded there, and you'll see the matter recorded apropos the conversation we've just been having in the second to last bullet point "continue to have support of Chinese assets as guarantor for NZ," and this is a meeting attended by Mr Yan.

Then over the page the company discussion, or summary of the points from the conversation carries on, and the resolution of the board approves in principle the legal and governance framework as presented, further work is required, et cetera.

Mr Yan explains a little more about the context for the EY report in his evidence, if we go back to his brief, which is at, the relevant page is about 207.02584. if you can blow up paragraph 105 please to make it legible. Thanks very much. So this is Mr Yan's summary in his evidence-in-chief of what was involved. It explains it evolved from the idea that there would be an MLG intermediate role and then EY then recommended you cut MLG out and the prepaid would apply directly between CHC and Mainzeal, which is what the prepaid ultimately documented. So I have taken this evidence to confirm the proposition I put to the Court yesterday, that the proposals that were set

out in the Citron report were a combination of inputs from, obviously, Mr Yan and the group, would have done it in complete isolation, together with Ernst & Young and people inside Mainzeal. Ultimately it was implemented by resolutions of the board. Those board resolutions, if we can go, please to 319.11372, thank you. now this is Mr Pearce, CFO, on 8 February 2012 attaching resolutions, a bit at the bottom over the page is his request that he has approval to affix their e-signature, and then the resolutions themselves commence at 11374. There's also an assignment resolution on 11375.

WINKELMANN CJ:
So what's the relevance of this Mr Hodder?

MR HODDER QC:
I was responding to the query about what happened to Project Citron, your Honour. It evolves into –

WINKELMANN CJ:
The forward purchase agreement.

MR HODDER QC:
The purchase agreement, but this is giving the detail of it. At the completion can I take us to 11378. This is Mr Pearce setting out a preamble that he proposed for these resolutions, and of some interest, if we go down to (d) we see the amount involved is NZ$33 million and (f) says: "The projects will however still receive cash from the paying clients for those building materials which Mainzeal then maintains in its bank account enabling Mainzeal to become a stand-alone viable business in its own right." Then the process of all that is discussed by Mr Tilby in his evidence at paragraphs 183 to 188,

There was a question yesterday about the validity of the PPA, the pre-purchase agreement, and as I indicated yesterday, that topic was a topic that was addressed in particular with my learned friend Mr Mullins for Mr Yan and I am inclined to leave it to him to answer or respond in relation to that particular topic.

So those were the matters that I was responding to, what were, I understood, to be questions where the Court was interested in further detail, and so I am providing that further detail.

GLAZEBROOK J:
I think I have asked you to show us the backing for the change from 42 to two or whatever it was.

MR HODDER QC:
Yes, I don't know that I can – well, actually, maybe go back one step on that.

GLAZEBROOK J:
And I've got those figures slightly wrong, I'm sure, but…

MR HODDER QC:
No, no, you're quite right. I think that's discussed in the report itself which I…

GLAZEBROOK J:
Yes, I think it was but I'm not entirely sure how that – what actually came through in respect of that but…

MR HODDER QC:
I'm not sure I can take your Honour to anything about how it came through other than the report itself.

GLAZEBROOK J:
Okay, that's fine.

MR HODDER QC:
So the report goes to the board and it morphs its way through a series of discussions which I'm not sure we have the evidence of but I can't give it to you, and it finishes up in the form of the agreement. But the further discussion I would have taken your Honour to is a couple of pages on from the page I took the Court to yesterday in the Citron –

GLAZEBROOK J:
Perhaps we can go there if that's all right.

MR HODDER QC:
Sure.

GLAZEBROOK J:
I mean just briefly so that we understand it.

MR HODDER QC:
Now the passage that I took the Court to yesterday in the document was at 317.10365. I took the Court to the passage headed "Related party cash flows & interest". The more detailed discussion comes at page 10368, and that sets out the table which is showing the increase in assets, net assets, in 2011 at 24.7 million, by the end of '13 to 58.97 million, and those increases are in part reflected in the first few lines under "current assets" but among things we see there the related party receivables reducing from 42.1 million to 4.59 million. I don't have an immediate reconciliation between 4.59 million and the 2.6 million that's referred to in the previous pages but your Honour appreciates it is to the trend that the directors were no doubt entitled to focus on, or we say they were. That I think is – and the next page as well, 10369 of the report, has a bit more narrative in relation to that.

So that's probably as far as I can take the Court in terms of where things went to, or how things were organised.

In the interests of making forward progress and not going beyond my target end time, in relation to the general story of 2010 and 2011, I'd simply mention to the Court that if the Court was to pursue that then the discussion by Mr Tilby I think is a useful summary of it in his evidence-in-chief or his brief of evidence, and most of the documents that are instanced in 5.7 are referred to and mentioned and put into some degree of context in his evidence.

So the Court understands the general submission is there was no writing of the kind that the Court of Appeal had in mind on the wall in January 2011.

Then the next section starting at paragraph 6 is: "Was the writing on the wall in 2012?" and to a large extent, and again in the interests of efficiency I do invite the Court to have regard to the evidence of Sir Paul Collins. Sir Paul's position was unique, or particularly unique, one might say, if that's not a clumsy construction. He was originally subject to the claim under sections 135 and 136. That was discontinued by omission in about December 2017. He remained a defendant because there was a question about whether part of the restructure was invalid and improper, one of the matters that the High Court found against the liquidators on in favour of Sir Paul and that hasn't been pursued further.

So he gives his brief of evidence in July 2018, so he's a defendant but he's not a defendant on the section 135, 136 matters, and he comes to Mainzeal in the way that he describes in his evidence. Perhaps we should go to his evidence please, it starts at 209.03777. So picking it up going over paragraph 3 to the starting point. In general terms, it's unlikely the Court's unaware of Sir Paul, but in terms of where he describes his background for these purposes is set out at paragraph 3, but in particular experience with the way a multi-national investment group was managing operational subsidiaries. His interest in Richina is described on the next page at paragraphs 10 and 11. He thought, as he says at 11, that the trading businesses were undervalued in the Richina group and then he got more interested after RPL acquired the Shanghai Leather company in 2004 and he did, his interest was improved by the fact that with the Shanghai Leather company came 140 acres of prime development land in Shanghai which was occasionally, as I recall it, discussed at trial as possibly being the bargain of the century. But in any event, that was what was of interest, and he discussed some aspects of that in paragraph 12. Then he explains he didn't know any of these people until at some point he got more, he got invited into conversations with Mr Yan and ultimately Mr Yan invited him to become a director, there was a view that at one point he would become chair of Mainzeal in succession to Dame Jenny.

In terms of the group paragraphs 17 and 18 were his perception. One of the restructurings achieved that split between the China side and the non-China side as it were, but as he points out at 17 and 18 you couldn't opt out of being one or the other, everybody was in both, and as he says at 18 it effectively remained one group and operated as such.

Paragraph 21 he describes the CHC consolidated accounts, about NZ$60 million cash, and then he goes on to describe his being approached to become a director. So at paragraphs 25 and 26 he refers to the fact he was given an assurance by Mr Yan: "…assured me the group was willing and able to support Mainzeal. He told me the group took responsibility for Mainzeal's solvency. The Mainzeal board's priority was to ensure that the company operated profitably." He goes on to say he didn't consider Mainzeal to be insolvent when he joined the board and makes a point at 27 that: "Mainzeal always relied on the group's balance sheet for its solvency."

It goes on to say in 28 he: "…believed that Mainzeal was solvent in April 2012. It held cash, no bank debt and was paying its debts as they fell due. It held substantial trade debtors, which would turn to cash each month, enabling the company to pay its monthly payables. It had positive equity. Given the intercompany receivables, it was ultimately relying on the Richina group for that equity but the group had very substantial unencumbered assets. So that was the position that he took coming in without any compulsion, coming in as a particularly astute commercial businessman which is the same view that was being taken consistently by the directors who are appealing to this Court now.

On the topic of audit, he discusses that at 32. He understood that, this is where he attends a meeting on 29 March 2012. The auditors attend. "I understood the conclusion was a going concern depending on the recoverability of related party receivables." Needed to see a letter of support that matched his understanding. Holds the auditors in high regard. Then talks about cash being managed across the group.

WINKELMANN CJ:

So in light of Paul Collin's evidence, I think at paragraph 27, does this case really come down to, in terms of breach, whether it was reasonable, using your terminology, for the directors to rely upon the support arrangements without seeking any kind of proper, seeking the clarification and documentation the High Court Judge and the Court of Appeal Judges –

MR HODDER QC:

To a very large extent.

WINKELMANN CJ:

So it really turns on that simple pivot? It pivots on that, in terms of a pivot.

MR HODDER QC:

Yes, your Honour, that is a critical pivot, there's an associated pivot or possibly even an underlying pivot which is the approach you take which is what we were discussing yesterday. In our view that something rational is sufficient as opposed to what I have been describing as a sort of a more orthodox pivot substitutionary approach and so if you have a, putting it bluntly, if you have a home site exercise being undertaken in a courtroom then the ideal thing to do is to say, why didn't they have more documents? And that's an easy question to ask and it's often a difficult question to answer. At the time, we say they were acting perfectly reasonably, and they had been doing so for some time. But Sir Paul Collins coming in in early 2012 is, we say, particularly cogent evidence in relation to the belief about the position of the company.

WINKELMANN CJ:

In Ernst Young also relying on those support arrangements for really because the matter of emphasis really makes it clear that the solvency of the company turns on that support.

MR HODDER QC:
Yes.

WINKELMANN CJ:
Now, am I correct that no one, Ernst & Young did not give evidence?

MR HODDER QC:
They did not.

WINKELMANN CJ:
No, and Justice Cooke says he really doesn't know what to make of it, he makes nothing of it, I think.

MR HODDER QC:
I think that's right, your Honour. There's all sorts of comment that one would like to make about that, but I refrain on the basis we have no evidence. But, no, there was no evidence from the auditors and the only evidence we have relating to the auditors is the material that they have provided to, or they did provide to Mainzeal during the period we're talking about plus particularly Dame Jenny's discussion of the way in which they were engaged in the board's deliberation about these matters and I took you to that yesterday.

But can I just repeat in terms, your Honour the Chief Justice, that does come very much to the heart of the case we have on liability, that it is entirely appropriate to say that there was a good rational bases for the directors to assume that there was support and there was both the means to provide support and the willingness to provide support or the commitment to provide support short of something that was legally enforceable. Both the High Court and the Court of Appeal judgments turn on the proposition that there had to be something enforceable because otherwise there was a hole in the balance sheet.

WINKELMANN CJ:
Is it that high or really that there needed to be more clarity and certainty?

MR HODDER QC:

Well, when, for example, taking Sir Paul's narrative, if the assurance is that, his paragraph 25, going back a couple of paragraphs, if that's the oral assurance given, and it's a similar understanding that all the other directors had, that's reasonably clear, even if it's not dealt with in legal prose or in legal document.

The general proposition for the directors was that they understood that there would be support as and when required and, in most cases, with a company that's carrying on business, it doesn't require support apart from dealing with cash flow issues, and it normally doesn't require, well, this is the issue that arose, there were some questions asked of Sir Paul by Justice Cooke: "Well, shouldn't you be prepared to contemplate a problem like Siemens, isn't that what construction companies have to put up with?" And his response was: "Well, you wouldn't expect to have that very often and when you did you'd have to do something extraordinary," and they did do something extraordinary; they managed to get together enough material and funding in to overcome the Siemens but for the problems that they had in late January 2013. That was the view that he took and the view the other directors have taken. So they were surprised by Mr Yan's letter because it pulled the rug from the exercise that they'd all been embarked on and all thought meant they would get over the Siemens' hump and get onto carrying on a profitable Mainzeal business in this country.

I think Sir Paul went so far in those questions, might have been the questions from me, that if it hadn't been for Siemens then Mainzeal would be carrying on very profitably to today, to this day, or from the trial.

So there's no doubt that when he got involved, and this is paragraph 38 of Sir Paul's brief, he thought there should be additional working capital, and what he had in mind was getting another $20 million coming in, but he does say, as he said also in his oral evidence, it wasn't based on any particular calculations. He just thought it would be a good working number to have,

another $20 million available, and among other things to free Mainzeal from reliance on China to obtain the bonds and the Court will recall that the bonds were a feature that caused the High Court Judge to pause and is mentioned by the Court of Appeal, but they were an essential form of support for Mainzeal's operations.

So the 2012 narrative is largely dominated by Siemens. That was meant to be kind of a major and very successful contract and it turned into the proverbial nightmare because, or the way it's described by the witnesses, Siemens bought and the end result was, I think, that there's a hit of about $14 million on what they were expecting from it and that's a large cash flow problem that they had to wrestle with throughout this period.

It may be convenient to deal with the precarious point that the Court of Appeal makes something of. So the Court of Appeal says, in the narrative, it talks about Sir Paul's email from around July 2012 about the company being in a precarious position. There's also some reference to the fact that if there was a liquidation it would be the unsecured creditors who would be at risk and that seems to have featured, for example, in the Court of Appeal's analysis at paragraphs 474 to 475.

But if I could take the Court to the emails in question, can I suggest that there is a context that helps, and the first one of those is at 321.12913. So there's been a couple of email exchanges among various parties but this is from Sir Paul solely to Mr Yan, not to others, and it's – so his first line is it's "a precarious position to say the least". SRL support critical. "I understand from having seen their accounts that it puts them under real pressure…but at least we have a very strong China balance sheet". Again, the clear expectation that the China balance sheet is the matter of comfort. Future strategy depends on an integrated NZ/China structure. "You need to provide a payment schedule for $9.7 million." Fundamental to the survival of Mainzeal and the credibility of Richina in New Zealand.

So yes, this is in the middle of the Siemens problem. They got a $14 million – well, it turns out to be a $14 million problem, they're not getting paid and they have major cash flow issues on a particularly large business, and so it is precarious, there's no question about that, but the question is not whether it's precarious, the question is what are they doing about it? What they're doing about it, as Sir Paul's brief goes on to say and I won't go through it, is they worked very hard to try and make sure they get funds to come in and funds do come in, not in a tidy lump sum for $20 million but a significant amount of funds, many millions of dollars does come in during this period and at the end of it, apart from Mr Yan's blip in late January 2013, the commitment was to pay another $10 million in 2013.

WINKELMANN CJ:
Well it's not Mr Yan's blip, it's Mr Huo's blip isn't it?

MR HODDER QC:
Yes your Honour there's sort of this consequential blips as it were. Mr Huo first and that causes Mr Yan. But you're quite right. The next of the emails that gets attention from the Court of Appeal is at 321.12916 and if we focus on, well both emails. So the bottom one is from Mr Yan to Sir Paul saying" "BNZ certainly want their pound of flesh." This is in the context of questions about what kind of security arrangements BNZ wants to provide and extend the facility to Mainzeal during this time. Then the Collin's response: "If it's any consolation the guarantee and the second mortgage are in effect a zero sum game."

Just pausing there, this is meant to be a reassurance to Mr Yan that he can proceed in giving a guarantee and a second mortgage over family assets. I think there was a property in Auckland that was particularly involved: "… as in a receivership/liquidation the BNZ with security over the assets would always get their money out." Again that's completely unexceptional, that's exactly what you would expect to happen in any receivership or liquidation where there is a secured creditor over particular assets.

It then goes on to say: “The consequence of that is all the unsecured creditors who are seriously exposed,” and that again is true of an insolvent liquidation if that were to occur and, with respect to the Court of Appeal, we suggest that they’ve got more attention than it deserved in their paragraphs 474 and 475. I don’t want to overstate the point they took from it but they certainly see it as worth mentioning in the narrative and in the reasoning they provide and we say those are perfectly explicable letters in relation to what’s going on.

Sir Paul’s view continues on through into September 2012. If I take the Court to 322.13456 it moves on to September. You can spare the Court the difficulties of getting from Martinborough to the stadium in Wellington, but the real point is coming on further down the passage, “Siemens is likely – finally – to be somewhere up to $92 million.” It goes on to say, “I have studied all the forward cash flows carefully and it seems to me that there are two key issues – the funding ex China of the $8 million in materials between now and the end of 2012 and the introduction of say $5 million ex Richina. That and the settlement of Siemens on a half decent level will give you the foundation going forward. In my view given the events in CHCH Mainzeal probably for the first time in a long while will have a genuine foundation to have a business in CHCH via the PMO,M Living and contracting to produce a $10 million profit in 2013 to 2015 ex CHCH alone…” and then he was talking about various initiatives that Mainzeal had to be involved in the rebuild in Christchurch which had been delayed for some time but it was looking like it was coming on stream, and then he concludes: “This will enable further restructuring of Mainzeal to occur over time so that you have a slimmed down efficient group which will be continuously profitable.”

So there we have an internal email between Collins and Yan indicating Collins’ view that there was a way forward, a perfectly sensible way forward, it was going to lead to the required injection of equity which was entrain which would lead to a profitable Mainzeal which was the point of the exercise. In the road map we refer to the PwC appraisals and the whole (e), (f) and (g) I’ve given references to but I think, as the Court appreciates, there’s a need for the BNZ to continue and extend its facility towards the end of 2012. PwC is

engaged. They prepare two very blunt reports which I've given the references to.

The first report says the consequences of ceasing trading are dramatic and they confirm what is said by others, including Sir Paul Collins, that if there is a cessation of trading then there will be major issues for various parties which they proceed to list, and that would take us to page 324.14278. If we focus on the "consequences of immediate failure" paragraph. This is not stating that there could be any surprise about it but it does make the point that was made also in the passage from *Continental Assurance* I took the Court to yesterday, paragraph 281, that there is a loss of value if there is to be an insolvent liquidation, and it goes on to list those things in the six bullet points under the heading of "Consequences of immediate failure" which I won't read out to the Court.

So the fact that that's the consequence of failure indicates that by this stage we're talking about a company that is in the marginal territory, no question about it. The question then is what are the directors to do? Is the only way in which the directors are to respond to say: "Never mind, we will cease trading," when they believe, and the question is on what criteria they believe and what evidence they believe, there is a future for the company of the kind that Sir Paul's email in September suggested there was.

So again it's the immediate train wreck versus the possibility of trading forward for the benefit of creditors and ultimately, yes, shareholders.

Now I don't think I need to take the Court to the particular documents on the group assurances but there were specific assurances given in December 2012 and January 2013, and in terms of what happens at the end of the process, perhaps the most convenient way of doing that, which I should have mentioned in the road map itself, but would be to go to Mr Walker's evidence at page 207.02908, and paragraph 65 and 66 he refers to Mr Yan's advice, firstly that the CHC board couldn't commit to providing building materials and that came as a surprise to Walker, and in 66 on 29 January

Mr Yan sent a letter, and the reference is given in the – and it's hyperlinked in paragraph 66. Very disappointed as he considered the conclusions to be overly pessimistic, and then from there through to paragraph 76 he describes the efforts he went to try and get that position reversed. Paragraph 70, for example, he says: "I remained unconvinced" this was the end for Mainzeal. Got a conference call with the RPL board and spoke with Mr Yan.

Paragraph 71 he deals with Mr Huo via Mr Wang who has – able to translate Got Mr Huo's commitment. 72, got Mr Yan and Mr Huo firmly committed, and talked about support options in 73(a), (b) and (c), and then prepared a letter, bottom of the page, 74, a letter of 31 January from the CHC confirming the preparedness to make $10 million cash support available by the above means, and the letter was sent to Mainzeal and BNZ on the same day.

76, he thought he'd done enough to satisfy BNZ, but the BNZ responded saying it was unsatisfied and that, in effect, was the final incident or event in the end of the road for Mainzeal.

So the fact that $10 million was going to be given as by Mr Huo and Mr Yan, both in relation to CHC, we again say is significant, it does show that there was ability to get commitments and meaningful commitments, albeit in extreme and unhappy circumstances from the CHC's assets which were the underpinning of the assurances at all stages.

WINKELMANN CJ:
Of course, the counterfactual was the fact that it could be withdrawn and then reinstated again at the whim of individuals highlights the unsatisfactory nature of building the future of a company on this –

MR HODDER QC:
That can set against me, your Honour, absolutely right. And the question is then whether one's prepared to allow for blips in the world or not. But, yes. So 6.3 of the road map, we've just referred to Sir Paul Collins in summary. I haven't taken the Court to it but there are various references all the way

through the period in late 2012 when the board is considering these matters and on almost every occasion, considering whether they can honestly say that they are a going concern and as we say, as far as Sir Paul was concerned, in his evidence at 139 he refers to one of his internal notes, I think, and it's subsequently became his resignation letter, it was a perfect storm largely brewed up by Siemens.

6.4, I've referred to Mr Westlake's assessment. I mentioned yesterday that there were three governance experts, Mr Maier for the liquidators was a reasonably forthright individual, to put it in probably understated terms, Mr Westlake approached the thing on a two-stage basis, I mentioned stage A, stage B. Stage A he read all the board papers without having seen any of the evidence and came to some conclusions about what would happen, or what his view was about that, what that told him. He recorded his conclusions and he then read the evidence of the directors and I think Sir Paul Collins informed his views on the stage B basis which reinforced his earlier views that he thought it was unreasonable, would not have been reasonable for the directors to have put the company into liquidation at any earlier stage than the end of January 2013. His experience, we've mentioned, we say is relevant and the consequences of ceasing trading were a matter that was very much on his mind and I've given those references there, but his concern was simply that the huge loss of value occurred if you ceased trading when you are a large trading organisation, and I've given the other references there.

Mr Burt came in reply evidence and he had following in reply which Mr Maier had not, a similar approach to what Mr Westlake had taken in terms of two stages but came to different conclusions. So I'm not asking the Court to pick and choose between the governance experts in relation to this. The proposition is that there is a tenable and we say rational argument for the approach taken by the directors insofar as Mr Westlake offers a view. It's not the only view, but it is a rational, well-reasoned view about these matters. It goes to my point about, can you say there's a rational basis for it? And I took the Court yesterday to the different views about, do you, I think the phrase used was "pull the pin" by, particularly I think Mr Burt and Mr Maier,

their view was you shouldn't have pulled the pin, there was kind of no point carrying on. Mr Westlake took a different view. The directors took a different view.

WINKELMANN CJ:

So, at some point – well, all the way along the directors' views should've been shaped by their legal obligations under the Companies Act, shouldn't they? They're not simply entitled to make business judgments purely on the basis of risk. The Companies Act constrains their ability to take risk.

MR HODDER QC:

It does, but again it's in the same, once you're in the marginal territory, then can I refer again to that paragraph 281 from Justice Park in *Continental Assurance* –

WINKELMANN CJ:

Well, my point in why I make that point, at the time that we're talking about Mr Westlake, Mr Maier and Mr Burt is that ultimately, they can't, their opinion doesn't substitute for the Court's opinion.

MR HODDER QC:

Of course I accept that your Honour. My point goes back to a matter that's been, as the Court well appreciates, underpinning a significant part of what I've been saying to the Court that is that if you take a view that says was there a rational basis for it then Mr Westlake does reinforce that proposition, as I say, not unchallenged but it's a reinforcement of the position that there was a rational basis. If you say the Court has to decide this afresh, as it were, and forms its own view then you move some distance away from the idea of a wide discretion in matters of business judgement. It's inevitable and mother nature of the process.

WINKELMANN CJ:

And the Court of Appeal makes the point, so on your account of Mr Westlake's evidence he takes into account the train wreck I think he

described, should the company go into liquidation. The Court of Appeal makes the point, of course, that it's not the directors' duty to avoid that train wreck if the appropriate decision is that the point has arrived.

MR HODDER QC:

Again your Honours I agree entirely but the question is the last part of what your Honour just said, beginning with "if" because otherwise the 131 duty points in the other direction, or at least it was perceived to point in the other direction by the directors. So that's one of the reasons why I was saying at the outset of my submissions yesterday that if one reads the duties together there's an ongoing 131 duty, it doesn't stop at any point. The question that is overridden by 135 or 136 and the question how you approach that. That's really very much at the heart of what I've been submitting to the Court in relation to these matters.

WINKELMANN CJ:

Did you cover that in your legal framework outline as to relationship, did you?

MR HODDER QC:

Yes.

WINKELMANN CJ:

Right.

GLAZEBROOK J:

Can I just check. As I understand it your submission is that looking at this twilight zone, in that twilight zone issues like avoiding train wrecks are considerations that ought to be taken into account, possibly I suspect as long as there's a rational basis for thinking that the company is not insolvent or measures to get back to solvency because here we did have balance sheet insolvency effectively?

MR HODDER QC:

Correct your Honour, that's our submission. Yes that captures our submission and just to, if I can elaborate on the last point, it was, and I think I explained yesterday, part of our submission though is that there has to be attention being paid to getting rid of both the balance sheet insolvency and any trading problems, and we say that both were in this particular case. And the argument against us, we understand fully the argument, you didn't document all this stuff at the outset, and there weren't guarantees that this stuff was going to happen, and getting the money in from China turned out to be awkward and difficult and spasmodic at best, that's all true. The question though is was there a rational basis for thinking this could be, this company could be run into a position that would have created a future for it which meant that all creditors got paid, shareholders got some equity back and all the associated dramas and traumas were avoided.

WINKELMANN CJ ADDRESSES MR HODDER QC – OVERHEAD NOISE (11:18:36)

MR HODDER QC:

So your Honours I was going to move on to the last section of these which I can address relatively succinctly. My 7 and 8 and really 9 only become relevant if I am unable to persuade the Court that there is no basis for liability because it really is a matter of business judgement which heads off the question of liability through an appropriate interpretation and application of section 135 and 136. In terms of section 135 that is the subject of the liquidator's cross-appeal because the Court of Appeal has confirmed the view in the High Court that there was no net deterioration and that the net deterioration was the proper test and in a sense and in relation to 135 that's also the strong indication from this court in *Debut Homes*. To a large extent we can endorse what's said by both the High Court and the Court of Appeal on net deterioration and the appropriateness of the *Mason v Lewis* approach and indeed that aspect of *Debut Homes*. The point that we make at 7.1 is not, we say, to be overlooked. That the net deterioration approach is well-settled and understood. *Mason v Lewis* has been around for some time and Mr –

WINKELMANN CJ:

I'm not sure that's quite the right interpretation of *Debut Homes* but presumably you might deal with that in reply from the liquidators.

MR HODDER QC:

I'm happy to do that but my, I'm hoping not to in any way misrepresent *Debut Homes* where I thought the Court had said normal approach to 135 would be net deterioration.

ELLEN FRANCE J:

In paragraph 164 we say: "In terms of a breach of s 135, we accept that in most cases the appropriate starting point will be an amount equal to the deterioration… (the net deficiency approach)."

MR HODDER QC:

Yes, that's what I was referring to. I'm not wishing to exclude some extraordinary cases, but in my submission there's no basis to treat this other than one of those cases in the ordinary course, as it were, in 135. It's a trading case and the harm to the company is the counterfactual. What would have happened if you hadn't kept on trading, that then requires the two snapshots, as it were, one at a time, you should have stopped trading one at a time, that the trading did stop in the factual, and if there hasn't been an increase, then the company, in terms of the overall global approach to its creditors, has not suffered a loss. That's the logic behind the 135 and the *Mason v Lewis* approach.

In terms of well-settled, I'm happy to accept that it goes as far and no further than is said in that relevant paragraph in *Debut Homes*. In terms of what's understood was what I was about to say, is itself of some relevance in an important commercial area, and I just draw attention to Mr Graham's evidence. That's at 210.04081. Just while I've got Mr Graham, if we can turn please first to page 04098, or paragraph 31. Mr Graham sets out his very extensive experiences in insolvency practitioner in the earlier part of the brief, I won't take the Court's time with that, but in paragraph 31 the point he's

making is that about half way through the paragraph: “However, what makes this claim most unusual is that claims for reckless trading normally always share one characteristic, that being of creditors being strung out over an elongated period of time and certainly well in excess of what may be considered a reasonable period during which directors traversed their options to resolve their company’s financial problems. In this case however, the profile of ageing of creditors is to my knowledge unique in terms of claims bought against directors for reckless trading. In the Mainzeal collapse many creditors were simply owed sums for what amounted to the most recent month of trading.”

WINKELMANN CJ ADDRESSES MR HODDER QC – OVERHEAD NOISE (11:23:43)

MR HODDER QC:

Thank you your Honour. Just carrying on at paragraph 32. “That is because, at least to the end of December 2012, Mainzeal appears to have paid its creditors as a matter of course. Table [3] below shows the creditor ageing between 31 July 2012 and 31 December 2012.” He goes on to explain at paragraph 35, that it’s a large sum but that’s because it’s a large company, and when construction failure, whenever an entity the size of Mainzeal grinds to a half, there will invariably be a large sum outstanding. “Construction company failure has the added complication that once the company fails, surety bonds are called and counterparties… will often claim in the liquidation for the balance of those contracts. As a result, there is an amplification in creditor claims, which would not have occurred in a normal trading environment.”

Then paragraph 37 ends by saying: “… the fact that creditors were as up to date as they were, is that whatever support was in fact necessary, had been provided, up to the point in time when Mainzeal ceased to trade.”

Then going to where I was heading for, if you go to paragraph 148. So what happened in the evidential dialectic was that Mr Apps produced something

that he called a section 136 method that he was instructed to produce, a new EBIT method, and paragraph 148 through to paragraph 159 is what Mr Graham says about it, and I won't read it out to the Court, but perhaps I'll just stick on the idea at 151 he says: "*Mason v Lewis* has historically been a useful benchmark for insolvency and 'turnaround' professionals, either in providing advice to management and directors of companies in financial distress or acting in a capacity of liquidator of a failed company when considering director behaviour…"

Paragraph 153: "The decision of whether or not to continue trade is often very difficult for directors." Goes on to discuss what he understands directors understood in paragraph 154, and then goes on to discuss the new debt approach, but practically at 158: "While such an approach will necessarily result in a much larger loss number, I struggle to see how such a scenario would work in practice. As someone who has worked with companies in the workout and restructuring space for close to 30 years, I cannot see how directors would ever have the confidence to work through trading problems with such a threat of personal risk present. It would clearly represent a significant departure from what directors conventionally understand about both the limited liability nature of company law in New Zealand and the ability of companies to work through their problems."

Paragraph 59: The approach Mr Apps describes would, in reality, necessitate a move to trading on a 'cash basis' for any company facing trading or solvency concerns. Most companies in rude financial health would struggle with that, let alone those facing financial pressures. Were this approach to loss and personal risk replace that of *Mason v Lewis*, I cannot imagine directors having any appetite to attempt to work out company problems in New Zealand."

So in short Mr Graham's evidence is that to the extent that there has been expectation and legal room for rescue efforts and workouts, the application of a new debt approach, what Mr Apps had called the section 136 approach, would extinguish it, and we say that's a relevant consideration for the Courts,

and not one given weight by the Courts below, and we say that is a matter of real significance.

Yes, so the Court has heard me on the points about what that does. We are talking here of, this in terms of section 135, that the duty is owed to the company, that follows from section 169. The loss suffered by the company can be properly measured by the counterfactual snapshots I mentioned a minute ago, and when creditors come to receive the outcome of a liquidation process, and they have no security or preference, then they are treated equally on a pari passu basis by virtue of section 313. So the Act is reasonably clear about the structure. The basic elements of company law are reasonably clear that these are duties owed to the company, and there's quite a lot of evidence about what loss means to the company. Can I draw attention to the *Continental Assurance* case again, I won't take the Court to it at the moment, but at pages 295 and 296 I think, but I'll need to check whether I've got the same report that is in the bundle. In a preliminary ruling Justice Park discussed whether the new loss approach or a new debt approach was appropriate. It explained that a net deterioration approach was appropriate and that when debts are used, paid off in the ordinary course of business, they are given for consideration and they are not a loss to the company.

So on 135, assuming there is liability, the outcome and the reasoning to get to that point is generally supported by my clients in the purposes of this appeal. If the Court pleases I will leave eight and anything I want to say about nine until after the adjournment.

WINKELMANN CJ:
Hopefully we'll have that fixed in the meantime.

MR HODDER QC:
As your Honour pleases.

WINKELMANN CJ:
Sorry about that Mr Hodder, being distracted by that. We'll adjourn.

COURT ADJOURNS: 11.29 AM

COURT RESUMES: 11.55 AM

WINKELMANN CJ:
Sorry for that interruption, Mr Hodder. We'll come back at 2 o'clock so you're not disadvantaged by the loss of time.

MR HODDER QC:
Thank you, your Honour. I think it'll be our friends behind us who will be the ones because I will be finished quite soon, but thank you for that and it's hopefully disengaged for the duration.

I think I'd just finished my reference to the *Continental Assurance* case in relation to my 7, should be about 7.2, and can we go, please, to page 295 and 296, and I'm calling it 295 and 296 because it doesn't have the normal paragraphing of the main judgment. The main judgment has square bracketed paragraphs. This is a preliminary ruling in which the Judge ruled in favour of the net deterioration approach and his discussion of that starts in round brackets (7) on page 295 and carries over to 296. The premise of it is that where payments are still being made in the course of trade in discharge of genuine trading liabilities they don't inflict a loss on the company. A true trading debt paid in full does not mean that the company by paying the debt suffers a loss.

Then it goes on to discuss the possibilities in various semi-algebraic fashions which I don't think I'll take the Court's time with now but it goes through and it responds to the argument that says: "But the composition of the creditors has changed," and his Honour comes to the view and says, well, that doesn't affect what the loss to the company is, and that goes through to his paragraph 9 on the next page.

In terms of my section 8, (assuming liability) what is the quantum in terms of section 136, and here I am conscious that I am –

WINKELMANN CJ:
Mr Graham's comments at 148, were they not in relation to section 136 qualification?

MR HODDER QC:
Yes.

WINKELMANN CJ:
Right, okay, just checking that.

MR HODDER QC:
Well, what was described as "section 136 qualification" by Mr Apps –

WINKELMANN CJ:
Mr Apps' new debt method of calculation.

MR HODDER QC:
Yes. So the only point I make is only Mr Graham accepted it was the – or anyone else in the – necessarily accepted that it was the way of doing it, 136, in Mr Apps did it because he was instructed to.

So at section 8, and I'm conscious that this kind of gets into the area of the *Debut Homes* decision of this Court. The position, as the Court I think will appreciate, is what we say is that where there is a trading company's business which is being carried on then the net deterioration approach is appropriate, no less appropriate for 136 than it was 135 because you finish up with same snapshot scenario. If things shouldn't have happened which have caused liquidation, you take the snapshot at the time when the thing happened and then you take a time, some later point because of liquidation. That, we suggest, is an appropriate counterfactual analysis and it means there

is no mismatch between 135 and 136 when we're talking about exactly the same commercial circumstances, that is a trading company is carrying on its business.

So one way of thinking of different roles of 135 and 136 is that 136 will extend to non-trading obligations whereas 135 will be hard to stretch to non-trading matters.

In any event, we say that where they are the same then the logic behind *Mason v Lewis* and 135 would extend to 136, and to that extent the Court doesn't need to, doesn't inclined to say more about 136 for these purposes that other cases may be different. But what we would also perhaps say in this, at this time is that *Debut Homes* is a case of a quite different nature, I don't need to tell the Court that, but it is, in effect, quasi-fraud, as we read the judgment. It's done in the knowledge that the company was unsalvageable and done with the intent to inflict pain, if I can put it that way, on the IRD. In addition, or possibly in the same way look at the same set of circumstances, it was in fact undertaking a default liquidation and shuffling round who was going to get paid. So both those things, we say, are distinguishable from an ordinary trading company whose business finds itself in insolvency and, of course, in relation to that, in the *Debut Homes* case, there was no intention by the controller of Debut Homes to salvage the company. That wasn't a factor that had any relevance at all in the circumstances the Court was considering there.

Putting it in sort of the practical terms of Mr Graham's analysis that I took the Court to before the adjournment, there's nothing in the finding of the liability under section 136 in *Debut Homes* which could discomfort or deter or disincentivise any honest director on what they do because it was of a nature of quasi fraud and the de facto liquidation. Again, completely unrelated to what was going on here. So we say, if the distinction has to be drawn within section 136 about how one approaches it, then the trading company situation is the one that covers this case, the Mainzeal case, and there may be have to be some different consideration in relation to other cases.

ELLEN FRANCE J:

What do you say, Mr Hodder, then about paragraph 165 of *Debut Homes*, where the Court talks about the nature of the breach and, therefore, the appropriate type of response in terms of remedy under 136?

MR HODDER QC:

Yes. If I have to, your Honour, then I would respectfully disagree with the Court's 165. The section, therefore, concentrates on individual creditors. Our respectful submission there is a distinction to be drawn between the trigger that exists in section 136 and the consequence. The trigger is an obligation being incurred with a particular creditor, although it's true that in ordinary trading there will be individual creditors. The outcome is that the company is unable to meet the obligation, that is to say it has found itself in or in compounded insolvent liquidation. And so that analysis is premised on the idea that 135 provides two routes -

GLAZEBROOK J:

Well, it was certainly absolutely clear from the judgment that it was duty to the company.

MR HODDER QC:

Yes. So, that part we, of course, respectfully agree with. The question then is whether or not, what the harm to the company is? And we say the harm to the company is it's in a situation where it can't meet its obligations. And in an insolvency circumstance that means that it can't meet its creditors - it can't meet all the debts that it has. It's in no different position than the position of a company where there has been a breach of section 135.

GLAZEBROOK J:

You're arguing that we should depart from *Debut* then, obviously, because you can't be making the submissions that that's wrong if you're not saying we should depart from it?

MR HODDER QC:
Well, I'm submitting that the Court should constrain what is said in 165 so that it doesn't apply to trading company situations. I don't exclude some possibility of something in the area of fraud, which we're not concerned with here.

GLAZEBROOK J:
Well, it was part of the trading in *Debut Homes*, wasn't it?

MR HODDER QC:
Well I appreciate there's a semantic issue here, your Honour. We would've that what *Debut Homes* was doing wasn't trading in the same sense that Mainzeal was trading.

GLAZEBROOK J:
It was trading out.

WINKELMANN CJ:
It wasn't trading out. It was winding down, I suppose.

GLAZEBROOK J:
Well, trading down.

MR HODDER QC:
It was winding down on a limited activity, but it wasn't a regular pipeline churn exercise of business in the kind that I'm trying to capture in the concept of a trading operation.

So, yes, I'm unhappily unable to avoid saying to some extent I'm disagreeing with the Court on section 165 and asking it to reconsider if it isn't possible to draw a distinction between those sorts of trading operations and others. But we don't disagree with the idea that A, it's a duty owed to the company and B, that a breach of it is a wrong, it's a duty not to do that, and so the question though is what is the consequence and we say the consequence of, that's contemplated in the insolvency territory by section 136, putting aside

situations where there's a solvent company and possibly an injunction, is it the company is in insolvent liquidation, and once it's in insolvent liquidation then a range of people are affected, existing creditors, new creditors and shareholders are all going to be in difficulty in those circumstances.

WINKELMANN CJ:
So you're saying the harm that section 136 is directed to avoiding is the company either being precipitated into insolvent liquidation or that, the extent of the insolvency being exasperated?

MR HODDER QC:
I am. Then at 166 the judgment of the Court goes on to discuss the question about perverse incentives to continue to trade on. One point that I would refer to, Mr Graham's evidence from the *Mainzeal* case on, is he made the comment that directors that are faced with insolvent or marginal insolvent situations only go forward if they think there will be a significant improvement. "… why would you spend your time… just treading water, that doesn't happen..."

Now that is to be found at page 210.04307 in cross-examination of him by my learned friend Mr O'Brien, and we say there's an obvious common sense to that. I mean, yes, there could be perverse incentives in some situations where there's some fraudulent train in mind, but if we're talking about a non-fraudulent scenario then an honest director is likely to carry on unless there's a serious risk of getting some improvement from it. And to that extent we say that a case such as we're concerned with, that aspect of 136 as explained in paragraph 166 doesn't assist or doesn't bite.

So that, in a sense, takes us to the points that are made by the Court of Appeal judgment in paragraph 297 where there's a reference to matters that sit uncomfortably or difficulties that exist by the analysis that the Court of Appeal thought it was required to undertake. We respectfully say that they indicate that none of those difficulties arise in the position that I am advancing, as I apprehend it, that if one treats for trading operations like Mainzeal, the

position as being analogous to and governed by the same approach as for 135, then none of those issues arise. Insofar as you have a quasi-fraud case like *Debut Homes*, then there may be a basis for a different approach, but it is so far from our case that we say that that doesn't assist matters.

So I really dealt with 8.2 and 8.3 I think, as much as I can sensibly do so. 8.4 and 8.5 are contingencies. If the Court confirms or comes to a view that this case should be governed by a new debt approach under section 136, then we've given reasons in our submissions why no quantum case has been made out. I've nothing to add to those submissions. If, in fact, that isn't accepted, and there's a specific quantification exercise required, we say it should go back to the High Court for the reasons given by the Court of Appeal and we do note that there are some points of principle that will have to be resolved and which would be logically dealt with by a court below, so that when it comes back to this court it doesn't have to sort of start afresh. So, for example, you may recall that from our friend's written submissions at paragraph 14.7, their proposing to give a credit to reduce the sum and encourage this Court to make it's own decision, but in proposing that credit, they are in effect putting on to the creditor's all the costs of the liquidation. And the question of whether all the costs of the liquidation are recoverable on a claim for breach of duty is a live question it requires to be answered in proper argument, not in the space and time available in this court.

Then there's also the proposition that it's reasonably well established, and we would refer to *Shaw v Owens*. I can't recall if it's in our bundle or not but it's at [2017] NZCA 315. There's authority there and elsewhere that a director being in breach of a duty doesn't mean that they're necessarily liable for the costs of a liquidation. That's paragraph 18 of the judgment that has a reference to that point.

Relatedly, the idea that liquidation costs include litigation work undertaken by the liquidators is also an open and live question which will need to be resolved in some difficulty, and there's probably going to be, if we did get back to the High Court, going to be an issue about whether or not further evidence is

admissible or not and we will be obviously resisting that but I wouldn't exclude it as the bounds of possibility because, as we've indicated in our submissions elsewhere, there really isn't an evidential foundation in our submission on what there is before the Court so far.

Turning then to my last written section, section 9, about 301 and the scope of discretion. The short point is we agree with the majority of the Court of Appeal as opposed to the minority that there is a discretion and that it should be utilised to enable compensation in a principled but "in the round" matter.

I have given you there a reference to *Continental Assurance*, if we can perhaps bring that back up because among other things that reference should be corrected. The reference to the paragraph should be "296", paragraph 296 in square brackets.

WINKELMANN CJ:
I think there's another Court of Appeal decision discusses this about the nature of the discretion, 301 discretion, and I'm trying to recall the name of it but it's a case that Justice Gilbert and I sat on and one of the parties was Brown.

MR HODDER QC:
Well, I confess that I don't have access to that, your Honour.

WINKELMANN CJ:
No. I might try and find it myself.

MR HODDER QC:
Paragraph 296, please. So the English legislation is somewhat analogous in terms of the way it concludes. "Liable to make such contribution to the assets of the company as the Court thinks proper." The language is not identical with it but the thrust of it is similar to that of our section 301 and the Court goes on to say, well, of course there's a discretion but it has to be exercised on a sensible basis. The maximum –

WINKELMANN CJ:
In a principled manner.

MR HODDER QC:
Yes. So just to correct that reference and to indicate where that is to be found.

There's nothing else I think I can usefully say about section 301 that isn't already in our written synopses.

Can I conclude by mentioning that we have updated, as I indicated we would yesterday, the authorities bundle by adding an extract from the Law Commission's 1990 report number 16 that covers the passages I referred to yesterday.

WINKELMANN CJ:
And the extra material from Professor Goode's text?

MR HODDER QC:
Yes, that should be there as well. If we can go to that, please. Can we go first to paragraph 8-02 or page 291? So I've added two pieces. The first part is I've added some pages from chapter 8 because it has a helpful discussion about the pari passu principle. There's only a few pages there but I've indicated 8-02 and then 8-04 is also in the same area. It's quite a useful discussion of the fact that in the real world unsecured creditors rarely get a rate or distribution because they, firstly – rights in rem come out and then, the last paragraph, secondly, on the right-hand side, they're subject to equities affecting them, and, thirdly, huge chunks of what free assets remain must be applied to meet claims ranking in priority to the ordinary unsecured creditor. So the position of the unsecured creditor is affected by, firstly, limited liability and, second, by all the preferences and exceptions to pari passu which the law already creates.

The last addition, which is the one I referred the Court to yesterday, is at page 755, paragraph 14-21. And the passage I referred the Court to yesterday is on the next page, 765, thank you. And what I read was from about the four lines down, just after the footnote 133, The True Principle. Going on to conclude: "must have regard predominately to the interests of creditors." And then there's a discussion of what that means, footnote 135: "As indicated in the last edition of this book, this ought to require directors to consider the impact of their actions on the interests of the creditors ahead of but not to the exclusion of shareholders." Then it goes on to discuss the Supreme Court of the United Kingdom, this is in *Bilta v Nazir*, that's of some relevance because our friends for the liquidators cite Lord Sumption I think twice where he says: "The interests of the company are then synonymous with those of its creditors." That's different language used in the joint judgment of Lords Toulson and Hodge, both are completely obiter because they're dealing with the ex-turpis causa principle at a much different level of abstraction, but I mention that as being part of the material that goes to any issues arising from the common law as it's developed in relation to the director's duties.

If your Honours please, those are the matters that I wanted to make by way of oral submission, subject to any questions.

WINKELMANN CJ:
Thank you, Mr Hodder.

MR HODDER QC:
As your Honours please.

MR CHISHOLM QC:
Please your Honours, we filed, I hope you received an outline, a five page outline that was filed, I think, hard copies were handed in as well, but it come in electronically. What I will primarily address is section 136 but in particular the remedy or loss in respect of 136. Mr Mullins will cover the cross-appeal issues which to a large extent go to a section 135. My first heading in the

outline is “Context”, but before I say, get to the outline itself, it should be stressed that this case has been pleaded as the liquidator’s counterfactual case. Essentially, we were told, and it was asserted against the directors that we should’ve ceased trading at a particular point in time. And we know now from the findings that no loss was suffered as a result of Mainzeal continuing to trade up January 2011 and indeed, if the directors did what the liquidators pleaded they should’ve done, then there would’ve been both greater losses to the company and greater claims. And we see that summarised in paragraph 517 of the Court of Appeal judgment where the Court said: “We agree with the Judge that the conclusion that a net deterioration was not made out is far from surprising. The trading losses over this two year period were to a significant extent off-set by the financial support from the Chinese entities and the contract book was much smaller at the time of liquidation, some 42% of the book, as at 31 January 2011. Other things being equal, one would expect both losses and claims to be significantly lower in those circumstances.” But the converse is that is that whatever - whether or not the directors were in breach post 31 January 2011, what they did after that point in time improved the condition, the financial condition of the company.

And indeed, this case was unusual at trial because that point wasn’t actually in issue. But what the liquidators were seeking to argue that the net deterioration had to be judged on a propensity to prove but even on that, what we said was a misconceived basis, even on that basis the Court found there was no net deterioration.

WINKELMANN CJ:

I’m not following that statement, Mr Chisholm. What do you say the liquidators were arguing?

MR CHISHOLM QC:

The net deterioration that they were seeking to prove was based on what Mr Apps described as a propensity to prove in liquidation rather than a measurement of the actual loss that the company suffered over the

counterfactual period. So that's the starting point which is an unusual fact in the trading while insolvent case. No loss to the company.

The second context point I make is that even excluding the prepaid arrangement for product supply, and I think that was valued in the region of, I think, about $6.1 million, more funds flowed into Mainzeal from the Richina or the CHC, more particular, companies from 2007 and thus for the period in issue that Mr Yan was a director. So, net funds over the period of breach and before were not flowing out of Mainzeal, they were flowing in. And also to put context for support, as at liquidation RPL had outstanding and needed to play $19 million worth of bonds. As at liquidation you would've seen from the High Court and Court of Appeal judgment, RPL had to go into provisional liquidation and over a number of years it then had to repay $19 million in bonds. So there was a significant financial commitment that was made by the CHC and RPL to the Mainzeal Group over a number of years.

The third context point is, we say and that there could be no soft landing for Mainzeal. Essentially, it was the liquidators' case that the company should have gone into liquidation as at January 2011 and, indeed, at paragraph 237 of their opening, what the liquidators stated in writing was: "The directors should have ceased trading from January 2011, if not before. The plaintiff's case is that by no later than that date the directors allowed MPC to carry on business, section 135, and agreed to incur specific obligations, 136, that involves significant and illegitimate risk to creditors.

And at 1.4, while it wasn't in the opening or pleaded, a number of alternatives were subsequently put that may have occurred which could've changed things. These were referred to in the Court of Appeal judgment, perhaps pressing for repayment, written assurances o support, a formal review. Both the High Court and the Court of Appeal acknowledge that whatever occurred these sorts of actions would've been speculative as to whether they would've made any difference. But we say, in any event, what occurred as between January 2011 and February 2013, the date of receivership and liquidation, whatever occurred throughout that time Mainzeal couldn't be described as

unsalvageable, certainly in the Debut Homes sense. We have those findings both in the High Court and the Court of Appeal where both courts confirmed that it wasn't necessary for Mainzeal to actually cease trading as at January 2011. So this wasn't a case like Debut Homes where essentially the sole director, Mr Cooper, was seeking to carry out his own private insolvency administration. And it wasn't a case where I think there was a robbing Peter to pay Paul. In Debut Homes, Mr Cooper was actually incurring obligations knowing that those obligations wouldn't be paid. That's effectively the GST obligations. Again, nothing like that occurring in Mainzeal. There was simply trading over a period of time which improved the financial position of the company, as a matter of fact.

Finally, at 1.6, I not that it was found that Mr Yan acted honestly and he was committed to Mainzeal succeeding, and we say the financial support that was provided through RPL and the CHC companies reinforced that, as a matter of fact. We accept, of course, and there was some debate that the letters of support or comfort plainly weren't legally enforceable. That's both before and after the restructure in 2009, but ultimately we say that what occurred in fact reinforced that the support was there.

At point 2 of the outline I deal with Mr Yan's personal position because he was certainly differentiated by Justice Cooke in the High Court and underlying it was almost the suggest that he should be punished for being a proxy for RPL, an indirect shareholder of RPL. Just to make it clear, the claims, the section 135 and the 136 claims did not differentiate Mr Yan in any way from the other directors. He was a director in the relevant time from 16 April 2009. He'd previously been a director from 1999 to November 2004, so that's well before the alleged breach periods, and he was never sued as either a shadow director or as some sort of proxy for RPL.

WINKELMANN CJ:

They didn't necessarily see him as a shadow director, though, did they because he was actually a director?

MR CHISHOLM QC:

From that point in time, but a lot of the allegations shifted in the High Court to earlier in time. Certainly, when, for example, issues of discovery and the like, it was very much focused on the breach time but a lot of time was spent on what occurred in 2004, 2005 with the loans which created the subsequent balance sheet issues.

WINKELMANN CJ:

Okay.

MR CHISHOLM QC:

And so we say that Mr Yan is entitled to rely on the pleading, the third amended statement of claim against him. And again, all of the relevant pleadings that are left, the 136 and the 135 claims, are pleaded collectively against all directors.

WINKELMANN CJ:

Is your point in that regard that you say the section 301 discretion, are you saying the section 301 discretion couldn't have been used as it was?

MR CHISHOLM QC:

Correct. There were no pleaded facts and nothing was put to him even in the evidence. Of course, the 301 finding was effectively overturned by the Court of Appeal with quantum being at large again. In respect of the 136 claim, if I could take your Honours to that. I know my learned friend, Mr Hodder, took you to it, it's at 102.00619, and it's the first amended statement of claim starting at 102.00643, and this is the 136 claim and you'll see that the actual breach in paragraph 61 is almost a hybrid of 135 and 136. We have the allegation that MPC directors breached their duties, pleaded by agreeing to MPC continuing to trade and incurring new obligations. So essentially it was the fact that they continued to trade, and this is what the Court of Appeal found, by reason of continuing to trade you incurred new obligations and that was enough. So we didn't have separate obligations pleaded. We simply had the general trading continuing to incur obligations.

Tactics such as threatening to resign and the like that had more focus in the High Court weren't pleaded. The focus was on, you shouldn't have continued trading after 31 January 2011.

So coming to part 3 of the outline, coming to the "Components of the 136 Cause of Action" which aren't going to be in dispute, the agreement – the belief of the directors, the grounds, none of those were in issue. But normally when one is facing a cause of action, normally those components of the cause of action are pleaded against the defendant and the particulars of the breaches, the allegations are put to the defendant. That didn't occur in this case in respect of Mr Yan. Just to note that, and it may be trite, but 135 and 136 are not liquidation causes of action so theoretically they can apply. It's unlike the old section 320 which was a liquidation cause of action. So these theoretically could apply while a company continues to trade. So one has to be careful that there would necessarily need to be a failure of a company before there could be liability under 135 and 136. Very difficult to see. Obviously a non-failure would be rare, but that could occur.

They have to be distinguished from the old section 320. At 3.2 I refer to 320(1)(a) and (1)(c). That should read (a) and (b) because the old section 320 had the built in remedy and perhaps if I could take the Court to that. I think it's at tab 137 of the bundle of authorities and you'll see essentially (a) is the equivalent of 136, (b) is the equivalent of 135, but then one had the built in remedy and that was expressly what the Court was able to do up until the 1993 Act: "Declare that the persons shall be personally responsible without any limitation of liability for all or any part of the debts and other liabilities of the company as the Court may direct."

WILLIAM YOUNG J:

It sort of carried through, but I agree not explicitly in section 301(1)(c) isn't it?

MR CHISHOLM QC:

Well, I submit that it's not, certainly the Parliament was careful to carry it through in respect of keeping proper according records.

WILLIAM YOUNG J:

But look, section 301, which is the general power of the Court on a liquidation and which obviously overlaps or picks up sections 135 and 136: "Where it appears to the Court that a person has been in breach, or being guilty of negligence, default or breach of duty it may enquiry into the conduct et cetera, order that person to repay money or property and then see where the applications made by a creditor order the person to pay or transfer the money or property or any part of it to the creditor." Now, that sort of disaggregates what was previously in section 320 because, and the old section 320, as I understand it, an order in favour of a creditor could be made whoever the plaintiff was.

MR CHISHOLM QC:

Correct.

WILLIAM YOUNG J:

Under section 301(1)(c), that's been actually disaggregated, so it's only in a case where the creditor is making an application.

MR CHISHOLM QC:

I think there is still, certainly there has been some debate as to what (c) covers as to whether if an application is made by a creditor, the funds still need to go back into the pool.

WILLIAM YOUNG J:

Well, it does permit a payment to be made to the creditor.

MR CHISHOLM QC:

Well, yes, I accept that, although there is reference to transfer the money or property and whether that covers (b) to by way of contribution. For example, if

a claim was brought by a creditor, which a creditor can do for breach of section 135, whether that, whether a portion could go to the creditor.

WILLIAM YOUNG J:
Well say the creditors were simply joined, when the case goes back to the High Court, the creditors get simply joined as parties.

MR CHISHOLM QC:
Well, sorry, go back to the High Court.

WILLIAM YOUNG J:
Well, the Court of Appeal has remitted the case for assessment of damages, or assessment of loss to the High Court. Would it be possible for liquidators to, for creditors to chip in, or a class of creditors to be represented?

MR CHISHOLM QC:
Well, it would certainly be too late in my submission from a limitation perspective.

WILLIAM YOUNG J:
Would it be? That's what I had in mind whether it would be, is it covered by the Limitation Act?

MR CHISHOLM QC:
Your Honour, if a creditor is bringing a new cause of action –

WILLIAM YOUNG J:
But it's not actually a cause of action, is it?

MR CHISHOLM QC:
Well, it would be bringing its own cause of action, the creditor would be.

WILLIAM YOUNG J:
Maybe.

MR CHISHOLM QC:

In my submission it would be surprising if that was Parliament's intention, it was added into 301 only for the benefit of creditors to bring an application. In my submission, it would also be available for liquidators because liquidators are normally the primary, not solely, but normally the primary party that would bring a claim under section 301.

WINKELMANN CJ:

So do you argue, Mr Chisholm, are you arguing that section 301(c) is also available for liquidators to use?

MR CHISHOLM QC:

No, I'm not. I'm saying –

WINKELMANN CJ:

I was going to say, I thought that was an unusual submission for you to be making.

MR CHISHOLM QC:

No, I was – because it seemed, my argument, your Honour, is that that's not available for liquidators.

WINKELMANN CJ:

Yes.

MR CHISHOLM QC:

And there has been a deliberate decision by Parliament to remove the self-contained remedy from section 320.

WILLIAM YOUNG J:

Well, it has re-shaped it, it hasn't removed it, has it? It has re-shaped it rather unhappily, I think. Is there any explanation of it in the legislative history material?

MR CHISHOLM QC:

Sorry, I didn't hear that, your Honour?

WILLIAM YOUNG J:

Is there any explanation of why section 301(1)(c) is narrower than the old section 320?

MR CHISHOLM QC:

No, I'm unaware of that in respect of (c). I haven't focused too much on (c) because for present purposes, this is not an application by creditors. In my submission it's surprising that there has been a deliberate decision by Parliament to retain a remedy that links back to creditors, or giving relief to creditors, or liability of creditors in respect of accounting records and that's the old section 319 and the new, not so new now section 300 that has the – there has been, there must have been a conscious decision to take out or reduce potential liability in respect of 135 and 136.

WINKELMANN CJ:

So is your submission that 136 – what is your submission? Are you saying that we should take from section 301(1)(c), that liquidators can't bring claims under 136?

MR CHISHOLM QC:

Not at all.

WINKELMANN CJ:

So what is your submission?

MR CHISHOLM QC:

I don't rely on (c) at all.

WINKELMANN CJ:

So what are you saying then? Perhaps go back to where you were.

MR CHISHOLM QC:

I'm saying the remedy that the Court previously had to make a director liable and reading it up for all or any part of the debts of the company, is no longer present under the 1993 Companies Act.

GLAZEBROOK J:

I think if you were looking at legislature history from memory they specifically decided to take out any possible punitive aspect of 301, from memory, and that might have shaped the way that they did it. Is that the submission or is it…

MR CHISHOLM QC:

My submission is that that's – it's the combination, your Honour, of taking it out but also reinforcing the duty is owed to the company. It's the combination of the two which suggestions one looks to what, as the victim, what loss the victim, the company suffered for the purposes of breaches of 135 and 136.

GLAZEBROOK J:

Again, you probably have to deal with what was said in *Debut*.

MR CHISHOLM QC:

I'll come to that, yes, your Honour, I accept that.

WINKELMANN CJ:

And also, as Justice Young says, you have to deal with section 301(1)(c).

GLAZEBROOK J:

At 301 as well, yes, but –

MR CHISHOLM QC:

But (1)(c), it would be unusual, in my submission, if there was a different remedy available for creditors but not for liquidators.

GLAZEBROOK J:

Well, I don't think that's what *Debut* is suggesting because it left open totally whether creditors could claim or on what basis.

MR CHISHOLM QC:
Well, certainly in my submission, one would suggest that if there was going to be a claim like that and available to liquidators, the section would have said it. Certainly, the –

GLAZEBROOK J:
Sorry, I didn't catch the – if there was going to be a claim?

MR CHISHOLM QC:
The section would've said it. The built-in remedy for all or any part of the debts of the company. It was certainly kept, and it has been kept for proper accounting records. So an application, that would be an application under section 300. So there is a distinction.

I note your Honour, Justice Young's, comments and could perhaps go to this in *South Pacific* which was a section 320 case, although ultimately I think your Honour found that something equivalent to net deterioration should be ordered. Your Honour's comments at 162, in respect of the difference, the different structure between the two. That's tab 43 and at paragraph 162. I think from memory your Honour was dealing with a 320 case but also gave a summary of the 135 principles as well.

What I submit is that a number of Judges, including, with respect, Justice Hinton in the High Court in *Debut Homes*, actually relied on section 320 cases which had the built-in remedy for the purposes of coming to the conclusion that she did. If your Honours go to *Debut Homes*, the High Court judgment, that's at tab 15 of the bundle and it's starting at paragraph 73.

GLAZEBROOK J:
So what do you say the difference is – I think perhaps go back a step. Just in two sentences, what do you say the difference is between 320 and 301?

MR CHISHOLM QC:

The primary difference is the Court had the ability under 320 to order a remedy that was based on paying all or some of the debts of the company and the Court also had a discretion, as his Honour, Justice Young, said, to actually make a direct order to creditors in respect of compensation. Under sections 135 and 136 they were no longer a liquidation cause of action and that built-in remedy under section 320 was removed, and it was reinforced by section 169(3) that the duty under 135 and 136 was owed to the company. Therefore the victim is the company.

WINKELMANN CJ:

So your point is that you're saying that shows a legislative intent to move away from any kind of damages that are calculated by reference to the creditors' claims and leaves you with a net deficit?

MR CHISHOLM QC:

Correct. But one looks at, as a matter of fact, what loss did the victim suffer, and the victim or the party that is owed the duty, and that's the company. Plainly though Parliament intended that those words still were required in the Act if a director failed to keep proper accounting records. So they were retained in section 300 but removed from the 135/136 context.

GLAZEBROOK J:

And why would that be? I mean why would there be a difference between the two in the way you're saying?

MR CHISHOLM QC:

To remove, in my submission – well, certainly there was a suggestion, whether it was taken up or not, from the Law Commission's report to remove or lessen the risk or liability to directors, and it reinforces that the duty is to the company where there was some uncertainty under section 310.

WILLIAM YOUNG J:

But under section 301 it can't be said sensibly that the duty is just to the company in a real sense because it does provide for creditor claims.

MR CHISHOLM QC:

But section 301 is procedural only. It's not creating a cause of action. You still have to have an underlying cause of action.

WILLIAM YOUNG J:

Okay, so say in the trial –

WINKELMANN CJ:

That's section 136.

WILLIAM YOUNG J:

– say in the proceedings there had been representation for all creditors, all relevant groups of creditors, creditors as at, who are unpaid at the date of liquidation whose debts go back one month, two months, three months, four months, five months, 24 months, would it not have been possible for the judge or the Court of Appeal to have made an order under section 301(1)(c)?

MR CHISHOLM QC:

With 301(c), if it's a creditor, one has to go back to the meaning of those words "property or money". There must be a distinction, in my submission, otherwise it would, this is going back to 301(c).

WILLIAM YOUNG J:

Can we just bring it up again? Why couldn't there have been they have been joined as classes to the litigation? No, no, yes, the current section 301 please where the application by creditors. So if each class of creditors was joined as an applicant in the section 301 proceedings by the liquidator, wouldn't it be perfectly possible for the Court to order that those creditors, such creditors as were in the relevant past, were to be paid money as the Court thinks fit?

MR CHISHOLM QC:

But, your Honour, the words “the money or property” in my submission link back to what is in the fourth or fifth line of 301(1).

WILLIAM YOUNG J:

So you say it doesn’t apply to breach, negligence, default or –

MR CHISHOLM QC:

Breaches of duty or guilty or negligence.

WILLIAM YOUNG J:

That doesn’t make much sense because if it’s money or property of a company that’s been misapplied, why should that be paid to a creditor?

WINKELMANN CJ:

Because your argument might have some force if it was just property, but it’s money and property.

WILLIAM YOUNG J:

Yes, but why should the property of the company, or even the money of the company, be paid to a creditor on your logic?

MR CHISHOLM QC:

Well, your Honour, certainly the Court, sorry, the Parliament distinguishes between compensation and money or property. On your Honour’s reasoning we don’t need (b)(ii) because money or property would cover everything and (b)(i) is more the restitutionary release of actually returning money or property while (b) –

GLAZEBROOK J:

Money is fungible, so it’s very difficult to really see that in a sensible way of being returning actual money.

MR CHISHOLM QC:

Well, that may be so if one is talking about actual cash. I accept that. But there is certainly the distinction that's been made between compensation orders under (ii) and restoring a restitutionary type remedy under (b)(i).

WILLIAM YOUNG J:

I'm not 100% sure that the Limitation Act would be an answer to this because I think it might be an ancillary claim. I don't expect you to deal with that on the fly.

MR CHISHOLM QC:

Well, it's certainly not the case that we've been answering or the one that's under appeal, but there must have been, in my submission, there must have been a conscious decision taken to remove that self-contained remedy.

WINKELMANN CJ:

Well, we know that this is a bit of a, what is it called, a woodman's axe. It's got bits and pieces pulled together from different places. It's not a perfect thing, the Companies Act.

MR CHISHOLM QC:

Certainly I accept that your Honour.

WINKELMANN CJ:

A woodman's axe is not the thing I would say.

GLAZEBROOK J:

I think this bit has some logic to it though in terms of what they were wanting to do.

WINKELMANN CJ:

The Court of Appeal said that there's a lack of coherence because obviously what the case law before this Act said was that really at a certain point your primary concern has to be, is with the companies when you're in this situation

where you're on the edge of precipice and so the interests of the company became equated with the interests of the creditors. That must be in the minds of Parliament when they're thinking about section 136, one assumes, and the Court of Appeal makes the point that there is a lack of coherence between section 136 and the failure to provide this, in section 301, failure to provide the ability to allow their liquidator to recover that as well, and your answer to that is?

MR CHISHOLM QC:

Ultimately, there is a distinction between – 301 is only procedural. You still need to have an underlying cause of action before you get to section 301. So whether it be a creditor or the liquidator, or the company, they have to have an underlying cause of action first.

WINKELMANN CJ:

So do you say that section 301(1)(c) does not respond to section 136?

MR CHISHOLM QC:

Well, I say that a creditor is entitled to bring a section 135 or a 136 claim under 301(1) but I say that section 301(1)(c) does not respond to a damages claim under section 136.

WILLIAM YOUNG J:

Something has gone wrong with the drafting here though, hasn't it? I mean I suspect that the hand of whoever has drafted this is faulty because logic would suggest that it's the assets, it's the "such sum" as compensation that should be available to the creditor because there can be no obvious reason why money that actually belongs to the company, or property that actually belongs to the company, should be vested in the creditor.

MR CHISHOLM QC:

Well, certainly on the face of the legislation the distinction is made because what I submit is I can bring, if I'm a creditor, I can bring a claim under 135 or 136 but if it's a damages claim the money will generally go into the pool under

(b)(ii) because remember a creditor can – while (c) refers specifically to creditors, a creditor can still bring a – seek relief under (a) and (b) as well.

But underlying it, your Honours, 301 is still procedural. You still have to identify the cause of action and the underlying cause of action is still a company cause of action.

GLAZEBROOK J:
I'm just not sure where this gets you. I don't understand the submission, I suppose.

MR CHISHOLM QC:
My point simply is trying to understand 135 and 136. Effectively, there was the move away, a deliberate moving away, from providing a built-in remedy which would be that all or any parts of the debts of the company would be ordered against a director or directors in respect of 135 or 136 type breaches and that is reinforced by those breaches being expressly held to be or directed to be duties owed to the company.

WINKELMANN CJ:
So do you say that section 301(1)(c) is really limited to the sort of claims where the asset that the creditor is claiming would not be just in the general pool of funds of the company but would rather have some sort of trust attaching in favour of the creditor, so you're not – so the creditor's not stepping around – the creditor is now allowed under section 301(1)(c) to recover something where the company is the victim?

MR CHISHOLM QC:
Well, your Honour, the company has to be the victim, strictly speaking, in any event, but 301(1)(c) is still directed to the money or property. The body of (1) distinguishes money or property.

WINKELMANN CJ:

Yes, I'm just asking you what, how – because you seem to be saying it's – section 301(1)(c) is directed to some subcategory, it's not, and it's not allowing you section 136, and I'm just trying to get from you what subcategory you say section 301(1)(c) is directed at.

MR CHISHOLM QC:

Well, your Honour, 301(1)(c) seems to effectively replicate 301(b)(i) which suggests that it's a subcategory of the causes of action that could be brought.

WINKELMANN CJ:

Yes, well, I think you might have a better argument if your argument is effectively that what the creditor's doing is being, is pursuing kind of a trust-type claim on its own behalf, but I don't understand your argument then under – if you're not arguing that, I don't understand your argument under (b)(i), I have to say.

MR CHISHOLM QC:

Well, all I can say, your Honour, is if a claim for compensation or damages is being sought and that will be (b)(ii) generally, that will simply go into the hands of the liquidators or the company generally. (c) is limited to property or money.

WINKELMANN CJ:

Why should a creditor be able to have money that's due to the company, that should be repaid or restored to the company, paid and restored to them directly. That's they difficulty I'm having with your argument because on that analysis, it's still getting money for which, on your way of characterising these sections, the company is the victim?

MR CHISHOLM QC:

Well, there still needs to be an underlying company cause of action. So 301 is procedural only. I can take it no further than simply referring to the words of the section.

WINKELMANN CJ:

Right, okay.

GLAZEBROOK J:

My difficulty is that under the ’55 Act there was no, the duty was still to the company as well, so I don’t see what your difference is?

WINKELMANN CJ:

Well I think the Law Commission suggested that there was uncertainty and under 169(3) it was made explicit and in particular, when one looked at section 320, the fact that a creditor could say that sums of money could be paid directly to it suggests that creditors could be victims, effectively bring the claim as a self-contained liquidation cause of action. 135 and 136 are not liquidation cause of action.

WINKELMANN CJ:

It is a bit hard to imagine that occurring outside liquidation.

MR CHISHOLM QC:

Correct. Although, your Honour, one example would be an injunction.

WINKELMANN CJ:

Yes, under section –

MR CHISHOLM QC:

One could apply under section 164 to restrain a company doing an imprudent transaction, entering into an imprudent obligation. That could occur. And I do submit, and that certainly there are cases, and I say the High Court in *Debut Homes* Justice Hinton simply framed her remedy on the assumption that section 320 still applied and you can see that in my submission from the cases that her Honour referred to starting at paragraph 73.

GLAZEBROOK J:

What is the point in referring to a High Court decision?

MR CHISHOLM QC:

Well, it seemed, your Honour, that this Court actually seemed to adopt the reasoning to a certain extent that –

GLAZEBROOK J:

Well then attack our reasoning and ask us to overrule it. Good luck with a recent decision, but try. But there's no point attacking a High Court decision which was confirmed on different grounds.

MR CHISHOLM QC:

My point is simply going that one has to be careful with cases that refer to the section 320 reasoning because that happens quite commonly in my submission.

GLAZEBROOK J:

Yes, I suppose I still don't quite understand what you say the difference is.

WINKELMANN CJ:

Right, well perhaps we should take the luncheon adjournment at this point, Mr Chisholm.

MR CHISHOLM QC:

As your Honour pleases.

COURT ADJOURNS: 12.58 PM

COURT RESUMES: 2.02 PM

MR CHISHOLM QC:

Thank you, your Honour. Just really, if I could just finish off the point and perhaps too long was spent on the section 301 point just before lunchtime, but in contemplating the matter over lunch, I do say as your Honour Justice Winkelmann put it, that it is essentially a breach of trust type situation by a director. If I could ask your Honours to note, *Mitchell v Hesketh* (1998) 8 NZCLC 261, 559 (High Court), which reinforced the interpretation that I submit, this is in respect of (1)(c), so this is a creditor's application, and an example of that type of trust or misappropriate situation is a case which is not in the bundle but I'll simply give the reference, it's a judgment of Justice Heath called *Sanders v Flay (*2005) 9 NZCLC 263,906, and that was a misappropriate of money case that had come to the director from the creditor who was the plaintiff. So I would submit that that sort of case, if you were a creditor, you could bring under (1)(c).

WILLIAM YOUNG J:

So what if the director is a party to the company's fraud?

MR CHISHOLM QC:

Well, essentially that would be the case, a party to the fraud, in that particular case, yes, your Honour. And that's consistent with the reference to "the money" or "the property or money".

So moving back to the 136, back to the outline, and these are probably not contentious points. Going to 3.3, there is certainly a difference in words in respect of the difference between "agree" distinguished from "cause or allow" and I think your Honour have picked up that point in paragraph 92 of *Debut Homes*. Although, your Honours didn't have to directly deal with it in that point, given that you had Mr Cooper by himself who plainly controlled everything, and one was only referring to the particular debts in issue.

What we submit is that the Court of Appeal's interpretation, at least on proof, renders section 135 redundant and what the Court of Appeal said at paragraph 279 was that, and where they agreed to continue trading, they agreed to the company incurring all the obligations that would normally result from such trading. A similar statement was made in 460. So in my submission on the Court of Appeal's reasoning, if you're caught or found liable under 135 because you've continued to trade, you will necessarily be liable under 136 for all the obligations that are incurred thereafter.

GLAZEBROOK J:
Wouldn't that only be if you, just looking at the words of 136, if you didn't think they were going to be paid, because in some of these cases I thought that was partly your argument that in fact they would be paid because of the continued trading.

MR CHISHOLM QC:
Well, they were paid as a matter of fact here and –

GLAZEBROOK J:
No, exactly, but that's – so in fact 136 couldn't have applied to those and I'm not sure the Court of Appeal said it could either, did it?

MR CHISHOLM QC:
Well, it must've, with respect, your Honour, because the Court of Appeal found that we were liable, or the directors were liable for all debts after 5 July, but debts continued to be paid after 5 July. If one looks at the ageing of the creditors schedule one could see that it reduced and then went up again.

In my submission, my point is that if simply by reason of continuing to trade you agree to all obligations, effectively the two sections become conflated.

GLAZEBROOK J:
Well, you do agree to incurring all the obligations by continuing to trade. Whether you agree to them knowing they're not going to be paid is the separate question, isn't it?

MR CHISHOLM QC:
Well, yes, it is, but that was the extent of the evidential proof by simply continuing to trade and that's my issue. I submit, your Honours, that one can still carry out the inquiry under 136, so one can still be liable under both 135 and 136, but it's a separate test that needs to be separately established. Simply by reason of breach of 135 it doesn't follow that there is a breach necessarily of 136.

That's really the point I make at 3.5. If it's effectively a trading remedy for continuing to trade then I would submit that the same remedy should apply.

Part 4 is, we say, no breach of section 136 on the facts, and we support, or Mr Yan supports what Mr Hodder submitted. It's an unusual case because the allegation of or the reasonableness or otherwise of incurring the obligations wasn't put to Mr Yan at all. The particular obligations weren't pleaded. There was a reference to the four contracts, the four construction contracts, in the opening, I think, at paragraph 238(c), but certainly neither the subjective belief or indeed the reasonableness was challenged during cross-examination at all. There was limited formal proof. I think a portion of the MIT contract was actually in the bundle before the Court but that was it. So there wasn't an assessment at all of the nature of the obligations.

I simply say, as with any other cause of action, at 4.3, it's the plaintiff or the liquidators have the onus to prove the components of the cause of action, and at 4.4, further, the reasonableness of the directors' belief, which necessarily must be assessed at the time they're incurring the obligation, can't be assessed in isolation of whatever that obligation was.

At 4.5 I submit that there's a distinction between what the obligation was or understood to be at the time it was incurred and that's really, in my submission, what section 136 is directed at; secondly, the time when that liability falls due which will necessarily be later in time after the goods or services have been provided; and, thirdly, in a case like this or in many 136 cases the consequences of the liability on liquidation.

(c), the consequences of the liability on liquidation, is quite distinct, in my submission, from what the directors understood was being incurred at the time and if I could take your Honours to one of the English decisions *Grant v Ralls*.

GLAZEBROOK J:
Can you perhaps just explain factually what you mean by that first?

MR CHISHOLM QC:
Well, your Honour, necessarily a director or a company may incur an obligation at particular points in time, but when one comes to liquidation, what the liability turns out to be is significantly more. There could be a number of effects. If it's a principal, they could be – sorry, if it's a contractor, they could be suing for the balance of their contact. There could be all sorts of liabilities that simply flow from the collapse, from the fact of liquidation and this is referred to in *Grant v Ralls*. Mr Graham, I think it was in one of the paragraphs that Mr Hodder took the Court to, also referred to this fact. Perhaps I could go to Mr Graham's evidence first before going to *Grant v Ralls*.

GLAZEBROOK J:
How does that work in the fact here?

MR CHISHOLM QC:
Well, for example, if a contractor sues for the balance of the contract price, or incidental damages.

GLAZEBROOK J:

I understand that. I'm just not sure how it relates to what's in front of us now.

MR CHISHOLM QC:

In what context, sorry, your Honour?

GLAZEBROOK J:

Well, in any context actually.

MR CHISHOLM QC:

Well, it's relevant here because in this case the way the so-called fresh debts have been assessed is that Mr Apps simply got account payables. So the liabilities weren't assessed, or the obligations weren't assessed or ascertained at the time they were created or incurred. We simply had liabilities at a particular point in time. That was the starting point and then the fresh debts were assessed against what claims were, proofs of debt in the liquidation. So there was no assessment as such as to what the obligations were that were incurred at the particular time by the company. So that's the assessment and in my submission, for the purposes of 136, one must fairly look at what the obligations fairly understood to be at the time they were incurred. Certainly in the context of the net deterioration point, the Court of Appeal was quite critical of the High Court's reliance on debts as a proxy, but that's precisely how the fresh debts, or the quantum has been calculated in this case and this is the point going back to Mr Graham's evidence. That's at paragraph 35. That's at 210.04099.

WILLIAM YOUNG J:

Paragraph 35?

MR CHISHOLM QC:

Mr Graham talks about there and is half way through talking about: "A construction company failure has the added complication that once the company fails, surety bonds are called and counterparties to construction contracts will often claim in the liquidation for the balance of those contracts."

WINKELMANN CJ:

Can you just pause there for a moment, Mr Chisholm, so I can just read it myself?

MR CHISHOLM QC:

That's paragraph 35.

WINKELMANN CJ:

Perhaps if you could put the paragraph in the middle of the page rather than the top. Yes, all right.

MR CHISHOLM QC:

An analogist comment, it's analogous to foreseeability, but an analogous comment was made in the English judgment of *Grant v Ralls* at paragraph 242. That's at tab 16 of the authorities. We would also submit, of course, given that the –

WINKELMANN CJ:

Sorry what were you actually referring to?

MR CHISHOLM QC:

Sorry 242. Essentially the nature of the liabilities in a construction company collapse will necessarily be significant and indeed there will be the liquidation process as well.

WINKELMANN CJ:

Your point that you're taking from that is that the losses incurred by virtue of the insolvency process should not be laid at the doors of the directors?

MR CHISHOLM QC:

Correct and indeed one should incur ,even in assessing what the so-called debt is or the obligation for the purposes of 136, that needs to be assessed at the time the debt or the obligation was incurred.

WINKELMANN CJ:

Do you mean a short-fall or in the nature of – when you're saying "the nature of the obligation" what do you mean I'm sorry, I'm not following you. The nature of the obligation has to be assessed?

MR CHISHOLM QC:

Well what the obligation actually was because when one looks and when one goes into liquidation –

GLAZEBROOK J:

I'm not sure that 242 says anything about that at all, all it's saying is if he would have incurred those losses any – I mean it's talking about probably net deterioration?

MR CHISHOLM QC:

Well it's, I accept that. It's simply touching on the difficulties with construction companies analogous to what Mr Graham said or gave evidence on.

GLAZEBROOK J:

Well we must have to have more background because that doesn't seem to do anything of the sort.

MR CHISHOLM QC:

Well what we do know, your Honour, all we had for the assessment, the quantum assessment, is –

GLAZEBROOK J:

No I understand that submission, I'm just, you had it under no breach of section 136 on the facts or have we moved onto something else?

MR CHISHOLM QC:

No sorry your Honour it was simply for the purpose, perhaps it should have been under the previous section but simply for the purposes of saying what occurred here because at 4.6 we simply deal with what occurred here and

what occurred here was this analysis where simply a comparison between accounts payable at a particular time and simply what the underlying proofs of debt were in the liquidation. I can give examples and we don't need to go them now but Mr Apps, for example, at paragraph 368 of his evidence at 203.00790 and also at paragraph 376 confirms this type of process, that was the analysis he did. In my submission that's not a reasonable analysis, at best that can only be a rough proxy for what the obligations actually were, in particular in a case like this where we don't even have the obligations before the Court to understand precisely as a matter of evidence what the directors are alleged to have agreed to.

ELLEN FRANCE J:

Sorry just in terms of Mr Apps, what was the page reference for that?

MR CHISHOLM QC:

I'm sorry your Honour, it's paragraph 368 and it's at page 203.00790. Effectively, as I said, he simply took the accounts payable ledger which would be liabilities at a particular time and then compared that to the proofs of debt in the liquidation. So the fresh debts are effectively assessed against the fresh, are stated to be the liabilities in the liquidation. So as a matter of quantum we say at best that's at best a rough proxy only, in particular when the underlying obligations are not before the Court. In respect of liability, at 4.7, the Court essentially undertook its own analysis and it found liability or a breach in respect of those four construction contracts in general or short-term obligations from 5 July, and as I said before, in respect of short-term obligations, it even included obligations that were plainly met after that point in time. I support what Mr Hodder said in respect of these, one can go through and pick up individual references in the evidence but important factors, even the - I think my learned friend took the Court to the Paul Collins emails, the particular, the 27 June board paper reference to Reegan Pearce, which was relied on, that's at 321.12795.

WINKELMANN CJ:

What is this document?

MR CHISHOLM QC:

This is simply one of the documents that, one of the primary documents that the Court of Appeal relied on for establishing that the company couldn't meet its liabilities as they fell due from 5 July.

GLAZEBROOK J:

And what paragraph did it rely on those?

WINKELMANN CJ:

There was a comment someone made that they were having to carefully manage payments on a daily basis.

MR CHISHOLM QC:

That was at, this is at paragraph 474 of the Court of Appeal judgment, 27 June 2021 and again, one can pick out particular references, but my submission in isolation documents like this simply don't prove that the company wasn't meeting its liabilities as they fall due. And we see, in fact, there was reliance on the aging of creditors which is shown in paragraph 471 of the Court of Appeal judgment, a larger copy of it is appendix D, of the Court of Appeal's –

WILLIAM YOUNG J:

Quite hard to that, I think, is this the one that it really has to be in colour, I think, to read this one?

MR CHISHOLM QC:

The one that's schedule D to the back is easier to read, your Honour. Are you looking at the one under –

WILLIAM YOUNG J:

I was looking at D, I find it quite hard to pick up the different categories.

MR CHISHOLM QC:

Red is the current –

WILLIAM YOUNG J:

Right, thank you, yes. Sorry, I've printed a hard copy version.

MR CHISHOLM QC:

The red is the current, the bluey-green is one to 30 days. Certainly, often aging of creditors are relied upon for showing breaches of 135 and often you'll see the, it will be a line going upwards that would normally show the trading, but when one sees here, it seemed that the Court was relying on the June 2012 figure as justifying liability from 5 July, but then one can see payments came immediately down again. And, further, we know that from almost exactly that time the directors and in particular Mr Yan had arranged for more money to come in, and we see a schedule of when the payments came in, there's a schedule B attached to the joint memorandum that was put to the Court of Appeal, where some agreement was reached, there's money coming in. That's at page 102.00449.

GLAZEBROOK J:

So you're relying on money that came in after that period to say at the time they incurred them they thought they'd be paid, or what is the point?

MR CHISHOLM QC:

Well, simply, your Honour, that there's been a finding, for example, that we couldn't meet our debts generally from 5 July, but it's plain in my submission that the directors had or were aware of funds coming in and we see that the funds came in as a matter of fact after that time and liabilities –

GLAZEBROOK J:

So there's something that says: "We're expecting some funds," is there?

MR CHISHOLM QC:

Well, some of those, I think some of those earlier papers. I can find some references for you. I may have to provide a schedule but I can do that. But we know as a matter of fact that funds were coming in and we see them. In particular, there seems to be a 500 in/500 out, so that's neutral, but from 6 July onwards there's reasonably significant funds coming in. But these are factors that the directors could have regard to, in my submission, as to reasonableness.

Of course, none of these things, the directors weren't cross-examined on, nothing was mentioned or put to Mr Yan as to reasonableness or what he was relying on.

Finally, I think my learned friend, Mr Hodder, took you to Mr Graham's evidence and that was paragraphs 32 to 35 which I won't take you to again, but one of the points that he made was that this was an unusual feature of this case for directors to be sued when they were essentially meeting most of their liabilities up to a month or two, or the company was meeting its liabilities up until a month or two before the actual formal insolvency or liquidation. So they're simply additional points that go to liability.

At part 5, none of these issues, the way the Court of Appeal decided to reformulate the 136 case again was put to the directors, so they didn't really have an opportunity at the time to address that issue. I don't need to say anything more on point 5.

Now part 6 is duty and damage caused by breach. These, in my submission, are simply matters that one deals with with any breach of duty case. Even if there is breach of duty, there still must be loss that flows.

6.1 is well known and been confirmed.

At 6.2 I simply repeat what the Court of Appeal found, that it was common ground that "loss recoverable from directors for a breach of sections 135 and

136 must have been caused by the relevant breach". So one is looking at the conduct of the directors post-breach and assuming that there's a breach from January 2011 it's conduct from that point in time that's material, and I say that loss is a question of fact, and putting to one side anything else, at least loss to the company as a trading entity, we know that what the directors did from January 2011 has caused the company's position to improve.

At 6.3, and again these may be basic things, but just to define the nature of the case that the defendants had to meet, it's acknowledged that it's not a loss of chance case. Some of these factors were raised, for example, that if you'd done this or that a different result may have occurred, but ultimately the liquidators acknowledged that they were not pleading this as a loss of chance case and the Court of Appeal recorded that at paragraph 504.

WINKELMANN CJ:
So when you look at the breach here, if you focus on the section 135 breach that's alleged to have occurred, you could say that by allowing this company to proceed with this legally unenforceable and uncertain support arrangement the real risk the directors were running was that the company would be precipitated at high speed into insolvency should someone decide to withdraw that support which was non-binding, and if that's the case – well, yes, I don't I'll take it the next step but…

MR CHISHOLM QC:
Well, your Honour, still the breach and the founded breach date is still January 2011 and the case is, as I said at the beginning, it's expressly pleaded as a counterfactual case, as a counterfactual breach case, so one assesses, and I think, with respect to his Honour, Justice Young, it's well summarised in *Sojourner v Robb* [2007] NZCA 493; [2008] 1 NZLR 751 (CA) which actually I'll take the Court to.

WINKELMANN CJ:
It's not, however. That may be how it was pleaded but that's not how it was found, is it? The High Court and the Court of Appeal both found there was

failure to take steps that would've – it wasn't saying they should have put it into liquidation but rather they shouldn't have carried on trading unless they had crystallised these issues.

MR CHISHOLM QC:
Well, they found that there were things that they could've or should've done but acknowledged both the High Court and the Court of Appeal said it was ultimately speculative as to whether it would have made any difference, and the case as put to us was we should have ceased trading in January 2011.

WINKELMANN CJ:
And as the High Court and the Court of Appeal said, unless you could get these things clarified.

MR CHISHOLM QC:
Correct. If I could perhaps take you – at the end of the day, though, we, or a plaintiff, when one is putting a counterfactual case, and that will often be the case whatever the breach. It doesn't just apply to 135 and 136. One will be comparing the position. One will be saying that there is a counterfactual of what would have happened absent the commission of the legal wrong and by reason of taking steps or not taking steps this particular loss was suffered.

If I could perhaps go to *Sojourner v Robb*. The Court of Appeal is at tab 47 of the authorities.

GLAZEBROOK J:
So what do you want us to do with it?

MR CHISHOLM QC:
Sorry, your Honours, and in particular at paragraphs 71 to 73. The point I picked up, effectively paragraph 6.3 was paraphrasing what the Court of Appeal said in paragraph 71. *Sojourner v Robb* was effectively a restitutionary-type case. I think it was the directors, from memory, purchased the business at an undervalue, and that's why his Honour, I think it was

Justice Young, at 73 said: "The reckless trading cases are not a good analogy. A reckless trading case proceeds on the hypothesis that at a particular time, well ahead of the company eventually ceasing to trade, the directors ought to have stopped trading," and that's precisely what we have here. The case is unusual here for the point, and it comes back to the core point, the company's position is as a matter of fact its position improved from the counterfactual. The issue will ultimately be on, the issue of the fresh debt, whether that is loss that the company suffered.

The English cases and – I'm sorry, your Honour?

WILLIAM YOUNG J:
Just remind me, was the result of the decision an award of compensation direct to Sojourner?

MR CHISHOLM QC:
No. Sorry –

WILLIAM YOUNG J:
What was the upshot of the case? What was the result?

MR CHISHOLM QC:
It was effectively a restitutionary award. The director had –

WILLIAM YOUNG J:
Can we just go to the relief?

MR CHISHOLM QC:
Sorry the relief in?

WILLIAM YOUNG J:
In *Sojourner v Robb*, what's the –

WINKELMANN CJ:

You could go to the headnote, couldn't you?

GLAZEBROOK J:

Just move down to the result of the case, thank you.

O'REGAN J:

You probably need the High Court.

WILLIAM YOUNG J:

You need to go up a little bit.

WINKELMANN CJ:

You need the headnote, I think. I think you need the headnote.

MR CHISHOLM QC:

This was not your classic trading while insolvent, it was effectively the transfer of the company's business to the director so that issues of –

WILLIAM YOUNG J:

Mr Sojourner or was it Mr Sojourner, I can't remember –

MR CHISHOLM QC:

I can't remember whether it was a mister or –

WILLIAM YOUNG J:

All right, well, Sojourner was a creditor of the company, is that right?

MR CHISHOLM QC:

I wasn't looking at it for that point.

MR CHISHOLM QC:

You should know the facts of the case.

MR CHISHOLM QC:

Sorry? I'm told he was.

WILLIAM YOUNG J:

Okay, but Sojourner receives an award direct for a wrong done to the company, is that right?

MR CHISHOLM QC:

I would have to check. So it's the liquidator, yes. He ordered them to pay the liquidator so much as would meet the claims of the unpaid creditors in the liquidation. So it may well have been a case where the creditor bought the application under the 301 but it simply went to the general body effectively. It was a restitutionary, effectively section 131 was engaged in this case.

WINKELMANN CJ:

So what happened was that Justice Fogarty in the High Court said that: "In considering the remedy for a breach of a director's duty under section 301 the Court should examine carefully the character of the breach and then look for guidance from the common law, including equity, when considering how to judge what contribution should be made to the assets of the company. In this case a breach of trust analogy was particularly strong, and therefore the underlying principles should be restitution and account rather than compensation."

MR CHISHOLM QC:

Correct. I don't dispute and this case reinforces it, but there can be –

WINKELMANN CJ:

So the creditors were allowed to claim, recover –

MR CHISHOLM QC:

Restitutionary relief and it can be, it can be restitutionary damages too or analogous to an account of profits, for example, could be a restitutionary

remedy. And I accept too that that can come under (b)(ii) as compensation. I was simply relying on –

WILLIAM YOUNG J:
Just going back, the headnote says: "Accordingly the plaintiffs were entitled to damages for the full amount of their proofs of debt et cetera by the liquidator." I'm just looking at the headnote 4, para 4 of the headnote.

MR CHISHOLM QC:
At the top of 752, we look at them to pay the liquidator –

WILLIAM YOUNG J:
809. Perhaps the headnote's wrong though.

MR CHISHOLM QC:
809. I can certainly come back and look at that point. Sorry, page 809, your Honour?

WILLIAM YOUNG J:
Page 809 of the report. Sorry, it's the High Court judgment, yes.

MR CHISHOLM QC:
Yes, I think the Court of Appeal one's immediately below it.

WILLIAM YOUNG J:
I see, okay.

WINKELMANN CJ:
The Court of Appeal just dismisses the appeal.

MR CHISHOLM QC:
It seemed that a discretion may have been exercised so that it was limited to meet the claims of the unpaid creditors which suggests that –

WILLIAM YOUNG J:

Sorry, and then I see at 111 of Justice Fogarty's judgment it said: "Mr Laurenson for the plaintiffs was not seeing an award by this Court directly to the plaintiffs. He did not think that was possible." I agree. Okay, so I think the headnote isn't accurate.

MR CHISHOLM QC:

The point I was referring to this judgment for is just those general principles in 71 to 73, but also acknowledging that factors such as general equitable principles may apply of section 131 if engaged, which is not the case here and that one can have a restitutionary type award under section 301(b)(ii) necessarily because this is what I think your Honour did, or reinforced, could occur in this case. But that doesn't engage here. We are still in the counterfactual situation simply effectively common law principles in respect of damages here.

My learned friend Mr Hodder referred to the English cases. He referred to *Continental* and I will simply ask you to take a note. I don't know whether he got all the paragraphs that I wanted to refer the Court to just in respect of principle and the English court's preparedness toward a fresh debt. They're at paragraphs 296 to 297 of *Re Continental*. That's at tab 73 and also paragraphs 377 to 380. If one goes, there are actually two copies of *Continental* in the bundle. It's better in my submission to go the one at 73. Simply, it's a reported decision. It has the interim orders at the beginning that my friend referred to that refer to that fresh debt question.

For the purpose of the English cases, *Grant and Ralls*, I'd ask your Honour simply to take a note of the paragraphs 236 to 242. That's at tab 69 of the authority bundles. Again reinforce that fresh debt wasn't appropriate. *Grant and Ralls* is the case that Gabriel Moss QC wrote his article about in which he was critical of and which is in the bundle as well and just so your Honours understand the nature of the remedy, section 214 of the UK Insolvency Act is at tab 8 and that's a liquidation cause of action and it includes in subsection (3) a reference, effectively a defence section that:

"Every step with a view to minimising the potential loss to the company's creditors." So under the, even though in the English liquidation remedy there is a reference to minimising loss to creditors, the English courts have still reinforced one looks at the loss to the company in the sense of net deterioration.

Now moving to fresh debt, which is the central focus of this case, this Court in *Debut Homes* effectively treated in 165 of the judgment, effectively talked about the fresh debt being in substance a restitutionary remedy. The Court of Appeal, while relying on section 165 talked about it more as deemed loss rather than restitution. As I said I accept that restitutionary (**spelling)** relief can be ordered under section 301 but I submit loss under section 136 and this is why I respectfully depart at least partly in respect of the reasoning of 165. I would submit that compensation under section 136 is restitutionary, it's not restitutionary but simply compensation and in particular for the purposes of 301 it's really going back to the question that was debated before lunch-time. In a case like this the company has not lost any property or money, it's effectively trying to give the company what, assess what damage the company has suffered if any. But importantly –

WILLIAM YOUNG J:

Just pause there Mr Chisholm, I'm just looking at section 136. It's not really cast in business judgement terms, it's less construed literally, it's quite onerous as far as directors are concerned. Must not incur "an obligation unless the director believes… the company will be able to perform the obligation…" "Believes" is, on the face of it anyway, a stronger word than "thinks there's a pretty good show" or "thinks that it's worth taking a risk because it's in the best interests of the company to do so". Is there a history of section 136, was it part of the Law Commission's recommendations?

WINKELMANN CJ:

Section 320 is the history.

MR CHISHOLM QC:

It's very similar to 320, slightly different wording, "knowingly incurring a debt or."

WILLIAM YOUNG J:

So what was the standard of belief that the director was meant to have in relation to whether the debt would be paid, believed it would be paid or was reckless as to whether it wouldn't be paid?

MR CHISHOLM QC:

Well the belief is not relevant here.

WILLIAM YOUNG J:

Why?

MR CHISHOLM QC:

Because it was never put to the directors, their belief wasn't challenged but the reasonableness of is.

WILLIAM YOUNG J:

But, well it might not have been put in those – sorry. But did they really believe that the debts, I mean I don't actually think it can be construed entirely literally but could the directors really say they believed that debts they incurred would be paid?

MR CHISHOLM QC:

Well they…

WILLIAM YOUNG J:

Well they know there's a risk, they knew there was a risk they wouldn't be.

GLAZEBROOK J:

They have to believe on reasonable grounds anyway so that's an objective subject too.

MR CHISHOLM QC:

Correct.

WILLIAM YOUNG J:

Yes well they've got to believe but there have to be reasonable, well sorry, I mean we have similar issues, ie, search warrants.

GLAZEBROOK J:

Yes.

WILLIAM YOUNG J:

But the belief does suggest a reasonably high level of confidence that the debt will be paid?

MR CHISHOLM QC:

No, well we had an – that subjective element and I accept, of course, because there is an objective element as well, but the subjective element wasn't put in issue and that was recorded, simply because their belief wasn't questioned. So it comes down that –

WINKELMANN CJ:

Where you're dealing with the facts of this case we're talking about the law though Mr Chisholm so, carry on.

WILLIAM YOUNG J:

I mean it's a different sort of, it's got a different sort of feel for me from the test stated in section 135 which is probabilistic.

MR CHISHOLM QC:

Yes.

GLAZEBROOK J:

And you can certainly breach 135 without 136.

WILLIAM YOUNG J:

See there's the words of "likely to create a substantial risk" so there's ideas of probability and substance likely to create a substantial risk of serious loss, questions of indeterminacy, probability and substance. Whereas section 136, if you look at it, is rather more specific, don't incur this obligation unless you believe you can pay it.

MR CHISHOLM QC:

Yes.

WINKELMANN CJ:

It's further along the wrongful behaviour chart really isn't it, I think it's how I had conceptualated it.

WILLIAM YOUNG J:

Well it might be more, I mean it's not really a business risk, what I'm trying to say it's not very conducive to a business risk, business judgement analysis.

MR CHISHOLM QC:

Well perhaps, your Honour, then it's going back into 135 because that's the trading risk.

WILLIAM YOUNG J:

Well that's right sorry, but what I'm saying is 136, it doesn't look like it was a, there was evens, the chances that we were going to get away with rescuing the company were evens, it was worth going because the losses weren't going to exceed, were going to be less than the gains if we all came, that might be a 135 approach.

MR CHISHOLM QC:

Well it's still a matter, it's still assessed by reasonableness whatever the belief is, I know that's like asking how long a piece of string is and that's always going to be fact specific at the time the obligation is incurred. Does it mean, and I'm asking rhetorically, does that mean, you're confident you'll trade for

six months, it will be relevant to how long the obligation perhaps goes up. It is fact specific.

WILLIAM YOUNG J:
I mean, the Court of Appeal's judgment is premised, I think, on a view that the directors knew that there was at least a substantial possibility that the creditors would not be paid.

WINKELMANN CJ:
Or, another way of saying it is they transfer over their finding that there's no rationality to their optimism in relation to the letters of support, I suppose.

WILLIAM YOUNG J:
No, a slightly different issue. I mean, it may have been, when it –

GLAZEBROOK J:
I think they said there was no rational basis for believing that they would be paid, therefore, there can't have been reasonable grounds. I think we went through that with Mr Hodder, the particular passage.

WINKELMANN CJ:
Then they come to section 136 –

WILLIAM YOUNG J:
But I suppose like you said, if you know there's a substantial likelihood that the creditors won't be paid, can you say, do you get over the subjective requirement, that you believe they're going to be paid?

MR CHISHOLM QC:
Well, you've got to get over both, the subjective and the objective. But here, remember Mr Graham's evidence was that this is very unusual in an insolvency situation, that the creditors were being paid up until a month or two before the formal insolvency event, and that evidence wasn't disputed, and it's

not the usual, while the Court of Appeal relied, as I said it's not the usual aging of creditors situation that starts for months going –

WILLIAM YOUNG J:
No, I agree.

MR CHISHOLM QC:
– and keeps going up like that.

WILLIAM YOUNG J:
No, I agree.

WINKELMANN CJ:
I think it is, in some ways, what I said because it's actually at 462, they say at 461 and 462 they say they: "Proceed on the basis that the directors did believe Mainzeal would be able to meet its obligations," so the focus is on reasonable grounds. "In circumstances where directors trade on knowing that the company is vulnerable to failure at any time, and if it stops trading there will be serious, blah, blah, blah," it's odd to say that there weren't reasonable grounds.

WILLIAM YOUNG J:
I would read that as saying they didn't believe, that if you know that a company is vulnerable to failure at any time, and that if it stops trading there will be a gross deficiency, then do you actually believe that your –

WINKELMANN CJ:
Well, they did believe but not on reasonable grounds is exactly what they found.

WILLIAM YOUNG J:
Yes, but I mean, sorry, if you think that with a bit of luck they will be paid, but no, they mightn't be, is that a belief that they're going to be paid?

MR CHISHOLM QC:

Well, I can't put a percentage on it. We never had to assess belief and whether or not that was genuine or not, because that was never challenged. Plainly, reasonableness could be but that was actually not put to the directors either. But if it was 50%, certainly when one looks, there was acknowledgement that there were issues throughout 2012. One can see that from the papers. But there were steps being taken including –

WILLIAM YOUNG J:

I understand all that. That's the sort of business judgment argument I understand. What I suppose I'm interested in is the relationship between 135 and 136 and they do seem possibly to be looking at slightly different things. And possibly that is itself a consequence of the growing like Topsy way in which the statute came to be enacted. So is there no select committee report or anything that explains why these sections came in?

MR CHISHOLM QC:

No, and remember, your Honour, they're slightly different, 135 and 136 are slightly different to what the Law Commission recommended which I think was at 105 of the Law Commission's draft.

WILLIAM YOUNG J:

Okay. All right.

MR CHISHOLM QC:

Which was a slightly stauncher, I think Mr Hodder will correct me if I'm wrong, it was a slightly stauncher test on directors than what ultimately eventuated.

WILLIAM YOUNG J:

You mean more favourable?

O'REGAN J:

I think you're bringing back some very bad memories for Mr Hodder.

WILLIAM YOUNG J:

So it's more favourable to directors or tougher on directors?

MR CHISHOLM QC:

I think the Law Commission was going to be tougher.

ELLEN FRANCE J:

"A director of a company must not agree to the company entering into a contract et cetera unless he or she believes at that time on reasonable grounds that the Act concerned does not involve an unreasonable risk of causing the company to fail to satisfy the solvency test."

WILLIAM YOUNG J:

I would say that's a lesser risk because that's expressed in terms of risk and whether it's reasonable. Belief that something will happen is stronger than that. To me, at least literally.

GLAZEBROOK J:

Well, actually, just looking at the directors' belief, I think the finding was the directors did believe it.

WINKELMANN CJ:

Yes.

GLAZEBROOK J:

Because they believed that they were going to be bailed out, to put it – or the funds were going to be introduced under the arrangement, but that was not reasonable.

WINKELMANN CJ:

The finding is definitely that the directors believed it. They make that finding twice, but they say that they didn't have reasonable grounds.

WILLIAM YOUNG J:

They say, what page?

WINKELMANN CJ:

They say that they didn't have reasonable grounds. So it's at 461 and then again at 463. Yes, 463.

WILLIAM YOUNG J:

Okay, all right. I wonder whether the state of mind they attribute to the directors is properly described as belief. Anyway, I will leave it at that.

WINKELMANN CJ:

That's a rational belief.

WILLIAM YOUNG J:

No, it's not a belief at all arguably. Okay, I think my horse is going to win the race, but it doesn't mean that I believe it's going to win.

WINKELMANN CJ:

Yes, it's an article of faith then.

WILLIAM YOUNG J:

No, it implies a level of confidence. Belief implies an understanding there isn't there any substantial risk that it not being coming to fruition. Anyway, I will leave it there.

WINKELMANN CJ:

It's capturing something less than dishonesty because if you don't believe it, then you're dishonest. So it's obviously aimed at capturing something less than dishonesty and I suppose that is the gap they have created for that.

MR CHISHOLM QC:

Certainly, your Honour, that's the subjective aspect of it. This sort of case though, the other end of the spectrum is obviously the Cooper, the *Debut Homes* situation where you had someone who, whether you call it

quasi fraud or quasi, he was incurring an obligation he knew would not be met and we are, in my submission, nowhere close to that. He knew that the GST would never be paid. But coming to, and again, what I'm dealing with here is effectively on the assumption that a breach is found in part 6 of the outline.

And I just pointed out that certainly the Court of Appeal talked about it more in terms of deemed loss where you simply take the face value. So, in my submission, certainly the way it was put by the Court of Appeal was more of a fictional loss rather than loss in fact which is normally the case when one is assessing damage. It's a question of fact. You may have a breach, but one has to establish, or a plaintiff must prove that damage flowed from that breach.

This Court confirmed in 165 that it was a restitutionary remedy rather than the deemed loss the way the Court of Appeal rationalised it. I, with respect, depart slightly. As I said before, I accept that restitutionary remedies can be ordered under section 301, but in my submission, loss under section 136, it's not restitutionary. It's simply compensation and the point is that the company has not lost any property or money. But importantly, even if one –

GLAZEBROOK J:
Well, in *Debut Homes*, we did not find that there was no net deterioration. Neither did we find there was net deterioration but a restitutionary remedy was said to be apt in relation to new debt that had been incurred in circumstances where it was not going to be repaid and knowingly. So, how do you reconcile what you are now arguing with that?

MR CHISHOLM QC:
Well, your Honour, if we're on the playing field of restitution, I would submit that if one is saying that a restitutionary remedy is available or required, one can't simply give the face value of a debt.

GLAZEBROOK J;
Well that may be the case. That's to do with quantum. That's fine.

MR CHISHOLM QC:

Yes.

GLAZEBROOK J:

But let's simplify it down. You incur a debt of $100, a new debt of $100. You know you're not going to pay it. You're in breach of 136. Wouldn't *Debut Homes* say whether there had been a net deterioration or not, you could have a restitutionary remedy of 100?

MR CHISHOLM QC:

The immediate, with respect, and I understand why a remedy was justified on the facts of *Debut Homes* because it was extreme conduct, but the difficulty with the reasoning in my submission is when one gives restitution one, as I said before, one has to have regard to the benefits that the plaintiff has also got. There has to be counter-restitution as well, and we say in this case the company who is the plaintiff or the victim has got the benefit, it has got the money, and credit must be given for that, and that's a standard restitutionary principle, whether one describes it as –

GLAZEBROOK J:

So what's the counter-restitution here?

MR CHISHOLM QC:

Well, the counter-restitution on the facts of this case that the company received, it received payment of the debts, or the payment, whatever it was. The company itself received payments. In substance, the company as the plaintiff will be getting double recovery.

WILLIAM YOUNG J:

What do you mean it got the services or goods and now it's getting the money back?

MR CHISHOLM QC:

Or the services or goods, yes, the benefit. It's analogous to restitutio in integrum –

WILLIAM YOUNG J:

I don't understand that actually.

GLAZEBROOK J:

No, I really don't understand that.

WINKELMANN CJ:

Isn't that a problem with the compensatory measure as well?

MR CHISHOLM QC:

What in particular, your Honour?

WINKELMANN CJ:

You're saying it would be a double recovery because they get their assets, they get the supply.

MR CHISHOLM QC:

Well, then you're recovering more than the loss. One still has to – one doesn't – the law of damages is not to provide windfalls to plaintiffs. It's an assessment of the loss that the plaintiff has suffered.

WINKELMANN CJ:

All right.

MR CHISHOLM QC:

Just on the face of restitution itself, I – and judges always have to, sometimes face the wrath of academics. But I would take your Honours first of all to Peter Watts QC's article "*Debut Homes*…– a product of the vicarage". That's at tab 115. Just with this restitutionary point, he addresses it on pages 110 to 111, and it's really starting in the second column towards the bottom of the page: "The Court also seems to have thought that a

‘restitutionary’” remedy. He responds to that and respectfully suggests that a restitutionary remedy wasn’t appropriate but the point he makes, which is the important one that I support, is that effectively the company got the full benefit, so the company didn’t suffer a loss. So even if one is in the ballpark of restitution, one has to say, well, what is the property or what is the item that’s being returned? There is nothing. There does not need to be restitution.

Just in respect of these cases, I’ve put in the bundle a case that talks about these counter-restitutionary cases.

GLAZEBROOK J:
So then you could never get any compensation under 136, could you, because you’d say: “Well, they’ve had the services. They just didn’t pay for them.”

MR CHISHOLM QC:
In respect of some. But it doesn’t make 136 – there will be situations where 136 bites where there is loss.

GLAZEBROOK J:
Like what? Because you usually don’t incur a debt unless you’ve received something, do you?

MR CHISHOLM QC:
Well, if I, for example, as a company agreed to purchase a property but pay a deposit but am unable to complete, the company was unable, was improper to incur the obligation, ultimately lost the face value of the deposit, that’s a loss that the company suffered which could be recovered from the directors under section 136. Perhaps financing a capital item which the company couldn’t afford, you may get the benefit of the capital item but then you’ve got financing costs on it which are costs the company couldn’t meet. These are obligations that could be recovered under section 136.

Again, one can talk about restitution, but in my submission one also has to talk about counter-restitution or have regard to the benefits, and the case I was going to take you to, again different facts but it –

WINKELMANN CJ:
What about the notion that Mr Hodder said that section 136 is really designed to stop companies entering into contracts which tip them into insolvency or exacerbate their insolvency?

MR CHISHOLM QC:
Well I'm not necessarily putting that rider on 136, I'm not putting any words onto 136 because remember –

WINKELMANN CJ:
You're not reading words in?

MR CHISHOLM QC:
Beg your pardon?

WINKELMANN CJ:
You're not reading words in as Mr Hodder would have us do?

MR CHISHOLM QC:
No well I've got to accept, your Honour, that 136 could apply outside of liquidation. Remember as if, I could apply the example I used before, I could apply as a shareholder to injunct the board from undertaking an obligation that was in breach of section 136 and the company could still be trading but it could be putting the company at risk. So 136 still has teeth, there is still a loss that can be incurred. The counter restitutionary –

WINKELMANN CJ:
But you pretty much reduce it to a damp squib because it would only be a tiny category of case where anyone should be bothering with it.

MR CHISHOLM QC:

But, your Honour, this is, one is talking about a plaintiff who is a company and what loss it has suffered or whether it is entitled to a restitutionary remedy or a compensation order. That's what 169 says.

WINKELMANN CJ:

Another way to read sections 135 and 136 together is that it's one thing to carry on trading which is kind of like you can carry on trading by paying off your debts in your own non pari passu way but it's another level of trading where you bring in new creditors who you aren't going to pay. So that's consistent with Justice Young's sliding scale of travelling along the road of civil wrongdoing.

MR CHISHOLM QC:

Is, your Honour's example though a *Debut Homes* type situation where it's creditors you know you're not going to pay.

WINKELMANN CJ:

No it's a situation, well it's a situation where you have tripped over into the land of section 135, you're in breach of the section 135 threshold, you carry on paying creditors when you shouldn't be. Section 136 is the next step along where you actually carry on bringing creditors' money into your, you know, you carry on entering into fresh obligations, contractual obligations.

GLAZEBROOK J:

Which is effectively what *Debut* says.

WINKELMANN CJ:

So that's a sort of a different, that give base to what Justice Young was saying which is it's a different, it's getting in a different level of wrong.

MR CHISHOLM QC:

But you necessarily, take this case as an example, you necessarily incur new obligations by continuing to trade.

GLAZEBROOK J:

Well you do but you could be incurring, well in this situation you are definitely incurring new obligations that you actually probably on reasonable grounds thought were going to be paid because they were just those continuing trading obligations. It was just when it got to the point that what the Court of Appeal found and I'm happy to be disabused of or to have argument so that there wasn't a point at which that arose. But at some point it became clear that there wasn't reasonable grounds for believing that they would be paid, so they were being incurred at a time when there were no reasonable grounds for thinking they would be paid which is why they took those contracts.

MR CHISHOLM QC:

But that's the difficulty with the Court of Appeal reasoning, in my submission.

GLAZEBROOK J:

Well it might be but I'd rather you dealt with that difficulty with the reasoning than an argument that I'm finding difficult and I think everybody's finding difficult to understand on the wording but.

MR CHISHOLM QC:

But my argument is simply on loss, your Honour. On the Court of Appeal's reasoning they are continuing to breach section 135, you were essentially in breach of section 136 you necessarily incur obligations.

WINKELMANN CJ:

Well you still have to prove that somehow, or you have to meet the test that's articulated in section 136 so, which is two pronged, that they have this, they believe, yes they don't believe they're going to meet those obligations or they don't believe it on reasonable grounds. They might believe, for a lot of trade creditors, that they will meet those obligations and on reasonable grounds but some large contracts they won't.

GLAZEBROOK J:

Some of the short-term ones.

WINKELMANN CJ:

Yes.

MR CHISHOLM QC:

But the, as I said I referred to 279, paragraph 279 of the Court of Appeal's judgment and where they agreed to continue trading they agreed to the company incurring all the obligations that would normally result.

GLAZEBROOK J:

Well, they would, but that's just self-evident. If you're going to continue trading, you agree to incur the obligations. So if you're continuing trading, you agree to incur the rent obligation, the employer salary obligation and buying materials. The second part of the test is whether at the time you incurred them you had reasonable grounds to believe they'd be paid. I'm paraphrasing.

MR CHISHOLM QC:

Essentially the Court of Appeal found though that once you have established the breach, you've gone past –

GLAZEBROOK J:

Well, I don't think they did because they said, if you look at, is it 462 we were looking at?

WINKELMANN CJ:

Yes, 462, 461 through to 464.

GLAZEBROOK J:

So they say: "With those four contracts they were relying on the shareholder support, but that was not based on reasonable grounds," if you look at 463.

MR CHISHOLM QC:

The difficulty you have though, whether it be this case in construction contracts, that was the business of the company. You either carry on that sort

of business or you cease trading. That's the only way this company, and remember, your Honour referred to incurring obligations for employees. Remember, you incur obligations well before. Employees are a bit like leases on one level. You will employ someone, but the obligation will continue for quite some time into the future. The obligation will continue. But necessarily, if Mainzeal couldn't enter into construction contracts, it would have to go into liquidation. That was its job, or its business.

GLAZEBROOK J:
Well, the liquidator's argument was that either should have fixed up the shareholder support or gone into liquidation.

MR CHISHOLM QC:
It's an unusual or a perverse result in my submission that when looks and even when one goes to liquidation you look and there's pari passu sharing that what the directors did is improve the company's financial position by the steps they took. But it's a perverse outcome in my submission if they should be punished or penalised for that and that's precisely what is occurring here and it's precisely the points, from a policy perspective, that Mr Graham's evidence was addressing. Their conduct, their steps have improved the company's financial position. They haven't, in fairness, if they took steps and the company continued to deteriorate, that was at their risk. They took that risk, but here it's submitted that it is perverse because the company, the plaintiff's financial position has improved and this comes back to who the proper plaintiff is.

In respect of restitution, if I could give you the reference to the case because again that, in my submission, you get to the same result whether one talks about it as compensation or restitution. The judgment is a relatively recent Court of Appeal judgment *School Facility Management v The Governing Body of Christ* [2021] EWCA 1053. I think Christ, the college. And I think it's been put into the electronic bundle now at tab 140. The facts aren't analogous. It's not a case in this area, but it reinforces the counter-restitution principle.

Whether one deals with it in compensation or in restitution, one still must give credit for benefits.

WINKELMANN CJ:
So, what paragraph was it?

MR CHISHOLM QC:
Sorry?

WINKELMANN CJ:
What paragraph of the judgment?

MR CHISHOLM QC:
Your Honour, I could pull out the paragraph. It just gives simply a statement on counter-restitution. I could pull out the paragraph overnight perhaps. It gives just a history.

WINKELMANN CJ:
Your point is it addresses counter-restitution, so there's no unjust enrichment at the end of the day?

MR CHISHOLM QC:
Sorry, your Honour, in respect of unjust enrichment?

WINKELMANN CJ:
It's making sure that no one ends up – there's effectively a balancing out is what you are saying?

MR CHISHOLM QC:
Correct. Plaintiffs shouldn't be over-compensated and it comes back to who the plaintiff is in this case. The English cases reinforce these points as well, reinforcing too the point that at the end of the day it would be different if the creditors had direct remedies, as they did under the old 320, but the monies still will generally, at least generally, go to the general body and be shared amongst all the unsecured creditors.

I made the point jumping on – at 6.10 I think I referred to the examples of section 136 biting, whether it be deposit, loss of deposit, wasted financing costs. An injunction, so section 136 is not a dead letter.

6.12 the policy rationale, my learned friend Mr Hodder has already taken you through Mr Graham's evidence, which is not really disputed, but in my submission it's plain. Why would directors take any risk at all, in particular, if they're confident that they can improve the company's financial position, but they can still be liable for the face value affect.

Reference to the perverse incentive which I think this court may have referred to. In our submissions at paragraphs 205, 206 we refer, that's one article but there is a number of other academic commentators that –

GLAZEBROOK J:
Well this incentive we referred to was a perverse incentive to keep trading as long as you were very careful you didn't land up with a net deterioration so you could rob Peter to pay Paul with impunity.

MR CHISHOLM QC:
But, well rob Peter to pay Paul was certainly a reasonable way of describing Mr Cooper's conduct because he knew he wasn't going to be paying the IRD. He was entering into obligations knowing they would be not met but if people are continuing to trade and it's simply trading there is nothing wrong with that, in my submission, and that was, I think, the paragraph that my learned friend Mr Hodder took you to in the *Continental* case. But I think the perverse incentive may have been referenced, I'm not sure whether your Honour's referred to it, but it may have had a reference or come from a particular article and there are all, we say, there are competing articles.

At part 7 of the submission I refer briefly to [157]. It may be semantics ,and I probably don't need to go there, about what section 301 does or what provision or what subsection of 301 you rely on. I do accept that under 301 there can be restitutionary remedies, whether it's under (1)(b)(ii) or (i) is

simply the issue but I accept that restitutionary compensation could come under (b)(ii).

But your Honours, unless you have anything more you want to hear from me on Mr Mullins will address the cross-appeal issues which are primarily section 135.

WINKELMANN CJ:
At 8?

MR CHISHOLM QC:
At 8.

WINKELMANN CJ:
Thanks Mr Chisholm.

MR CHISHOLM QC:
Thank you your Honour.

MR MULLINS:
May it please your Honours I'm very conscious of the time. I have about a half hour I think subject to –

WINKELMANN CJ:
Right you've got plenty of time then, wasn't your estimate that you were going to take, combined the two parties would take 2.25 days?

MR MULLINS:
Yes, we're well ahead of that.

WINKELMANN CJ:

Right so no need to panic, we're not suggesting you proceed at an overly leisurely pace but no need to panic.

MR MULLINS:

I think I understand, your Honour. Mr Hodder past to me providing a little bit of assistance on the arbitrage question for the prepaid agreement. I was just going to address that relatively briefly, but there are a few references to go through to explain that and then after that I was going to, with careful attention to avoid repetition in view of the fact that I'm going third, a little bit of, some further remarks on new debt and then to address the main question which is whether or not this Court ought to take up the invitation to determine quantum at this stage and then finally, although we say the Court shouldn't get to that point, some other remarks just about the exercise of the discretion under section 301. So, if your Honours are content with that, I'd just like to ask Mr Marcetic to bring up the Court of Appeal judgment at paragraph 150 in this case.

So, there is the genesis of the question to Mr Hodder, or the proposition to Mr Hodder that there was agreement amongst the experts that the prepaid arrangement was unlawful arbitrage, but the paragraph begins that by stating that the arrangement was not enforceable and was unlawful.

Now, in the High Court, if we can get the High Court judgment up Mr Marcetic at paragraph 118, if I have my references right, some comments about that arrangement and there the agreement amongst the experts was that it was not consistent with the laws of China and it was therefore not enforceable. So the references can be provided if your Honours are interested, but there were two Chinese law experts, one called for the plaintiffs and one called on behalf of Mr Yan as defendant. What they did agree on was that it was unenforceable. There was some discussion, and I'm summarising here because there were two briefs from each. Sorry, two briefs from the plaintiff's expert and one brief from the defendant's expert. There was some discussion about what the legal consequences were. But where that coalesced was that

the agreement couldn't be enforced in China. Not that there was necessarily any particular illegality associated with it and the point that I'm just trying to assist with and clarify is that the defendant's case at trial and now on second appeal is that the support supplied via the purchase of materials overseas and shipping them to New Zealand to Mainzeal at no cost was lawful under Chinese law.

I think the easiest way to do that without diving too deep into the bundle is just to look at Mr He, who is the expert for the plaintiffs, his supplementary brief. So, to help you with that Mr Marcetic, I think it's 206.02503 and if we can scroll down to paragraph 11 and have a look at the export of materials point. There he explains that when he prepared his initial brief, which raised some issues of legality under PRC law, he wasn't fully informed of how it was that the CHC, the Chinese Holding Company, was procuring these materials and he's revised, as he would as a responsible expert, his opinion and he lands on the position that if the evidence that's been given about that is right, then the exports are generally in compliance with SAFE regulations, so SAFE being the State Authority for Foreign Exchange of China. There was a little bit of cross-examination about that and there were some underlying witness statements as well, particularly one from Ms Huang who worked for the CHC and had arranged these exports and she produced an example set of documents. They're in Chinese. I'm not proposing to show the Court them let alone try to translate them and in cross-examination with Mr He, he agreed that the exports themselves were lawful. So where that lands with the prepaid arrangement in the submission, and it's been consistent and I think the Court of Appeal's statement might have just picked up something from one of the briefs what seeing the cross-examination and the further brief, was that as a practical matter the exports of materials as support from China occurred and they occurred in a way which was lawful under Chinese law. I am happy to supply a relatively extensive list of references that tracks that through, but I'm sure my learned friends will correct me if I've got that wrong, but I just wanted to clear that out if it's any assistance.

WILLIAM YOUNG J:

So are you saying that the Court of Appeal was wrong?

MR MULLINS:

I think that the Court of Appeal is incorrect to say that there was agreement amongst the experts because, I mean I can take your Honour to where there's a difference of opinion about whether or not it is actually arbitrage, but it doesn't matter because the actual arrangement –

WILLIAM YOUNG J:

Sorry, do I take it that basically what permission was required to shift the money, an agreement to transfer money was ineffective but not actually illegal because it would be subject to a requirement that permission be granted?

MR MULLINS:

It was performed in a lawful way, but the complaint of the liquidators, in fairness to them, was that because the actual underlying arrangement was never approved by the authority, that meant that the liquidators couldn't pick that up and enforce it and that it wouldn't, you know, it wouldn't have effect in that way. So it wasn't an enforceable thing from the Chinese perspective. So what of course happened in fact was that it was performed and quite a lot of materials came under criticisms about whether or not they were that much help in the end and whether there were faults with them. But the point I'm trying to make, your Honour, is just that the suggestion in the Court of Appeal's judgment, or the inference that you might take from the Court of Appeal's judgment that there was something unlawful or illegal in the sense of illegal things were being done in China, that's not correct. Lawful things were being done in China, but the agreement was not enforceable in terms in China. Does that assist?

WINKELMANN CJ:

It does, thanks.

MR MULLINS:

Well, just turning to the three issues, or the sort of two and a half issues I suppose I have to address, the first overlaps fairly significantly with what has already been discussed in terms of the conceptual arguments that Mr Hodder has given and some of the observations about who the sufferer of the loss is with respect to what happens when a company continues to trade under these sorts of circumstances. But on the assumption of some sort of a breach, what I wanted to make a few remarks on is how so far as new debt is concerned, or the incurring of new obligations, it's even less apt as a remedy, or as a way of framing a remedy with respect to section 135 and again with caution not to be too repetitive with what has gone before, section 135 explicitly treats the creditors as a whole. It refers to creditors. It's there to protect the company by having the directors have regard to creditors. The authorities that are cited in support of the submission that section 135 can in the normal course support a new debt remedy starting with the *Walker v Wimborne* (1976) 137 CLR 1 (HCA) type cases and those, all of those talk about creditors as a body and they talk about factoring in the interests of creditors. None of them make some sort of distinction and as, I think, Mr Hodder mentioned yesterday *Nicholson and Permakraft* his dictum from Cooke J as he then was, suggesting that that sort of split between existing and prospective wasn't something that the Court ought to embark upon.

So in terms of regard to creditors as a whole we say that's inconsistent with the Court applying a new debt remedy in a case where, on the assumption that there is a breach of section 135, and that the net deterioration remedy, which treats the company interest its financial position as a whole, is the one that's most consistent with the words of section 135.

I'm a little bit cautious to embark on a discussion of the legislative history of section 320, 320(1), 135 and 136.

WINKELMANN CJ:

I think you should feel free to if you have anything to add Mr Mullins.

MR MULLINS:

I have just a few things to add and I suppose I say that as an advance apology for taking it very, very slowly. I heard his Honour Justice Young asking about where section 136 came from. There is a couple of sentences in our, or the wording of it, a couple of sentences in the main appeal submissions that talk about where the actual wording came from because it's not section 105, sorry it's not clause 105, which was the Law Commission one which has got this, as some on the Bench might have it, sort of probabilistic but also tied very hard to the Solvency Test, with a capital S and a capital T. So that wasn't adopted, but prior to that the law had already been amended, and I've forgotten the year, but what had happened essentially was that following the Macarthur, I keep it calling it McCarthy but it's Macarthur report, the sections that had been put into the uniform code of the Australian Companies Act, because they used to have Companies Acts per state and then they kind of amalgamated them, and I do apologise not for having references because I've just been trying to think this through now. What happened was the wording of some other sections in that Act were adopted in, and that's where some of that wording seems to have come from for section 136, and that sits along what the reckless trading, you know, because it was all under a heading "reckless trading" of course it was, you know, that was the, initially fraudulent trading and then reckless trading so –

WINKELMANN CJ:

Can I just ask you to clarify? You say that the Act had in fact been amended prior to the, are you saying –

MR MULLINS:

Prior to the Companies Act yes.

WINKELMANN CJ:

So the 1955 Act had been amended prior to the Companies Act 1993?

MR MULLINS:

The 1955 act was repealed –

WINKELMANN CJ:

No are you talking about, which one had been amended, was it the Australian Act or the New Zealand Act that had been amended?

MR MULLINS:

The New Zealand Act and I do have, if I can be forgiven a moment to try to find it. So just for orientation on it, and it might help to bring it up on the screen if we can Mr Marcetic, Mr Yan's appeal submissions at paragraph 86. I'm pleased to see I was reasonably close with my guesses about the years. So if we get down to paragraph 86 and then paragraph 87 records the answer to your Honour the Chief Justice's question, which is that that version of the Companies Act and we see there in 320(1)(a) is, looks like the section 136 that we see now.

WINKELMANN CJ:

Yes I must say I was very confused because the section that's in the materials didn't correspond with my memory and this corresponds with my memory.

MR MULLINS:

But, yes, there is a bit of a problem with tracking it through sometimes and I think there was an erroneous…

WINKELMANN CJ:

Because this is not a short-term?

MR MULLINS:

No, not at all.

WINKELMANN CJ:

This was the one I learnt at law school.

MR MULLINS:

Quite, and the one that I just missed out learning at law school by a little bit. So that version came after the McArthur report recommending the adoption of

these two limbs and there we see the earlier formulation which is very close to what has been observed about the belief and knowing point, which is knowingly a party to the contracting of a debt by the company and not honestly believing on reasonable grounds. I'm not entirely sure what honestly really adds there because you need to believe on, you know, dishonestly believing isn't going to help you, or anything and then in section 320(1)(b) we see the precursor which is just this reference to recklessness. That then gets amended into the 135, 136 rather than the Law Commission's version which was that clause 105.

WILLIAM YOUNG J:

What I sort of find a bit hard to work out is why section 301(1)(c), which provides the relief to be granted directly to a creditor, is confined to a transfer of money or property which if you follow the textual logic of the sections through must be money or property that actually belongs to the company.

MR MULLINS:

Yes, well I think just to clarify an initial point, section 301 doesn't have in it a Law Commission paper original provision. It, on my understanding, I mean I think it's actually recorded in the Court of Appeal's decision in this case, replaced section 321. Sorry, yes, 321 and in 321 we saw that procedural mechanism to allow for compensation for –

WILLIAM YOUNG J:

Well, it's 320 really, isn't it? Is it 320 of the Companies Act that provides for relief to be granted directly to a creditor, or is it 321 as well?

MR MULLINS:

So 321 didn't require, didn't, excuse me, didn't, on my memory but let's have a look at it. I was just trying to look at it over the luncheon break.

WILLIAM YOUNG J:

They're terrible statutory provisions to read.

WINKELMANN CJ:

The sentences are half a page long.

MR MULLINS:

They're not the friendliest. I think that if we look at the first of the, I think it might actually be tab 1 in the authorities' bundle.

WILLIAM YOUNG J:

We had it then.

MR MULLINS:

I'm just trying to find, your Honour, 321, and show how it looks like and embodies a lot of 301.

WINKELMANN CJ:

I think it is 320(1).

MR MULLINS:

Yes. Can we blow that up a little bit? So, here we see that language about facilitating a claim procedurally rather than creating one. So: "In the course of winding up some subject people either misapply or become accountable for money or property, restitution type claims, or been guilty of negligence, default, breach of duty of trust in relation to the company, the Court may, on the application of certain people, including a creditor, contributory," now known as shareholders, "look into that and compel them to restore the money, property or any part thereof, or contribute such sum to the assets of the company, by way of compensation." And that section doesn't – I understand it has been in the company statute since about the 1880s or something like that, something like that, something along those lines, but it doesn't include the 301(2)(c), or (1)(c) that your Honour is referring to.

WINKELMANN CJ:

Well it might because it says "repay" doesn't it?

MR MULLINS:

Quite. Well, repaid, if it has to be repaid to whom paid it, it would and that would fit more closely with the restriction that we say there is.

WILLIAM YOUNG J:

The first bit: "Misapplied, retained or become liable or accountable for any money or property the company," suggest effectively the director, prior director, breach of fiduciary duty has got hold of assets of the company.

MR MULLINS:

Yes and because it's in liquidation, the creditor would really rather that they got it rather than it went back into the company and then they had to sue them.

WILLIAM YOUNG J:

But this section 320(1) didn't provide for that to go to the creditor?

MR MULLINS:

Well it might have if interpreted broadly enough in terms of what repay means.

WILLIAM YOUNG J:

Repay or restore the money suggests it goes back to whoever owned it, which is on this footing the money or property of the company so it must be the company.

MR MULLINS:

Yes, it's not.

WILLIAM YOUNG J:

So 301 seems to be a slightly unhappy combination of 320(1) and 320 that hasn't been thought through perhaps.

MR MULLINS:

I think that that's probably where we depart in terms of the reasoning because the point I was trying to come to was that, as Mr Chisholm was submitting, the

deliberate omission of the compound wrongs plus remedies, i.e., those two wrongs that ended up section 135, 136 are now divorced from that statutory remedy and it was retained for some things, the failure to keep proper records in section 300, but was not carried through anywhere suggests that it ought not to be.

WILLIAM YOUNG J:

Well they've carried through in what seems a strange on a literal approach incomprehensible way in section 301(1)(c).

MR MULLINS:

Well, I think we'd have to differ on that because I don't think it was.

WILLIAM YOUNG J:

Just explain to me why, I will just bring up section 301(1)(c) myself, sorry. Just hold on for a second. On a literal approach to 301 there's a claim where a director et cetera has misapplied or retained or become liable or accountable for money or property of the company. Right, so it deals with that claim and then as to relief for such a claim: "Where an application is made by a creditor, order that person to pay or transfer the money or property to the creditor," which I can't see why the Court would want to do that because it's the property of the company, why should the creditor get it?

MR MULLINS:

Sorry, your Honour, I'm just bringing up the section so I can follow the text.

GLAZEBROOK J:

Perhaps if we can all have it, it would be good, if we can, thanks.

MR MULLINS:

That's section 301 of the Companies Act.

WILLIAM YOUNG J:

So why would a Court ever want to direct that the creditor gets the asset or the company?

MR MULLINS:

Well, if the case was a case of fraud and the defaulting person, director, had used the company as a conduit to essentially take the property with a, you know, absence –

WILLIAM YOUNG J:

That's sort of bit of a fifth wheel because on such a case the creditor would have a direct claim against the director?

MR MULLINS:

Well, I suppose in a lot of these cases there are other claims possible because there are direct claims possible generally.

WILLIAM YOUNG J:

So, where, if 301 followed the logic of the old statute section 320, section C where the application is made by a creditor, it would go on to say: "Order that person contributes such sum to the creditor et cetera, et cetera as the Court thinks fit." That would be the logic of bringing section 320 into this section. They didn't do that.

MR MULLINS:

Well, there are many things that could have been done to make this clearer, but what the argument is, your Honour, is that that section 301 was something of an afterthought or something that wasn't properly explained and what it did was it carried forward and changed a little bit section 320(1).

WILLIAM YOUNG J:

So if this case fell to be determined under section 320 of the old Act, it would have been perfectly possible for the Court of Appeal to direct that debts not

properly incurred by the responsibility of the directors and required to be paid to the creditors.

MR MULLINS:

Yes, and we are saying that because section 320 had removed from it the wrongs and those were placed into the Companies Act 1993 and the remedy, which is this very, very sweeping remedy, which is to, you know, pay debts in liquidation, pick them out and so on was removed. So that's the submission, your Honour. I appreciate that we are differing on the –

WILLIAM YOUNG J:

Is there any commentary on this?

MR MULLINS:

There is some in Professor Watts', dare I say his name's, text. If we bring up…

WINKELMANN CJ:

So if it was also under this old Act, it would have been perfectly correct for a section 135 claim to be quantified on the basis of the Court of Appeal's approach.

WILLIAM YOUNG J:

The Court of Appeal's approach would be right, would broadly be right, under the old section 320.

MR MULLINS:

It would certainly be permissible under the law as it was in the 1980s roughly.

WINKELMANN CJ:

And your submissions take us through all the – or you say the legislative history, it makes it plain that there was an intention to walk away from that measure, or is it simply just this –

MR MULLINS:

Well, taking the words of the statute and the absence of that built-in remedy for sections 135 and 136, but its presence for section 300, I say that that is quite plain as a matter of statutory interpretation.

WINKELMANN CJ:

I think it might have found it difficult to understand these submissions because the reference to "built-in remedy", don't you mean an indication, just a measure of quantum as opposed to built-in remedy? It tells how you quantify, qualify the relief really, isn't it, is your point?

WILLIAM YOUNG J:

I starting point 320 had it all rolled into one section. It had the wrong which was incurring debts.

WINKELMANN CJ:

Yes, and it also told you how much you were going to be liable for.

WILLIAM YOUNG J:

And who it might be paid to.

MR MULLINS:

Well, I would say that that's correct and if we can use different words it contained duties, it contained obligations, and it contained an express power for the Court to make orders about the consequences of the breach of those duties, whereas what we have under the Companies Act is we have some statutory duties owed to the company, and I'm not going to go down the path of further discussion about that because I think it's been explored, but interpreting that based on the words of the statute which is where we have to start and the whole of it, I say Parliament's intention must have been to remove from the Court the power to simply order some selection of the debts and the liquidation to be the remedy for the breaches of those duties.

WINKELMANN CJ:

It's interesting, isn't it, this has got antecedents –

GLAZEBROOK J:

So *Debut's* wrong. So you're actually asking us to overrule *Debut*, is that the – because you have to be.

MR MULLINS:

I think for this bit, for the section 135 part.

GLAZEBROOK J:

Okay, 135. No, no, that's fine. Sorry, I thought we were on 136 but…

MR MULLINS:

Yes. Can I say "phew"?

WINKELMANN CJ:

So just going back to my questions, it's actually, it's antecedents, the antecedents of section 320 lie in England, don't they?

MR MULLINS:

They do, yes, because it would have been the England/Wales –

GLAZEBROOK J:

It's just I don't quite understand how the 301 sits at – because the argument on 135, isn't it, that if there's not a net deficiency then normally –

MR MULLINS:

Yes, that's right.

GLAZEBROOK J:

– absent whatever, we shouldn't have the new debt. But I don't see how 301 helps you because then you would have to be arguing that *Debut* was wrong on 136 because somehow – and I don't actually even understand the argument. I'm just totally lost on the argument. Mr Chisholm totally lost me.

You haven't helped. In terms of how 301's worded, I can understand it in respect of creditors but I can't understand it – I can't understand why that means that *Debut's* wrong in terms of the remedy it ordered.

MR MULLINS:

Well, I suppose, firstly, what I'm trying to address is the cross-appeal point which is whether or not section 135 would admit of this type of remedy and what I'm –

GLAZEBROOK J:

But if you say that that type of remedy isn't available at all then you're attacking *Debut* rather than saying it's not an appropriate remedy for 135.

MR MULLINS:

I hadn't seen my submission as quite going that far but obviously, with Mr Chisholm and Mr Hodder, I need to be part of that team.

GLAZEBROOK J:

No, no, it's not that I'm criticising you. It's just that I don't understand the submission, which I've said. I said to Mr Chisholm – actually, I don't know whether Mr Hodder made that submission but…

WINKELMANN CJ:

I'm interested in the notion because it's really been presented to us, which this may be to overstate it, but that the approach of the Court of Appeal was really to create a rip in the space-time continuum of company law because the victim's always been a company and therefore the net deficit approach is the correct one, but when you look at this, this a long-standing provision which has its antecedents in the UK which allows a different qualification.

MR MULLINS:

But that provision is no longer in force. That's the point that –

WINKELMANN CJ:

I know but that – yes.

MR MULLINS:

And I'm saying that there was a change and I don't propose to advocate –

WINKELMANN CJ:

Yes, okay. I'm just challenging the notion that it's some revolutionary concept form of it.

MR MULLINS:

Well, it –

WINKELMANN CJ:

That's not how you were putting it so…

MR MULLINS:

I don't think so.

WINKELMANN CJ:

And I may have misunderstood the arguments that were put earlier.

MR MULLINS:

Well, I'm happy to try to answer some questions to clarify it but –

WINKELMANN CJ:

I don't think I've asked you a question now.

GLAZEBROOK J:

I think it would be more helpful to just deal with the cross-appeal point in terms of this case.

MR MULLINS:

Yes, because –

GLAZEBROOK J:

And the facts of this case.

MR MULLINS:

That's right. So there's that point on the law which is –

WINKELMANN CJ:

I think Justice Young's got a question.

WILLIAM YOUNG J:

Well, just before you depart from it, you were going to – Professor Watts dealt with the meaning, application and history of section 301(1)(c)?

MR MULLINS:

There is a section in his text book which is, I think, the last item in the authorities, or it's near the last. So this came out this year and the chapter that deals with directors' duties has a brief discussion of section 301. I'm trying to find the page. Apologies, your Honour, I think just in view of the time if I could – I say that it embodies roughly what I said before which was that 301 comes from 321. It wasn't something that the Law Commission proposed.

WINKELMANN CJ:

So we're at 358, I think. Ms Marcetic has taken us to 358.

MR MULLINS:

Thank you. Mr Kennedy says it's at 382, page 382.

WINKELMANN CJ:

That looked interesting, what we were at. Note that down, 358.

MR MULLINS:

Yes, thank you, that is the part that I was thinking of.

GLAZEBROOK J:

Can you run it down because it's going onto the next, the bit that we want, I think? We just want the bottom of the previous page and the top of – okay, maybe just can't do it.

WINKELMANN CJ:

Perhaps you can move on to the next page now.

MR MULLINS:

So I don't know that it addresses the point about 301(1)(c) in that part.

WINKELMANN CJ:

Can we go to the next page? Right, okay, no.

MR MULLINS:

If I might be permitted to suggest we leave that particular point unless there's a specific question about it.

WINKELMANN CJ:

So moving on to your next point.

MR MULLINS:

Moving on to the next point. So there are a number of things about the plaintiff's, the liquidator's claim, that have already been canvassed reasonably thoroughly by my learned friends, Mr Hodder and Mr Chisholm, insofar as the actual circumstances in 2011/2012 did not represent times when there was gambling at the doorstep of insolvency and really the point that I wanted to – there was one further point of law which is that, of course, the solvency test isn't actually embodied, didn't end up getting embodied in section 135. That's a very short point. It could've been if section, if clause 105 had been enacted and it wasn't.

The other is that the behaviour of our client, Mr Yan, and the other directors at the times when the pressure really came on in terms of trading was redolent

of not gambling with the creditors' money but trying to make sure that creditors, the objective, the duty in some senses in section 135 were going to be paid by bringing a lot more money in and Mr Chisholm has already talked about the funds flow that occurred over the July through to the end of December or so of 2012. That's all covered reasonably thoroughly in our written script.

The only other thing I wanted to mention about the case and how it's now presented for the liquidators, and it seems to be connected to this idea of a privilege of trading, the warranty of solvency by having a company at all kind of principle, is that there are a number of places where it's suggested that because there were criticisms to be made of some of the financial accounts that this somehow amplifies the need for a remedy in this case and all I have to say about that is that the case has never been put on the footing that there was a particular creditor who was mislead. That would be a different claim, it might be deceit, it might be some other form of fraud but it was never the case put.

So I didn't really have much else to add to that question on the cross-appeal side of things and the other part in the last four minutes of the day is the suggestion that this Court should embark on assessing quantum either on the Court of Appeal's new formulation or on the generic new debt argument made for section 135.

Without going to the individual documents to do this the submission is that the Court of Appeal is right, that it didn't have enough information to assess its formulation. One of the main reasons for that is that the way the evidence was put at trial was based, as Mr Chisholm has said, on assessments based on proofs of claim which build in a whole lot of things that happened at the end when obligations aren't fulfilled together with, and this applies to Mr Apps' calculation as well, the use of an accounts payable analysis.

Now an accounts payable analysis is kind of the middle step if you've got an obligation that isn't met on liquidation. The first step is as a company director

someone signs up to a lease, maybe it's five years long, then they're incurring that obligation. There will be an assessment necessary of what the quantum, what the financial implications of that obligation are at that stage and that will be important to understand, more important we say than when the particular lease payments fell due. They are important but not as important as the actual entry into of the obligation, the incurring of the obligation which is the subject of both new debt analyses.

The other part that we say needs assessment, and this is all on the assumption that we are going to assess quantum at the second appellate level which we say is inappropriate and also on the basis of new debt which we say is inappropriate, is that there are some anomalies in terms of working out when and what the components of the proofs of debt were which were essentially consequential damages rather than the obligations incurred that were not met. So those are just some very summary submissions about how those things work. I have actually looked to see whether or not there were term obligations in Mainzeal, there are some things in the financial statements which go out to five years, you have to disclose any term commitment, capital commitments, those sorts of things. So there are reasonably substantial numbers in all of that. I don't propose to bore the Court with any of the arithmetic on any of that and the submission is that it's just simply inappropriate to embark on any sort of quantum exercise even if, which is denied, this measure is available.

I'm very conscious that it's just hit 4 pm. I have some very, well assuming there are no questions about the quantum submission which I have just rather raced through, I was going to make just a few remarks on the exercise of discretion vis-à-vis Mr Yan. I don't know if I should do that now or wait until –

WINKELMANN CJ:

I think, didn't Mr Chisholm QC start off with that by making the case there was no basis for differentiating him from the others, that the case had been run on that basis?

MR MULLINS:

Yes and I suppose all I was going to add is that we support, from a legal, this is the legal part of it, the existence of a discretion which the majority in the Court of Appeal favoured.

WILLIAM YOUNG J:

There is a difference though. The other directors were relying on Mr Yan. Mr Yan, who was probably best placed to know what was going to happen must have only been relying on himself.

MR MULLINS:

That's right.

WILLIAM YOUNG J:

So perhaps there is a difference between him and the other directors.

MR MULLINS:

He is in a different position, but we say he's not in a position which marks him out for a greater part of whatever remedy there might be at the end of the discretion because of all of the things that he did which showed commitment, his honesty, all of those other things which Mr Chisholm has already mentioned.

WILLIAM YOUNG J:

He did give assurances that in the end weren't honoured.

MR MULLINS:

Oh, is this a reference to the Court of Appeal's –

WILLIAM YOUNG J:

No, just the letters of undertaking, the letters of comfort. He did say we will stand behind it.

MR MULLINS:

Yes.

WILLIAM YOUNG J:

He then seems to have said: "Well, that's subject to an unexpressed condition that it was only if Mainzeal remained a going concern." But in fact he didn't honour them. Or the undertakings that he was responsible for giving were not honoured.

MR MULLINS:

Well, I think that the main answer to that is that Mr Yan did his best right until the end and no one can survive a bankrupt because the quantum of any undertaking like that of course, I mean it can't be limitless.

WILLIAM YOUNG J:

It can't be, sorry?

MR MULLINS:

Pardon me?

WILLIAM YOUNG J:

Well, I suppose the sequence of events that led to the company failing started with Mr Yan getting cold feet over the guarantee I guess and the mortgage?

MR MULLINS:

Well, in our submission, Mr Yan, the reason that Mr Yan, just getting into the weeds of the fact slightly, was so upset about the guarantee was that his wife had inadvertently signed up to a limitless guarantee as well. Sorry, a guarantee with the same limit as him. There were some discussions about that with Dame Jenny and my recollection of the evidence from John Walker is that the issue of the guarantee wasn't really the proximate cause in any real sense of the Chinese entities running out of money and not being able to fund the overseas, the exports, which is what they were meant to do and obviously there were some efforts to try to substitute something but it wasn't enough rather than his guarantee being the thing that made Mr He the –

WILLIAM YOUNG J:

Okay, well what triggered it is Mr Yan's letter that MPC and Mainzeal were no longer going concerns as CHC was unable to provide the necessary assurances.

MR MULLINS:

That was the beginning of the end because Mr He had told him that he wouldn't, that there wasn't sufficient funding available in China to back the overseas support.

WILLIAM YOUNG J:

Well, he had given assurances that implied that there was sufficient funding available.

MR MULLINS:

Well, he had been given assurances a lot earlier on, yes, and he done his best right the way through.

WILLIAM YOUNG J:

Yes. Well, it's like saying I gave an undertaking, someone gives an undertaking and doesn't honour it and they say: "Well, at least I gave an undertaking." I don't know if that's completely an answer.

MR MULLINS:

Well, I suppose looked at –

WILLIAM YOUNG J:

Particularly if the undertaking is relied on.

MR MULLINS:

Well, looked at from the perspective of the support letter as the undertaking of support, that's sort of roughly April or so 2012 and after that date a really substantial amount comes in and every effort is made. I appreciate that I'm just saying every effort again, but I think that the timing there fits in with

Mr Yan doing his best and that was what his evidence was and the judge found him to be genuinely committed. So eventually the CHC was unable to supply further funding to meet what the BNZ wanted and then Mr Yan wrote that letter and then Mr Walker, as Mr Hodder said, tried to talk Mr He round and got something else but it wasn't enough because the bank had lost confidence, or refused to…

WINKELMANN CJ:
Right, okay, so do those conclude your submissions then?

MR MULLINS:
Unless there are any particular questions, and I don't know that I need to repeat any of the law and other sort of lists of factors in the submissions, but if there are any questions I will answer them. I will do my best to answer them.

WINKELMANN CJ:
You've faced a fair few, Mr Mullins, already. Thanks you very much.

MR MULLINS:
As your Honour pleases.

WINKELMANN CJ:
So, does that mean that tomorrow we will commence with Mr O'Brien?

MR O'BRIEN QC:
It does, your Honour, yes.

WINKELMANN CJ:
Okay. We will retire now thanks.

COURT ADJOURNS: 4.05 PM

COURT RESUMES ON WEDNESDAY 9 MARCH 2022 AT 10.04 AM

WINKELMANN CJ:
Mr O'Brien QC.

MR O'BRIEN QC:
Thank you, your Honour. May I begin just with introducing Mr Thomas Leggat who is just over my right shoulder. He has come to run the documents, so with your permission, so he's not appearing per se but here with us.

WINKELMANN CJ:
Thank you, Mr O'Brien.

MR O'BRIEN QC:
Your Honours, what I intend to do this morning and I imagine it will take all day is begin with some opening remarks, really an overview, and then take you to the pleadings which received some mention yesterday and the day before, then a sort of overview response to the key themes which the appellants have presented and then what I was intending to do is spend quite a bit of time on a detailed run through the facts using in part our written submission but particularly the chronology which we filed last week which is linked to the documents and to the relevant paragraphs of the Court of Appeal judgment. I think your Honours will find that useful I hope today and certainly when you come to review matters later. And then move on to legal issues, including the legal history touched on yesterday and developments in the common law and in statute and then later, quantum.

WINKELMANN CJ:
So I can indicate we're very interested in the quantum point, so don't run out of time on that Mr O'Brien.

MR O'BRIEN QC:
Yes. No, thank you, your Honour. In fact, Mr Kennedy is primarily going to deal with those, but he will take you through those carefully.

In terms of an outline of where we are going, apart from that, we don't have yet another document. We figured your Honours have more than enough, but we are going to use the written submission and the indexes as a good enough outline. So, I am going to track the written submissions reasonably carefully in places.

But if I can just start with this general overview and here in fact your Honours I would invite you to open the written submission because I am going to follow the first couple of pages of it which really outlines our case in a nutshell and indeed, quantum aside, the case that has been accepted in the High Court and Court of Appeal judgments.

So, paragraph 1.1 really captures in many respects everything we have got to say and I will just, without reading it exactly, but I do want to go through it because there is about seven points in there. So, as you know, the collapse occurred early 2013. Losses are huge, over $100 million to unsecureds and why? Well, we say that is a direct consequence, or they are direct consequences of allowing the company to trade over an extended period whilst insolvent since really 2005, 2006 and with, by the end of 2010, a critical period in our claim late 2010, early 2011 with, at that point, $44 million of loans outstanding made by Mainzeal to companies within the Richina group which could not repay them and therefore, with the company totally reliant on verbal assurances mainly, and to some extent written, of group support which were simply not reliable assurances and with a trading performance that was poor and itself reliant on a steady stream of high value, low value, sorry, low margin projects and I will take you to that, prone to significant one-off losses and different to forecast with certainty.

So those, that in a paragraph is the theme of the liquidator's case, as it has been presented and as we will present it again today.
So, when did it all begin? We say well back in 2004 and particularly in 2010. 2009, 2010 pivotal periods. But if we go back to 2004, we find, and I will take you to this document shortly, but we find Mr Yan writing to his shareholders in

Richina Pacific indicating reasons as to why they would continue to keep a company such as Mainzeal. Just by way of background there, your Honours, when what became the Richina group, when REH, Mr Yan's investment vehicle, acquired Mainzeal's parent some years earlier, their primary focus was China and a company within the Mainzeal group called Mair Astley which had leather interests which they intended to marry with actual or intended interests they had, or intended to have, in China. Mainzeal was a sort of incidental acquisition.

Some of the investors Mr Yan explained to us and indeed the annual reports tell us we're not really interested in Mainzeal, thought it was a bad business to keep, couldn't understand why they would keep it. So Mr Yan, writing as he said in cross-examination to a wide audience, a mixed audience, was justifying it and the reasons are briefly summarised there in 1.3.

Basically, you could run the company with little or indeed, or little equity, a negative working capital. So, as long as you got a profit, you would actually be getting as a shareholder a really excellent return on investment. The question then posed, which he posed, was well, how to contain the downside risk and we say that is what he then set about to do.

So, shortly after this in 2004, 2005 we see the beginnings of the lending and I say there by the end of December 2006 the value transferred by loan was 36.7 million. By the end of December that had grown to 44 million and, as I said, the problem for Mainzeal was the companies that had borrowed, didn't have the funds to repay and were themselves reliant on group support, or shareholder support, and that structure wasn't accidental, it was deliberate and the High Court found it was deliberate. Justice Cooke, having heard all the evidence and the Court of Appeal agreed, a deliberate structure, thus leading to what Justice Cooke called: "A policy of insolvent trading."

O'REGAN J:
Was there any similar letters of assurance given to the upstream subsidiaries that actually owed the money to Mainzeal?

MR O'BRIEN QC:

Not, well at this point, your Honour, in 2005, ’06, ’07, ’08 and ’09, maybe, I’m not sure about ’09, certainly 2005, ’06, ’07, ’08 yes in the sense that – well, they didn’t really need them at that point. Possibly they did, but RPL, which was the controlling company within the group, was at that time providing the audit letter of assurance and it was after the restructure that that changed and that, we say, is a critical event and should have been seen and should have been pursued and wasn’t.

O’REGAN J:

But there wasn’t any equivalent in the letters that Mainzeal were getting for its auditors?

MR O'BRIEN QC:

I’m not sure about the early period.

O’REGAN J:

It doesn’t really matter. I’m really thinking of the end period.

MR O'BRIEN QC:

No, there wasn’t and I will take you to that, your Honour. But while we are there, and because Justice France asked about it the other day, very briefly there was a proposal that there be such letters. There was a proposal that there be a letter of support from the CHC company.

WINKELMANN CJ:

What year are you discussing here, Mr O'Brien?

MR O'BRIEN QC:

2010, your Honour.

GLAZEBROOK J:

So, this is October, are we around October?

MR O'BRIEN QC:
I think earlier, your Honour.

GLAZEBROOK J:
Earlier, oh okay.

MR O'BRIEN QC:
Well, it evolved over a couple of months, but yes, there was a proposal that the CHC provide a letter of support to the companies that were providing a letter of support to Mainzeal, but it was never executed.

WINKELMANN CJ:
But the directors said they understood it was, didn't they? Everyone seems to have said in the belief that it existed, but the judge made a finding in fact it didn't.

MR O'BRIEN QC:
That's right and his Honour made that finding of fact because no one could produce any such letter and in fact, I will take you to it in due course, but in fact, there was the resolution at RPL level that perhaps not the letters wouldn't be given, but there's a resolution which clearly says what support is going to be given and what we never had was any evidence of any of the Mainzeal directors really following up on that. Although you are right, your Honour, they did say, or some of them said, they thought there was such letters. Well, with respect, not good enough.

So, we say that restructuring in 2008 to 2009 and into 2010 was really critical. It exacerbated the vulnerability of the Mainzeal company. Why is that? Well, because Richina was delisted from the NZX and is that important? Yes, because it has no reputational presence in New Zealand and it moved fully offshore and is that important? Yes, it is because again no reputational presence, less likely to support despite its verbal assurances it would and it ceased to be Mainzeal's direct parent. Is that important? Yes, of course it is because the asset side of the business was now solely in China, or the asset

rich side of the business, leaving the New Zealand side with really nothing but Mainzeal. Also important because, not that anyone thought about it, because it precluded the possibility of a pooling order under section 271, these companies could not be run as a group in a legal sense under our Act.

Then with the exception of providing the guarantees for performance bonds, which were required to secure new work, so you had to have them to get new work, Richina signalled to the Mainzeal directors at the time that the company was expected to be a stand-alone business and I will take your Honours to the documents which show us that and that it was expected to be financially self-sufficient and yet the loans, which were critical to Mainzeal's balance sheet, remained unpaid and there was no promise that they would be repaid.

PwC, at that time the auditor and engaged to assist with the restructuring, noted all this, or some of it, noted that Mainzeal couldn't survive as a stand-alone business and required a capital injection, or a loan repayment of USD 13.5 million, so about 20 million kiwi at the time, or 25. My calculation says 25, but it depends on the exchange rate you use and the Court's below have adopted 20 million and that was because, without the loan repayments, or without the loans being readily collectable, Mainzeal was in a deficit position.

The directors knew all this. They certainly should've known it and yet they allowed the company to continue trading and they allowed it to continue to bid and secure major new contracts and I will take your Honours to minutes which demonstrate this was occurring on a monthly basis, or at least a quarterly basis.

And they continued just to rely on the assurances and that is despite another pivotal event which occurred in August 2010, this is at 1.7, when Mr Walker, who was chairman of the group wrote to the directors in response to queries they had raised about who was responsible for solvency and he said: "You are." And what did the directors then do? Well, with respect, we say not much.

WINKELMANN CJ:

What was the date of Mr Walker's letter?

MR O'BRIEN QC:

26 August 2010, your Honour, and I will take you to it. So, no capital – we won't go there right now though, thank you Mr Leggat. If your Honour doesn't mind, I will just get there.

WINKELMANN CJ:

No, that's fine.

MR O'BRIEN QC:

So, no capital. No capital, what do you need? You need cash flow and you need a steady stream of it. It's critical. How do we get that? Well, new work, how else? So the directors therefore encouraged and approved the continuing business and on it went and inevitably margins were low. It's a tough industry. I think everyone was agreed on that. Quite high risk and quite low margins. We say prospective counterparties wouldn't have been aware of the precarious state of the business and I say precarious echoing Sir Paul Collins' statement shortly after he joined. There was no indication in the accounts that the company was in a precarious position.

WILLIAM YOUNG J:

Just pause there. I've seen them, but I didn't look closely. So the balance sheet records of the loans aren't noted?

MR O'BRIEN QC:

Well, sorry, your Honour, we will go to a set of accounts. I think we should. There are several of course. No, the loans are recorded as assets, but they're not impaired and there is no indication in the notes that they are impaired. There is no indication in the notes that the part, the borrowers are unable to repay.

WILLIAM YOUNG J:
That they can't be paid.

MR O'BRIEN QC:
There's no indication, direct indication in the note that repayment of the loans depends on shareholder support. What there is, is the emphasis of matter and the emphasis of matter being the auditors emphasising that this business is only a going concern because of shareholder support, or the assurance of shareholder support I should say.

WILLIAM YOUNG J:
But that doesn't directly relate to the recoverability of the loan?

MR O'BRIEN QC:
I don't think there is a direct link, no, but that is the cause as we understand it in large part of the introduction of the emphasis of matter.

WILLIAM YOUNG J:
Okay.

MR O'BRIEN QC:
But you wouldn't necessarily – well, yes, you wouldn't…

WILLIAM YOUNG J:
So who would see the audited accounts? Would some, the principals on the other side of large contracts, large construction contracts, might want to see them.

MR O'BRIEN QC:
That's what we understand, your Honour. So, yes. Bear in mind – and we're jumping time periods a little here – I don't think they produced audited accounts until after the restructure. But after the restructuring, as you'll see, they were keen to have accounts to show to counterparties, and we'll see a reference to Mr Reegan, the CFO, saying: "Well, we need some glossy quality

accounts to show the counterparties." So, yes, would everyone who dealt with the company see the accounts? Well, there's certainly no evidence for that, you wouldn't imagine, because of course people follow the leader. If principals are accepting Mainzeal as a counterparty, then others will follow suit. But the evidence, as far as it goes, suggests they were being used to show and – well to show to the major, yes, principals and other major counterparties.

WILLIAM YOUNG J:
What's the basis of the second-to-last sentence in 1.9? Does that go beyond the absence of a note in relation to the other, the company loans and the very limited provisioning for defective building?

MR O'BRIEN QC:
Is that the sentence saying there was no indication of the magnitude of legacy claims?

WILLIAM YOUNG J:
No, then there's – yes, it says compounding the steps were taken to make the balance sheets –

MR O'BRIEN QC:
Oh, yes, sorry.

WILLIAM YOUNG J:
So what are those steps?

MR O'BRIEN QC:
There's other sources. First, well, first the fact that they're producing the accounts, but second –

WINKELMANN CJ:
What do you mean, they're producing the accounts?

MR O'BRIEN QC:
Well, they're producing a glossy set of accounts and they're prevailing them to the market.

WINKELMANN CJ:
Okay.

MR O'BRIEN QC:
But the compounding – sorry, I hadn't really got to it – the compounding was twofold a least. First, and as I'll show you, at years end 2010 and 2011 there was a reasonably significant inflow of funds into the company late in December, in fact largely on 31 December, the balance date, and then those funds were extracted in the weeks following, not exactly but largely, and that occurred in 2010 in particular and into 2011 for the extractions, and again it occurred, at least in terms of input, at the end of 2011 with funds, not all of them, going out in early 2012. And secondly there was, and the Court of Appeal noted this, there was a transaction by which "paper equity", so-called, was introduced into the Mainzeal parent, RGREL, so not into Mainzeal itself but into the parents company accounts, and there's references in the board minutes to how the New Zealand division accounts would be used. And the paper equity we'll come to, but in effect it wasn't real value.

So, we say and the Court said, Justice Cooke said, adopted by the Court of Appeal, what this really amounted to was a policy of insolvent trading, and that served to ensure that existing creditors were paid, for a time, until it all stopped. But it put new creditors and the company itself, we say, at great risk, and that's what the Courts have, we say, rightly found.

Now, of course, Mr Hodder and Mr Chisholm say differently, they say that it was perfectly reasonable for the directors to rely on these assurances, that the writing was not on the wall and they made rational business decisions, and Mr Chisholm adds and in fact the company position improved over time so there was no net deficiency between the breach date and the collapse and never mind the new creditors because the law effectively doesn't cater for

them, and we see, well, that cannot be right and is not right, and on *Debut* it's certainly not right, and there's the added submission from my learned friend Mr Chisolm that the liquidators case was not pled in the way it's now put.

So at this point I would like to take your Honours to the pleadings and spend 10 minutes on them, or so and the best place, your Honours, is tab 39 in the bundle which Mr Leggat has up, so that's the merged pleading document. I won't take your Honours through every paragraph by tortuous paragraph, but if I could just ask you Mr Leggat to scroll down to paragraph 14. That's where we see the beginning of the factual summary and in paragraph 18 we see, oh, paragraph 17, there's mention of a charter. We will come to that. Paragraph 18 we begin noting the loans and 19, when they were repayable and then from 20 on we start recording snapshots of the financial position and financial statements and then 22 is probably the first key paragraph. So the pleading there was that: "As at 31 December 2008 and at all material times after that date, MPC couldn't satisfy the solvency test." So that is absolutely pled.

And why couldn't it? Because the value of its assets adjusted to exclude non-recoverable related party loans were not greater than the value of its liabilities and then there are particulars set out and I won't go into all of that, but what's the response from the defendants? Well, first, Mr Yan in the middle column denial of that and then references in (a) and (b) cash flow solvency and auditor reports and then (c) which is probably the critical paragraph where he says in his pleading: "As a result of shareholder support provided ultimately by RPL via the CHC up until 29 January 2013 MPCL," which is Mainzeal, "KFL, MGL and RGREL were all able to pay their debts as they fell due until this date," and then the independent directors in the third column echo that and they say, well, I will let your Honours read it.

So, assets available within the group to support the company and reasonably understood to be sufficient for that purpose and they say: "Were made available," and we agree, yes, to some extent late in the patch they were, but not enough and not sooner enough and that's probably all we need to look at there.

Then 23, we plead the restructuring, or we begin the pleading on the restructuring, i.e., the separation of assets. The assets of the Richina group in New Zealand and China were separated and then we state the basis and that's largely admitted, but could I draw your attention to the independent directors' defence which is out in the right-hand column and particularly at paragraph (c) where they say that: "The restructuring within the group reduced neither the group's ability nor its expressed willingness to support Mainzeal."

And then 25 we say by February 2010, MPC's independent directors were aware that the separation between the New Zealand and Chinese assets meant that the existing authorisation and governance arrangements, that's under the charter under which MPC had advanced funds et cetera, no longer reflected the new group structure and created uncertainty, so the separation created uncertainty as the parent entity that had this duty to ensure Mainzeal had adequate resources, and the answer from Mr Yan is essentially that the board didn't consider there was any uncertainty about whether it would be supported and…

ELLEN FRANCE J:
Sorry – thanks.

MR O'BRIEN QC:
It's just Roman (ii), your Honour, (b)(ii).

Just after that I should say you'll see in a not-very-distinct blue a sentence: "She anticipates she is not required…" That's the pleading for Ms May Kwan who was one of the defendants but the case against her was discontinued. So she was the sixth defendant as we see up in the grey statement at the top of the page.

Then out to the right, similar response from the independent directors. They didn't consider – this is in their 25.3(b) – they didn't consider there was

any uncertainty about whether it would be supported. So again, reliance on these assurances of support.

Then the pleading really continues to address the restructuring for a time and then goes into 2011 and various events, and I won't take you to all of this.

It then gets into some of the particular transactions, restructuring transactions, which were part of the claim initially but which were either abandoned or dismissed and which hadn't been pursued.

Then we get to the first cause of action which is at paragraph 58 it begins, and that is the pleading of breach of section 136. So somewhat unusually we've started with that, or at least in this iteration of the claim.

We plead the statutory duties in 59 under 136 and 137. So 137 was a feature of the pleading but we didn't really pursue it much at trial because it's really captured, we thought, within 135, 136, and so that hasn't been pursued during the appeal or appeals.

Then 60 we say duty to consider the interests of creditors "at all times after 31 December 2008" here and we say why, because they were insolvent, and then (b), and (b) became really the focus: "Alternatively, at all times from January 2011, at which point it was or should have been apparent to the directors, including from the *Corporate Governance* report," produced by Ernst & Young, "that there was significant uncertainty over the collectability of related party debts and over leaky building claims and also that structural and governance issues affecting Mainzeal added further risk," and then "alternatively" again and we just plead a different date which was July 2011.

But can I draw attention to the fact that we don't say that this was only in January 2011. It was at all times from January 2011. So the Court of Appeal, we say, was well within its remit to make the findings it did about obligations incurred, long-term obligations, incurred from January 2011 and short-term from July 2012.

Your Honours will see the responses in 61. Again, effectively, reliance on Richina Group companies.

Then at 61 we say breach, and why breach? We say because the directors were agreeing to MPC continuing to trade. Yes, we did say that, but we say: "And incurring new obligations at a time when reasonable grounds didn't exist for the belief that MPC would be able to perform those obligations when required to do so", and then because, we use the word "as", but because, and then we list out the reasons: it couldn't get financial support, couldn't obtain repayment, couldn't compel Richina Bermuda – Richina Bermuda in this claim is what we keep talking about as Richina Pacific, it's just Richina Pacific then in Bermuda, but it's the same company – and we say they failed to make an ongoing and realistic assessment, this is at (b), of ability to tender for new work, of the current and prospective financial position, of leaky building claims, of non-recoverable related party assets, at (iii), reliability of building materials from China under the prepaid goods arrangement and, last but not least, the risk to prospective creditors.

Now the answers to this are very interesting. So if we start with Mr Yan at 61, probably (b)(iii), begin the key points. He says: "the Richina group had real ability to provide financial support and did so as required," he says that "at all material times," this is at (iv), "the group held significant assets," agreed, (v), he says Mainzeal was part of a wider group and "operated with a consolidated balance sheet for as long as Mainzeal remained a going concern," and at (vi) "assets within the group were available to support the company," support Mainzeal, "for as long as Mainzeal remained a going concern," well, that's handy. So, as long as you're a "going concern", query what he means by that, but viable, you'll get support, but if you're not maybe you won't. And the independent directors, similar pleading but not qualified by, but without the going concern qualification, so 61.4 is probably the key passage there and that that was and still is the case that they were entitled to and reasonably did take, well, comfort from verbal and written assurances. The case goes a little bit further than that and they say they relied on them.

WINKELMANN CJ:

Did Mr Yan, you know, clarify what he meant by as long as it was a going concern, like, in whose assessment?

MR O'BRIEN QC:

I did ask him about this, your Honour, I could take you to that…

WINKELMANN CJ:

No, it's all right, you can do it in order if you want to.

MR O'BRIEN QC:

But the answer is, the answer initially from him was something like, well, the question was something like: "As I understand your evidence, you say you would support Mainzeal so long as it was a going concern?" Answer: "No, I would support Mainzeal period," and then: "Well, that's not what you say in your evidence and that's not what you say in your pleading," and that was really the end of that. But, no, I didn't explore with him what he meant by "going concern". The point really, well established by himself, was that there was a limit to the support. What that limit was, who knows, no one knew. My learned friend, Mr Mullins, candidly said yesterday: "Of course the support was not limitless." Well, of course it wouldn't be limitless, no one would give a limitless assurance of support. But quite what the boundaries were, who knows.

ELLEN FRANCE J:

Mr O'Brien, in the context of the 136 pleading and the reference to obligations and so on, there's no specific reference to, say, the contract in relation to Wigram?

MR O'BRIEN QC:

No, your Honour. So we pled all obligations entered into after a date and then when we got to opening we gave examples of four specific contracts, and why those four, well, curiously, they were the only contract documents which could be found by the liquidators in Mainzeal records. But the board minutes tell us

that the board was approving, in effect, certainly knowing that month-by-month or quarter-by-quarter the company was bidding for other contracts, and it gives us, the board minutes list them for us. But, yes, we just pled general all obligations and if I could take you to 62, that's our loss claim. So we see it as a consequence of the breach as pled above Mainzeal incurred obligations to its creditors of 75 million after 31 January 2011 and (b) was the alternative after 31 July 2011 and then the particulars were a reference to: "As to obligations incurred, all those incurred after the date and not satisfied as particularised in schedule 2."

Schedule 2 is brief in the extreme, but and actually it's not here I don't think, but if we went to the statement of claim we would see it, but it is very brief. Perhaps we should do that.

WINKELMANN CJ:
102.00666, is it?

MR O'BRIEN QC:
I will borrow Mr Hodder's, but I don't think we can get to it that way.

O'REGAN J:
Schedule 2 is there I think.

MR O'BRIEN QC:
There it is, thank you. So, related party payables subcontractor and other creditors, legacy claims. Unfortunately you are seeing nothing, so they're not treated as new obligations, they're not. Principal claims, surety bonds, employee entitlements, total loss.

Now, if I could just explain about this briefly and Mr Kennedy may go into it. I am sure he will go into it in some more detail, but Mr Apps was asked to produce this assessment as Mr Chisholm or Mr Hodder was saying. He was instructed. Yes indeed he was because we were making this new debt, what we called a new debt claim, i.e., obligations, to reflect obligations entered into

after the specific dates and he has a much more detailed breakdown of how he calculated these numbers and what the composition of these numbers was in his evidence served of course well before the trial began and the subject of, or could have been the subject of, expert conferencing. But the defendant's chose not to engage with this part of our case, or this theory of our case they might say, or we might say, i.e., this new debt theory because they took the view and argued successfully in the High Court that this was not a proper approach to an assessment of loss under 135 or 136 and his Honour Justice Cooke did not find in favour of the liquidators under 136. He took the view that greater specificity and identification of specific obligations was required, whereas we argued, and the Court of Appeal found, that that was not necessarily that one could refer to all obligations entered into after a specific date and effectively, Mr Apps identified those.

Now, I should perhaps add this. Somewhat controversially we asked Mr Apps to give a credit in respect of debts owed to creditors at the counterfactual. So, perhaps best explain by way of an example. If a creditor was owed say $150 at the counterfactual January 2011 and $250 at the liquidation date, then Mr Apps included only the 100. So he only included the increase. Now, I say controversial because it was controversial within our own team and I think Justice Cooke referred to this approach as an ungainly hybrid, but we thought it had a degree of simplicity and symmetry.

WILLIAM YOUNG J:
That was built into these figures the 75,000?

MR O'BRIEN QC:
Yes, it is, your Honour and that's partly why –

WINKELMANN CJ:
So it's a net deterioration model but for each creditor?

MR O'BRIEN QC:
In effect, yes.

GLAZEBROOK J:

It probably is reflected in, to a degree in *Debut* I think because I think that was the approach that was probably in the context of *Debut,* identifying new creditors as against this sort of approach, but it would certainly be consistent with what was in *Debut* because it was whatever the worsening position was.

MR O'BRIEN QC:

And I think that's exactly what your Honour and the Court did in *Debut*, yes, and that's exactly what Mr Apps was asked to do here.

WILLIAM YOUNG J:

So it's new debt, not new creditors?

MR O'BRIEN QC:

It's new debt, exactly, not new creditors, although there are many, many new creditors. Most of the creditors are new creditors. I think it's fair to say most, yes, so that partly answers –

GLAZEBROOK J:

And of course this isn't quite right because there could have been sort of a 300, this particular approach is a proxy in terms of what was new after that date probably.

MR O'BRIEN QC:

Yes.

GLAZEBROOK J:

But probably justified because you are looking at the liquidation date.

MR O'BRIEN QC:

Yes and if there was a creditor at the counterfactual date owed. Oh no, perhaps I will leave that there. But certainly all new creditors that came in after the counterfactual date, the full amount owed to them was included in the figures. But if the creditor existed at both dates and had a recovery

effectively, or a partial recovery, then there was a credit for that. With your Honours, if I might say, your Honour Justice Glazebrook, it's quite similar, I thought, to the approach taken in *Debut Homes*, although of course we did this several years before that.

So that was our new debt pleading and because it was thought to be my friends controversial or unsustainable legally or for whatever other reason we don't know, they did not engage with it. So, these figures and all of the makeup of these figures were never challenged and so we say your Honours can rely on them as proved.

So, that was our 136 pleading and then our 135 pleading begins at 63 and you will see the basic pleading at 65. We start with the December '08 date, but I again say we didn't pursue that. We pursued the case, or the breach as at end of January 2011, alternatively July 2011.

And then 66, you will see there the key pleading. We say they breached the 135 duty by agreeing to allow the business to be carried on in a manner that created or was likely to create a substantial risk of serious loss to MPC's creditors by and then we had a list of things. I will just let your Honours cast an eye over them, but if I might, well, I might just highlight some. (a) is allowing continued trading in the circumstances where pled in 61 above, which you've seen. Failing to ensure it was adequately capitalised and there's reference to a capital call. That didn't feature much, but just so you know, in the early days there was a capital call option for $5 million which was in favour of Mainzeal and somewhere along the line it disappeared.

Failing to, this is at (ii), failing to ensure they had adequate control over cash advances and then failing to ensure that those advances were able to be sustained by the company and properly documented.

Then (iv), failing to ensure MPC had the ability to recover the debts and failing to ensure it had the ability to call on and enforce the support.

(v), failing to ensure there was an audit committee and appropriate risk assessment processes and (c) failing to monitor properly.

(d) failing to plan for the possibility that Richina Bermuda, i.e., Richina Pacific, would elect to withdraw the provision of support. Failing to take reasonable steps to ensure related company debtors were able to provide funds or that related company promisors of support were and would be able to be compelled to pay and so on. Approving the prepaid goods agreement which was unlawful and approving and allowing the debt restructure, that really doesn't continue to feature, and then last –

WINKELMANN CJ:
Where you say "unlawful" wasn't there, are you going to come back to that Mr Mullins submitted to us that it wasn't unlawful, it was simply unenforceable.

MR O'BRIEN QC:
Yes your Honour.

WINKELMANN CJ:
You'll come back to it.

MR O'BRIEN QC:
I think it was unenforceable because it was unlawful. I think what Mr Mullins was saying, and I stand to be corrected, but I think what he was saying was is what was happening in China on the ground wasn't unlawful. That perhaps wasn't very clear but the evidence was that the agreement was unenforceable because it was unlawful.

WINKELMANN CJ:
Right.

MR O'BRIEN QC:
But yes, I will take you to that. So – and then last, and I'm not suggesting least (h), by allowing MPC to continue trading when they should not have

done so. So when it was said that we didn't plead that they ought to have changed their trading, and that we were focused solely on a cessation of trading in January 2011, we say well that's just not right. That is not what we pled. That is the box into which the defendants sought to drive us to that they could show that there was no net deterioration therefore no loss, therefore no claim. That wasn't solely our case at all, and just carrying on with that, we did then go on to say, as one does with a 135 claim because it is the usual so-called approach, we pled a net deterioration. We didn't prove it, we're not pursuing it. But we also pled, at 69: "Alternatively, Mainzeal incurred obligations to creditors and those creditors suffered loss as pleaded in paragraph 62 above." So we brought out new debt pleading into the 135 claim. So it wasn't solely a counterfactual case.

Now it's fair to say that a lot of the time and effort at the trial, and leading up to the trial, was focused on the counterfactual claim, and in particular on trying to assess the loss as at the liquidation date, by way of a comparison with what it might have been, as at January 2011 or July 2011, and it was an extremely difficult and extremely expensive job, and I would commend your Honours that, as you say or hint in *Debut*, that the net deterioration approaoch mustn't be a straightjacket for these claims. It's just too difficult and it's too expensive and it doesn't respond properly to a breach of the sort that we have in this case where you have a prolonged period of insolvent trading, which we say is simply not permitted by the law, and of course no one can point to a case, because I don't think there is one, where a prolonged period of insolvent trading has been sanctioned on the basis that the directors thought they might be able to work their way out of it over a period of two or three years, which is essentially the proposition for the appellant, there proposition being that it would be rational, or was rational to continue trading as they were and with some changes and for the directors to allow and agree to the company continuing to do that because it was a decision made by directors with experience, exercising a business judgement, and with a view to salvage or correction or improvement, and that is to be judged against the counterfactual of cessation and what loss that would have occurred. So they say on that basis it's permissible and we say, well no, with respect, it's not, and the

High Court, of course, didn't think it was, and nor did the Court of Appeal, and in a similar but not exactly the same situation, your Honours didn't think that in *Debut.* It's not the test under the Act, and if I could just move onto that.

The test under section 135 doesn't say anything like that. The question centres around the likelihood of a substantial risk of serious loss. That's the trigger. Carrying on business in a manner likely to create a substantial risk of serious loss. There is nothing in there to support, with respect, my learned friend Mr Hodder's proposition, and likewise 136, that centres on the question, broadly, of reasonable grounds, whether there are reasonable grounds to believe. Well, of course, first of all one must believe, but that belief has to be founded on reasonable grounds that the obligation to be incurred will be able to be performed when the company is required to do so, and we say here that there was a huge risk at all times after January 2011 that the company could go down the gurgler at any time, and that no one could be assured at that time, or thereafter, and particularly from mid-2012, as the Court of Appeal found, that obligations being incurred could be met. They were high risk.

GLAZEBROOK J:
Do you – I suppose one of the issues, especially with 135, is the risky from the start business issue, where obviously you could say on a literal reading there's a significant risk of loss, but equally creditors who are dealing with that company will usually take into account the risk in terms of interest rates et cetera, if the business is inherently risky.

MR O'BRIEN QC:
Yes, well –

GLAZEBROOK J:
So I'm really just asking what do you say the limits are? So Mr Hodder has put forward something that either plunges you into insolvency, for 136 anyway, or makes it worse, and for 135 business judgement of a salvageable or non-salvageable company.

WINKELMANN CJ:

Are you coming to this all later?

MR O'BRIEN QC:

Yes.

WINKELMANN CJ:

Okay. I'm not stopping you answering Justice Glazebrook's –

MR O'BRIEN QC:

No, no, your Honour, I'm going to come to all this a bit later, but no I'm very happy to answer it now because what I'm now doing is I'm, and perhaps I should have signalled that, I'm just responding broadly and very high level to the appellant's case and then I'm going to go to the facts and then come back to the law. Broadly your Honour, if I can recall exactly the question, but perhaps it doesn't answer it exactly –

GLAZEBROOK J:

Well it was really what limits do you accept on 135 and 136. I mean you're perfectly able to say absolutely no limits and they did intend to capture risky businesses from the start, but I doubt that.

MR O'BRIEN QC:

Well I doubt that too your Honour, and I doubt that because when one looks at the Law Commission report, and when one looks at the history of the law, the boundaries around these provisions are protection of creditors not shareholders, and one of the key boundaries is effectively solvency. Certainly that was the Law Commission approach. The Law Commission approach was that you could not trade whilst insolvent, full stop. Now the cases under these provisions, and similar section 320 provisions, did suggest that perhaps you can, for a limited period, for the purpose of salvage, and with a good likelihood of salvage. So that's the boundary.

So your Honour 135, no problem if you're creating a substantial risk of serious loss to shareholders, for example. Of course that might fall foul of one of the other provisions but unlikely, but if there's a substantial risk of serious loss to creditors, that's it, that's the boundary. And the boundary, if one wants to put it in different words, is broadly solvency. So if the transaction is going to make you insolvent, it's not permitted. If you're already insolvent, well you shouldn't be trading unless perhaps on the authorities there's a good chance of salvage and not just improvement, that's not good enough we say, salvage.

Now just on this, and while we're here, but I'm sure I'll come back to it repeatedly, I say your Honours we're not in, this company wasn't in the twilight zone. What is the twilight zone? And Mr Mullins said, I think, it was on the doorstep of insolvency. Well not so. Not so. This company and the directors had crossed the doorstep and they were in the void of insolvency and they were operating in that void for quite some time, and we say from at least the end of 2010. Why the end of 2010? Well, perhaps because until then, perhaps, they were entitled to rely on the assurances possibly which they – we say "no", but anyway – on the assurances which they had from their then direct parent, RPL, but after the restructuring they didn't have that link and RPL was offshore and the main assets were – well, they were always offshore – and the writing was on the wall. They'd been trying to become profitable. They hadn't become profitable. They'd been trying to improve the business and they hadn't managed it and it was time to either call in the loans, get the money in, or, if necessary, stop trading and stop putting new creditors at risk.

Now what about existing creditors? Well, if they were incurred legitimately, and our claim effectively says they were because we set the date at January '11, then with respect the law has no concern for them because they were legitimately incurred debts and legitimately incurred losses. But once you breach 135 or 136, that, of course, changes.

WINKELMANN CJ:

So at some point when you come in more detail to this, I'd be interested to hear how you see your position relating to group company, groups in general,

because, of course, often subsidiaries depend upon the support of their parents so – but you don't have to deal with that now.

MR O'BRIEN QC:
No, but if you don't mind, your Honour, I will just give you my first answer to it lest I forget later. The answer that it might be – our broad answer and our answer in the Courts below and now is that in some circumstances it might be okay for a subsidiary and the directors of a subsidiary to rely on assurances of support from a parent but it depends on the facts and it depends on the structure.

So to take an extreme example, an Apple subsidiary, for example, reliant on its parent's balance sheet with assurance of support, operating in the US, say, then it might be okay.

WINKELMANN CJ:
So it's reputational commitment? Size of the group, reputational commitment and jurisdiction and assets?

MR O'BRIEN QC:
Yes, all of those things, your Honour. So Mr Burt gave some evidence on this, as did Mr Maier, and actually I think Mr Westlake too. Mr Burt, he was a director and in fact I think chair of Ngai Tahu Holdings and had been of several other companies, and he said they would always properly fund their subsidiaries, that it was never good enough to leave your subsidiary hanging out for cash whilst incurring obligations, not good enough. But in any event, of course they would support their subsidiaries if they were allowing them to continue.

So there's a local company, deeply rooted in the community, with assets in the community, assets in the jurisdiction, subject to section 271 of the Act, the pooling section, maybe it would be okay then. But he said they didn't do it because they didn't think it was okay and wouldn't have done it because it wasn't okay.

Sir Paul gave an example – well, no, he didn't give an example. Sir Paul Collins suggested, your Honours, on the same theme, that it's fine. Well, I'm not quoting him verbatim but his evidence was generally as Mr Hodder described it, that it's okay to operate on a group basis and it's okay in those circumstances for a subsidiary to be reliant upon the group balance sheet and on sort of a central treasury operation.

But I asked Sir Paul Collins about a matter with which he was involved some years ago and which at least one or two of your Honours will be familiar with. So back in, I think, the late '80s the National Provident Fund acquired Development Finance Corporation or DFC and I asked him about this because he was chair of the National Provident Fund at the time, or chief exec, I think, chair, and various public statements of support were made by NPF for DFC, and then it was realised that DFC, which I think Sir Paul described as "something of a dog", was, well, it was seeking more funds from NPF, some more had been put it, it was seeking more and seeking more tangible support, and Sir Paul said he had someone go and look at the DFC book and assess it and they came back and reported that, well, actually the assets were probably worth "only about half of what they're said to be worth on the balance sheet", and what did NPF do, it pulled the plug, it declined to provide any more support. So there is a tangible example within the realm of experience of the witness where the parent was not obliged to provide further support, and when it realised the subsidiary was in trouble it cut it off, it let it go. So it's not generally good enough just to have, we say, a verbal assurance, you need much more, and even a written assurance, you need much more. And an audit letter, unenforceable, or thought to be, certainly not good enough. And you need, if you're balance sheet insolvent but for support of the debtors, then you need to make sure that is in writing, enforceable, legally and practically, and none of that existed here. There was no written legally binding commitment from the companies with money, there was no guarantee, there was no security, there was nothing, nothing but vague verbal assurances, which Justice Cooke nicely, if I may say, described – and this is at 2.2 of our written submission – nicely described as – I'll just get this up,

show you the words, these are his words not mine, although it's not an exact quote but more or less, this is in 2.2, line three, they were "remote", they were "ambiguous", they were "conditional", they were "unenforceable", and they were "subject to the constraints of Chinese law", and they were all of those things. So we say, as we say at the end of that paragraph, they were not assurances on which any directors could reasonably rely.

Now that is the short answer to the submission from Mr Hodder that it was reasonable to rely on the assurances, but I will as I go through the facts show you what we say were the signs that should have told the directors that these assurance couldn't properly be relied upon.

And then Mr Hodder put forward three or four further points. He said, well, it was also, they'd also put in place the prepaid goods arrangement and they were working on profitability and looking at future projections of profitability and they were reliant on new business initiatives, which they'd begun to put in place in two thousand and, really I think 2011, '12, but perhaps 2011 as well, and I'll answer all of those points with your Honours as we go through the course of the morning or the day. But the prepaid goods, I'll come to it when we come to it, but short points are it was actually unlawful and unenforceable and none of the directors though to get an independent opinion on that, on the agreement at the time. But even that aside, first up why did they need this, why did they need this agreement? Oh, because they couldn't get the cash in. So the prepaid goods agreement, sometimes called the "forward agreement", was in effect an admission of a serious problem, and the serious problem was that Mainzeal couldn't get back from the Chinese entities the money which it had lent out and which was owed to it and which by this time was about $44 million. So it's a manifestation of a problem, not a fix, and to the extent it was a fix, well, it didn't really work because it was unenforceable, it wasn't cash. What if the company fell over? Would the liquidator be able to enforce it? No. Wouldn't have any business to buy, couldn't assign it, couldn't sell it, couldn't get the cash in. Interest stopped running, another problem with it.

What else? Well, no sooner had it been implemented than it became very apparent, and particularly to Mr Gomm, that it wasn't working well and it was causing loss, and I'll take your Honours to it but the estimated loss over the period, short period in which it operated, I think about a year, was something like $10 million caused loss to the company.

So far from being a panacea, it was just a manifestation or an admission of a problem and then created a series of other problems.

Profitability? Well, I'll come to that, but perhaps I'll come to that right now because that's quite an easy answer, and your Honour, I think, Justice Winkelmann, already gave it to us. But if we could go to schedule 4 of our written submissions. So this will take us to a table of financial performance. Mr Hodder took you here so forgive the repetition but it's a very interesting, and I say very telling, document. It's an annexure to the Court of Appeal judgment, and if I could start up with – well, you'll see the years it's covering: 2005 through to 2012. You'll see the revenue in those years and you can immediately see, as everyone acknowledges, that this was a very sizeable business with revenue, gross revenue on an annual basis of somewhere between 300 more or less, or late 200s but let's 300 to 400 million per annum.

Then the line which we focus on, and which Mr Hodder took you to, I say correctly, is the line half way down the page: "Operating profit (at the level of EBIT)" and there we see the financial performance. I'll come back to that in a minute, but why do we focus on this line and not the profit at the bottom of the page? Well, primarily because the very next line on the page gives us finance income. Now the finance income is essentially just the accumulation of interest on the loans that Mainzeal had made to other companies in the group. So first year 5 million, second year 2, then 3, then 3.4, 3.4, 2.7. So none of that was paid, or not paid as such, and therefore we say it's best to disregard because it effectively is just an accumulation on the debt that was already owed. It's not coming in to Mainzeal.

WILLIAM YOUNG J:

Was there any accounting expert evidence as to the accuracy of these accounts? I mean –

MR O'BRIEN QC:

Yes, your Honour, there was. These are accepted, for all –

WILLIAM YOUNG J:

No, sorry, whether this was a true and fair presentation of the financial position of Mainzeal.

MR O'BRIEN QC:

No. No, it wasn't. So we did call Mr Schubert who had been the auditor. He was a PwC partner. So PwC were the auditors.

WILLIAM YOUNG J:

So he said he got cold feet.

MR O'BRIEN QC:

Well, he was also fired when he made – yes – and happily, he said, and the Judge accepted, happily, he was happy to go because he'd lost faith, he said, in Mr Yan, and the board, effectively.

WILLIAM YOUNG J:

But were there audit notes produced? I mean I'm aware that things don't always appear to auditors as they appear to me, but I am interested in assets being valued in a way that doesn't necessarily accord with their legal and practical status and income being recorded on a basis that doesn't really record with the ability to recover, in this case, the interest income.

MR O'BRIEN QC:

No one called Ernst & Young, Sir. We didn't and nor did the directors. Our approach to this was these are the directors' accounts.

WILLIAM YOUNG J:
And they knew what was behind them?

MR O'BRIEN QC:
They knew what was behind them, very well knew what was behind them. How they got signed off, if that is what your Honour is asking, by the auditors, one has to wonder, not because of this particular statement we are looking at, but because of the balance sheet, when we come to it, and frankly the lack of impairment on the loans and the loans included these figures we are looking at in the finance income because that was just accumulation.

Now, why are the interest figures different each year? Well, I think, I'm not absolutely sure of the answer to this, but I think the answer is that the interest on some of the loans was linked to the profit of the Shanghai Leather Company. So it was effectively an equity tracking interest arrangement and some of the interest was just a flat 9%. But in any event, no one challenged any of these figures. All these figures are accepted as accurate except for 2012 where they're based just on the management accounts and there wasn't really any acceptance across the board that these figures were exactly accurate, but I think acceptance that they are broadly accurate. Certainly Mr Bethell's evidence was that these figures came from the management accounts.

So that's the line anyway, that's why we're looking at operating profit before, at the EBIT level and you will see big loss 12 million in 2005, equal amount of profit in 2006, a smallish profit on a turnover of 280 million in 2007, similarly smallish loss 2008, 2009 very small profit on a turnover of nearly 400, then another loss in 2010 and then things start to fall off the cliff more in 2011 where we have a big loss and then another loss. So on any view of the world, this was not a profitable company. This was a company which couldn't easily withstand a shock.

There is a good phrase in his Honour Justice Cooke's judgment where he refers to one of the witnesses saying that: "Siemens hit them for six." And his

Honour said: “Yes, but six hitting is not unusual in this industry. It was to be expected.” And, we can see when you look through the Mainzeal history, that they had a series of problems. Problems were not abnormal. They were normal.

Now, whilst we’re on this topic, because it was relied upon, a reasonable view, or a rational view that there would be a return to profit, well, so far as history is a guide, I would suggest that it indicates that a return to profit was unlikely.

And then as to forecasts, could I just jump through the submission and take you to paragraph 9.15 and your Honours see there a table from Mr Apps’ evidence which shows budget presented by management to directors for each of these years in question and then actuals and the difference.

WILLIAM YOUNG J:
But where do we get – oh, I see, sorry. I see the lines.

MR O'BRIEN QC:
Now, I should say confusingly the figures which you see in here, particularly down the bottom, they’re not the same as the figures we’ve just been looking at and that’s because these figures are taken from management accounts. So these are management account forecasts and management account actuals, so they’re not exactly the same. What they do show you is the comparison of forecasts to actual and you will see, readily see, the actual never, never exceeds forecast. Forecasts are always higher than actual. Sometimes they are quite close, sometimes not, but you never see profit, actual profit, exceeding forecast profit.

Now, your Honours, just while I’m here, could I ask you Mr Leggat just to bring us up to 9.8. So, your Honours, I'm not going to go through all of this now, but you see a heading there “poor trading performance” and this really captures this area in a relatively short space of a couple of pages, but 9.5 there, or 9.9 gives you a recut of some of the figures we’re looking at. So you see in the middle of the page I've said there for 2012, figures are only from the

management accounts, and then I go on to say: “Some years were profitable…” list those, “… but profit was never assured and, as often as not… was eclipsed by loss.” Then a summary, my workings, I hope they’re right, of 2005 to 2010 overall loss of 270,000. That’s over five years in trading with hundreds of millions of dollars a year, and in the years 2005 to 2012, well overall a loss of $23.355 million. So this was not a profitable enterprise, but as we say in 9.10 it was a business of scale, and you can an indication of that from the gross revenue figures, and right through that 2005 to 2010 period my calculations say that 2.16 billion of revenue, and then 2005 to 2012, an extended period, it’s 2.87 billion, and I give you an average gross revenue there. So this is a really big business, and it’s got not capital and it’s got no profit.

Just on that “got not capital” point can I just, at the risk of jumping around, well actually just while we’re here, I will take you to the no capital point in a minute, but if we keep scrolling down, 9.12, we submit there that’s it’s apparent, well we submit, we’ve also got findings, “… that unreliable forecasting was an ongoing feature of the business and a regular source of concern.” Then 9.13: “In cross-examination Mr Tilby confirmed that forecast had not always been correct and that the board had been disappointed…” and I've given your Honours’ a reference. “Mr Gomm also acted that some forecast turned out to be unreliable, and considered it was very difficult to provide accurate forecast in a period of constant change given the GFC and two earthquakes.”

Then: “Dame Jenny accepted that she had been frustrated by Mainzeal’s failure to achieve forecasts. She noted that in the environment of 2007 to 2011, it was very difficult to accurately forecast what work would come to market and what share of that work Mainzeal would win.”

WINKELMANN CJ:

I just want to ask you about that, because of course these have been, since possibly 2011, unprecedently terrible times for people to be in business in terms of uncertainty. 2009 probably.

MR O'BRIEN QC:

Well, your Honour, I'm not sure about that, but assuming that –

WINKELMANN CJ:

Well there's been a lot of disruption to business.

MR O'BRIEN QC:

Oh, a lot of difficult – in the construction industry sure.

WINKELMANN CJ:

Yes.

MR O'BRIEN QC:

And all the more reason to have two things. Real care as to what you're doing and secondly, capital. So, yes, difficult times, difficult to forecast, so that's my answer, your Honour, to that. It just highlights the need for a buffer.

WINKELMANN CJ:

And I suppose at a certain point businesses now have to plan for the fact they're going to be facing disruptions, just like institutions do.

MR O'BRIEN QC:

Yes. Disruption is normal. This company was in a crisis and, with respect, I think the directors failed the first test of crisis, which is to recognise it. They didn't see it. They thought it was fine. Now my learned friend Mr Hodder's submissions on Monday and into Tuesday were focused on the attempt at salvage, but that's not how, that wasn't quite how they put the case in the High Court, or in the pleading which you've seen. Their case was, there's nothing to see here. We were fine. We were solvent because we had assurances of support. Now, to be fair however, they were constantly focused on trying to, as would any board, they were focused on trying to improve the business, and to make a profit, but that's something different all together. They did not think it needed to be "salvaged". It wasn't presented as a salvage case. It is now but again to be fair I suppose that's just the flip side of

the coin that says they were attempting to make a decent return. But they were never going to get back to a solvent situation unless – well never, that's possibly too long a time. They weren't going to get back to a solvent situation this side of 20 years unless something magical happened, or they recovered their loans. That's what they had to do. That's where their focus should have been. The only time we really see that beginning to happen is with the prepaid goods arrangement. That barter transaction, well, you know, barter has long been thought to be less efficacious than cash in a modern economy, and it didn't work, and no surprise.

So that's the profitability issue to which I won't necessarily return again. But while we're here, and just answering some of these points, I'll definitely come back to the loans, but answering another point which was put for the appellants, that is that they were engaged in reshaping the business and had embarked on a number of new business initiatives which were designed to strengthen the balance sheet and achieve profit. The High Court Justice Cooke responded to that, could we have that judgment up please, and it's at paragraphs 254 to 258. So he noted that the defendants were emphasising that in 2010 in particular, and would add later that they were making a considerable effort to transform the business strategy. I'll just let you read that, and we can probably move to 255, this goes on until 258, but if we move down, thank you.

So first point, recognition that the existing model wasn't working as well as they would hope, and then please just scroll down. It's really all of these paragraphs, it's 254 to 258. The short point is that his Honour, can we go to 258, so he concludes: "The above factors, in combination with the fact Mainzeal was trading while insolvent without reliable group support, meant that Mainzeal's trading position made it vulnerable to failure with consequential substantial loss to the creditors." So that's really not the conclusion on the new business, but he concludes that, just in the words on the screen actually: "The changes also increased the likelihood of one-off losses occurring in the short-term given the risks associated with new types of

activities, which only further deteriorated Mainzeal's ability to rely its financial trading position to avoid a complete failure…"

So it didn't work and they were risky, and after the break, because I see we're at 11.29, I will take you to what the experts view about this, but just while we're here, and just before we finish, the Court of Appeal dealt with this very briefly at paragraph 371, we needn't look at it, but essentially accepted the High Court findings. Is that a convenient moment?

WINKELMANN CJ:
It is, thank you Mr O'Brien. We'll retire.

COURT ADJOURNS: 11.29 AM

COURT RESUMES: 11.45 AM

MR O'BRIEN QC:
So, your Honours, I was addressing one of the points made by the appellants that essentially they were looking to salvage the company and were engaged in a number of new business initiatives, my submission being and the Court findings being that those venture were themselves risky and not a panacea.

I took you to the High Court and gave you a reference to the Court of Appeal brief commentary on that. Can I take you to the evidence, the supplementary reply or a reply brief from Mr Maier, which Mr Leggatt's brought up for me. So on the screen we have paragraph 35 of that brief, it's in the index, easy to find, and Mr Maier there is dealing with forecasts and he captures a number of things which I might pick up when I go through the chronology. But essentially we've seen the outcome in them already, these are just instances of directors saying or the CFO saying, you know: "We're behind budget, we're behind budget, we're not meeting our targets," et cetera, it's a fairly regular thing. But then if we turn to paragraph 36 he says: "It would appear that Mainzeal management had a long and consistent history of failing to achieve such key projections as forecast turnover, gross margin and gross margin percentage.

This appears to be borne out in the following analyses undertaken by the liquidators," and you'll see these graphs. So that first one, the yellowish, is the budget, and greeny-grey actual, and then the lower figure is just a tracking of how much over or under, but you'll see they were usually under. And then the next graph, please – so that one's turnover – and then gross margin, more importantly you'll see always under, and then as from 2010 falling quite dramatically away from forecast. So the point for now is the initiatives weren't working and the board should have seen that quite quickly, certainly as 2011 progressed. And then the next one, net profit, same story different figures, but same story.

And then Mr Maier goes on to say at 37: "For a business that operates with negative equity (if the loans were impaired as they were) and requires shareholder support in the form of loan repayments or otherwise for solvency, the risks of failing to deliver on forecasts are potentially catastrophic and lead to rolling uncertainty and questions about the reasonability of continuing to rely on management projections going forward." And then 38: "Adding to the inherent difficulty was the uncertainty around the rapidly expanding new business initiatives," so he said "adding" to the uncertainty, or the difficulty, sorry, was the uncertainty about these new initiatives, and he notes there in (a), (b), (c), (d) some of that, and some of the comments he sees in the papers, I'll just let your Honours read those, those are some of the new initiatives, or perhaps all of them. Then he comes to 39 and he says: "In addition to all this, Mainzeal was for several years before the receivership, in an almost constant state of projected and actual restructuring – de-listing and amalgamation;" he's really talking about the group, but then: "Group restructure and separation; Project Citron; 200 Vic Limited and Mainzeal House;" that's the building of Mainzeal House, "a restructure of King Façade Limited; Project Shutter; New Blue, restructuring of the Mainzeal Holding Company," and he says about this: "All of these factors resulted in a company that I would describe as highly complex; rapidly changing; with, in parts, an unproven business model; exposed to new risks; dependent on continuing group support and difficult to forecast," and so on, and I'll just let your Honours read the rest.

So that was one expert's view of the new initiatives, essentially adding to uncertainty and exacerbating already existing difficulties.

Now your Honours, there was a joint expert report from the three governance experts which I will take you to. I don't think it's got anything particularly useful on this but Mr Burt certainly commented on it, but so did Mr Maier in cross, so we'll go there first and that's at page 202.00452.

It's really 306, question at about line 12 from my learned friend, Mr Hodder: "We discussed as a business model change and what the evidence is on this, is that during this time Mainzeal was seeking to change its business models in various ways, and I take it you will say well, you can't do that unless there's a detailed discussion of risk on the papers, is that how we approach these?" and you'll see Mr Maier's, the beginning of his answer there, and then just when you're ready, over the page, this goes on for about a page. I'll just let your Honours read it, and further down I think we could happily go to.

So I won't take you through all of this, your Honours, but essentially he's saying there's just no evidence in the board papers of what he would see as a proper analysis of the new initiatives and the risks that go with them and how they're going to be – you know, where the talent is going to come from to manage them and where the capital is going to come from.

Then finally, if we turn to page 308, please, you'll see at line 12 again, Mr Hodder says: "And what you have just told us I thought was that if this was the sort of document you had received you would expect that there would be a question raised of the kind you just mentioned?" and this was one of the project documents, and you'll see Mr Maier's colourful reply. He said: "I would but climbing up on the table and asking management what the risks were involving these new directions. I would be in contact sport mode. I would be postponing a lunch. I would be asking how this fits with the month before. I'd be asking how they were going to manage this the month afterwards and how we were going to deal with those risks. I'd be asking where the cash and the

capital and the talent came from to do these businesses amidst a very busy schedule of a company that really didn't have a great track record so far."

Then he gets asked: "Is this your evidence of what a reasonable director would do?" Mr Maier: "Give me the date again?" Question: "February 2011." "Yes, my evidence is that earlier I can excuse people who don't know and who are inexperienced but by February 2011 there is a problem. I don't give the average director inexperience to pass at that point. What I say is that the water was boiling the frog at that point." Whereas the Court of Appeal put it: "The writing was on the wall." And Mr Hodder rightly asks: "The problem you are talking about is about the recoverability of the loans," and Mr Maier's answer is basically yes and that triggers a whole lot of doubts because the company is hanging from that. So, in that circumstance, to go chasing opportunities, to go doing things without the discussion of the aggregate risk, is not responsible, it's not prudent.

Mr Burt is similar. I will just give your Honours a reference. I won't take you there, but page 205.01844.

GLAZEBROOK J:
Can you just repeat that, sorry?

MR O'BRIEN QC:
Sorry, your Honour, 205.01844.

GLAZEBROOK J:
Thank you.

MR O'BRIEN QC:
And broadly what he says is: "Well, yes I see that the management are talking a good game but that's the sort of thing you can expect from an upbeat Chief Executive," and you really need as a director to be questioning these things and asking effectively how we are going to do it and where has the money come from and what are the risks and so on.

Now, I will come back to that later. I will come back to the experts, but can I just say this as a precursor to finding the reference because I haven't written it down on my paper. Mr Westlake, Mr Maier and Mr Burt were critical of the conduct of the board. There evidence supported the idea that the conduct, you've seen it from Mr Maier, was imprudent, that it wasn't good enough to carry on business as they were and they should've fixed it or shut up shop, one of the two and I will take you to some more of the passages about that, but just to give you a heads up for now.

Now, Mr Westlake, and Mr Maier and Mr Burt are both, and some of your Honours will know certainly with Mr Maier, they've very experienced directors and in Mr Maier's case, a very experienced trouble-shooter. He's worked as a statutory manager of DFC and then a statutory role with, I've just forgotten the name –

O'REGAN J:
South Canterbury.

MR O'BRIEN QC:
South Canterbury Finance, thank you, and multiple other workout situations, but also just ongoing good businesses as well and his evidence left no doubt about his view. Likewise, Mr Burt has left no doubt, left us in no doubt about his view that it wasn't good enough. So when your Honours hear that it was rational to continue, well, I would recalibrate and say well, was it reasonable, was the conduct of the directors reasonable? We say no. We say it's a breach of the Act, that's plain. And was it reasonable? Well, two of the experts said no, certainly not.

Now, the third expert, Mr Westlake, what did he say? Well, he essentially relied upon the fact that group support was demonstrable, that it was being demonstrated that there was a flow of funds not only out of Mainzeal but into Mainzeal and that this was a manifestation of group support. That was the factual underpinning of his view and in his view, in no circumstances and

because it's a group situation, it was fine for the directors to carry on. But, as I say, he was assuming that support was actually being received. We say well, plainly it wasn't. He said that: "In the absence of group support, in the absence of group support, the position at early 2011 was totally unacceptable and intolerable." So that's his word "intolerable" in the absence of group support and we say, well, the only group support that was going on then was support by Mainzeal of Richina Pacific, not vice versa.

ELLEN FRANCE J:
There was some support going the other way at earlier points in time?

MR O'BRIEN QC:
Into Mainzeal? Yes, I think there was the evidence that for example, when they had a problem with Arena there was money coming in and certainly money came in in late 2012 and money came in from time to time in the intervening period, but money also went out.

So, while we are on that your Honour, can I take you to some figures on that. I will end at 2012, but perhaps if we could go to, in our submissions, Mr Leggat, appendix I think it is 3. So again, this is a schedule to the submissions. It's an appendix to the Court of Appeal judgment, I think also the High Court judgment. So this shows us the adjusted net asset position of the company over the years in question. All the figures taken from the audited accounts apart from 2012 where again it's management accounts and not accepted by the appellants, or not fully.

So, 2005, you will see there is reference down the bottom, your Honour, to Midland Tower payable forgivables and shares in a subsidiary written off. This is Midland Tower. There was quite a lot of evidence about this and Mr Yan maintained that a great deal of money had been put into Mainzeal via the Midland Tower transaction, or the Midland Tower project which was the Midland Tower build at Midland on the park in Wellington. In the end, I say we weren't really able to bottom that out and identify quite what happened and Justice Cooke essentially said it was just unclear. But in the end, it doesn't

matter. If it came in, it came in as equity and so what we see here in 2005 is money going out. You will see the two loans 12 million going to RGREL and 20 million to MLG which was the other group borrower, a company that was at all times completely bereft of any ability to pay. RGREL had some, but limited.

So, the net-net of 2005, if you look down to the penultimate line, we have: "Less: related party and intercompany accounts." You will see that at that point $25 million had gone out. So whatever might have come in, what we know is 25 went out.

And then the last line is the adjusted net asset position, i.e., adjusted if you discount out the related party payables and so it's negative 25 million. So that's essentially the balance sheet position in 2005 negative 25 million. 2006, the loans have jumped up. You will see that where several lines up we've got: "Less: RGRE," which is also called RGREL and I should say also called Richina Land sometimes, same company, it's had a name change. So that by this stage there's 14 million advanced to that company and 22 to MLG. So, if you drop your eye down to the penultimate line, at that point we've got a total of 36.7 lent out by Mainzeal and adjusted negative net assets of 21 and so it goes on.

If I take you to 2010, because of course that is a critical year we say, by that stage the loans out to RGREL are 11.9, to MLG 30. There's some advances also, well perhaps, well, money owed anyway, by KFL and Mainzeal Living, net, net, is 44 million, and these are coming straight from the accounts, 44 million and related party payables, or receivables for Mainzeal, and a balance sheet of negative 17 million, and then by the end of 2011 figures are 55 million with negative of assets of 36, and then 2012 that will be it, not settled, much more again.

So, your Honour, did money come into Mainzeal, did cash come in from time to time? Sure, it did. But frankly, with respect, and our friends constantly refer to this, in fact Mr Chisholm started with it yesterday. Yes, money came

in, but overall money went out, and the net position at the end of each year up to and including 2011 is as recorded. So whether a million dollars came in in 2011 – it didn't, but whether it did – is really immaterial, because actually 55 million had gone out, and when I say "gone out" I should say that includes the accumulation of interest. And by the end of 2011 or at the end of 2011 we have the prepaid good transaction entered into and that's why the figure shift around, and you'll see that over the left, prepaid building material, and 33 million has gone into that row and the MLG row has gone from 2010, 30 million to nothing, but that's the shift to the prepaid goods arrangement, which we'll come to later.

WINKELMANN CJ:
So these figures aren't accepted?

MR O'BRIEN QC:
No, these figures, all but 2012 are accepted, your Honour.

WILLIAM YOUNG J:
2012 is just, they're the management accounts?

MR O'BRIEN QC:
Yes.

WILLIAM YOUNG J:
And so is there any particular challenge to them?

MR O'BRIEN QC:
I don't recall, your Honour. No, I don't recall, I'm sorry. In some ways we didn't really focus on them because by then it's just way too late. The last critical date in terms of annual accounts is 2011, things just, where it's acknowledged that things went south after that, I'm sure all the figures indicate that.

But yes, your Honour Justice Winkelman, yes, no, these figures are accepted by the defendants, now appellants, and they're from their accounts.

WINKELMANN CJ:
So Mr Chisholm I think yesterday said – and it was because this money was coming in – that the net asset, it's not surprising that the net asset, net deficiency, reduced over this period of time when this money was coming in.

MR O'BRIEN QC:
Well, that might be one reason. Another reason might be that the book was starting to fall away slightly. Another reason was simply – and we know this – the state of the construction contracts, it depends where you catch the company in its construction cycle. But, yes, money did come in in 2012. Now, I'll take you to that, your Honours.

So at the conclusion of the Court of Appeal case the parties filed a joint report on, a joint memorandum on cash flows for 2011/2012. It's tab 10 in the index, please. That's the one. So this is dated 15 September 2020 and it's an agreed position, paragraph 3 is the first critical one to go to: "In summary, the evidence shows a net inflow of funds into Mainzeal from Richina companies of approximately $8.56 million in the period from February 2011 to 31 December 2012, comprised of a net outflow in the period from 1 February 2011 to 30 April 2012. So some out despite the extraordinarily precarious position of the company, money is still going out. Not coming in, going out, and then there was a net inflow of approximately close to nine million from 1 May 2012 to end of December 2012, and that's the support which both my learned friends referred to, Mr Hodder and Mr Chisholm in particular.

So that's only two years your Honour, and bear in mind, as we saw before, that at the end of 2011, it's not nine million that's owed to the company, it's 40 something million that's owed to the company. So, yes, some come in, helpful no doubt, but it was only part of what was owed, and then your Honours –

WINKELMANN CJ:

Can I just ask, and sorry to be dim, can you reconcile that paragraph 3 with your schedule?

MR O'BRIEN QC:

Yes. Well I can try. Which schedule though your Honour, the one we were just looking at?

WINKELMANN CJ:

Yes.

MR O'BRIEN QC:

Yes. So we'll go back to the – well actually – yes I will and then I'll take you to other parts. So if we go back to that schedule please, so you can either get that in our submissions, okay, so you're there. Actually maybe I can't. So this schedule 3 gives you an end position, and what we're just looking at is just a cash flow position. So I don't think you can reconcile from these particular, from this particular table. If we go to schedule 4, that's probably not going to help us much either. No, but the memo to some extent will help us your Honour.

WINKELMANN CJ:

Well I suppose part of the reconciliation is accruing interest.

MR O'BRIEN QC:

Yes, part of it.

WILLIAM YOUNG J:

The other thing, these are years, but for reasons I don't know and you can explain, but the memorandum starts at the 1st of February?

MR O'BRIEN QC:

Yes. Their honours just wanted to look at what was coming in in those two critical years, and what was going out.

WILLIAM YOUNG J:

But why start at 1 February, why not start at the beginning of the balance date. Does that make a difference or not?

O'REGAN J:

It was 31 January.

WILLIAM YOUNG J:

Oh 31 January. I thought it was 31 December was the balance date.

O'REGAN J:

No, 31 January was when they were meant to have stopped trading, on Mr O'Brien's case.

WILLIAM YOUNG J:

Oh I see. Sorry, yes. So the balance date is 31 December.

MR O'BRIEN QC:

Yes, and you're right your Honour, balance date was 31 December.

WINKELMANN CJ:

And you say, and I don't know if it affects this year, that funds came in before balance dates and then go out after them. So does that mean that in early 2011 monies went out?

MR O'BRIEN QC:

Yes.

WINKELMANN CJ:

Which would be outside this time period or…

MR O'BRIEN QC:

Yes it would be.

WILLIAM YOUNG J:

You had a schedule that showed that somewhere. It's schedule 6 isn't it?

MR O'BRIEN QC:

So if we go back to the joint memorandum please, which was tab 10, and if you go to schedule A, for example, so what we've got there, it's quite small print, up top you see "Register of Cash Flows between Richina Companies and Mainzeal from 1 January 2010." So your Honour Justice Winkelmann, this began to be produced as it indicates in February 2010, and the board had asked for it because there was a constant flow of money, certainly out of, maybe into, Mainzeal and the board, this is at the time of the restructuring, they wanted to start watching it. Just to give you, before we look at the detail, to give you some background to this. Under the charter, which I should take you to, the Richina group maintained the right to effectively take money out of Mainzeal whenever it so decided. Now not to say that excuses the directors from watching it, but that was the, if you like, the governance structure until the restructuring time, at which point all of these things ought to have changed, and did start to change.

So if we look at this, what you're looking at here your Honours, is the register of cash flows, but all of the blue markings are the liquidators. So that's nothing something the directors saw at the time, and if you want exactly what they saw at the time it's in the back of, it's in one of the schedules to our submissions, and it's also an annexure to the Court of Appeal judgment. But if you go down to 31 December 2012. So you'll see we start with 1.3 cash out, and then monies going in and out, so the in is the black in the – sorry, is it the other way around. In any event we get 2.1 million out over 2010, and then at the very end of –

WINKELMANN CJ:

I think red is out, isn't it, judging by the narrative.

MR O'BRIEN QC:

Yes, red is out, sorry. So on 31 December you'll see three entries. The first two is cash going out, smallish amounts, 288,000 and 42, and then you see $5.3 million comes in. That's on balance date. So Richina, the group, is putting $5.3 million into Mainzeal on the balance date, and then on 5 January, two million goes out, and then 200,000, and then 1.3, and then two lots of 500. So by the 27th of January, 4.5 has gone out. So we've got 5.3 coming in on the balance date, strengthening the balance sheet, and within a month 4.568 million of that has gone again. Then if we –

WILLIAM YOUNG J:

Just pause there. Was there an explanation for this?

MR O'BRIEN QC:

It's called window dressing, your Honour.

WILLIAM YOUNG J:

Yes, I wonder –

MR O'BRIEN QC:

No, that was the explanation.

WILLIAM YOUNG J:

The defendant said it was just window dressing?

MR O'BRIEN QC:

Well that's what the, one of the emails say, to be fair. What did the defendant say about this? Not much, I think is the short answer. I don't think there was an explanation. I can't recall quite what the answers were.

WINKELMANN CJ:

Can you scroll down please?

MR O'BRIEN QC:

Yes, can we go down to look at 2011 please, all of it. Thank you. So 2011 we see a similar thing occurring on balance date. Money coming in – some money going out – well money going out right through the year, 5.579 million up to 31 December, and then repayment plus more. On the 31st we get 259,000, 3.1 and 2.9 coming in, so a total out to the right of 6.368 came in on balance date, and then over the next three, four months, 1.195 going out. So you see the figure out to the right of 406,000, that is the figure which appears in the memo to which this is attached at 3(a), which says there was a net outflow from 1 February 2011 to 30 April 2012 of 406,000.

Then this stops. Now after that the cash flow register just stops being used. Well perhaps a better way to put it is that this reporting format seems to have been discontinued by the board. But after this money came in, and that's the figure we see in 3(b) of the joint memorandum. So nine million almost came in, in the rest of that year. But again, at the risk of labouring the point, that's just a fraction of what was owed.

One thing I think I should say to your Honours, a lot of this money in that year came in via a standby letter of credit mechanism and if you happen to read thoroughly through the evidence and perhaps even the judgments you'll see that a lot – there was a far greater number seemingly came out of China through the standby letter of credit mechanism, about 30-odd million, I think, but only about 8 million of that found its way into Mainzeal. In any event, agreed position, this is what came into Mainzeal.

Now, your Honours, while we're there, and talking about reconciliation, if your Honours have to hand the first appellant's outline, and if we go to paragraph 1.2 you'll see counsel there saying that more funds flowed into Mainzeal from the Richina companies than flowed out during the period when Mr Yan was the director, that is from 2007, and you'll see Mr Chisholm's given you the figures.

I've gone and checked these against what's called the "red box". The red box was a sort of cash flow diagram that the liquidators prepared. I'll take you to that. But yes, the red box shows us that money came in in 2007, Your Honour, Justice France, and I'll take you to it, and in 2008, but it went out in 2009, came in 2010, went out in 2011, came in 2012, and the net-net, according to this calculation, is 8.56 net inflow – well, no, that's the agreed figure – 8.56 net inflow between February '11 and December '12.

But, with respect, this only gives you a small part of the picture and the bigger picture and the right picture, I suggest, is the one we looked at before, ie, schedule 3, schedule 3 to our submission and an appendix to the Court of Appeal judgment, where we see that by the end of 2011 55 million was owed to Mainzeal and by the end of 2010 44 was owed to Mainzeal. So to say that more came in during these years than went out might be technically correct – it looks like it is – but it's of no consequence. It's just of no consequence.

WILLIAM YOUNG J:
Do you mean because it has no particular consequence on the balance sheet position?

MR O'BRIEN QC:
Nothing. Barely dented it, your Honour – well, until the last year. In fact, it rather puts paid to the point on which Mr Westlake relied that although the position on the balance sheet was totally unacceptable and, indeed, intolerable, it was okay for the directors to carry on because support was coming in from the Richina Group. Well, with respect, it was very limited. They didn't even repay the loans. They didn't repay the loans. The loans were due and owing and not repaid.

WINKELMANN CJ:
Well, that's not that unusual in a group situation, is it, a group treasury situation, just to have loans standing there, is it?

MR O'BRIEN QC:
Well, no, perhaps not, your Honour, but what is unusual is to have those loans owed by companies which are hopelessly insolvent without any guarantee from the parent. That is most unusual, I would suggest.

So, could we go please Mr Leggat to schedule 5. So still in our submissions. This is the so-called "red box" analysis. I can't recall why it got called red box, but it did.

WINKELMANN CJ:
Something was in a red box.

MR O'BRIEN QC:
Well, I think it must have been, your Honour. I think it did have a red circle around it initially, or box. So this is just another form of looking at the position as it was from 2006 to 2011 and again, not agreed, 2012 and you will see the related party balances there. But if you go down to the second red box analysis, it's actually quite hard to read, but it does give us theoretical cash and it's only cash into and out of and I think Mr Chisholm has taken his figures from that line under "cash flow position, cash received in". So his figures looked right, but again, I say well, it's only part of the position.

I think this came in. I can't exactly recall how this came in, but it wasn't in evidence. I'm not sure to what extent there's debate about it. But in any event, the first one did come in in evidence and there was quite a lot of discussion about money in and money out and you have seen the register of cash flows, at least for those years in question. But whatever the position with money in, money out, the overriding position was masses of money out, i.e., several tens of millions and accumulating.

So, your Honours, just while we are in these schedules, I didn't mean to stay in them, but while we are here, if we could go up to schedule 2 please. I know your Honours have seen this. So this was the group position post-restructuring and your Honours I think noted it as all the assets being on

the left-hand side. That's right. And you will see Mainzeal towards the left but on the bottom, but it's really part of the right-hand side. So you will see that post-restructuring, its parent is RGREL and that is in turn a subsidiary of Richina (NZ) LP and that's the company we see giving the letter of support and you will see that's held in turn by a BVI company, Richina Holdings (BVI) Ltd which also owns MLG and Mainzeal Trustees Ltd. And you will see, so there is no direct link between Mainzeal, and anymore, between Mainzeal and Richina Pacific out on the left, or critically, Richina Pacific (China), the CHC, which held most of the assets, although one might say Richina Pacific held them through that subsidiary. The link is the common shareholders including Mr Yan. So that's the group structure and that's why when we occasionally hear talk of parent company support at this point, it's just if they're talking about CHC, it's really not the parent company. Mainzeal is not, at this point, a subsidiary anymore. That tie has been severed and rearranged. Mainzeal is a subsidiary of RGREL and ultimately of Richina (NZ) LP. Most of the, well, suffice to say those entities just don't have the wherewithal to support Mainzeal.

Now before that, if we go up to schedule 1, so this was the position prior to the restructuring, you'll see it's quite different, because we see at the time Richina Pacific, then Bermuda, the owning amongst other things Richina Pacific (China), which is out to the left, and Shanghai Leather and Richina Leather and so on, and all of those subsidiaries offshore to NZ, but also directly owning Mainzeal, which is Mainzeal Property and Construction Limited, so out to the left in the green box. So that's the structure that existed up until the implementation of the restructuring, and at that point, as we'll see, up until then the audit letters of support came from Richina Pacific Limited. If we just go back to schedule 2 again – and that had real, you know, that company at least had real value – and then schedule 2, the audit letter support came from Richina (NZ) LP to RGREL and Mainzeal, and that company had no real value beyond those companies and certainly didn't have the wherewithal to, for example, cause the repayment of the loans.

Now, your Honours, with that could I invite you to, unless your Honours don't want me to do this, but I was going to take you through the chronology, not every entry, but I think it's quite a useful way for your Honours to see some of the critical documents, and I won't –

WINKELMANN CJ:
Go ahead, Mr O'Brien.

MR O'BRIEN QC:
So the chronology, if you could bring that up, please? I plan to start a little slower than I finish, but if we could start way back in '95, 1995, well, the first entry just records Mainzeal's incorporation, 1995 we record REH capital, which is investment consortium controlled by Mr Yan. I'm not exactly sure, we didn't quite figure out what percentage he owns, but a substantial percentage, and, yes, he did describe himself as "benevolent dictator" of that organisation and the Richina group generally. But he didn't have total control, he couldn't, because he wasn't a hundred per cent owner. Anyway, that consortium was formed and it acquired Mainzeal's parent company which was then Mainzeal Group Limited, and we say there: "The primary objective was to acquire Mair Astley Holdings to associate with leather industry interests in China," and the focus of the investor group, mainly American investors, not only, but it was very much on the emerging, then emerging, market of China. Then you see out to the right, your Honours, I've got a link to the Court of Appeal judgment passage. So one of the reasons we did this was to give your Honours a link to the actual documents which the Court of Appeal's used or relied on, and then there's a link to the annual report, we'll go to one of those in a minute.

Then September '96 Mainzeal group gets renamed as Richina Pacific, so you'll see the focus there on China and perhaps also on Richard, but anyway Richina, and then we have Richina removing itself from the New Zealand Companies Register in 2003 and becoming incorporated in Bermuda, which is why the references in the statement of claim to Richina Bermuda, but it is the same company as the one referred to in the judgments as Richina Pacific.

And then March 2004 – I've said this but I'll take you to it – and this is how Mr Yan describes Mainzeal. But let's go please to the document, and if you could just scroll up to page 410, and you'll see we're looking at a chairman and CEO review, ie, Mr Yan, and I'm just going to highlight some things in here for your Honours. If we look at financial performance, he's talking about the profit, and we say all of this is relevant because the directors came on board shortly after this, or Dame Jenny and Mr Tilby did, and Mr Yan, of course, came on in 2007, and this gives you a good idea of the drivers of the group. Nothing unusual but let's read.

So we see in the left-hand column, about five, six lines up from the bottom, we see: "Our goal and absolute focus now is to provide an improving rate of return on capital, to generate greater cash flow, and to resume dividend payments," et cetera, and then you'll see over to the right there's mention up in the top right-hand corner of the Mobil-on-the-Park operation, but nothing of great note there, and then under "Richina Pacific Board", first two lines under "Richina Pacific" they're introducing Mr Walker and Dame Jenny Shipley, and then there's nothing much there we need to look at.

But if we just scroll down, please, to page 00414, and if you go down to the bottom of the left-hand column, we see discussion about Mainzeal. The first thing I ask you to note is the comment in the third line that it's in "a market characterised by competitiveness and volatility". That never changed. "Competitiveness and volatility," and then: "For the past several years, Mainzeal's contribution to Group profits has often been affected by the need to provide warranty work on past projects." Well, that was a pattern that was to continue.

Then over on the top of the right-hand column, please, at the end of the first paragraph there you'll see it says: "Over the years, we have been asked why we do not sell Mainzeal, and it is appropriate to address this question here," and: "The reason is that we believe that Mainzeal is a good business and that it is being managed well. A little historical perspective is called for," and he explains how they acquired it, with the focus on Mair Astley.

Then if you just scroll down a little, Mr Leggat, we'll see a paragraph: "Like most construction companies, Mainzeal generates income from two distinct but related sources. First, it generates revenue, and hopefully also profits, by constructing buildings. Second, it generates interest income from the negative working capital it holds… Because of the negative working capital it generates, Mainzeal employs little equity capital and as a result, as long as it makes an overall profit, which it has with one exception in the past 10 years, the return on capital invested in this business can be excellent. With such potentially outstanding economics, the critical factor becomes how do we contain as much as possible the downside risk in this business?"

Then further down the page, last three lines: "As long as Mainzeal can be profitable on a sustained basis, the excellent return this business is able to generate on its limited equity capital will justify our owning Mainzeal for the long term. Our management at Mainzeal is fully committed to this low-risk approach to the business and we can look forward to many years of improving performance."

So what do we make of that? We say that really set the scene and it never really changed and this idea that there were commitments to Mainzeal, sure, but for what? To what extent and on what basis? Why was there a commitment to Mainzeal? Because it was a business that might return a profit. If it wasn't returning and profit and if it was going to be a cost to the parent, there's no indication anywhere that it would continue to be supported. Mr Yan himself said support it as long as it's a going concern. Yesterday we heard, well support couldn't be limitless, a self-evident factor. It should have been obvious to the directors. So what was expected from Mainzeal? If we turn to page –

WINKELMANN CJ:

So generating interest on limited, even negative equity, means really what they're focusing on is cash flow, is that right?

MR O'BRIEN QC:

Cash flow, that's right, your Honour and in the construction industry, cash flow coming in can be held and used before it has to be paid out and so you generate, or use what is effectively negative working capital, or generator.

Mr Gomm incidentally said when it was put to him that they've effectively using creditor's money, he said: "Well, basically that's what the construction industry does." Well, yes, but companies that are well capitalised, take Fletcher Building, for example, I'm sure they – of course that's an advantage of the cycle, but they have capital and when they got into trouble, what did they do? They went to the market to get more capital and what did Mainzeal do? Well, nothing much, prepaid goods, barter.

So 417, return on capital: "So the most important measure for any commercial enterprise is the return its management is able to deliver to its shareholders et cetera. We believe that Richina Pacific should aim to consistently deliver a net return of 15 to 20% on equity capital."

So moving back to the chronology, that was 8 March '04. That's referred to in Court of Appeal paragraph 19 and then 19 March '04 we have reference to the draft charter under which Mainzeal was to operate. So it was about at this time Mainzeal's board was being established and you will see that under the 1 April 2004 entry. Now, I should say that the charter that we refer to in the chronology is just a draft, but in the submission there's a hyperlink to the actual document. I don't think they're very different, if at all.

So the board, the Mainzeal board, gets established on 1 April 2004 and at that point of the current cast of characters there is Dame Jenny and Mr Tilby and they have their inaugural meeting on 13 April and they raise some questions about the charter and then on 10 June 2004, Mr Lobb replies to that and amongst other things he says: "If you want capital you will have to compete for it." So, if we just link quickly to that document just to give your Honours at least an opportunity to eyeball it, you will see it is a Richina Pacific, it's to the board and if you look at paragraph 8, he talks about reporting lines.

At this point RPL had a serious degree of control over Mainzeal and it adopted many of the powers which a board would normally operate and then at 10, that's under the charter, but at 10 he says: "Within the RPL policy, Mainzeal should determine its own policy." And then third line down, this is 10: "To the extent it requires more capital, it will have to compete with other demands from other subsidiaries or initiatives within the RPL corporate group. Allocations may need to be made, and if that is the case, the basis would be need, and expected returns on investments." So there you have it, right from the outset they are being told: "If you need money from us, you will get it if you can compete for it and if you can deliver an expected return on investments." We know from the RPL report that that's expected to be sort of 15 to 20%. But, in any event, without worrying about the numbers, there's the key. If you need money, you will have to compete. It will depend on other demands and on whether you can deliver a return.

And then the charter itself, it may or may not be in this document, I don't think it is, but you'll see that's signed off by a Mr Warwick Lobb, who I think at the time was company secretary.

So if we then go back to the chronology. Later that year we start to see the money starting to flow out, that's 6 October, so there's this proper loan agreement, it's what's called a floating rate debenture loan, but it's a debenture not secured, it's an unsecured floating rate debenture loan with interest linked – do we say that there, perhaps not – but the interest is linked to the profitability of the Shanghai Leather Company. So the money was borrowed to help acquire the Shanghai Leather Company in China, and there's a link to the agreement there, we don't need to go to it, so it gets advanced to MLG and MLG, as we say there, didn't have any enforceable right to repayment because MLG lent it on.

7 December we note the interests point, and that's Mr Yan coming to the Mainzeal Board and telling them about the acquisition and how profitable it's expected to be and how Mainzeal can share in that through this interest

arrangement, equity-linked interest arrangement or profit-linked. 31 December, the annual report record a capital call option from the parent of 5.5 million. That disappeared at some later stage, that wasn't really explored to any great degree in the evidence, not terribly material, and then February '05 that's just the date of the agreement I've already referred your Honours to.

At March 2005 the RPL annual report. This is a very interesting document, or at least it was at the trial. Mr Yan's describing 2004 as a "pivotal turning point for future success" with the acquisition of the SLC, which he compared to the "Louisiana purchase", and again somewhere in here records the group expects 15% return on equity for Mainzeal. So just so your Honours can see that document, let's just have a quick look. Yes, so there's Mr Yan as CEO writing to his shareholders and just in that first column: "What a difference a year makes! I have little doubt that 2004 will be recorded in the history of Richina Pacific Limited as the pivotal turning point for its future success," and then a sentence down: "The acquisition of a 90% interest in Shanghai Leather Company certainly confirmed that belief," and he goes on to describe under the SLC acquisition.

I won't take you through it all, your Honour, but essentially they acquired this company, it was basically a large state-owned enterprise group, and they acquired it or 90% of it, they later I think picked up the other 10%, and the extraordinary thing is that it had about 140 properties in Shanghai and around the periphery of what was then the, or in the industrial sector of Shanghai, and Shanghai of course was growing at a great rate of knots and these properties became fabulously valuable. And so when my friends say that the assets were there in China, sure, they were, and very, and what became hugely valuable. So you'll see while we're here mention up in the top right-hand corner of SLC's chairman and general manager, Mr Huo Jianguo, who I think is the same chap who got mentioned yesterday.

Now, bottom right-hand corner, the reference there is to "40 plus prime land parcels". I may have got that figure wrong – 140 acres, right, thank you Mr Hodder, 40 sites, and then financial results over the page top right-hand

column: “While RPL has also taken and will continue to take a long term patient and strategic view of each of our businesses and investments, we must only allocate new capital to businesses and managers that can make an adequate and even more importantly, a consistent return for shareholders.” Did Mainzeal do that? No, sadly it didn’t.

Then down the bottom of that page right-hand column an analogy. You will have to keep going, an analogy thanks: “Your New York based chairman and great student of American history has likened the significance of RPL’s acquisition of SLC to that of America’s Louisiana purchase.” At the risk of sounding a little grand I find this analogy most fitting and that’s probably all in there. So no doubt that there were assets.

At this time one assumes they weren’t worth necessarily a lot more than what was paid for them and what was paid for them was about USD 20 million of which funds from Mainzeal contributed about 10%. But over the few years that followed, the value rocketed as we will see.

So back to the chronology, November 2005, the second loan facility agreement. This one, different terms. I think just a straight interest rate. So we don’t have records of all of the advances, but it doesn’t matter because the annual accounts tell us that by the end of that year 31 December 2005 the related party receivables to Mainzeal, i.e., loans out had grown to 25.6 million and so adjusted net assets, i.e., if you exclude the, if you treat loan receivables as impaired, it’s negative 25 and the loss that year is 12 million.

And then 2006, just to note that Richina Land becomes renamed as RGREL and then I’ve given your Honours the profit figures for 2006 and there is a profit that year similar to the loss the year before and related party receivables have grown to 36.7. So if any money came in, that was eclipsed by the growth in the receivable.

Then 18 March ’08 another Richina report. Again, and remember Dame Jenny’s on this board. She’s on this board, so she sees these things

and Mr Yan again expressing support for Mainzeal. Fine, but, but, again, it's linked to an expectation of a consistently profitable organisation. No surprise. That's on page 8. We needn't go there.

Then May 2008, you will see reference to a letter of support from RPL. So I will take your Honours to this. It's not directly relevant, but it's a good counterpoint to what we see later. Now, although I haven't got there and it's immediately, I am immediately reminded of one oddity which is that it's addressed to the directors of Richina Pacific Ltd. But if we read it, and that looks like possibly a mistake, because if we read it: "In order for the directors of Richina Land, now RGREL, and Mainzeal Property et cetera, to be in a position to support the use of the going concern basis et cetera, et cetera." And then down further to the paragraph just above the second bullet point they say: "We being directors of Richina Pacific Ltd hereby acknowledge to the directors of the three above companies that Richina Pacific accepts responsibility of providing and undertakes to provide sufficient financial assistance to the group as and when needed et cetera."

So, what do we say about that? Well, we don't really have to say anything because it's pre-dating our critical date, but we say, well, everyone says it is unenforceable although sometimes I wonder why, but that's for another day. But at least at this point, in 2008, Mainzeal is getting at least an audit support letter and an expression of support from the company at the top of the tree, the company which controls the money, and that's signed, of course, by Dame Jenny as a director of Richina Pacific and by Richard Yan. So again they well know where this support letter is coming from.

So if we go back to the chronology, please, so that's 18 March 2008 – sorry, May 2008. Then later that year we see the beginnings of the restructure and we see a PwC report on a proposed restructure of the group and amongst other things, as we say here in the chronology, Mainzeal is to be spun off into a stand-alone New Zealand division, and your Honours noted this yesterday but the report says at 15 that Mainzeal's in deficit, if you exclude the intercompany loans, and requires a cash injection to operate independently

and that that is to be effected by, PwC was told obviously, to be effected by the issue of redeemable preference shares to RGREL, ie, the New Zealand division, and there's also note that because CHC is going to become an – well, going to become something, I can't recall what – that it needs to minimise its exposure to the other divisions.

So that's covered in the Court of Appeal at paragraphs 48 and 53 but if we just look quickly at the documents themselves, if we look at first the report – well, that's probably not the helpful place to look so if I could ask you to go back, and it just gives you an idea of the report but in it we see at 02533, it's the hyperlink there, you see the note on the New Zealand division at paragraphs 15, 16, and over the page the other note I just mentioned.

So that's the plan. Mainzeal will be, well, perhaps not directly recapitalised but its parent will be, its immediate parent.

Now I haven't taken your Honours to it but if you were to go to paragraph 53 of the Court of Appeal judgment, I just haven't taken you to it, and the PwC report, but you'll see their Honours there recording that the funds to come in – well, they record what we've just read but they also note that the preference share issue is to be for USD 13.5 million or around that number, and at 54 they refer to another document which is in the chronology and that's the investment statement which says that Richina Pacific will ensure the division is appropriately capitalised.

So that was the plan, but things didn't go quite according to plan. So the restructure was implemented but that recapitalisation was not implemented, and we'll come to that in just a moment.

So then if we look at the entries at 31 December 2008, several things happening then. First, Richina is delisting from the New Zealand stock exchange, a significant event we say. You'll see the end of the year results there. We saw them before – well, perhaps we haven't seen them all but there are the end of year results.

The third entry in the cell we have there is the reference to the MLG financial statements. So this is the main borrower. This is the main borrower from Mainzeal so let's just have a very quick look at that before the lunch break – no, it's 1 pm, sorry, your Honour.

WINKELMANN CJ:
It's 1 pm, yes. So you can feel free to go at a bit more of a clip if you like, Mr O'Brien. We've all read the facts and just take us to the documents that you think are really impactful. You don't need to take us to the documents as if you were proving it to us because…

MR O'BRIEN QC:
Sure, thank you.

WINKELMANN CJ:
We'll take the luncheon adjournment.

COURT ADJOURNS: 1.00 PM

COURT RESUMES: 2.17 PM

MR O'BRIEN QC:
Your Honours, we were looking at papers at the end of 2008 and in the chronology we were at the entry 31 December 2008. I won't take you to the document, but there we have a link to the MLG financial statements, that's the borrower, total assets nil, total liabilities 44 million, so no question about its solvency, none, and so totally reliant on support from the shareholder and no suggestion that there was any written commitment to it. Then the RPL financial statements we also reference there, and interestingly they under the New Zealand division note that it has negative equity of about US10.358 million, and we've given your Honours links to those, and then what's going on after this?

Well, January 2009 the CFO report to the board, so it's a regular feature of the board paper, notes that they anticipate no further support from Richina other than the potential cash injection to the new parent of the New Zealand division. So that's January 2009. At that point, self-evidently from that comment, there's still at least the potential for that cash injection, and in February the CFO again reporting – it's three lines up from the bottom of that entry – "Due to the insolvent position of the New Zealand division the continued support and guarantee of the parent company will be relied upon," and yet there was this message coming through: "We can't expect anything more," and you see that in April 2009, Mr Yan reaffirming support but at the same time saying that whilst it's ongoing the directive is for Mainzeal to be "self-sufficient and to compete for equity to grow to become a much stronger stand-alone viable entity. A similar theme in May 2009 where MPC, Mainzeal itself, is reporting to the RPL board noting that it's operating on this principle that it's to be financially self-sufficient and stand-alone with the one exception of Richina Pacific bonding support, ie guaranteeing bonds to the bondsman.

Then 22 May PwC raise a concern that the redeemable preference shares hadn't be called. So they'd been issued, curiously, but not called, and they were also concerned about transparency re related party transactions. Shortly after that they were dismissed as auditor, and that's in the evidence of Mr Schubert, who we called, and the Court of Appeal refers to that so I won't take you to it. But the Court of Appeal noted with some dismay that this hadn't attracted attention, or no obvious attention at the Mainzeal Board level, and nor had it. I did put this to Dame Jenny and to Mr Yan. Dame Jenny's response was she understood it to just be a normal rotation of auditors and that auditors were to be rotated regularly in accordance with good governance. Mr Yan's response I don't recall immediately but he justified it on the basis of, I think, performance.

And then we have on 26 May – and we should go to this…

WINKELMANN CJ:
Did we get any response from the corporate governance experts about whether or not auditors are normally rotated in accordance with good governance?

MR O'BRIEN QC:
No, I don't think we did, your Honour, but we certainly got one from Mr Schubert, who said that was nonsense basically, said it was wrong, it's not normal, certainly not in the timespan that PwC were auditing. But, as I say, he did also say he was very happy to be exiting that role. No, I don't think that was commented on by, certainly not in the joint report. I'll double-check that.

Now there were questions as to why the 13.5 million hadn't come in and there were several answers really, and I'll just tell you briefly what they are. So this is in the submissions. So Mr Yan said that there was an investor expected to come in to Richina Pacific or perhaps REH at about the time of the restructuring, but due to the GFC that investor had pulled out unexpectedly at the last minute, indeed when Mr Yan was about to meet him in New York for the signing of the documents. But later there were other investors who came in to replace him so that didn't seem to provide an adequate explanation.

The other explanation was that Mr Yan was told by the bondsman, Vero in particular, that an injection of 13.5 million into RGREL would not be sufficient from a bondsman's perspective to relieve the need of a guarantee from Richina Pacific. So in other words they could put the 13.5 in but they'd still have to guarantee the performance of the performance bond. So on that basis it just wasn't, from a Richina perspective, wasn't worth doing. No thought given, it seems, to the solvency position of Mainzeal. But then again, that was just sort of business as usual, the money hadn't been there.

So if we go to this 26 May 2009 report we'll see it there, I hope. Yes, at (3) now – actually, just before we go there, so if I can just show you what this is and who's at the meeting. If we scroll up to the top of the document we see it's a Richina Pacific Limited meeting minutes, Audit and Governance

Committee, who's present, Mr Walker, the Right Honourable Jenny Shipley and Mr Wallace Mathai-Davis, who's a director of the company, so is Dame Jenny, and in attendance we see Mr Yan and Mr Mike Schubert of PwC and Mr David Randell of PwC and on the next page under the heading: "In response to PwC's queries the chairman responded as follows." So these were queries about various issues that PwC were raising and you will see there in the second bullet point, I will just let your Honours read it, but at the time of the notice of meeting, so we get some of the explanation here just as I've explained it.

GLAZEBROOK J:
Did you say we're supposed to be at paragraph 2, did you?

MR O'BRIEN QC:
No, your Honour. The paragraph on the page 1. Yes, I said the second paragraph of that.

GLAZEBROOK J:
Thank you.

MR O'BRIEN QC:
So now your Honours, that's under the heading "availability of funds for buyout of shareholders". So at the time Richina was buying out shareholders, but it marries up with the explanation that Mr Yan gave as to one of the reasons why the 13.5 hadn't been put into the New Zealand division. But we see, but remember the other reason which I gave you which you see in the judgment and if we turn to page 3. Not page 3 sorry, the next page, it is page 3, and item 3 "issuance of fixed rate cumulative redeemable shares up to NZ," well it should be US. There was never New Zealand 13, it was always USD 13.5. That's agreed and I will just let your Honours read that. So it wouldn't be prudent, well, it wouldn't be prudent for who? Richina Pacific obviously and thus, that USD 13.5 never came into RGREL. Of course, if it had come into RGREL, that's not exactly a proper fix for Mainzeal, but at least it

would've helped because that's it's immediate onshore parent who was at least giving it a letter of audit support as we will see.

So, moving through the chain of sorry events we're back to, in the chronology, May 2009.

October 2009 there's this idea of putting paper equity interest into the New Zealand division. That's quite complex. It's covered well in the, certainly in the, it's covered briefly in the Court of Appeal judgment but it cross-references you back to the High Court judgment where it's covered in some more detail. But essentially the idea, and you will see it from those two October entries, the idea was that there would be transferred into RGREL rights associated with a proposed hotel development in Kunshan in China, but it was conditional on regulatory approval and that in fact was never sought and therefore, well, and never given.

Now, we did have a cause of action in respect of this particular transaction by which we sought to establish a claim to recover that asset. That failed. No surprise really. Well, I say that now, but no surprise really because regulatory approval had never been sought or given, so in fact it was worthless and that's what his Honour Justice Cooke found. But there it was in the RGREL balance sheet and we see that later.

And then 22 January, well actually, I just note in December, so it's December '09, we have the end of year balances again and curiously, just no discussion recorded by the board of the RPS issue and no discussion of PwC's removal as auditor and no advice sought and yet in January, just a month later, the CEO was noting that the balance sheet was negative US 10 million and welcoming plans to strengthen the balance sheet.

Now one of your Honours asked about the negative 10 million, I think, so perhaps we could just quickly go to that document. It's one of several in the same form, doesn't tell us much, but you see there under "KPI8" we have "Mainzeal Balance Sheet" and we see first bullet point, negative circa

US10mil, and then a comment about the market perception of Mainzeal being reliant on Richina, which, of course, until this time had been within New Zealand, and then third bullet point: “Plans to strengthen the Mainzeal balance sheet are welcomed,” and then last one: “More than ever we need to have a strong Richina/Mainzeal, as our early entry point for future projects such as PPP’s or BOOT’s” –

WILLIAM YOUNG J:
What are “BOOTs”?

MR O’BRIEN QC:
Build, own, operate, transfer, I think.

WILLIAM YOUNG J:
So a turn-key sort of…

MR O’BRIEN QC:
Yes, well, I’m no expert, Sir, but I think so, yes. But it is “build, own, operate, transfer”. PPP’s, of course, public/private partnerships, which Mainzeal did later bid for, in fact particularly Wiri Prison. It spent about $5 million on that bid, didn’t succeed. But that’s one of the complaints about the new business initiatives. That was one, very expensive, no return.

So that comment there, negative US10 million, can only reflect a view that the loans are irrecoverable and we see it not just in that board paper but we see it regularly appearing, at least for two or three months.

Then February 2010, by now the split has occurred, and then interestingly, and I’ll just draw your attention to this in that 11 Feb entry, key for Mainzeal is “how it communicates its financial position to the numerous and various parties who request financial information…” It can no longer represent it’s – Richina’s the holding company and so on, and one suggestion, this is from the CFO, is to produce or prepare “glossy quality accounts” which they did proceed to do.

Then 16 February is perhaps a more interesting entry because this is the board itself, and if we go to that document, please. So this is February 2010, and under the heading "Financial" – I should show you what we're in. If you scroll up to the top of the document you'll see we're in a minute of a board meeting held 16 February 2010, and then if we go back to the third page, please, and third dash point: "It was noted that the board required a schedule of all cash movements with relevant dates…" So that is the genesis of a cash flow register we looked at earlier today, and the genesis of that in turn was further request for money out from Richina, or Mr Yan just organising it, one or both.

Then you see the next dash point, reference to the board needing a full understanding between the respective boards so that directors are aware of their obligations.

Then under "Mainzeal Accounts", which was the main reason to come here, we see first sentence: "Mainzeal needs to present accounts to confirm financial strength for various project related submissions." So that's why – I think the consensus at the trial was that Mainzeal wasn't required to produce its own accounts even though it was this – well, that was the consensus, but it did so anyway and here's why, and then I'll just let your Honours read –

WILLIAM YOUNG J:
Well, it would have to. Don't – I mean they would prepare accounts in the ordinary course of affairs.

MR O'BRIEN QC:
Sorry, publish, ie, make them available at the Companies Office.

WILLIAM YOUNG J:
Yes.

MR O'BRIEN QC:

And wouldn't have needed necessarily to audit them.

WILLIAM YOUNG J:

So these accounts were on the Companies Office file?

MR O'BRIEN QC:

Yes, I – no, they're not. So they were presented to –

WILLIAM YOUNG J:

To those who were interested?

MR O'BRIEN QC:

– selected counterparties. Mr Gomm, in his evidence and cross-examination, said that it was selective, ie, they would do it sometimes, wouldn't do it at other times, but the board here is saying they need to present them for various project-related submissions and they go on to say – well, you'll see it there. They require them to win new work, especially in the case of larger projects, and the question is how they are to be presented.

So if we go back to the chronology and just cast an eye back up to what preceded this. You see the CFO note saying, questioning: "How do we present the financial position to the numerous and various parties who request information?" So there's really no doubt about this. Counterparties are seeking information. Exactly who, we don't know.

Then I didn't take you to – I should have taken you to this but in my – I won't go back to it but in my chronology you see on the top of the next page, still on 16 Feb, there's a question in the board paper's about whose overall duty is it to make sure the New Zealand division is operating while solvent? They were going to seek a briefing from Richard Yan on this. Your Honours may think that's a curious question for the directors but if we went back to the charter we would see that RPL had limited the powers of the board but, with respect, that didn't limit the board's duties. It was always its duty to make sure the

company was solvent. Early 2010 after the restructure they're starting to focus on this.

O'REGAN J:
Are you going to take us to the charter?

MR O'BRIEN QC:
I can do, your Honour. Yes, I will.

O'REGAN J:
Was the charter continuing to apply throughout the whole period?

MR O'BRIEN QC:
Well, that became a question. So it certainly applied – it presupposed that Richina Pacific was the parent and therefore it applied until Richina Pacific was no longer the parent and thereafter it seems to have become something of a question, not necessarily focused on exactly, but there was a focus on, well, who's responsible for what now, and we're just about to see that. Well, we've just seen the beginnings of it. But in fact the charter can't have really applied because it was a Richina Pacific document.

But yes, I will take you to it, and probably, now in here, in this document, I've only got a draft of it, so if I go to the submissions, I think it is at footnote 7 of the submission, please, and that'll give us a link to it. It's quite a longish document. I'll just take your Honours, if I may, to some of the parts. So if I take you to page – well, obviously, page 1 tells us its for Mainzeal. The introductory bullet points tell us that Mainzeal is a Richina subsidiary, and then over the page, second bullet point: "Nothing in this Charter document should operate to cause the directors of Richina Pacific, or any of its subsidiaries, to act in breach of any company constitution or the statutes of its place of registration, nor to limit the liability of appointed directors arising from any such breach." So I just pause to note to say, well, regardless of what this goes on to say, the directors are left with their responsibilities, legal at least.

Then if we go down to paragraph 6, which is on page 402, 6.2: "The shareholder may at any time exercise any of the powers which would otherwise fall to be exercised by the board," and so on, and then a comment and under the comment, second paragraph, RPL will consider amendment to the constitutions if appropriate to ensure all appropriate governance powers for the appointed board are established.

But probably the key next paragraph is on page 403 where we see "Authorities" and you will see there that RPL's carving out quite a lot of power to itself.

WILLIAM YOUNG J:
Did this have the effect of making the RPL board members directors of Mainzeal?

MR O'BRIEN QC:
Probably, your Honour. I think so.

WINKELMANN CJ:
Yes, it would have. But one assumes that that was not pursued because of the restructuring and because things changed over time?

MR O'BRIEN QC:
Yes, your Honour.

WINKELMANN CJ:
I thought that when I was reading through it. They do seem to be shadow directors.

MR O'BRIEN QC:
Early on I would say for sure, yes, and in part that's why we submit, say, and the Court's accepted, that things changed after the restructuring because if one was fully analysing the position before then as a director one might come to the conclusion that not only did one have an onshore parent listed with

reputation at stake but that board of that parent had effectively taken control of, for example, loan accounts, dividends and loan accounts. Well, there were dividends, but loan accounts –

WILLIAM YOUNG J:
Business transactions?

MR O'BRIEN QC:
Pardon, Sir?

WILLIAM YOUNG J:
And business transactions?

MR O'BRIEN QC:
Yes.

WILLIAM YOUNG J:
Which is quite a big carve out for company.

MR O'BRIEN QC:
Yes, huge. Which is a nice segue back to where we were in the chronology because at about this time we were looking at in 2010, early 2010, the Mainzeal board is starting to wonder where they are and, as I said, under the 16 February heading at the top of that page, they were saying: "Well, whose overall duty is it to make sure the division's operating while solvent…?" And we'll see the answer to that later this year and it's UR, so by that point I say the charge is out the window. So 19 Feb 2010, emails between Dame Jenny and John Walker: "re above issues," and there was no immediate response, but I will take you to that document please, Mr Leggat, thank you. So, it's an email and if you scroll down the chain, we come to one from Dame Jenny, dated 19 February, and it's going to Mr Walker, copy to Mr Yan. It deals with a number of things, but you get the gist of it from the second paragraph, what it's going to deal with and it says: "At a recent board meeting for Mainzeal NZ a number of important governance and management issues

were raised," and she gets on to that. "Cash Flow", there's a concern that money is going out and that they're not controlling it and in the second paragraph she says: "The preference is to maintain a minimum cash balance on the Mainzeal balance sheet." And "Cash Movements", similar thing. I won't go through all this with you. I'll let your Honours look at it later, if you wish, but "Mainzeal Accounts", again you see, the same thing: "Mainzeal has an on-going need to present accounts to confirm financial strength for various project related submissions," so there's just no doubt about this point, that's why they were producing them. And then she goes on to say: "We seek the boards guidance on what accounts can be presented given Mainzeal is now a subsidiary of Richina BVI Limited, yet as I understand it we still enjoy the support of RPL for Bonding purposes," and so on. And then, next paragraph, you know, a question raised in the third line about how they're presented to the market. And then under the heading "Richina Bonding", second paragraph, first line, this question about solvency duties.

And Mr Walker's response, if we scroll up the chain, 20 February: "Thanks for setting out these important governance and management issues. The RPL board will work with Richard, Peter, Reegan et cetera to address them," and he says: "They will be in Auckland at the end of March, we should meet then." And then if you scroll up, we're moving through the time period here a bit, but you'll see Mr Pearce writing to Dame Jenny, the third paragraph, a request for 500K cash from Richina and Dame Jenny just saying: "Leave it to me." That's all in there. So that's the request. And as I say, there was no immediate substantive answer. Mr Walker did respond, as you've seen, but not in substance, that comes in August. And your Honour asked me about that and we'll get there and I'll take you to it.

WINKELMANN CJ:

That's where he basically says: "It's your responsibility"?

MR O'BRIEN QC:

Yes. So, just before we go there, I probably don't need to take you to anything here, but if we go to 6 May 2010, there's further emails. So Dame

Jenny chasing up saying that: “EY are coming to do their audit and they will focus their audit on the likelihood of MLG funds being returned to Mainzeal and whether related party issues are properly documented.” And then concluding on 18 May, so same email chain, “and that the issues do pose risks to Richard, the company and the directors.” Well, indeed, they do, but I might comment that what’s surprising is there’s no mention of the parties who might ultimately bear the loss, or at least immediately bear the loss, and that is the creditors.

So we could go into that document, or we probably don’t need to, your Honours, but it’s there, and an interesting follow-up. So Dame Jenny seeking answers and then in May. Now I will come back to this, but in May you’ll see the letter of support is now from Richina (NZ) LP, but I’ll come back to it shortly. And allied to that, under that 31 May heading, and I’ll come back to that, there’s a letter of representation from the Mainzeal directors, Mr Yan signing it, but on their behalf to Ernst & Young re loan recoverability saying: “There’s sufficient likelihood of recovery so that a provision is not necessary.” So it’s not Ernst & Young telling the directors that, that’s the directors telling Ernst & Young.

And then July we see a similar thing going on within RGREL and then 12 August, and there’s a request for $1.2 million advance and Mr Yan saying, you know: “Cash is managed on a centralised basis.” And then 13 August, this begins another, is another trigger for the response we’re about to see, Dame Jenny expressing concern to Mr Walker and Mr Yan. Likewise, Mr Tilby and Mr Yan coming back saying: “Well, you don’t need to worry because Mainzeal operates under a shareholder guarantee. There’s no issue of independent director liability, Mainzeal’s not an independent company,” so we should go to that.

WINKELMANN CJ:

What date is that one – 13 August.

MR O'BRIEN QC:

Sorry, yes, and there's a chain, and if we can scroll to the bottom we'll see the catalyst for the chain is Richina's requested an additional 1.2 million from Mainzeal, so it's right down the bottom. Just commenting if I might, your Honour, on your Honour Justice Winkelman's comment that it's quite normal for groups to operate on a centralised Treasury basis. Well, your Honour, maybe, but usually that's with money coming from the parent to the subsidiaries, whereas here the money was usually going from the subsidiary to the parent, that's one example. So that triggers a concern, not necessarily because it's so abnormal, as we've seen, but it just triggers a concern. So that goes to all the directors and Mr Yan responds on 12 August and you'll see that there, managing everything "on a centralised basis", and then if we go up to Friday the 13th from Dame Jenny to Richard Yan, Reegan Pearce, Clive Tilby, Peter Gomm, copy to John Walker: "I am very concerned by this request," and then next paragraph: "The Board has asked on a number of occasions for the matter to be clarified as to accountability," second line: "As you know, as Mainzeal directors we are responsible for the contracts we sign and our ongoing ability to meet our obligations to fund those contracts." And then the next paragraph: "While I note your desire to run a central treasury function for the New Zealand interests, it is unreasonable to ask Mainzeal directors to approve the associated related party transfers without a clear understanding if we are liable for those decisions," and so on.

Then Mr Tilby chimes in on the same day, that's the one, underlined in pink, and then Mr Yan responds on the 13th, and I won't go through this but essentially says – it's summarised in the chronology. And interestingly, the penultimate paragraph, he's saying operations "are centralised" and "against the same equity and cash which Richina as a group has plenty of", well, maybe, but they're still asking for money fairly regularly, as we saw from the cash flow register, asking for and/or extracting, and in any event otherwise saying the shareholders are "on the hook for everything". Well, the independent directors then had the perfect opportunity to try and achieve exactly that and they didn't, and it was plainly wrong because there was no guarantee, they were just assurances from time to time and, according to the

directors, regularly. Mr Maier, interestingly, asks: "Well, why do you need regular assurances? Surely you should just get one and make it binding –

WINKELMANN CJ:
And wrong about no issue of independent director liability of course.

MR O'BRIEN QC:
Yes, well, completely wrong, your Honour. But obviously wrong. But if it wasn't obvious then, it soon was. So, 16 August –

WINKELMANN CJ:
Well, do you say anything about that? Because this is the man that they say they're all standing on.

MR O'BRIEN QC:
What do we say, your Honour?

WINKELMANN CJ:
Do you say anything about his completely wrong characterisation of the legal obligations of the directors in this context given –

MR O'BRIEN QC:
We say that that, your Honour, is a factor which the Court should have front and centre of its mind when it's assessing compensation, and particularly culpability, yes. Now if he didn't understand the right position then, which I doubt, he certainly did shortly thereafter, if we go to the 26th August 2010 entry. But incidentally, your Honour, we also say the independent directors, the other directors, should have been well and truly alive to this. That's their role. That's why they are there.

O'REGAN J:
They didn't take any legal advice at this stage?

MR O'BRIEN QC:

No, although, no, they did later but, you know, a year later when they went to Mr Arthur at Chapman Tripp. But there is, as we will see, some advice from a Mr Frank Chan who was primarily Mr Yan's lawyer, but there was some advice to the board. I will come to that. I can't recall the form of it, but the gist of it was to get the, I think it was essentially to ensure that this was properly documented, that the assurances were properly documented, which they didn't do.

So 26 August, so this is Mr Walker's email and I have summarised the key points there, but it is better to go and look at the document itself please. So, I should say, your Honours, just in case you are curious as to why it took something like six months for Mr Walker to respond, we don't know for sure what the answer to that is, but we do know that Mr Walker and Mr Yan said that they were very busy and they were working on a Richina prospective acquisition of AIG assets in Asia and that was occupying their attention.

So, if we go through this, we go down under group structure, that's nothing in there that your Honours don't know. Then we get to a heading "approved protocol for intercompany fund transfers" and this is a response to the concern about money just coming in and out without the Mainzeal directors having adequate control.

Then if we go over the page, there is a proposition which was being put by Mr Walker. He said: "Well, we are going to pass these resolutions at the audit committee meeting of Richina Holdings." I will just let your Honours read them. So essentially: "In any calendar year we will take out up to 3 million, take out up to 3 million with the approval of the Mainzeal board." And then: "For transactions above that," this is very curious, "but for transactions above that, we will have to get the prior authorisation of the audit committee." Now that's the Richina audit committee not the Mainzeal audit committee because there wasn't one, so that's hardly satisfactory but not really a focus.

O'REGAN J:

That seems to be –

MR O'BRIEN QC:

Bizarre, your Honour?

O'REGAN J:

Upside down.

MR O'BRIEN QC:

Yes.

O'REGAN J:

Nobody suggested it was an error?

MR O'BRIEN QC:

No.

O'REGAN J:

That he didn't mean it the other way round?

MR O'BRIEN QC:

It should have been. Yes, no –

O'REGAN J:

So he's saying we need approval for small advances but not big ones?

MR O'BRIEN QC:

Well, it seems to say that your Honour, yes. We didn't really pursue it because it didn't become a particular, because remember, after this stage, well money kept going out of Mainzeal until 2012 when it was coming in, so it didn't become, that wasn't a major issue. But yes, it is quite odd and more to the point, it wasn't pursued by the directors.

Now, last and not least, we have down the bottom of page 2 the heading "reporting expectations of the Richina Holdings board" and Mr Walker then saying that they expect the board to be reporting, Mainzeal board to be reporting to the Richina Holdings board and so on, but the last sentence is the critical one: "However, we believe that it is the role and responsibility of the Mainzeal board to make going concern, solvency and similar determinations with respect to Mainzeal."

Now, yes, that is a sentence tucked away on page 2, but remember, the purpose, the central purpose of the inquiry which led to this letter, or one of the central purposes, was the question of who had responsible for Mainzeal's solvency. So you couldn't miss this if you're a director of Mainzeal, or you certainly shouldn't miss it, because there's the answer to the question you asked.

So we submit by this stage the charter is out the window. It's not operating. It's not operating because Richina Pacific is no longer the parent, it's no longer onshore, no longer listed, got a different structure with a different parent and the group parent, if it's properly called a group, is saying: "You Mainzeal directors are responsible for the solvency of the company."

O'REGAN J:
But at the same time what we're saying, you don't have the decision-making power to ensure the solvency occurs because the group can take money out without you knowing.

MR O'BRIEN QC:
Well, there may have been an error in that, we don't know, your Honour, but it was saying they wouldn't take money out without Mainzeal directors' approval at least up to 3 million.

So that's 26 August and that is a pivotal moment, we say. You'll see what else is going on about this time from the chronology. The CFO identifying the need to strengthen the balance sheet by – it does "CFO"; I think it should be

"CEO" – but at any rate, by repayment of balances or equity build-up, and then ongoing leaky building claims, we see in the next note, with legal costs at unsustainable levels, and then a critical KPI to replace work consumed with new work, but that was a regular given.

Then October MPC board meeting. Governance issued discussed and with an agreement that they would try to get them resolved before Christmas, but we don't see a great deal of follow-up on that. We see some.

Then 27 October, John Walker provides to Dame Jenny and Richard Yan a series of draft resolutions re financial support undertakings from RGREL to MPC and by MPC that followed the delisting, and then, curiously, saying: "The concept of independent directorship has become irrelevant." So we're back to that. But these are never signed as far as we know. Well, they weren't signed. There's no evidence they were signed.

But what did get signed, if I could jump back to – actually, if I could –

WINKELMANN CJ:
So when you say from RGREL to MPC, it's not – that's that some were but not CHC?

MR O'BRIEN QC:
Not CHC. But let me take –

WINKELMANN CJ:
This is RGREL which is the –

MR O'BRIEN QC:
Yes. I'll take your Honour through this. It's a bit…

WINKELMANN CJ:
Because wasn't the RGREL one actually signed?

MR O'BRIEN QC:

Yes. But perhaps not that one, but yes. So…

WINKELMANN CJ:

You don't need to take us to the detail. You can give us a broad brush outline unless there's a lot in it because the point is, isn't it, that some were but not – but they were all on that, to use, I think, in my own defence, it was Mr Hodder's expression first, on the right-hand side of the wiring diagram?

MR O'BRIEN QC:

Yes, yes. So the letter of comfort came from the right-hand side of the wiring diagram. In fact, I would suggest the concept of or the description of that as a letter of comfort is, whilst the usual description, is actually in this case completely inapt. It's actually a letter of discomfort or it should have been.

But if I could ask your Honours to jump into paragraph 3.29 of the written submission. So you'll see there, first sentence, in connection with the 2010 audit of the 2009 financial statements, a letter of support, well, we say, was expected from Richina Pacific. But to put that in context, that's what Mr Reegan Pearce expected at least as a possibility and if we go to the footnoted email, it's 30(a), this is really the beginning of the story.

So, 27 April – this date by the way I should say is not in the chronology, I don't know why, I just left it out, but it's not there, or we left it out, but in any event it's quite important. So he's writing to Mr Yan, copy to May Kwan, saying: "Of the eight outstanding audit issues I can deal with six. The first two however I need an update on being, one, parent company support. Will this be RPL or Richina Holdings BVI Limited? I assume probably the former, as this is the only company that has a balance sheet substantially different and more substantial than Mainzeal's. Number 2, recoverability of related party balances," and then Mr Yan replies saying, you'll see it there on both: "I will have a discussion with Ernst Young direct and let's decide when that needs to take place, Richard," and then – well, it's signed off "Richard", sorry, and then Reegan Pearce sending this chain on to Dame Jenny saying: "This is fairly

much the standing response I get on any issues I raise these days, ie, leave it to me." So what then happened is that the – well, first up the audit support letter came, as you know, from the right-hand side of the wiring diagram, and that's at footnote 39, so we'll just go there because I know – oh, perhaps we did go there yesterday but I'll go there again. So that's it there. Richina (NZ) LP letterhead addressed to the directors of both RGREL and Mainzeal, and I think are also separate letters, but in any event this one's enough, and you'll see, second bullet point from the bottom, that it's, well, it's in the usual audit sort of form, and then second bullet point from the bottom we have Richina (NZ) LP accepting responsibility of providing and undertaking to provide sufficient financial assistance to RGREL and Mainzeal as and when needed, et cetera, and it's for a minimum of 12 months and it's signed off by Mr Yan, and my learned friend Mr Hodder would submit or did submit that the directors of Mainzeal took that to be a letter from Mr Yan or would take that to be a letter from Mr Yan consistently with his assurances as being on behalf of the group. Well, with respect, plainly it's not. Plainly it's from who it says it's from, Richina (NZ) LP and signed off by Mr Yan as the director of the general partner of that limited partnership.

WINKELMANN CJ:

I'm a little bit confused about the directors' position. If their position was that they thought they had an undertaking from CHC, the presumably the position is that they were relying on the undertaking from CHC.

MR O'BRIEN QC:

But there wasn't one, your Honour, there just wasn't one. Dame Jenny explained, and the other directors explained, they were relying on Mr Yan's assurance that there was, that the group would support Mainzeal, but there wasn't after 2009, or in 2009 and after 2009 there was no comfort letter from the parent, well, not even the parent then, from the left-hand side, from the money.

WINKELMANN CJ:

Because why I'm saying it's confusing is they, were they saying: "I relied on this undertaking that we had from the ultimate parent with the assets because we had a letter, but in any case even if we didn't Mr Yan told us we could stand on him"?

MR O'BRIEN QC:

That's about it, yes: "Mr Yan told us that the group would support the company but, and we got a letter signed by Mr Yan." But the problems with this are, well, actually, Mr Yan was telling you pretty clearly from 2004 to 2009, if you were reading the tea leaves, that you would get support so long as you were profitable, and he was also telling you, if you were reading the tea leaves, that the loans that had been made by the company were to companies that couldn't repay and, therefore, the support was critical. Then in 2009, when Mr Pearce suggested maybe the audit support letter should come from Richina Pacific, because that's the only company with a decent balance sheet, what emerges? An audit support letter from the New Zealand division which had no money above and beyond – or nothing of substance above and beyond Mainzeal. So, if they were paying attention, as they should have been, they should have been really concerned by this.

Now, your Honours, if I go back to, well, perhaps actually, could I ask you, Mr Leggat, to go to tab 28 of the index? Now, your Honours haven't seen this before. So this is a memorandum that was filed during the course of the trial on 25 October 2018 and it concerns the audit support letters and one of the reasons why it was filed is that because of the formatting of the electronic discovery, it wasn't terribly clear which draft audit support letters went with which emails. And there was a suggestion from Mr Walker and Mr Yan and Dame Jenny that there were audit support letters, or letters of support from the CHC or from Richina Pacific Limited, just as your Honour's have been asking. So those witnesses, those directors, or in Mr Walker's case, that chairman, suggested that there had been support letters executed in favour of Mainzeal from either Richina Pacific or the CHC, but in fact there's none in the record. There's none, and none of them could produce any and his Honour

Justice Cooke, having seen everything, concluded that they were never signed.

WINKELMANN CJ:
And that's not challenged now, so.

MR O'BRIEN QC:
It's not challenged.

WINKELMANN CJ:
No.

MR O'BRIEN QC:
But even in the Court of Appeal I notice in the judgment their Honours say: "It appears that, it appears that." Well, in part the answer is in this memorandum which, I don't think we ever, well I know we never took the Court of Appeal to this memorandum, I don't think. Because there was no particular need, because it wasn't challenged, but there are still echoes of uncertainty and your Honour Justice Winkelmann is not alone in wondering what the heck was going on. So the memorandum partly answers it. So if we could have a look at it please?

The next page, the body of it. So, it's a bit complication but I will try and be brief. So on 5 October 2010, paragraph 1 explains that we've reviewed the discovery platform although, signing the memo had. Paragraph 2: "On 5 October 2010, May Kwan circulated to John Walker and Richard Yan copies of draft RGREL and CHC undertakings of financial support and associated board resolutions." Then: "Later on 27 October 2010, Mr Walker sent," well it probably says "only sent" but it should really say: "sent Dame Jenny, Mr Yan and Mr Mathai-Davis copies 'only' of the RGREL undertaking of financial support and the associated board resolutions." So a draft letter of support coming from CHC went to John Walker and Richard Yan and what emerged was just one from RGREL.

WINKELMANN CJ:
What paragraph are you at in that memorandum?

MR O'BRIAN QC:
2 and 3.

WINKELMANN CJ:
Right, great, thanks.

MR O'BRIAN QC:
And then paragraph 4 explains that: "The 'parent' email from Ms Kwan to Mr Walker is annexed, marked 1, two documents attached and the first one is subject line 'financial support – RGRE'. Three documents, a draft RGREL financial support undertaking to Mainzeal and then next one a draft Mainzeal board resolution. Over the page please, Mr Leggat and the third one a draft RGREL board resolution and then next at (b) financial support CHC and the documents were a draft CHC financial support resolution information RGREL and a draft board resolution to go with it and a draft RGREL and then 5 tells us, from memory, what emerged and what emerged is notable for the absence of anything from the CHC.

So, could you just scroll up slightly Mr Leggat? So the draft CHC financial support resolution is at (b)(i). It is marked 1(b)(i). Could you take us to that please, Mr Leggat? Page 047 it should be. Possibly one more. Yeah, and so there you see it Richina Pacific (China) Investments Ltd support letter addressed to RGRE with the CHC accepting responsibility and undertaking to provide support.

WILLIAM YOUNG J:
So, what did Mr Walker say about this?

MR O'BRIEN QC:
He said he thought it was signed, but it wasn't. The judge found it wasn't and there's no challenge and we spent quite a bit of time on this.

WILLIAM YOUNG J:

So, did he say why, did he send, which email, just going back to the emails, did he send the final email?

MR O'BRIEN QC:

Can you take us back to the emails? Yes.

WILLIAM YOUNG J:

So, what, if he sent that email, why did he think it was signed, you don't know?

MR O'BRIEN QC:

Well, he was just suffering a memory lapse in my humble submission, your Honour.

WINKELMANN CJ:

But this went to the board, didn't it, of which company?

MR O'BRIEN QC:

RPL.

WINKELMANN CJ:

RPL.

MR O'BRIEN QC:

Well, or CHC. It went up the chain.

WINKELMANN CJ:

But there's no note, and there is no note of any CHC undertaking, so we can be confident then.

WILLIAM YOUNG J:

But he sent, he has sent the final version to – oh I see.

WINKELMANN CJ:

But not of CHC.

MR O'BRIEN QC:

So what you can be confident of, in my submission, your Honour, first, as the High Court and the Court of Appeal found, there is no support letter from CHC and you can also be confident, in my submission, that it was considered and from that we can be confident it was decided not to. But none of the witnesses necessarily accepted that because they thought it had been signed, or so they said.

WINKELMANN CJ:

But Dame Jenny did not see it was not, a draft CHC one was not sent to her?

MR O'BRIEN QC:

I don't think so, no, your Honour.

WINKELMANN CJ:

According to your memorandum.

MR O'BRIEN QC:

According to our memorandum, but my proposition, indeed, the obvious proposition about all of this is that having been told by Mr Walker in August 2010 and before that having been alive to the obvious fact of the restructure and the fact that the $13.5 million hadn't come into RGRE, your immediate parent, and the fact that you don't have enforceable loans, or recoverable loans, and all of the serious issues which they face, they must have been alive to the fact that: "Oh, we really now need some demonstration of support," at the very least from the companies with the money. So when they got an audit letter from Richina (NZ) LP, that should have been alarming. So, as I say, I wouldn't describe it as a letter of comfort. I would describe it as a letter of discomfort and they didn't do anything.

O'REGAN J:
So, did Dame Jenny say in evidence that she thought the loans were in fact subject to a letter of comfort from CHC?

MR O'BRIEN QC:
Not exactly. She, broadly, without – I mean she said a lot of things but the central point of her evidence was that they were – she acknowledged that Mainzeal was absolutely reliant from a balance sheet perspective on support from the parent, and by the "parent" she meant Richina Pacific or the CHC and she said in respect of these audit letters when these issues were raised about whether the CHC, proposed CHC audit letter had ever been signed or come to her attention, she said she thought it had been. But no one could point to one. There wasn't one. But more broadly her evidence was that she was assured on numerous occasions by Richard Yan in particular and by John Walker that support was available for Mainzeal.

But she acknowledged, as one had to, that there was no legally binding commitment from Richina Pacific or from any other company in the group with money and there was no security and so the loans were unsecured and Mr –

O'REGAN J:
But more to the point here there was also absolutely nothing at all from Richina Pacific and CHC. There wasn't even a letter of comfort.

MR O'BRIEN QC:
Nothing, and it was deliberate. His Honour, Justice Cooke, found this. We spent a lot of time on this. The structure was deliberate. It wasn't an accident. It wasn't an accident that the money got lent to MLG. There was some suggestion that it may have been channelled through MLG for tax purposes but that may or may not have been right, but it was a deliberate structure and the money went to – most of the money, not all of it – went to a company, ie, MLG, with no funds whatsoever, and Dame Jenny was a director of that company so there's no question about the knowledge. They knew.

Dame Jenny was also a director of the Bank of China, you know, a typical bank that lends money out, not a verbal assurance of repayment, or not merely on a verbal assurance of repayment. So if your Honour is mildly astonished, may I suggest you wouldn't be alone.

So that's it from the letters of support. There's another one in 2011. It's in the –

WINKELMANN CJ:
Yes, well, Mr Hodder took us to those, I think.

MR O'BRIEN QC:
Yes, you don't need to see any more, your Honour. They're all in the same form.

Now just about this time we're at – well, I was at 27 October. I won't take you to all of those documents. It takes a while. 27 October, we're done.

12 November, email from Mr Pearce to Mr Walker saying he found the situation frightening, and there's some criticism in the submissions of my friends that, you know, we didn't call Mr Pearce and we didn't put that to him, and we did put it to Mr Yan and Mr Walker and they tended to play it down somewhat, particularly Mr Yan, and we didn't call Mr Pearce but nor did the directors.

WILLIAM YOUNG J:
So Mr Pearce's role was what? Was he…

MR O'BRIEN QC:
Chief financial officer, Sir.

WILLIAM YOUNG J:
But never a director?

MR O'BRIEN QC:
Never a director.

O'REGAN J:
Of Mainzeal or something further up the chain?

MR O'BRIEN QC:
He was CFO of Mainzeal. He may have been CFO of RGRE but I don't think so. I think he was just CEO of Mainzeal, big enough job.

Then Mr Walker in November telling Dame Jenny and Mr Pearce that he'd told Richard Yan of the importance of addressing governance issues in November. Well, that's interesting. So here we should look at this. In the second cell a set of board papers for the 19 November board meeting. Amongst them is a white paper on governance and I think, Mr Leggat, it's that one, yes. We should look at that.

So this is a paper written by we know not who but either Mr Gomm or Mr Pearce or both. So having received the Walker email, the board is obviously thinking about what to do about governance. I would suggest their thoughts were misplaced, but in any event they were going to get advice from Ernst and Young and they were focussed on this and this is their so-called white paper, and the reason I want to take your Honours to this, apart from letting you know this was going on, is down the bottom this page, paragraph 4 – well, actually, we should look at the intro to it. So under the heading "Possible Mainzeal governance requirements" and then we just have these four numbered paragraphs, and the third one is: "Audited accounts of the New Zealand division to be completed in a timely manner," "and all NZ-related party companies (as defined…" that "Richina Global/Mainzeal transacts with to be audited annually. And then 4: "All available cash to be deposited with Mainzeal at half year and year end for window-dressing purposes," and we've seen or your Honours have seen that in practice.

So did the board say anything about this? There's nothing in the minutes. What did the directors say when this was put to them? Not much. "You'd have to speak to the authors of the report," I think was the answer. And what did they say about the fact that this cash was coming in and going out? They said that the accounts properly reflected the position at year end. I'm not seeking to be exact with these comments, your Honours, but I hope generally those are broadly a reasonable summary of what was said.

So, moving on, December 2010 the results we've looked at, so related party receivables now 44 million. 31 December again, we've covered that, that's the money out. January 2011, the EY corporate governance report, your Honours have seen that, I won't take you to it, even though it's important, very important, in the narrative of our claim, because we say that receipt of this report should have driven everything home to the directors. But at the same time we also say there's nothing in there they didn't know. They knew the loans were irrecoverable, they knew they weren't secured, they knew they needed support, et cetera, et cetera, so it was nothing new, and actually we also suggested it was a milk statement of the differences the company was facing, and there were a series of recommendations, including for example to set up a risk management, a risk committee, and an audit committee, and those things didn't happen, the directors say: "Well, we didn't really need it because we're a small board," although just by the time they crashed they were looking at at least having an audit committee.

So, February 2011, CEO noting the balance sheet's still subject to parental support letter, planning to strengthen through Chinese imported materials, that's what became the prepaid goods arrangement, and then recording – and this is a feature of every Board pack and so first time I've put it in here though, your Honours – the CFO reporting on new work won, it's at page 23, including RNZAF Ohakea at 30.8 million gross revenue and Bowen theatres at 12.4, and a suite of others. So did we put each and every one of these new contracts to the directors? No. But did we put to the directors that they were aware that the company was bidding for and winning new work? Yes, absolutely, and there's no question about that, that is what the company

was doing and in every Board meeting it's as you would expect, there's a report on it.

Now, 28 April 2011, financial support, again letter of comfort, we don't need to go to that. The second entry there, I'm not sure your Honours have been to one of those documents, but this is the representation letter, typical representation letter from the directors to Ernst & Young re the financial statements. I don't think you've been to one, so if I may just take you to that one. It's quite long. You will see it is on Mainzeal letterhead and importantly at the end of the first paragraph Mainzeal is defined as the company. Sometimes it's not on a Mainzeal letterhead. This one is. It makes it easier.

Then under the, if we scroll down please Mr Leggat, that's it under the heading "financial statements" you will see the sentence that begins: "We acknowledge, as directors of the company." So this is a letter from the Mainzeal directors and it's always in this form, although once or twice at least on another group company letterhead.

And then if we scroll down to the end of the document, oddly this one is not signed. It probably wasn't the best one to come to. But they are usually signed by Mr Yan and there's a heading "recovery of related party debtors" and there's a representation from the directors: "We consider there is sufficient likelihood of the recovery of the MLG, Richina Ltd, Richina Land Ltd, Richina Global Real Estate et cetera, debtor positions such that a provision against those balances is not considered necessary." So that happens each year.

WILLIAM YOUNG J:
And the leaky building provision, is that that they simply cover it by the legal costs over the following 12 months?

MR O'BRIEN QC:
Generally, oh, that's a good point, your Honour. Generally just legal cost, but sometimes I think other costs as well. Generally they would be trying to

achieve settlements whereby they performed the work themselves, so they weren't paying out cash to the claimant. But, in answer to your Honour's question, the better answer is they would provision just for the year ahead. So if they had a claim that came in, as they did around this time from Botany town centre, I think AMP, for about 38 million, they didn't assess the likely ultimate outcome of that and say: "Oh, we are probably going to be liable as best one can tell for $5 million worth of work. We will provision for the five million." They provisioned for what they thought they would have to spend in the next 12 months and that's all they ever did provisioning wise.

WILLIAM YOUNG J:
Was there no evidence as to whether that's an appropriate accounting treatment?

MR O'BRIEN QC:
I don't think there was, although his Honour Justice Cooke accepted that it was, or took the view that it was.

WINKELMANN CJ:
You didn't challenge it?

MR O'BRIEN QC:
I don't think we did really challenge it. Well, we did really. We said it was inadequate. It might be okay when you've got capital. It's not okay. So we did challenge it in this way it's absolutely not okay when you haven't got any capital and you're operating on the smell of an oily rag. It's too risky and we did challenge it –

WILLIAM YOUNG J:
You just challenged that as a matter of I suppose commercial judgment rather than accounting practice?

MR O'BRIEN QC:
Possibly, your Honour, and on that we had the expert directors who –

WINKELMANN CJ:

The point of this though is that the company is only able to carry on trading so long as it doesn't have qualifications to its accounts from the auditors and the fact they are not qualified is because the directors are certifying this?

MR O'BRIEN QC:

The directors are saying we've made adequate provisions. The directors are saying you don't need to impair the loans because we believe that they're recoverable.

GLAZEBROOK J:

Well that just wasn't right, was it?

MR O'BRIEN QC:

No.

GLAZEBROOK J:

So, they would have to have been saying that just on the basis of the letter of comfort, wouldn't they?

MR O'BRIEN QC:

Yes, yes.

GLAZEBROOK J:

Because otherwise it is just not true.

MR O'BRIEN QC:

I was about to qualify my no, your Honour. No, it wasn't right at all except as your Honour explains it. The only basis for saying that was the verbal assurance of support.

GLAZEBROOK J:

And you say "verbal" because the letter of comfort was one, not enforceable and two, worthless anyway, is that the submission, sorry?

MR O'BRIEN QC:

Yes, it is, and thirdly, we didn't actually see, they didn't see – just checking with my colleagues if I'm right about this, but as I recall there was no evidence that there was a letter of comfort in favour of the debtor, for example, except RGREL there was but that was from – so there were two debtors, two principal debtors. RGREL at this point had had a letter from Richina (NZ) LP, worthless, and there was MLG hopelessly insolvent and was there any letter of comfort in its favour? I think not that we are aware of, and none produced in evidence as I recall.

So ultimately goes back to the verbal assurances and, as your Honour said yesterday, does in this case pivot on the question of whether it was reasonable in the circumstances of this company to rely on a verbal assurance of support, undocumented, undefined, from companies with no immediate business in New Zealand? Answer, absolutely not. No.

WINKELMANN CJ:

So your submission is that these were improvident transactions absent good comfort, reasonable comfort, improvident transactions absent a reasonable basis to rely upon those, to rely upon the group's assets being available?

MR O'BRIEN QC:

Yes.

WINKELMANN CJ:

That's it, isn't it?

MR O'BRIEN QC:

And as per our pleading, either they should have fixed that at least by January 2011 or they should have stopped trading.

Now my friends always say that our case was solely focused on cessation of trading. I still respectfully say it wasn't and I go back to the pleading to say it wasn't; read the pleading. But it's fair in a way to say there was a great deal

of focus on a cessation of trading because that was the principle and complex model by which we were looking to establish loss, ie, net deterioration, but we also, fortunately, pled the new debt which your Honours – which some cases had approved, effectively, in the past but certainly your Honours did that in respect of 136 and the Debut Homes situation in the *Debut Homes* case. But we did not solely say they only had one option which was cease or continue. It was all of the options we saw in the pleading. Fix the problem or cease trading. On the cessation of trading –

WINKELMANN CJ:
It was fix the problem or resign, wasn't it?

MR O'BRIEN QC:
We never – we didn't plead that they ought to have resigned and there was some criticism of us and indeed his Honour, Justice Cooke, for focusing on resignation, but the idea of resignation emerged out of the expert evidence and, indeed, out of submission where the experts and we as counsel said, well, resignation was an option and it would have been a very good one, but it was only one of many. I mean they could have done all sorts of things at all sorts of times and particularly around the time of the restructuring and they just lost so many opportunities to –

WINKELMANN CJ:
Of course. Anyway, resignation is a passive/aggressive way of precipitating insolvency, isn't it, in this context?

MR O'BRIEN QC:
Well, it would have precipitated either insolvency or a work-out.

WINKELMANN CJ:
Well, it would've been an insolvency event for the purposes of the bank probably.

MR O'BRIEN QC:
Could've been, yes.

WINKELMANN CJ:
If all of the directors mass-resigned it'd be, probably would be some sort of insolvency event for the purposes of the banking documents anyway.

MR O'BRIEN QC:
I imagine, your Honour, yes. We never explored that but that's probably right.

So, your Honours, I'm going to skip – even though the chronology becomes in some respects increasingly interesting, you're probably increasingly familiar with it so I'm just going to skip through things more quickly again, although, having said that, your Honour, Justice Young, I think, pointed out we hadn't really been to a set of accounts so perhaps we should just do that quickly at 28 April 2011. So there's a set of accounts there. I'm not going to go through them in great detail but you see broadly what they look like at least. If we go to the balance sheet which is on page 090302, we see under "Total equity and liabilities", third line down, under "Non-current assets", a related party receivable which at this point is nothing but in 2009 was "3", and then under "Current assets" there are two entries. The fourth and the fifth ones down there are "intercompany receivables 14 million and related party receivables 30 million," so the 44 that we have referred to and then I won't go through all this, but if we go down to note 6, that explains the position to the extent it needs any explanation, although it doesn't really, but just your Honours get an idea of how to navigate for these points. So you see "related party transactions" and there's just a record there of what's owed and by whom.

Then if we continue down to the EY report, there is the emphasis of matter paragraph and that's on page 09312.

O'REGAN J:
Was there any evidence about what an emphasis of matter is in terms of accounting standards?

MR O'BRIEN QC:

Yes, there was from Mr Schubert and another expert whose name I, Mr Van Zijl, Professor Van Zijl, yes.

WINKELMANN CJ:

Van Zijl, is how you say it.

MR O'BRIEN QC:

Thank you, your Honour.

WILLIAM YOUNG J:

It emphasises something that is otherwise stated anyway. That is, that there is a going concern assumption.

MR O'BRIEN QC:

Yes.

WILLIAM YOUNG J:

It doesn't really relate directly to the recoverability of receivables treated as current assets though, does it?

MR O'BRIEN QC:

No, not really, although if we look at this one, I should have perhaps started at note 14, but they are drawing attention to note 14 which describes continued support of the shareholders.

WILLIAM YOUNG J:

What does note 14 say sorry?

MR O'BRIEN QC:

I will come to it. Well, let's go to it. It says: "That the considered view of the directors of Mainzeal is that after making due enquiry there is a reasonable expectation et cetera that the company has adequate resources to continue operating and that the shareholders of RGREL have undertaken to provide assistance, financial assistance, if necessary."

WINKELMANN CJ:

All the same, it seems unusual that the auditor didn't enquiry into because the shareholder didn't comment about the fact that RGREL was not an asset rich company.

MR O'BRIEN QC:

Well, the directors would say and particularly Dame Jenny would say that they had meetings with the auditors and the auditors provided them with a degree of comfort, but really, with respect, these accounts are pretty clear it's the directors making the representation. We see that in the representation letter and then Ernst & Young emphasising, putting emphasis. The evidence was that's what it is, it's just an emphasis of a particular matter and here it is that continued support would be available and that the statements have been prepared on a going concern basis, the validity of which depends upon that continued financial support. So it's really just emphasising that this financial support is critical in these financial statements.

O'REGAN J:

At least implicitly not qualifying the audit report means that the auditors are accepting that it is appropriate to treat it as a going concern in those circumstances.

MR O'BRIEN QC:

Well, I guess so, your Honour, but again, the auditors are reporting to the directors and the shareholders and here the directors and the shareholders know exactly what is going on.

O'REGAN J:

It all gets pretty circular at that point, doesn't it?

MR O'BRIEN QC:

It does, yes, it gets a bit circular.

WILLIAM YOUNG J:
But they're doing it obviously in this context for the purpose of the report being shown to other people.

MR O'BRIEN QC:
Yes and they're drawing attention to it. But the fact of the matter is when you read these accounts, you wouldn't get, you wouldn't actually get, a decent view of what's really going on. You would not realise that the related party receivables were not recoverable without this financial support. So you see that financial support is critical to the financial statements but what you don't see is that it's critical to recoverability of the major assets and you don't see that the shareholders who have assured financial support actually can't provide it, or can't provide any of substance.

But I go back to the point these are the company's accounts, these are directors' accounts, they're signing off on them, they're approving them, they're making the representations on which these are based and we see that on page 1 – one down, that's it – where they're signed off. Sorry, it's perhaps not page 1 – yes, it is. So they're confirming that they are authorising the financial statements.

Now if the directors wanted to join the auditors they could have, but they didn't. They would say we could have joined them. We didn't. But we say, well, we didn't need to. Claim's not against them. Claim's – how would the company sustain a claim against the auditors when the company had all the information that you don't see and that is critical in the papers? In any event, regardless of that, the liquidators made their claim against the directors.

So, your Honours, I'm just going to whizz through some more. So perhaps I could take you through – again this chronology is giving you all the hyperlinks and references that you might need, mostly linked to the Court of Appeal judgment. There's some additional material in there.

If you look, for example, at 29 August you will see again that this is just typical board meeting notes showing involvement in bidding for significant projects. This is in August 2011. A CFO report recording a "must-win focus" is required on new projects, including MIT. So "we must win it". Now that one we certainly did put to Mr Yan and he proudly announced or told us that he had actually won that contract. So he certainly knew about that. But in fact, as other directors confirmed, they knew about not necessarily the words of each contract, not the contract document, but they knew about the contracts that the company was entering into.

30 September is interesting. I would take you there if we had – but I don't need to, but I think this is a reasonable record summary. CEO report noting a soft market, head winds having a material effect on the business; major set-back on the F&P project; MIT still a "must win"; King Façade growth pains dealing with offshore partner; legacy issues continuing with new claims also continuing – slight typo there; serious cash flow issues with daily monitoring and very tight cash flow for the foreseeable future; a competitive market with reduction of gross margin for three years; and so on. It's not exactly a pretty picture at September 2011.

Then on we go. The story is much the same.

If we jump through to 24 February 2012, this is in the judgment though, you'll see the entry into the MIT contract.

29 February 2012, the much vaunted prepaid goods arrangement. How is that going? Well, it's only been in place two months. Actually, I should have drawn that to your Honours' attention. That gets signed off 31 December 2011, and that's in the chronology. So how did that work? There's a very short summary in the chronology but if I look just at that first entry on 31 December 2011 MLG, which was, you'll recall, a debtor, acknowledges a debt of 33 owed to Mainzeal, they agree that it will be repaid in 10 years subject to profitability, interest in no longer accruing, and then Mainzeal assigns that debt then in that condition to the CHC, and I don't think

we've got it in here but the other leg of the transaction, well, it's up the top actually, first part –

WINKELMANN CJ:
So this is a debt that's already passed due but has not been called up?

MR O'BRIEN QC:
Mhm.

WINKELMANN CJ:
And it's been compromised in this way because it's actually, they're accepting a lesser sum?

MR O'BRIEN QC:
Yes.

WINKELMANN CJ:
Right.

MR O'BRIEN QC:
Not a very good deal.

WILLIAM YOUNG J:
Was this one of the, treated as a current asset in the accounts?

MR O'BRIEN QC:
Well, it should – I think it was.

WINKELMANN CJ:
Yes, it was.

MR O'BRIEN QC:
Yes, it was a current asset. You'll recall we saw it in the second segment.

WILLIAM YOUNG J:

And was the current asset in the accounts that were produced at the beginning of 2012? Was it treated as a current asset in the accounts…

MR O'BRIEN QC:

As at December '11, yes. Well, as at – sorry, no, but the time we get the accounts for the year ending December '11 it's morphed into the prepaid goods arrangement.

WILLIAM YOUNG J:

Okay, right.

MR O'BRIEN QC:

So the debt gets compromised, as your Honour put it, in this way, and then in the first leg of, or the other leg of the transaction, which we've got in the first part of this 31 December cell, MPC enters into this prepaid goods arrangement, also called a forward purchase agreement, with the CHC for the supply of building materials with an estimated value of 33.

So, Mainzeal gave up its interest-producing or interest-accumulating receivable in favour of an agreement with the CHC that the CHC would provide materials over a period of three I think years to a value of 33 million. Not sure how that value was estimated, not sure whether it was a good value or a bad value, but anyway that was the deal. Unlawful, as it happens, unenforceable.

WINKELMANN CJ:

So the agreement to supply building materials, was that, it was over 10 years subject to…

MR O'BRIEN QC:

No, your Honour, over…

WINKELMANN CJ:

No.

WILLIAM YOUNG J:

Three years.

WINKELMANN CJ:

Okay, three years.

MR O'BRIEN QC:

Three, I think.

WILLIAM YOUNG J:

You'll show us how that's accounted for in the general, in the accounts to 31 December?

MR O'BRIEN QC:

I will, your Honour. So, if we go to – "I will" I said confidently, and yet I'm not sure where we've got these financial statements. I'll find them for you though.

WILLIAM YOUNG J:

Well, it will be with the audit report, won't it?

MR O'BRIEN QC:

Yes, 18 March, Mr Mullins tells me – May. So if we scroll through to 18 May we see the financial statements, and if we go to the balance sheet, which should be on page 958…

WILLIAM YOUNG J:

Prepaid building materials.

MR O'BRIEN QC:

Prepaid materials 22 million. And there's another entry for it under "Current assets", which is "Prepaid building materials 11 million". So they're accounted for as assets, 11 million currently receivable within the next 12 months and the

rest receivable over time, and then note 6 will give us more detail about that, and then it just gives you an explanation about that, to some extent, down the bottom, “Prepaid building materials”. So it’s treated as payments in advance, well, hmm.

WILLIAM YOUNG J:
How much, well, I suppose it’s another story, but how much in building materials were supplied in the last year?

MR O'BRIEN QC:
Someone is whispering about 6 million. I think that’s right. In the 2012 year, about 6–8 million.

WILLIAM YOUNG J:
So that’s in addition to the 8 million net that was paid back?

MR O'BRIEN QC:
Yes, yes, it is, although with it came a suite of problems.

WILLIAM YOUNG J:
Yes, I understand that.

MR O'BRIEN QC:
Which had an estimated negative value of about 10 million. Mr Gomm explained them as, well, he wasn’t happy about them, but explained them I think as teething problems and bedding down new business difficulties, that sort of thing.

So, now while we are here on that topic, can I give your Honours, I will take your Honours to it. It will just take me a second to find it. I will take you to the evidence about the prepaid, about the legality of the arrangement. So if we go please to the index and we go to the evidence first of all of Mr Cao and I think he is tab 19. I think he is tab 19. So he is called for the directors and if we go into his evidence please at 54, paragraph 54 and you just see here

conclusions. In 54(d), oh, I have got (d), 54(4): “The arrangements in relation to the agreement and forward purchase agreement between CHC and MPC were not enforceable for lack of clear ground in PRC law (including SAFE regulations) and indeed such arrangement was not allowed in practice.” So, in effect saying it is unenforceable. Why is it unenforceable? Because it doesn’t comply with PRC law so it’s unlawful. So that’s the evidence of the expert called for the directors, or by the directors I should say.

And if we go into the evidence of Mr He. Yes, that’s it, thank you, tab 10, and if you go to paragraph 7 and just blow that up. So: “Between 2004 and 2005, MPC advanced funds to enable the acquisition et cetera. Some of the MLG loans fell due.” It must be paragraph 11. Oh, it is of the reply, sorry. Thank you. We’re in the wrong document.

Yes, so according to paragraph 51 of Mr Cao’s brief, he reached a similar conclusion with my initial brief. So we haven’t seen that, but it’s there, that the forward purchase agreement would likely be in breach of SAFE regulations even though Mr Cao had a slightly different rationale.

And then paragraph 11 which I think Mr Mullins took you to, wasn’t sure how CHC managed to conquer the practical difficulties in self-payment et cetera. Understand it wasn’t the actual exporter and so on. But he, as Mr Mullins pointed out, Mr He is saying that export would generally be in compliance with relevant SAFE regulations. That’s the export of goods, but that’s kind of beside the point because the agreement is unenforceable and unlawful, so it had even less value then it may have been intended to have, but I go back to my opening point, well, it was never anything as good as cash. Nothing like cash, nowhere near as good, likely to be problematic, was problematic and effectively an admission of a longstanding difficulty, i.e., irrecoverability. Is that a convenient time, your Honour?

WINKELMANN CJ:

Yes. How are we going for time Mr O'Brien QC?

MR O'BRIEN QC:

Pretty good. I'm going to finish up on the facts within I think 30 minutes tomorrow morning and get onto some law and I think 30, but let's say an hour, no longer, and then get onto legal issues and then hand over to Mr Kennedy. We will certainly be done by close of play tomorrow, if not before if that's okay?

WINKELMANN CJ:

Yes, that will be good because I should say, and I haven't told my colleagues, we need to finish by 3 o'clock on Friday because I have to –

MR O'BRIEN QC:

Well, I'm sure that's very good news to everyone on this side of the Bar, your Honour. I can't speak for your colleagues.

WINKELMANN CJ:

There's a Law Society webinar I have to present.

COURT ADJOURNS: 4.00 PM

COURT RESUMES ON THURSDAY 10 MARCH 2022 AT 10.02 AM

MR O'BRIEN QC:

Good morning your Honours. Yesterday we left off at 31 December 2011, and in particular the prepaid goods arrangement. Your Honours asked, or one of your Honours asked what volume of goods was delivered under that arrangement. To answer that, can I take you please to the joint memorandum regarding cash flows, which is at tab 10, and in there to paragraph 18, and there we find the answer in really beginning the third sentence. So it said there: "The cashflow register records that Mainzeal was also provided with almost $8 million of building materials from July 2010," so that pre-dates the agreement, "to March 2012 (in addition to the cash payments), and Mr Bethell's evidence was that Mainzeal received $6.1 million of building materials in 2012 alone." This was obviously a paragraph drafted by the appellants, but I don't think there's any quibble with the figures and Mr Bethell, of course, is one of the liquidators. Then it goes on to say: "These building materials were funded by SBLCs obtained by the Richina group from 2011 onwards." I'm not exactly sure about the 2010 arrangements.

But in any event, your Honours, if we could then turn the page, or scroll down please thank you, to schedule A, you'll see that register of cash flows, which we looked at yesterday, with annotations on it, and if you keep scrolling down please Mr Leggat, to the foot of that page we see the goods paid for in China on account. So this is the goods supplied during the period stated there. So from 1 July 2010 onwards. On my calculations, and your Honours will see it's at least roughly correct by just casting an eye down it. In 2010 some $2.4 million of goods were supplied. Query how exactly how they were valued, but anyway recorded in the books was 2.4 million of goods supplied. Then in 2011 it was 2.9. So we get to a running total at the end of 2011, you'll see it out to the right, of 5.3 million, and that's before the prepaid goods arrangement actually formally kicked in. Now of course the appellants say this was real value being delivered to the company. Well yes it was, to a degree, but it came with handicaps. But in any event can I just ask

your Honours to take a note of this and then I'll take you to the figures. But if we look at schedule 4 to our submission, which is also one of the appendixes to the judgment, thank you Mr Leggat, you'll see there that in 2010, if we cast our eye down to the finance income row, which is just below operating profit, you'll see that the finance income, meaning interest accruing, was 2.799 in 2010, and 3.077 in 2011. So a total of 5.8.

WINKELMANN CJ:
That's down the second half of it, is it, finance income?

MR O'BRIEN QC:
Yes your Honour.

GLAZEBROOK J:
Okay, the finance income, that's right, I remember from yesterday.

MR O'BRIEN QC:
Yes, so just below that line, which both Mr Hodder and I took you to of operating profit. So the finance income is essentially interest on the debt owed to Mainzeal on the receivable. So we see again 2010, more or less eight million and 2011, more or less three million. So a total of 5.8. So if you recall my reference to how much had been delivered by the end of 2011, in terms of prepaid goods, it was 5.3 million. So the short point is, sure, goods came in in 2010/2011, but they didn't even quite match the interest that was accumulating on the debt that the group owed, broadly speaking, to Mainzeal. So put in context there's still a net negative flow interest accumulating is more than the value of goods supplied in those two years.

2012, of course everything changes. There's $6.1 million of goods delivered that year. That's in the joint memorandum at paragraph 18, which I just took you to, and there's not much accumulating by way of interest that year, but that's because, as your Honours saw yesterday, interest ceased to accrue on the debt. In fact the debt was assigned over to the CHC by way of payment for debts to be delivered over a period of three years.

So just a couple more things on this prepaid goods arrangement, could we go, please, to a report, it's not in the chronology, I call it a viability report, or it calls itself that, and it's at, I'll have to give you the number for this Mr Leggat, it's 324.14404. Thank you, and if you could just blow this up, and just have a look at the heading. So this is, I'm not exactly sure of the date of this, it's not dated, but it's plainly late 2012 or early 2013, it's the group business plan for 2013 to 2015 and it's a viability report to the board and PwC and the BNZ Credit Committee, and you'll see it begins by noting, could you just make that a little bigger, thank you, major losses in 2012 depleting working capital requiring significant shareholder and banking support, and a litany of difficulties.

Then in about the fifth paragraph down you'll see reference to over-run cost due to the non-performance of the King Façade JV partner from China. So that's the supplier of the prepaid goods.

If we scroll down, please, to page 14408 you'll see "Key Issue Legacy Tail and King Façade" and just beginning: "King Façade entered 2012 on the basis that the design, procurement and labour installation would be undertaken by King Façade China (KFC)," and all the costs would be to the account of that joint venture partner and budgets were set accordingly.

Then the third bullet point which I submit is significant. Well, it's all significant, this in particular. "It became clear during the first quarter of 2012," so not the last, the first quarter, "that KFC were not going to undertake the role as required by Mainzeal and King Façade New Zealand," and then goes on to say design was undertaken in New Zealand and it lists out problems and solutions that were put in place.

I'll leave your Honours to look at that just briefly and then take you to the final paragraph on this page which we could do now because it's really the key. So, the culmination of all of these delays is that during the course of 2012 Mainzeal incurred costs in excess of 10 million "which we are now seeking to

recover from our JV partner". So that was the net effect of the prepaid goods arrangement in the course of 2012, a cost to the company in excess of 10 million.

Mr Gomm said in his evidence, I won't give you a reference but it's in the submissions somewhere, he said that it was likely to take three to five years to bed this down, which we say was one of the problems with the prepaid good arrangement and, indeed, one of the problems with new business initiatives generally.

Now on that could I take your Honours to the joint expert report? Now if we go to the index, I'm not sure if your Honours want to know this or not, but if we go to the index it's right towards the very end and if you come up just a page. So your Honours will see there on the screen that the second cell down we have the joint expert report of the Court governance experts and then the third cell down we have the joint expert report of the financial experts, but the documents have been mixed up and in fact the document numbered out to the right finishing 00015 said to be the financial experts report is in fact the governance report, so if we could go there, please, and if we could go to item 6, please.

Actually, your Honours, I'm not sure you've been into this, so this is the report of Maier, Burt and Westlake and if we just have a look at the index to it, please. Table 1. You'll see they address in this report the following issues and you'll see what the issues are.

I'll just let your Honours read them and then I'll just show you then how it works by taking you to item 6 which is prepaid goods which is on page 26. So they jointly agreed – and the report on each topic is in this format: they have joint comments and then they have Burt and Maier comments and then Westlake comments – and you'll see they all agreed it was meant to be helpful and reduce uncertainty but wasn't as desirable as cash, obviously, required to supply materials when and as needed that were of adequate quality and from offshore or overseas, and then the Maier comments – I'll just

let your Honours read them – and then Mr Westlake. And so, your Honours, basically better than nothing but not nearly as good as the cash that should have been paid that was owed, was taken out of the company and not returned.

WINKELMANN CJ:
So this read – what's the format here? Because is Mr Westlake necessarily disagreeing with the earlier statements by Messrs Burt and Maier?

MR O'BRIEN QC:
I think to a degree, your Honour, yes, I think it would be fair to say, I don't think he's specifically disagreeing in this instance. Sometimes with these formats he is but in this instance it doesn't look like he's specifically disagreeing, he's just adding a comment, I would say. He probably is disagreeing with point 5 though, because he maintains in other parts of this report – you really have to read it all – but he mains in other parts of this report that support was coming in from the group, and that was his basis for saying it was okay to trade on but in fact, as we've seen, the support wasn't coming in, it was going out. It came in occasionally but the net net was it went out.

Actually, while we're in here, your Honours, I didn't mean to go here right now but we probably should because we're in this document, if we go to item – in fact I'll just quickly run your Honours through it, if you go to item 1, which is the charter, you'll see they all agreed, we needn't linger on that except as you wish, but you'll see their conclusion at 6, still left the directors with the responsibility of looking after the interests, the subsidiary's interests, i.e. Mainzeal's, and then item 2, leaky buildings. General agreement on this basically getting worse, certainly through to 2011, the board never got to the bottom of the problem, management never sufficiently explained why it was getting worse, leaky building claims became a material and toxic factor, increasingly so, and then over time legal claims jeopardised profitability of the whole business, and then comments from Burt and Maier, and Mr Westlake saying that in terms of quantum by 2011 it was reducing, in fact we say, well,

that's just not right, and if you look at the board papers you see that because in fact the expenditure on the claims was increasing and in a couple of significant claims at least came in in 2011/2012.

And then Issue 3. I won't dwell on this, but in a nutshell they all thought there ought to be a better focus on audit and risk committees and Maier and Burt especially were very critical of the fact the there was no risk committee, they say that's a standard for a Board of a company of this size and it should have been in place. And Mr Westlake says, well, it wouldn't have "materially affected the decision to continue trading" and: "At times the board was looking for firmer assurance from Richard Yan or the parent," as was Dame Jennie.

And then the next one, possibly the most important one, enforceability of support. Now they refer to a letter of support existing, I'm not sure what they're referring to, I think it's the audit letters or audit letters, the letter in each year, "unenforceable", "absolutely critical" or the support was. Burt and Maier: directors should have taken steps to push it and test it. Flow of funds was negative, not positive. Emphasis of matter meant the enforceability of the letter was pivotal. Then Westlake: board didn't see the letter as enforceable but it provided significant comfort and assurance, and the evidence of support came in the substantive matter of group funds flowing to Mainzeal over an extended period. Well, with respect, he's just wrong about that.

Then issue 5, weight to be given to the reports. That's the Project Citron and governance reports. I won't dwell on that issue. Your Honours have seen those.

Then prepaid goods, 6, we've seen that.

Then 7, reasonableness of reliance on forecasting, and broadly they're critical, Mr Westlake less so. He says they could reasonably rely on trends of historic results – well, with respect, that wasn't very good – and the trend showed improving normalised earnings. Well, terribly minor if that's correct.

Then next, item 8. Now it's a long one. "Certainty of loss versus probability". So this is really do you accept a certainty of loss by cessation of trading if need be or do you carry on, and I'll just let your Honours cast an eye over that.

WILLIAM YOUNG J:
What's "all projected profitability has capitalised interest factored in"? These are the projections that include interest on the inter-company advances.

MR O'BRIEN QC:
Yes, which wasn't being paid. Well, in 2010, 2011, one might say some of it was or most of it was being paid effectively by goods coming in but that's as good as it ever got. It certainly was never paid as it should have been in cash.

Now your Honours there's one more we should go to. Next page, please, Mr Leggat. It's just the tail-end of that, nothing of consequence but – and then two more issues just so you know they're here, or three, but we needn't really look at them. Issue 9 was an issue about board capability and size.

Issue 10 was this issue about group and subsidiary. We should perhaps look at that. They all say it was part of a group of companies and there was a two-way traffic of funds but with the net balance owed to Mainzeal rising over the period. Burt and Maier: couldn't rely on the group; increasingly unreasonable to rely; no ability to take comfort unless properly testing; accepting a letter from an entity with no real substance wasn't enough; two-way traffic of funds didn't help Mainzeal on a net basis. Then Mr Westlake: "Board was justified in relying on group support"; and then he says two-way flow of funds "over an extended period showed that there were funds going to Mainzeal and therefore support was demonstrated. This as well as Richard Yan's expressions of support gave the directors a reasonable expectation that this support was likely to continue and that the group also had the substance to provide the…support." Well, again, with respect, the net flow was out not in. So and then last item 11, they address

the question of whether the letter from Mr Yan came as a surprise, and they disagree on that.

With that, your Honours, I'll go back to the chronology in a minute, but while we're on this topic, could I take you please to Mr Westlake's evidence in final, it's sufficient just to go to his brief, and that's at tab 20 of the index, and if we go please to paragraph 33, and to orientate we probably should go up to 28, and he addresses what he calls "The First issue: January 2011 – cease trading, or not?" And I, again, ask your Honours to remember we never suggested that was the only option, but was certainly the right option if the problems couldn't be fixed, and he says. No, wouldn't have ceased, and then he carries on, I won't read all this, but if we go to 33, this is of interest. I'll let your Honours read that. When your Honours are ready we'll just turn the page, scroll down, and just pause there. So just summing that up, terrible position in the end of December 2010, which he describes, and he says normally, of course, this would be a totally unacceptable position, but he then goes on to say, but given the support from the group it was okay and he refers to, or he doesn't use the word "okay" but he, in effect, and he refers to the register of cash flows and the frequent two-way payments. Well, again, I took your Honours through that. It's money mostly out not in. Sure, money's coming in, especially on the balance date, it makes the accounts look good, but net, it's out, until the last year.

Then 37, so just to state what it says there. "If it had been a stand-alone company, and I submit it, in effect – well, no, I'll leave that, but we've been over that, but if it were a stand-alone company "… the balance sheet position I have described above would have been intolerable…" and in our submission, and as the Courts below have found it was intolerable.

So with that could I take your Honours back to the chronology, and I'm just going to take a fairly quick trip through 2012, obviously a critical year but after the established breach date of course. So you'll see 24 February, that's a date that's known. The MIT contract, which Mr Yan and others had described

as a must win, and then February you'll see the CEO reporting further King Façade systemic delays and that cash flow was "a major issue".

Just pausing there, so they knew early on, not late, early, that this was a problem, in fact they knew it from 2009 when they were importing Façade materials from China and using them at Baradene College and it didn't go well.

Then you'll see there they're still involved in bidding for contracts, that just carried constantly, it had to, otherwise the music would stop and everything would come crashing down, and then the CFO recording new work won, including MIT and the Kapiti Aquatic Centre and so on. I won't take your Honours to that, but we've noted that right through the chronology, that's just a regular feature.

Then the report on 2011 and look ahead for 2021 noting "negative movements" since the December board meeting. So it's early in the year and things are not looking too good.

Then April 2012 Sir Paul Collins joins the board, 18 April, another letter of support from Richina (NZ) LP, we don't need to see it, same form as what you have seen, in fact I think you've seen that one as well. And then 26 April 2021 Sir Paul, been on the board for all of 24 days, observes that Mainzeal needs "significant cash injection" and he says in an ideal world 20 million. Perhaps we'll just go quickly to look at that, and his email is, we've got to go up one, yes, well, sorry, at the foot of the page there you'll see, it's the email from him to Reegan Pearce, copy, well, he's probably writing to them all, but Jenny Shipley, Clive Tilby, Richard Yan, Peter Gomm, and it begins: "Some comments from someone new to the situation," fourth paragraph, "the construction industry is not my area of expertise", "the current strategic plan looks sensible and, given a fair wind, achievable, *but* it does require adequate capitalisation to achieve", so right away pointing out the obvious. And then he goes on: "To me there are a number of key points," and first point: "Is any funding available from China and, if so, how much? In a perfect world this

should be 20 million," and he goes on. And then "Response", which I'm sure is his, he says: "Richard, what is achievable? To me this is pretty critical and should be a specific number if possible," and on the email continues, we don't need really to look at the rest of it.

So if I go back to the chronology, 27 April, how are we travelling? Badly. Mr Yan advises Dame Jenny that "for each of the past five years and only three months in we are another 1.5 million down from the budge we only approved in February!" exclamation mark, "everything boils down to operational performance only". I haven't got the fully quote there, but he's talking about the intro to the quoted part is that they haven't achieved budget for each of the past five years, and we saw that in the graph that Mr Apps produced.

And then the CFO looking for money, 22 May EY report on a group restructure, 23 May, and in the fourth line of our chronology you'll see we're just noting the KFL delay issue is now circa a $3.3 million loss problem, so again they didn't have to wait for year end.

And then moving down, 27 June, last comment in here, I won't take you to it but this is the CFO report. Actually, it's board minutes, I'm sorry. Perhaps we should go there. Let's quickly go there. So it's 27 June, and you'll see under "Financial reports" which is on page 563. First dash point: "Solvency going forward 12 to 18 months – needs to be fully assessed." Well, it's nothing more than that but you see that the board is conscious of issues. But what are they doing about them? Well, we see that in the rest of the chronology but in this minute just noting it needs to be assessed.

If we go back to the chronology, we come to the 4 July email which Mr Hodder took you to where Sir Paul describes Mainzeal's position as precarious to say the least and Mr Hodder asks that that be seen in context. Well, indeed, we have been seeing the context and it is precarious to say the least.

Then 5 July he sends that further email to Mr Yan which you've also seen about Mr Yan having to give a personal guarantee and effectively seeking to reassure him, and contrasting his position with unsecureds and saying: "It's all the unsecured creditors who are seriously exposed." Now this is a critical date. This is the date that the Court of Appeal used to trigger its finding that any short-term obligations incurred after this date could not necessarily be met, were at high risk, and it's the date from which it has found that all unpaid obligations can form the basis for the compensation to be ordered.

WINKELMANN CJ:
Can you just remind – and that's on the basis that, what, Mr O'Brien? They say…

MR O'BRIEN QC:
The Court of Appeal?

WINKELMANN CJ:
Yes.

MR O'BRIEN QC:
They say by this date it must have been, not their words, your Honour, but blindingly obvious that –

WINKELMANN CJ:
On the wall?

MR O'BRIEN QC:
– that – well, more than on the wall. Up in neon. Lights on the wall – that the position of the unsecured creditors and new creditors in particular could not be assured. There was no reasonable grounds to believe that obligations entered into after this date could be met, and they used 31 January 2011 as the peg for long-term obligations. There was no reasonable basis to assume or reasonable grounds to assume that long-term obligations should be met and 5 July onwards, or 5 July 2012 onwards, short-term obligations, and we

support that finding. Why 5 July? Well, for all of the reasons we've been looking at, for all of the reasons I went through yesterday which the Court carefully works its way through.

Then if we turn the page in the chronology, we also see the minutes there with a reference to the Court of Appeal judgment as usual, or as we've done where there's a direct link, and to the minutes. So they say BNZ is going to provide a $12 million facility but it's temporary and the BNZ requires daily cash flow updates. That must have been an alarming sign. Larger creditors will need to be deferred to make, or to defer to make the numbers work. Very little tolerance, and Mr Yan reluctantly agrees to give a guarantee and a mortgage.

Then, and I don't think your Honours have been taken to this and I'm not sure it's referenced in the Court of Appeal judgment, but you'll see an email from him informing the board that Mainzeal is now exhausting its ability to fund outside China and the performance of the company limits the appetite and ability to fund. So if we have a look at that, please. It's just one email, and I'll just let your Honours read it.

WINKELMANN CJ:
What number is that? 321…

MR O'BRIEN QC:
321.12921, but it's linked there, your Honour, if that's helpful.

WINKELMANN CJ:
It's on the list, is it? Yes, I see it. Yes, thank you.

MR O'BRIEN QC:
So, we say, your Honour, a very clear signal, if any more signals were needed from Mr Yan that any on-going funding was, at best, very uncertain. And when I say "on-going funding", of course there hadn't been much at this point. Again, net out, not in.

WINKELMANN CJ:
What does that mean, "our ability to fund outside of China"?

MR O'BRIEN QC:
I think it means, your Honour, the ability to, well, it means one of two things, it means to fund out of, out of, from China, to outside or it means any cash that's available outside of China is limited. I don't think that point, question your Honour just asked was explored with him, but context I think makes it clear. There was always a difficulty getting funds out.

And if we then go back to the chronology, so, your Honours, just on this. Back to the chronology, thank you. So where in the, like, 5 July, in the first cell we've got a Court of Appeal reference number to a paragraph, in the second and third cells on this date we don't and it probably means that either the Court of Appeal hasn't specifically mentioned this document or we have failed to spot it.

But the next one, you see here, Mr Yan informing Mr Walker that Mainzeal's struggling and that BNZ may bail it out for another month "otherwise it's all over", so 5 July, let's have a look at that email. And you have to scroll to the bottom and it begins with Dame Jenny sending an email to Mr Walker on the 4th of July, saying: "Mainzeal's position is very serious." And then some friendly emails back and forth and then you come up please to one from Mr Walker on 5 July, yes, that's the one. And he says in his final paragraph: "I will paste below a message that I received recently from Richard." Then we see that pasted below: "Dear John," and that's Mr Yan: "We are struggling mightily with New Zealand right now – we have an unresolved dispute," et cetera: "Luckily BNZ head visited Shanghai with me so there's a chance they will bail us out once more month otherwise it is all over!!" And it concludes: "No good news I'm afraid."

GLAZEBROOK J:
So that went to Dame Jenny is that right?

MR O'BRIEN QC:

Yes.

GLAZEBROOK J:

That was pasted into the message back –

MR O'BRIEN QC:

Yes, via, not direct to her as far –

GLAZEBROOK J:

No, no, but that was the thinking.

WINKELMANN CJ:

Can we scroll back up to the beginning? If we go a little bit higher. Thank you.

MR O'BRIEN QC:

And then back to the chronology. So, 6 July, Mr Pearce recommending formal arrangements with Mr Yan, including no payment on monies out, 9 July Mr Yan emails – this is not in the Court of Appeal, again as far as we've seen, but of course they didn't go through every single email or document, well, not in the judgment I mean. 9 July, so, yes, let's have a look at that, and if we scroll to the bottom of the chain we'll see, yes, you've just got to go to the foot of the next page – or perhaps just take it from me. If you just stay on that page. So this is from Dame Jenny – we'll see that in a minute – to Reegan Pearce, Richard Yan, Clive Tilby, cash flow, and then the important bit is the response from Richard Yan, which is one page up, so 12940, that's it, so you'll see that's from him, and then it's: "Peter and Reegan, We are really pushing the edge of the envelope here as KFC/HK testing centre are also asking for payment, which will further drain the US dollars, not sure if we can hold them off at all. There is a limit on how much case we can send out from China as we are already missing payment for SRL," that's one of the other companies in the group, I think. And then, last paragraph, "we can't drag the whole group down".

Then if we just go up, 9 July, well, Dame Jenny replies, and then 9 July response from Mr Yan again saying: “Everyone must chip in and *not* just always relying on the shareholder,” well, of course they weren’t, or hadn't been. And then last but not least, from Dame Jenny to Richard Yan and the others and then noting in the second paragraph: “Please note the urgency of the appeal for action re cash,” et cetera.

So, back to the chronology. So you see here we are, early July, and they’re in a crisis, there’s no question about it. Now, Mr Chan, and your Honour Justice O’Regan this is the email I was referring to, I had another look at it last night, it’s not quite as I thought although more or less. So if we go to it, yes, and it begins on page 12951, and so it’s from Mr Frank Chan and it’s to the board and others, Mr Pearce, and he is responding to BNZ contract documents by the looks of it, and he says: “Thanks, May is checking the existing securities,” and then, second paragraph: “The Board must be satisfied as to the grounds upon which it is asked to give the two acknowledges,” that’s to BNZ, and the he goes on: “The first relates to special condition 1,” and at the end of that paragraph he says: “The Board will need to prudently seek written comfort from the shareholder,” so “written comfort from the shareholder”, “that shareholder funding of that amount will be available unconditionally on that date,” so this is when the BNZ needs to be repaid. And then the next paragraph or the next section, similar thing, and he concludes there again: “The Board will need to be comfortable with the expected basis of the financial case to be put forward and also consider and have in place alternative funding sources, including further shareholder funding, in the event BNZ does not give its approval. Again, written comfort she be sought.” So it’s not a general call to action to seek a written commitment for all of the loans, but that’s not what he was addressing, he’s just addressing the BNZ loans but one might have thought that that would have been yet another trigger, if another were needed, to try to correct the inadequacy of the support arrangements.

10 July 2012, back to the chronology, and it's another Sir Paul Collins' email and worth looking at. It's referred to in the judgment, I think quoted. It begins at the bottom of 957, please. So it's just Sir Paul Collins to Richard Yan: "Hi there Richard, I would have to say I'm at my wits end. I joined the board under the impression Mainzeal was solvent," and then he continues on and I won't go through it all but you'll see he asks, on page 1958 about six lines down, seven lines down, he says absolutely fundamental to get cash out and he says: "I am unsure where we now stand – are the funds available or not?" Well, what reply does he get? If we scroll up to 12957, he gets a reply that says: "Paul, I have no idea why you are saying this as nothing changed," et cetera.

The chain goes on. I won't go through it all with your Honours. There's reference to New Zealand House there. That's an intended hope for build of New Zealand House in Shanghai as I recall.

Now if we go back to 10 July. We've finished there. 25 July, Mr Yan noting the cash flow position is $10 million worse than the worst case scenario; that Richina is funding significant amounts in China through King Façade which has been a bottomless hole; and even without Siemens, Mainzeal would have run out of cash by now on its own. I won't take your Honour to it. There's just too many of these, but it's one crisis email to another. By this stage they do realise they're in a crisis but, with respect, the writing of that was on the wall as the Court of Appeal said back in early 2011 if not well before.

Then 1 August we have the CFO stating that Richina has signalled that the prepaid goods arrangement will not be available from 1 August 2012 due to Chinese regulatory change. So significant uncertainty by August but by now well too late.

But meanwhile, 1 August, the company is still involved in bidding for contracts, significant contracts, and winning work, and then we just carry on through August, similar things. I won't go to all of it, but 13 September is of interest, and you'll see there we say Sir Paul Collins notes to Richard Yan they were

lucky BNZ didn't pull the pin in August, and Mr Yan responds that KFL exports in China can be funded but they, Richina, can't find any bank willing to lend foreign cash due to Mainzeal's extremely poor financial results and the huge misses of budget and forecasts for the past two years. The China businesses have been drained of all cash possible for offshore use. "Still hoping," however, "to get lucky before we go under".

Perhaps we'll just go and have a quick look at that and that email is in the middle of that top page, thank you. That's it. Richard Yan to Paul Collins: "Hi, Paul." It's that second paragraph which is the first key paragraph, and then the penultimate paragraph: "I have continuous meetings with banks here and I'm still hoping to get lucky before we go under but Mainzeal also needs to do is part…" Then concluding: "Unfortunately there's no magic wand."

Then back to the chronology, please, and, your Honours, this just continues in a similar pattern with similar board meetings, increasingly frequent it seems, still bidding for work, still bidding for new work, still taking on new obligations, right through this part of the year.

November we see, 29 November, the PwC stage 1 report. I won't take you to that. It's detailed and lengthy but doesn't tell us anything of great significance which we haven't already covered.

Then November, end of November, 1 December, Sir Paul Collins advises they need specialist advice regarding solvency.

WINKELMANN CJ:
What is the 30 November 2012?

MR O'BRIEN QC:
I will have a look at that, your Honour, but from memory nothing much more than…

WINKELMANN CJ:
Is it saying people aren't being paid?

MR O'BRIEN QC:
Yes. Yes, it's overdues. So this is 30 November. It's at the bottom of page 14339. That's the one. He's referring to an email below but just saying, you know: "I'm getting increasingly…"

WINKELMANN CJ:
Is the point that they're not paying creditors on due date?

MR O'BRIEN QC:
That's right, your Honour, yes. They're still paying but they're not paying –

WINKELMANN CJ:
They're giving them the stretch, in the language…

MR O'BRIEN QC:
Yes. So if we go back to the chronology. Incidentally, you might recall, your Honour, from that payment graph we saw that even in July there was a significant body of creditors who were not paid on time. Now they weren't, you know, 90 days overdue but they were overdue. So they weren't paying their debts on time in July of this year. Well, not all of them.

Then they seek advice, but just before we get to the advice you'll see 1 December, Mr Yan, last cell in 1 December, saying BNZ wants Richina to have more "skin in the game" but it "can't, won't and shouldn't unless there's also demonstrated commitment and skin in the game from management and the team".

3 December, there's email advice from Michael Arthur at Chapman Tripp. That's covered well in the Court of Appeal judgment so I won't go there, although I don't think the Court of Appeal references the email; it references the advice subsequently given at the board meeting. But there's the email,

your Honours. I won't take you to it. It's not unexpected advice. We wouldn't necessarily agree with all of it, with great respect to Mr Arthur, but he's very – we wouldn't agree with all of it with the benefit of what we know. He was very new to it at that point and then that advice gets picked up at the next board meeting which is at 4 December, and the minutes set out a record of advice given but it's also in the Court of Appeal judgment.

8 December, still problems continue.

11 December, Richard Yan confirms no capacity to bring further cash from China before 20 December, but he's committed to pursuing a repatriation of capital in 2013 if regulations allow, Dame Jenny asks him to put that in writing, it doesn't happen in quite that way though. And then 20 December Sir Paul saying Mainzeal still needs 20 million, and on it goes.

22 January 2013, maybe worth a quick comment, well, actually 21 January. So in the second cell there Dame Jenny's advising the other Board members that Mr Yan has said he will not proceed with support for Mainzeal unless the BNZ waives the guarantee provision in its legal term sheet, that's for the next rollover or next facility, or existing facility, I'm not sure, but just it's clear enough he wants out of the guarantee, and she also comments that he said he'll withdraw support when he's least exposed in the monthly cycle. Then 22 January she speaks to progress regarding Richard and Tina Yan but they will withdraw support unless the guarantee is varied. Then 29 January, the fateful letter from Mr Yan recording his belief that Mainzeal and the group are no longer going concerns as the CHC was unable to provide the necessary assurances, and then we see something of a reverse position on the 31st, which my learned friend Mr Hodder has referred to. But it's not unequivocal support, never has been, never would have been. And then if we look at the RPL letter of support to Mainzeal, which is in the second cell there, you'll see it's a letter from Mr Walker, and if your Honours would, if you looked at more papers you'd see it's, you'd soon tell is his writing, his style, and he's saying there's a commitment of four million NZ and then six million NZ by June 2013, so not a commitment to repay all the money that's owed or to

unwind the prepaid goods and repay all the money, it's just, it's a commitment to put this much in. But you'll see – quite hard to follow it all – but about halfway through that paragraph there's a sentence beginning "This commitment" and you'll see it's conditional on effectively Chinese regulatory approval. And then in the paragraph further down the page, well, ,next paragraph: "In order for the board of RPL to provide such confirmation the board of RPL has requested that the board of Richina Pacific (China) Investments," so the CHC, "provide its assurance and –

WILLIAM YOUNG J:
Just pause there. Is Tina Wang Mr Yan's wife?

MR O'BRIEN QC:
Yes. Sometimes she's referred to as Tina Yan but, yes, Tina Wang.

And you'll see there in the final paragraph that the CHC, on which Mr Yan and his wife sit, amongst other, well, the board of, have agreed to authorise Mr Hui to provide such an assurance, but again "subject to the following conditions". And the first one is: "BNZ will provide sufficient accommodation," and the second one, (ii), just at the end of penultimate line there, that: "Mainzeal provides…its three-year business plan," and reasonably concluding that Mainzeal going forward will be "a viable and business and able to service its debts." So it is a turnaround from where we were two days before but it's still subject to conditions, including a commitment, a good faith commitment to and demonstration of future profitability. So that really – and then the BNZ weren't having that and it was placed into receivership in February 2013 and then into liquidation.

So that, your Honours, but for one thing, that finishes my overview of the facts and the linking to the judgment, but could I take you to our submission and just pick up one or two small things.

3.10, please. Now the appellants say that there were sufficient funds within China and within the Chinese entities to give the directors comfort. Well, we

certainly agree with the first part of that equation, ie, there were sufficient assets in China. We don't agree with the second, of course. But what was the position in China? So your Honours will recall the acquisition of Shanghai Leather Company back in 2004 and if I take you to the last line on this page of 3.10 we say: "At trial, Mr Yan was reluctant to put a number on the present value of that asset," and if we just carry on, please, over the page, "but accepted that the acquisition had been 'very profitable'." That's probably not quite the right way to put it. He told us it had been very profitable. That's in his brief. So the footnote there takes us to his brief.

Then in cross-examination he acknowledged that by reference to the last land sale effected by Richina Pacific, the value had increased about 145 times compared to the cost of the acquisition. So 145 times. That's not per cent; that's 145 times. So the acquisition of Shanghai Leather was initial acquisition for 90%. The cost was 20 million. You can find this in the cross-examination around this part of the notes. Then they acquired the further 10% for more. Exactly what the overall acquisition cost is, I'm not sure, but it's somewhere between 20 and US40 million, and Mr Yan told us that at least the last sale was 145 times cost. So massive increase in value.

I was trying to get him to put a number on it. I was suggesting, I think, probably wrongly, that it might be 700 million odd. I think it looks like it was much, much more than that and he wouldn't say, as the Judge notes, but he did volunteer that there had been this sale, and there's also evidence from Sir Paul Collins, known to him through the shareholding of his company, Active Equities Limited, and they've got 4.5% of Richina Pacific. He told us that Richina had recently sold a Shanghai property of 12 acres (of the total 140) for 350 million. So 10% roughly, less than, but let's say 10% of the entire land holding was sold for US350 million. His Honour, Justice Cooke, concluded, well, it's plainly – he said Mr Yan was very reluctant to put a figure on it but it's plainly a very valuable holding.

So were there assets available in China that could have covered the Mainzeal shortfall, that could have been made available, at least in value terms, to

repay the money that was extracted? Sure, easily. There was huge value in China by this stage. But could Mainzeal recover it? No, it couldn't, because the loans had been deliberately structured as loans to companies with no money. And had Richina profited handsomely from the acquisitions to which Mainzeal contributed, query what, but at least 10% in value? Yes it had.

So your Honours, I've gone a bit over my half hour to an hour that I estimated, but with that I am going to shift gear and move to legal issues, and I will use the submission, but I'll depart from it. So – just before I leave the facts, I should say to your Honours, we dealt with the facts in section 3 of the submission, but again in section 9 where we answer many of the appellants' contentions, but section 4 we start a discussion on the law. I'm not going to go through all this with your Honours, and in fact the law is much more – it's set out in a much better way in the Court of Appeal judgment and in your Honours, or in this Court's judgment in *Debut*. So I won't go through 4, I will come back to parts of it though.

You'll see at 4.4 we make what your Honours might consider an inadequate attempt at summarising key principles from the judgment in *Debut*, but the first one, of course, is that solvency is a vital and key value of the Act, and I won't go through all that.

But what I would do your Honours is draw your attention to 5.1/5.2. We there set out a very short summary of the history of the legislation, but in fact in our Court of Appeal – in fact there's a paragraph or two seem to have dropped out. Our Court of Appeal submissions on this were much more detailed but the Court of Appeal has picked it all up and set it out in really good detail at 238 onwards, and I would just like to go through some of this with your Honours.

So Court of Appeal judgment 238. So his Honour Justice Goddard there, writing for the Court, refers to the statutory beginnings with the green report, the 1926 Greene Report in England, which led, as he notes in 239, to the introduction of a prohibition against fraudulent trading in the Companies Act

1929 in England, and then next sentence: "New Zealand followed suit, enacting a corresponding prohibition on fraudulent trading as 268 of the Companies Act 1933." Then: "When the 1933 Act was replaced by the Companies Act 1955, that provision was carried forward as s 320," and it's there set out, and it's just at that stage remains a prohibition on fraudulent trading. That's the original 1955 Act.

WILLIAM YOUNG J:
It does really look as though it's a duty owed to creditors.

MR O'BRIEN QC:
Yes it does your Honour, yes, and four lines up, they can be made liable for all or any of the debts or other liabilities of the company, as the Court may direct. In fact that's my theme really, your Honour, that even though the Act very clearly says that the section 135 and 136 duties are owed to the company, they are plainly intended to be for the benefit of creditors, both existing and prospective, and we say that is, and as your Honours said in *Debut*, that therefore is how you must measure loss, at least in a situation like this case.

So just on that theme, if we look at paragraph 239 of the Court of Appeal judgment his Honour notes there that the particular concern identified by the Greene Report was the scenario where a person in control of a company holds a floating charge and, knowing that the company is on the verge of liquidation, fills up their security by means of goods obtained on credit and then appointments a receiver.

WINKELMANN CJ:
Was there anything made of the point that Mr Yan was appearing to consider his own interests in relation to the guarantee?

MR O'BRIEN QC:
Not…

WINKELMANN CJ:

Because you referred us to the part where he says he's going to choose the right moment and withdraw his…

MR O'BRIEN QC:

No, we didn't make much of that, your Honour, because we – I mean it was noted, but the focus of the liquidator's case was earlier, it was January 2011 and…

WINKELMANN CJ:

Yes, this is late two thousand and…

MR O'BRIEN QC:

This is the end.

WINKELMANN CJ:

Yes.

MR O'BRIEN QC:

And whether he did that, I can't recall whether it caused any particular loss, would be difficult to say, but our focus was elsewhere. But then again, all of these things come into account when the Court considers culpability, as, we say, do his other interests, including his significant shareholding in REH, which in turn has a significant shareholding in Richina Pacific. He is a beneficiary of what has happened here.

So, back to that Greene Report. Can I just make this point? So in that scenario with which the Greene Report was particularly concerned, what is the loss to the company? Well, none, if you view the company as a body of shareholders or as an entity devoid of the interests of its creditors, there's no loss. The loss is to the creditors, the loss is to the prospective creditors who have sold those goods which have filled up the floating charge. And so what then would be the purpose of the fraudulent trading provision if you were to measure loss on a net deterioration basis, as our friends would have it? Well,

there'd be no loss, none, or, as Professor Watts would have it, there'd be no loss, so what's the point? And, as your Honour Justice William Young just pointed out, it does look like either a duty to the creditors or a duty to the company, certainly so regarded under current legislation, but viewing the company at this point or the company's interests as synonymous with the creditors. So in my submission, your Honours, it has always been intended that loss can be ascertained through the lens of lost creditors.

And his Honour goes on to note at 240 it enabled targeted relief. His Honour goes on to note also that targeted relief has been provided in various cases and refers –

WINKELMANN CJ:
Well, can I just take you back to the concept about the company's interests is synonymous with the creditors? That's pretty much what Justice Cooke said in *Nicholson v Permakraft…*

MR O'BRIEN QC:
Lord Sumption says – yes.

WINKELMANN CJ:
Isn't it?

MR O'BRIEN QC:
Not really actually, your Honour, he…

WINKELMANN CJ:
What does he say?

MR O'BRIEN QC:
He said that when the company's insolvent or near insolvent – I'll come to the words a little later…

WINKELMANN CJ:

Yes, so someone has said it, it wasn't there then in…

MR O'BRIEN QC:

Lord Sumption in the *Bilta* case, and I'll take you to it, your Honour.

WINKELMANN CJ:

Right, thanks.

ELLEN FRANCE J:

And how does that fit in with that provision that was being discussed the other day at 301…

MR O'BRIEN QC:

Our current 301?

ELLEN FRANCE J:

Yes.

MR O'BRIEN QC:

Well, we say it leaves room, as indeed this Court found in *Debut*, to treat the losses to the creditors as losses to the company. Indeed, I think their Honours said, or your Honour Justice Glazebrook said – and forgive me for misquoting – but in one simple paragraph articulately said that the fact that 136 is focused on creditors suggests that Parliament intended that the loss be measured by the loss to the creditors and, with respect, that must be right, and it fits perfectly with statutory history. So if your Honour's asking whether 301 allows a judgment –

ELLEN FRANCE J:

Well, I was just wondering where you have the ability for the creditors to act?

MR O'BRIEN QC:

Yes. Well, they certainly can under 301 query, and I think your Honours queried in *Debut*. Whether that means they can get a judgment in their favour

under 136, we would submit yes, but in most insolvencies of course the liquidator, and particularly one like this where all the debts effectively are new bar any legacy claims, then the liquidator controls the proceeding in the normal way and most creditors can't fund the kind of litigation that's required. Perhaps now they could with litigation funding, but traditionally it's a liquidator's claim.

So, now the Court goes from there, your Honours, to 240, 241, I won't read through it, I'm sure your Honours have and/or will. But his Honour notes that in 241, over the page, that: "In 1962 the Jenkins Committee in England noted 'widespread criticism' of the English provision, which did not 'provide a sufficient deterrent to dissuade directors from continuing the business of a company which they know to be hopelessly insolvent'." Then 242, recommended legislation: "…should be extended to make directors and others who have carried on the business of the company in a reckless manner personally responsible", and that was then introduced by legislation in section 214 of the Insolvency Act, this is in 243, and then, as my friend Mr Mullins mentioned, in New Zealand it was the 1973 Macarthur Report "recommended enacting a provision in relation to reckless trading that followed the Australian model". The Australian model had followed the Jenkins report and that led to the amendment of section 320 in 1981 and the section with which your Honours will all be familiar, I am sure, as it was enacted in 1981 and set out there in paragraph 244, and that's probably the one your Honour the Chief Justice saw at law school.

WINKELMANN CJ:
Yes, it is. But it's not in the bundle of authorities, is it, it's…

MR O'BRIEN QC:
I don't think it is, your Honour, but it's here.

WINKELMANN CJ:
Yes.

MR O'BRIEN QC:

No, I don't think it is. But we could get it for you easily enough.

WINKELMANN CJ:

No, it's all right.

MR O'BRIEN QC:

In fact I, believe it or not, still have a copy of the Act somewhere.

WINKELMANN CJ:

Well, it's a good idea.

MR O'BRIEN QC:

And, as your Honours noted the other day, at the foot of (c) we see that wide remedial discretion left with the Court. And your Honour Justice Young, this was the section which you would have been, which you were operating under in the *South Pacific* case and, your Honour Justice Glazebrook, when that came before you on appeal this was the section that was the operative one at the time, despite the fact the case well and truly post-dated the introduction of the '93 Act.

WINKELMANN CJ:

And it's interesting actually that section 321 was added into, amended to add in "guilty of any negligence, default or breach of duty".

MR O'BRIEN QC:

Yes, which made it absolutely plain that it was capturing offences under 320, or breach of duty under 320 I should say. Not that it was necessarily needed, I would submit, but it was put in nonetheless.

So I don't have anything to have to add to that statutory history up to and including 1980, '81 and beyond until we get to the new Act, but over the page his Honour, or their Honours, note at 248 and on, that in parallel with these statutory developments, there were decisions of the Courts in New Zealand

and elsewhere which recognised the responsibility of directors to take account of the interests of creditors, and that began so far as – well, it's generally accepted that that that began with *Walker v Wimborne*. I would suggest it actually began with *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL). I'll come to that. But it's generally accepted it began with that decision of the High Court of Australia in *Walker v Wimborne*, and the quote there from his Honour, Justice Mason, is the one most frequently seen.

Then, your Honours, the next development recorded here – it wasn't quite the next development; I'll take you to that in a moment – but the next development in this part of the world anyway was *Nicholson v Permakraft* in 1986 and particularly his Honour, Justice Cooke's, decision and the well-quoted passage we see at 249. Things have moved on, though, because his Honour, Justice Cooke, did suggest there that it might not be so clear that there's a duty to prospective creditors, but that is well and truly established both as a matter of common law and, of course, under the statutory regime.

Then shortly after that a landmark New South Wales Court of Appeal decision in *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722 (CA) which endorsed what was said in *Walker v Wimborne* and in *Nicholson v Permakraft*.

Then his Honour then goes to, or the judgment here then goes to the Law Commission because the Law Commission, as we see in what's quoted here at page 251, the Law Commission noted at 220 that this is an area of law which has recently been considered in New Zealand and Australia in *Nicholson* and in *Kinsela* and "the draft Act is consistent with these cases but in so far as they may suggest that in cases of near insolvency creditors are owed and can enforce duties directly" the draft Act would depart.

So the draft Act, and the Law Commission wanted to make it clear that the duty was owed to the company and that it would be a company right to enforce, not creditors, but those provisions, as you know, weren't fully adopted, although I don't suggest, we don't suggest it's a duty to the creditors.

It's well established that it's a duty owed to the company. We simply say yes but in a case of insolvency that has to be viewed through the lens of the creditors and that is plainly what's intended.

Now, your Honours, can I take you – well, I won't right now because I see it's 11.29 but after the break what I would like to do is just take you through a longer, but not too long, journey through common law developments both before and, to some extent, after the passage of the 1993 legislation because there were more than just these cases of *Walker v Wimborne* and *Nicholson* and *Kinsela*. There were several other others, several other English authorities, and they've all been very nicely collected together in a recent English Court of Appeal judgment called *Sequana*, or *BTI v Sequana*, so I'll take you to that.

COURT ADJOURNS: 11.29 AM

COURT RESUMES: 11.47 AM

MR O'BRIEN QC:
Your Honour the Chief Justice, my friend Mullins has helpfully pointed out that the relevant parts of the 1955 Act as amended have been introduced into the bundle during, I think, the course of this week at tab 137.

WINKELMANN CJ:
Wonderful, thank you.

MR O'BRIEN QC:
And another one for you, your Honour, at 5.14 of our submission you'll see the quote from the *Jetivia v Bilta* case from Lord Sumption.

WINKELMANN CJ:
Yes.

MR O'BRIEN QC:

But I will go there anyway, or at least I'll go there via *Sequana.* So if I could take your Honours to that judgment, it's tab 66 of the bundle, and we don't have a report with a headnote, which I must say would have been helpful if we'd put that in, because the fact are, well, moderately complicated, and I'll just tell you –

WINKELMANN CJ:

Is it reported?

MR O'BRIEN QC:

Yes, it is, your Honour, and…

WINKELMANN CJ:

A strong preference for reported cases in the bundle.

MR O'BRIEN QC:

Yes, yes, and likewise counsel has one. [2019] 2 All ER 784. So, your Honours, this case – I'll just give you an indication of the facts. So a company called AWA – and it's not much point looking at the, we could find it all in here but I'll just give you an overview and if you look at the headnote you'll see it all in reasonably short form – but company called AWA had paid two dividends to its parent company, which was Sequana, one in December 2008 and the other in May 2009, at a point in time where it had stopped trading but it had one material set of liabilities left which were contingent indemnity liabilities in respect of clean-up costs and damages for river pollution in the US, and the claim again it for that pollution was underway and was scheduled to go to trial at some stage in the future when these dividends were paid out. Now the directors, properly, didn't ignore that suite of liabilities but they made an assessment with advice and expert input on what the likely outcome was, and then they paid dividends up to the parent leaving in the company what they thought would be adequate resources. Those resources were an insurance policy called for some reason, I forget, a Maris policy, M-A-R-I-S, with a cap of $250 million US, and then other historic

insurance policies and cash, and so the dividends were, as I say, intended to leave sufficient to meet the liabilities but they weren't adequate, as it turned out, and a suit was brought by the, well, I think by the liquidators, actually I've forgotten that.

But anyway, a suit was brought against the directors for really two, on two bases: one was in respect to the dividend on a statutory basis which was section 243 of the Companies Act, and the other, which is of more interest to us, is on the basis that the directors above and beyond the dividend regiment requirements owed duties to consider the interests of the creditors, and if there were a real risk that the payment would leave the company insolvent then liability would follow, and it's on that issue, that issue really revolved around what was to be regarded as the correct trigger for the imposition of the duty. Was it an actual insolvency or near insolvency, or was it sufficient, as the claimant argued, that there simply be a risk or a real risk of insolvency, and ultimately the Court of Appeal decided that there was no – the proper trigger is not real risk, the proper trigger is insolvency or near insolvency and not real risk. So we're not in that territory in my submission at all, we're actual insolvency and long-term trading. But this judgment's very useful because it works its way through the history of the common law, and I'll come back to that in a moment.

So at first instance the case was heard by Justice Rose, who issued what I think was called a "very comprehensive" judgment, and the claims in respect of the first dividend were dismissed and the claims in respect of the second dividend were partly allowed, they were allowed under the section 423 regime but not under the creditor interest duty, and that judgment was upheld on appeal except to the extent of part of the remedy, and the part of the remedy that was not upheld was concerned only with interest.

WINKELMANN CJ:

Can you just remind me what was that regime that it was upheld under? You referred to it by its section number. Is that the dividend regime or the directors' duties regime?

MR O'BRIEN QC:
Dividend regime, your Honour.

So with that intro I will take your Honours to, I think it's about paragraph 118, and you'll see a heading there "Breach of duty: the judgment below": "The Judge referred, as I will, to the relevant duty as 'the creditors' interest duty'," but just for your Honours' note it's helpful if we start this a little earlier up in paragraph 105 where you'll see the heading "Breach of duty: introduction" and you'll see: "BTI appeals against the dismissal of its claim that payment of the May dividend was authorised by the directors of AWA in breach of their duties as directors. Such duties were owed to AWA and, as mentioned above, AWA had assigned this claim to BTI which was substituted as claimant," and: "BTI submits that this claim lies even though the dividend was lawfully paid…and with no breach," and it goes on to explain, hopefully, what I've already explained.

Then at 108, BTI submits this duty arises at common law but, since the relevant parts of the Companies Act 2006 came into force, it arises under section 172(3) of the Act.

WINKELMANN CJ:
What do you say about, that's a point, isn't it, which is the Companies Act is not a code on directors' duties? The common law continues to apply.

MR O'BRIEN QC:
Yes. Well, yes, we do say that, your Honour, yes.

WINKELMANN CJ:
This case doesn't turn on that?

MR O'BRIEN QC:
This case we're looking at here doesn't and nor does ours, no.

WINKELMANN CJ:
No, no, this – yes, right.

MR O'BRIEN QC:
Well, in this case there was a code, well, sort of a codification. If you look down at 110 you will see what section 172 provides and it provides that a director must act in the way in which they consider to be in good faith and most likely to promote the success of the company, and so on, taking account of (amongst other things), and then it's set out, (a) to (f) there.

WINKELMANN CJ:
And it does refer to…

MR O'BRIEN QC:
It doesn't in those sections refer to creditors but curiously what they then do, they have subsection (3) which says: "The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company." So they have specifically preserved the common law and made section 172 subject to that. So that's how they have redesigned their regime from 2006 onwards, apparently after much debate.

The critical issue in this case was really not things that particularly concern us because it's all about the trigger of when the duty arises, does it arise when there's a real risk of insolvency, in which case BCI said the dividend ought not to have been paid to the extent it had been, or does it only arise where there is actual insolvency or near insolvency, and her Honour, Justice Rose, said the latter, and – well, her Honour, Justice Rose, as she then was; I think she is now the same Justice Rose who is on the Supreme Court – and their Honours in the Court of Appeal, or Lord Justices in the Court of Appeal, said the same. They upheld that finding. This judgment is given by Lord Justice David Richards and, as I say, he traverses, for the reasons already outlined, the history of the common law and referring to it, as I say, at 118 or, as he says, as "the creditors' interests duty".

If we then scroll down, please, to 124, we'll see just below that a heading "Breach of duty: the authorities" and he begins this by just having a – no, I won't go through it all but he looks at the statutory regime and limited liability and creditor protection through mechanisms such as prohibitions against dividends and insolvency and maintenance of capital and so on, and he says at 128: "This approach has never been considered a complete answer to the issue of protection of the interests of creditors. There has been statutory intervention in two main respects. First, insolvency legislation," and then half way through the paragraph: "Second, companies legislation," and then he gets onto, at 129: "Any recognition at common law that consideration of the interests of creditors could in certain circumstances be an element in the duties of directors is remarkably recent," and he begins then with *Walker v Wimborne*.

Can I just say, at this point your Honour, now Professor Peter Watts seizes on this, he seizes on this sentence because he, and he notes that yes, this is remarkably recent, and Professor Watts regards this as an aberration. He thinks the law has gone off the rails. Well, we respectfully disagree and, of course, the Court has respectively disagreed with him in the *Debut* judgment. He's been quite critical of that judgment as I'm sure you Honours know and as my friend has alluded to, he hasn't been so critical of the Mainzeal judgment, but that, I think your Honour, is possibly because he's actually an engaged consultant to the first appellant, Mr Yan, and has been for quite some time. I know this because I attended a seminar at which he told us this.

But in any event, is it really remarkably recent? Well, I'm not so sure because first, we've had that long statutory history from 1933 and following the Greene Report in 1926, but as long ago as *Salomon* we had Lord McNaughton noting that: "There was no liability on Mr Salomon for what he'd done because there was no fraud on the creditors and none of the creditors were misled." So, right from that pivotal company law case, there's been a recognition albeit it in that high-level form, that the interests of creditors can't simply be ignored.

Anyway, *Walker v Wimborne* and the Lord Justice goes through that quoting well-known passages, or well-quoted passages, I should say. Then at 133 he says: "The first appearance of a duty to have regard to the interests of creditors in the English authorities was in obiter dicta of Lord Justice Templeman in *Re Horsley & Weight Ltd*." In that case, a solvent company made a lump sum payment to a retiring director and there was a later claim alleging misfeasance, but the company at that time had not been insolvent, and then you see passages of the judgment at 134 and in the first paragraph, second sentence – well, I'll let you read it, your Honours.

So the short point, had the company been insolvent, a duty to consider, effectively consider, the interests of creditors would have arisen and had that not been paid proper attention there would have been misfeasance.

Then at 136 it's noted that "in a short judgment, Lord Justice Cumming-Bruce considered that a breach of duty would be committed if 'the directors should, at the time, have appreciated that the payment was likely to cause loss to creditors'." So, similar.

Then at 137 there's reference to the Australian and New Zealand developments but the Court there starts with the English authority binding on them which was the decision in the case mentioned on Monday, I think, of *West Mercia Safetywear v Dodd*, and that's a case where Mr Dodd is a director, shifted funds around to the benefit of his own personal position in the face of insolvency, and at 140 we have an extract from – or probably we don't need to look at that.

The critical paragraph we should look at is 142 where Lord Justice Dillon said that he'd found helpful and would approve the following statement in *Kinsela*, so I'll let your Honours read that. So where a company is insolvent the interests of the creditors intrude. Now why would it be, I ask rhetorically, that the Court should accept in those circumstances that damages should be measured only on a net deficiency basis, ie, loss to the company on that basis as the appellants would have it? We say it just doesn't make sense.

You have to consider at this point of an actual insolvency, you have to consider the interests of the company to be synonymous with the creditors and vice versa.

So 143: "This Court's decision in *West Mercia* establishes two propositions. First, the shareholders of an insolvent company cannot ratify the acts of directors taken in disregard in the interests of creditors, and, as a necessary corollary, it is incumbent on the directors of an insolvent company to have regard to those interests," and: "Second, the rationale is that, because of the company's insolvency, its assets are in a practical sense the assets of the creditors, pending its liquidation or return to solvency."

Now, your Honours will see criticism in the submissions of the appellants of the Court of Appeal suggesting that in a practical sense the assets of an insolvent company are to be seen as the assets of the creditors. Well, there's nothing unusual, nothing novel in that proposition. It's been around at least since *West Mercia* and really since *Walker v Wimborne*, and before.

WILLIAM YOUNG J:
But this isn't really new creditors, is it?

MR O'BRIEN QC:
It's both, I think, your Honour.

WINKELMANN CJ:
Well, I think…

MR O'BRIEN QC:
Yes, I think it is.

WINKELMANN CJ:
There's a point though, isn't there, which is the new creditors aren't really being harmed by how the assets are being managed in respect of existing creditors? They're rather being harmed by what was captured in the old

legislation, this concept of fraudulent trading, that there is a representation you can pay them.

MR O'BRIEN QC:

Yes, that's right. Yes. So I think it is both, your Honour, and in fact – well, yes, and the –

WILLIAM YOUNG J:

I sort of saw these cases as indicating that really the directors, it's not enough for the directors to say: "Well, we just did what the shareholders told us to do."

MR O'BRIEN QC:

Well, these cases certainly establish that but they go beyond it.

WILLIAM YOUNG J:

So do any of them actually deal with an obligation to new creditors, see it as an obligation? As I say, the…

MR O'BRIEN QC:

Yes, a good question. Because some of these cases involve payments out and dividends or restructurings perhaps not directly, certainly *Nicholson v Permakraft* did but in a way that doesn't suit my argument or, indeed, I think what the Court of Appeal has found and what is generally accepted as being correct, ie, that it extends to new creditors. Justice Cooke thought that was – he wasn't sure, and Justice Richardson in that case didn't want to enter into the debate to any great detail and I think Justice Somers endorsed the general notice of a duty to consider the interests of creditors. I don't know if he got into whether that's just existing or future. I think not.

GLAZEBROOK J:

It's somewhat difficult to see how you could have a duty to creditors that didn't extend to future creditors.

MR O'BRIEN QC:

I agree, your Honour, yes.

GLAZEBROOK J:

If you continued trading, that is.

MR O'BRIEN QC:

Yes.

WINKELMANN CJ:

The nature of the name of the old provision, I come back to this, suggests a mindset for new creditors, the fraudulent trading concept.

MR O'BRIEN QC:

It is absolutely who it's directed at. It must be directed at new creditors and, as your Honour said, in *Debut*, you know, if you've got a company trading on a basically robbing Peter to pay Paul basis is that thought to be okay because the duty – on what basis could that be okay? Well, only on the basis that the duty couldn't extend beyond existing creditors. So if you –

GLAZEBROOK J:

So your duty is to defraud the new creditors in order to pay the existing ones which isn't an attractive proposition?

MR O'BRIEN QC:

No, not attractive at all your Honour, we agree. It's impossible to think that – well, perhaps impossible is going too far. It would be an anomaly in the law if that were right, and it would be a serious deficiency, and it is plainly not what's intended by 136 or 135 because those, 135 probably captures existing and new creditors, 136 is directed plainly at new creditors. But the answer your Honour Justice Young is I'm not quite sure, perhaps not directly but these cases might not have been directly concerned with new creditors, but they certainly – in fact *Walker v Wimborne* possibly was, but I'm not sure,

your Honour, but certainly the flavour and the intention of these cases is that new creditors are covered, except in *Nicholson v Permakraft*.

So then this judgment we're looking at goes on to address just that case, at 147, generally adopting what was said in that case with some degree of criticism, for example, at 149 a criticism of repeated references to duties owed by directors to creditors, and Lord Justice Davis they're saying that well that can't be quite right, that's not what is meant, and in fact in the middle of 149 he's got a sentence there saying: "Reading the judgment as a whole, I take the view that Cooke J was discussing a duty of the directors to have regard to the interests of creditors in certain circumstances, not a duty directly enforceable by creditors against directors."

And actually if you look at the sentences at the end of that paragraph it said: "Once it is established that directors are in certain circumstances under a duty to have regard to the interests of creditors, a breach of that duty will entitle the company to recover compensation for the loss caused to the company, which will not be limited to the loss indirectly caused only to present creditors or present and likely future trade creditors." Those certainly, in this judgment, the duty is thought to extend to future creditors. In fact really your Honour I think there's no controversy about that anymore. That definitely does extend.

Then his Honour goes through to deal with other aspects of the Justice Cooke judgment, doubting in 150, 151 the reliance on business ethics and doubting the concept of limited liability as a privilege, as Mr Hodder noted, but generally otherwise endorsing it at 152 for example. Then 153 noting that Justice Richardson preferred not to enter the fray on this, describing it at the end of the passage I've quoted as, well, stating: "I prefer to leave that for a case where this question, itself a difficult amalgam of principle, policy, precedent and pragmatism, must be decided." But he did broadly endorse, in my submission when one looks at his judgment, he did broadly endorse the idea of a duty to creditors in insolvency.

Then in 154 Justice Somers likewise endorsing the principle point in the judgment, and I'm not going to take your Honours through every paragraph, but you'll see that the judgment then returns to *Kinsela* and Chief Justice Street's comments, which are quoted quite extensively.

Then at 158 why is the Court setting these out in length, because as is said there, they have to a significant extent define the discussion of the creditors' interests duty in subsequent cases.

Then they go on to refer to another English case, *Brady v Brady* [1988] BCLC 20, that's 1988, where again there was recognition of a duty to take account of creditor interests where the company in question is insolvent, or doubtfully solvent, and just if one looks at the last sentence there, and crosses the page: "Conversely, where the company is insolvent, or even doubtfully solvent, the interests of the company are in reality the interests of existing creditors alone."

Then they note in 160, that passage is subject to – well that's possibly not of interest to us. 161 noting that decision was reversed in the House of Lords but not on that particular point to which we've referred, and then at 162 there's a reference to another case of *Official Receiver v Stern* [2001] EWCA Civ 1787, [2002] 1 BCLC 119, but that's 2001. So that's the legal scene in respect of the creditors' interest duty as it existed at the time of the introduction of the 1993 Act, although there are a lot of other judgments as well. We've footnoted quite a few of those in the submissions, but they're all captured in this judgment and if we turn down to 165, your Honours will see the Lord Justice is there referring to the English first instance decision of *Facia Footwear Ltd v Hinchcliffe* [1998] 1 BCLC 218, and the quote at 166, worth reading.

Then, your Honours, there's a number of other cases referred to, and then if we scroll down to 177, we reach the final English case to which reference is made, and that's the *Bilta v Nazir* case in the Supreme Court, and your Honours will see: "This was an application to strike out proceedings brought by the liquidator of the claimant company against the directors and

others for damages for conspiracy and for relief for fraudulent trading, on the grounds that the action was barred by the claimant's participation in the alleged conspiracy and the maxim *ex turpi causa non oritur actio.* The duties of directors were relevant. At first instance, Sir Andrew Morritt C said that it was not disputed that 'in circumstances' where the company is or is likely to become insolvent the requirement to consider and at in the interest of creditors is imposed on the directors of the company.'"

Then in the Supreme Court, this is at 178, you'll see there in fuller form the comment, albeit obiter, of Lord Sumption. We say, with respect, that's exactly right, that in insolvency, or near insolvency, the interests of an actual or prospective – sorry. The interests of a company as synonymous with those of its creditors. Then in 179 Lord Toulson and Lord Hodge put it somewhat differently, but similar effect.

I don't think I need to take your Honours to anything else in this judgment except to say, as I've already said – well, there is one last case actually, which is in our submissions but it's also in here, which is at paragraph 189, which is one of the cases arising out of the collapse of the Bond Group and that's at 189 *Bell Group Ltd v Westpac Banking Corporation* [2008] WASC 239, 70 ACSR 1(Owen J) and [2012] WASCA 157, 89 ACSR 1 (Western Australia Court of Appeal (*Westpac*) And your Honours will see there the quote at page 189, but generally again, just endorsing what's become undoubtedly the law i.e. directors of an insolvent company must have regard to the interests of creditors, both existing and prospective. And then note at 190 that: "The issue was discussed on appeal in the judgment of Drummond AJA." And if I could take your Honours – I'll come back to this case in just a moment, but if I could take your Honours to 5.12 of our submissions, we have a quote there from that judgment: "…if the circumstances of the particular case are such that there is real risk that the creditors of a company in an insolvency context would suffer significant prejudice if the directors undertook a certain course of action, that is sufficient to show that the contemplated course of action is not in the interests of the company." So again, treating the interests of the

creditors, and I submit prospective creditors, as synonymous with the interests of the company, as Lord Sumption neatly put it.

ELLEN FRANCE J:
I see there has been an appeal from *Sequana* but that seems to be on that trigger point, what is the trigger point?

MR O'BRIEN QC:
Yes, I think so. I think at least one commentator, I think again, Professor Watts my suggest that it's going to look at the entirety of the common law, and it might. But the centre of attention must be the trigger point. And that's been heard, I think, your Honour. Well, I believe it has been heard and judgment pending.

Now, just to finish this section, and I'm going to come to the Law Commission Report, but can I draw your Honour's attention to a submission we make at 5.16, or 5.15. First of all, a point made by your Honour Chief Justice Winkelmann more than once early in this hearing and I would make it again, in particular the last sentence: "Solvency is a condition reasonably assumed by trading counterparties." Of course it is. And it's a condition which directors are required, in my submission, to if not ensure at least guard.

5.16: "Insolvency on the other hand is a generally unacceptable trading condition." So once we get to that point it's not acceptable to continue, we say, unless as the authorities say, there is real likelihood of salvage and salvage which is achievable in the short-term, not the long-term.

So then, I say: "As seen from the legislative and common law history, insolvency has therefore been a focus of legal policy for at least several decades. This includes balance sheet solvency." And we then quote from the 1982 Cork Report, it seems apposite to this case where they said: "We intend our proposals to apply, not only to the company which is unable to pay its debts as they fall due, but also to the company which is insolvent. That is to say, whose liabilities exceed its assets. Such a company is able to pay

existing debts only by incurrent fresh obligations." And that's exactly what this company was doing for a very extended period.

So with that, your Honours, could we turn to the Law Commission Report? So your Honours have seen bits of this, of course, but I thought it worth going back to and I think probably the first paragraph of note is 214: "Creditors are protected in the draft Act by a number of provisions. In particular all company distributions are subject to compliance with a solvency test (section 42). Second, directors are liable if they take unreasonable risk with the solvency of the company or where they trade knowing the company to be insolvent to be insolvent (section 105)." We'll come to that. I know you've seen it at least in part. So just pausing here, the idea of the Commission and the draft Act it produced was that directors will be liable if they take an unreasonable risk with the solvency of the company or they trade knowing it to be insolvent. We'll it's exactly what we have here, no question.

Then if you just scroll down please. Nothing much more in there. Then if we go to 219 please? "Directors owe a specific duty to the company not to take unreasonable risks of breaching the solvency test (section 105)." If it is breached it can be enforced by the company or by the liquidator but the Commission - as the Commission planned it, not by creditors directly although we see that changed with 301.

Then 220: "This is an area of law which has recently been considered," and it mentions those two cases, but as we've seen, there were several others besides.

Then 222: "…duties owed by directors to the company in cases of near insolvency at the standard of unreasonable risk provided for in section 105."

Then 223, worth looking at as well: "The subject of a statutory minimum capital, whether paid up or not, arises whenever company reform is under discussion," and the Commission's view of that is captured in 226 which is: "The considers that the dangers of undercapitalisation are better faced up to

by imposing obligations upon directors who incur liabilities in the name of the company in such circumstances," i.e. undercapitalisation or insolvency, and then again, reference to section 105 there.

Then if we could scroll down please to I think it's about 114, page 114 of the PDF please, and we're going to go to 105. So there is the proposed section 105 in two parts, and you see subsection (2) is not really very different to what we have in section 136 and section 135 imposes, in my submission, what would be in the context of this case an even clearer standard because it quite clearly prohibits insolvent trading.

Your Honours, last but not least, if I take you to page – it's about page 96 of the PDF, please, Mr Leggat – page 120 of the document. Yes, 516, so here we see what some of the Commission is thinking on the then-existing 320, basically concluding that in their view it goes too far towards inhibiting the use of the company form as the vehicle for taking business risk. I'll just let your Honours read it.

WILLIAM YOUNG J:
Just go back. So the clause 105 was pretty much section 136?

MR O'BRIEN QC:
Second part was. First part was essentially prohibition against trading…

WILLIAM YOUNG J:
Yes, 135, sort of 135?

MR O'BRIEN QC:
Well, it's a different standard, your Honour, yes. My read of all of this, I know that others in the room will have a better, more intimate or familiar view, but my understanding, my read of this is the Law Commission was concerned that 320 might inhibit normal and legitimate risk taking in a company that's solvent.

WINKELMANN CJ:

Such as the establishment of some sort of prospecting type –

MR O'BRIEN QC:

Sure, yes, for example.

WINKELMANN CJ:

– where you have a risk that nothing will happen, nothing will be found?

MR O'BRIEN QC:

Yes.

WINKELMANN CJ:

So everybody understands that?

MR O'BRIEN QC:

Yes, or just the entry of a course of – yes, but it assumes – but plainly, I think, the Law – I submit the Law Commission was assuming that the company will be solvent, and we see that in 105 because if it's insolvent, if we could go back to 105, please…

GLAZEBROOK J:

Well, you mean that it will be solvent at the time they are taking those business risks?

MR O'BRIEN QC:

Yes, your Honour, yes. Yes, when they're embarking upon the course it will be solvent and likely to remain so.

GLAZEBROOK J:

Well, barring – well, the trouble with risky ventures is that because they're risky you've probably got quite a high chance of failure.

MR O'BRIEN QC:

Yes.

GLAZEBROOK J:
But then if you do succeed you can succeed beyond wildest dreams or…

MR O'BRIEN QC:
Yes.

GLAZEBROOK J:
If you're really thinking in terms of – well, not "wildest dreams" because obviously you're not going to prospect without the real –

WINKELMANN CJ:
So your point is – yes. The point is it's contextual, isn't it?

MR O'BRIEN QC:
It is contextual.

WINKELMANN CJ:
What's reasonable's contextual.

MR O'BRIEN QC:
And companies are intended as vehicles for risk-taking, but let's remember the long title which your Honours have been referred to a few times. They're intended to be a useful social vehicle for the aggregation of capital. It's not the aggregation of credit. It's capital. So it plainly presupposes, even in the long title, that a company will be adequately capitalised or at least solvent, and again the Law Commission, section 105, intended just that. Mustn't. A director mustn't agree to the company entering a contract or arrangement or acting in any other manner unless he or she believes at the time on reasonable grounds that the act concerned does not involve an unreasonable risk of causing the company to fail the solvency test. The other provision is the equivalent of 136. So this presupposes solvency, and we see that in the commentary. We saw that at, I think it was, paragraph 222.

WINKELMANN CJ:

Mr O'Brien, are you going to be taking us through the legal principles in relation to quantification of loss or is Mr Kennedy taking us both through the principles and the facts?

MR O'BRIEN QC:

I think he's taking you through both facts and principles on that, but if nothing else, your Honour, I'm seeking to establish quite clearly as a matter of recent legal history, and by that I mean the last century, the law has had regard to and has required directors to have regard to the interests of creditors and has intended albeit that that be done through the vehicle of the company, has intended that creditors who fall foul of dealing with an insolvent company are compensated, are properly compensated. The wrong that the legislation is directed at is insolvent trading and taking on obligations when there's no reasonable grounds to think that they're going to be paid or where there's a likelihood of a substantial risk of serious loss to creditors. It's all directed at the creditors and, therefore, the remedy must be directed at the creditors.

So that is the, if you like your Honour, the key principle which we advance, or submission which we advance to say the focus can and should be on the creditors for the loss to them. *Debut Homes* endorses that, and the Court of Appeal has adopted it, at least in respect to 136 and we say the only disagreement we have there is we say that should extend in a case like this to 135, a case like this being a case of long-term insolvent trading. Because clearly, in a case like that a net deterioration approach to the assessment of loss just doesn't work. It doesn't work. It wouldn't have worked in the case cited in the Greene Report as long ago as 1926.

WILLIAM YOUNG J:

Can I ask you a question that I raised yesterday or the day before about section 301 of the 1993 Act?

MR O'BRIEN QC:

Sir, yes.

WILLIAM YOUNG J:

Can you bring it up, someone bring it up?

MR O'BRIEN QC:

Incidentally, we either have in the bundle now, or have coming into the bundle, some history of how 301 came to be but it doesn't tell us much. It just tells us that it emerged into the Act with sections, what are now sections 135 and 136 and with a comment that some aspects of the earlier legislation have effectively been retained rather then the Law Commission proposals around that area. There's nothing to suggest that, if this is of interest to your Honour, there's nothing to suggest that there was a deliberate decision to abandon what I would respectively submit was the clearer regime of 320, 321 in respect of remedies. Someone has effectively redrafted them into 301 and with respect, not very well.

WILLIAM YOUNG J:

Well, that's the point. Under section 320, it was after amendment. The section 320 duty could be said to be owed to creditors, in a practical sense because it was possible to obtain, a specific creditor could obtain compensation for losses suffered by reason of the breach of the section.

MR O'BRIEN QC:

Yes, your Honour, although the cases establish that the duty was owed to the company, but yes in effect, in practise that was equated to a duty to the creditors because compensation could be awarded directly.

WILLIAM YOUNG J:

Were there cases where creditors were recovered compensation where new creditors obtained compensation direct where they hadn't been a net deficiency or the net deterioration?

MR O'BRIEN QC:

Yes, your Honour, there were cases. We went through quite a few of them in the Court of Appeal and the Court of Appeal – but they're not, with respect,

well-reasoned, well that's possibly not the right way to put it. They're not well-argued, well-detailed –

WINKELMANN CJ:
Detailed in their reasoning?

MR O'BRIEN QC:
They're not detailed in their reasoning, but you do see cases where effectively that's happened, and the Court of Appeal has mentioned a couple. As to your Honour's earlier point, I think you said, Sir, in *South Pacific* that the duty is under threat to any that's owed to the company, not the creditors, and that accorded with the weight of authority.

WILLIAM YOUNG J:
Just looking at section 301(1)(c), this is a carry-through it would appear of the amended section 320 or was intended to be.

MR O'BRIEN QC:
Yes.

WILLIAM YOUNG J:
But it's gone wrong though, hasn't it?

MR O'BRIEN QC:
Yes, well, I can't do any better than to say that there doesn't appear in the legislative history and the select committee history to be any reasoning behind the redrafting of 320 and 321 into what is now 301.

WILLIAM YOUNG J:
There could be never – it's difficult to think of any circumstance where money or property belonging to the company could be vested in a creditor. On the other hand, one can think of circumstances where an application is made by a creditor it might be sensible for the Court to order the defendant to contribute to the creditor such sum by way of compensation as the Court thinks just.

MR O'BRIEN QC:

Yes.

WILLIAM YOUNG J:

So they've carried into (c) little (i) of (b) instead of little (ii).

MR O'BRIEN QC:

Looks – yes, that's right, I think, your Honour. But my general submission about this is that this is still broad enough to allow orders in favour of creditors. Your Honours, or your other Honours, at least raise that as a question in *Debut*, unresolved question, I think. But in any event, more importantly for us, we say that section 301 certainly does not preclude the Court assessing the compensation to be paid to the company, ie, the liquidator or the company, on the basis of the loss suffered by the creditors.

WILLIAM YOUNG J:

Well, on that hypothesis would it not also be possible on a referral back to the High Court for classes of creditors to be added as applicants?

MR O'BRIEN QC:

Well, I would say two things to that, your Honour. First, yes, but I suspect we would then face a –

WILLIAM YOUNG J:

Limitation Act?

MR O'BRIEN QC:

– a difficult road with the appellants asserting limitation issues.

WILLIAM YOUNG J:

But it would be probably – it may or may not be an answer because they would be ancillary claims, I think, for the purposes –

MR O'BRIEN QC:

I think that's – well, yes, I was thinking about that the other day when your Honour raised it. To be frank, we've never considered it in any detail but when your Honour raised it the other day we at least thought about it and talked about it and I think, yes, one could argue, quite properly, that they're ancillary claims.

WILLIAM YOUNG J:

And so the limitation period –

MR O'BRIEN QC:

Wouldn't run.

WILLIAM YOUNG J:

– it wouldn't affect them, because they're ancillary to proceedings already before the Court?

MR O'BRIEN QC:

Yes, and so we wouldn't fall foul of them. What we'd end up with another argument, we'd probably end up back here probably two or three years hence and we, with respect to the liquidators, with respect, are keen to persuade your Honours that there's sufficient material already before the Court to actually enter a judgment now for a quantum, and Mr Kennedy is going to show you what that material is and where it is and how we get to a quantum. Is it the perfect quantum? Is it the full loss? No, not by any means, but at least it's an acceptable level of quantum for the liquidators.

WILLIAM YOUNG J:

Okay.

MR O'BRIEN QC:

So, your Honours, that probably ends the Law Commission section, and then if I could just revert back to the written submission, I'm not going to go through all of this but just, and I assume your Honours –

WILLIAM YOUNG J:

Just pause. You're going to provide a little bit more history of section 301?

MR O'BRIEN QC:

Well, I see Mr Leggat's anticipated that and he's brought it up on the screen.

WILLIAM YOUNG J:

I've seen this, thank you. It's pretty succinct.

MR O'BRIEN QC:

Yes. I think what I would take from it that there is no indication at all that there was a deliberate intention to change what, on the face of it, appears to be the more flexible regime that we used to have in the remedial parts of 320 and 321. Someone has redrafted it and, with respect, not terribly well, leading in part to the Court of Appeal comments in this case. But that didn't preclude your Honours coming to the conclusion, with respect, we say correct that the loss in the *Debut Homes* case could be measured by the loss to the creditors.

Now, I appreciate, of course, my friends say that's a different case because there was no hope of salvage, but with respect, there was no hope of salvage here unless the directors took steps to recover, and did recover, the money that the company had lent out and they never did that, certainly never successfully and to the extent they did it through the prepaid goods, well, it was hopelessly inadequate.

So, your Honours, I won't take you through all of this, but section 6 and yes, your Honour Justice Young, there's nothing, we haven't found anything more on this.

Section 6 Court of Appeal judgment. I'm not going to take your Honours through this. There is nothing there I need to, haven't already said. At section 8 of the submission we deal with this question of whether section 136 is limited to specific obligations. We say no and we rely in part on this Court's comments in *Debut Homes* and in particular the part quoted there at 8.2 and

the conclusionary comment, in other words, it's not legitimate to rob Peter to pay Paul. The same thing your Honour that we saw in effect in the Cork Report to which I took your Honours, i.e., saying that we have got a company that is balance sheet insolvent, the only way you pay existing creditors is by engaging new creditors. Not acceptable. Never has been.

I should say Mr Grant Graham had a somewhat different view, although tempered ultimately and then we deal with various other submissions in here made by the appellants including whether there had to be an affirmative act of agreement to each and every obligation. The Court of Appeal concluded no and at 8.9 the Court of Appeal concluded that by deciding to trade on, the director had agreed to incur the trade debts that the director knew would result from such trading. Exactly right. It must be right. As your Honours saw from that trip through the chronology, every board meeting these directors were being told what bids were being made, or were intended to be made, and they knew what work had been won and of course they knew, and they confirmed that in cross-examination and indeed that they were instrumental in winning some of the contracts, or at least Mr Yan was and certainly Mr Gomm was and they knew that with each one of those project obligations there would be a suite of associated obligations and it would be ridiculous if liquidators were required to identify each and every one of those obligations and then ask the directors if they specifically agreed to them. That can't be what's intended.

Then, your Honours, I won't run through all of this in any detail, but we do get to this question –

WINKELMANN CJ:

In some ways didn't their business model depend on them having those ancillary contracts coming in because they depended on the cash flow that came through, time lag between getting paid by the principal, by the contracting party and paying the subcontractors?

MR O'BRIEN QC:

That's right, your Honour, that was their business model. That did rely on a steady stream of new work. Mr Hodder says nothing unusual in that. That's correct. What's unusual is doing it when you're insolvent. What's unusual is when you turn that standard legitimate business model into a policy of insolvent trading which is what we have here as found by both Justice Cooke in the High Court and the Court of Appeal.

There's a suggestion which we attempt to deal with at 8.24 and on, of would section 135 become redundant if our proposed approach to 136, indeed we would respectfully suggest this Court's approach to 136 in *Debut*, is adopted. Well, the first answer is it really has already been adopted and the second answer is no, it doesn't, meaning 135 is redundant. Is there overlap between the two sections? Yes. Is it easy to articulate a clear distinction above and beyond the words? No, it's not. But we say, does it matter that there's overlap? No. They're just dual provisions intended to give a degree of protection to creditors. That's plain from the long title to the Act and it's plain from the Law Commission report and it's plain from reading sections 135 and 136. So, yes, there is some overlap, but that really does not matter.

There are situations that one can envisage where section 135 might apply but 136 would not. For example, where the creditor suffering the losses, a creditor under an existing and long-term obligation. So assume a company has a long-term obligation to a creditor or a suite of creditors and then ceases to pay them for one reason or another but carries on business and does so in a manner which is likely to cause a loss to those creditors and does cause a loss to those creditors and yet new creditors are paid so 136 wouldn't be engaged, but 135 would. It's not so easy to think of a situation where 136 would be engaged but 135 would not, but we say –

WINKELMANN CJ:

But that's true on whatever interpretation you give it, isn't it?

MR O'BRIEN QC:

Yes, it is your Honour and we say that just doesn't matter, they're just companion pieces intended to protect creditors against illegitimate trading.

So your Honours, we say with respect on this that the Court of Appeal judgment on 136 is right and the only thing we ask there on the cross appeal is that your Honours consider we hope favourably the idea of actually entering a judgment for a specific quantum. We say the figures, the data is there which is needed. There may be some minor element of rough justice, but the rough justice is rough against the creditors, not the directors on that and I refer then when I say "rough justice" to the *South Pacific* case in both the High Court and the Court of Appeal where it's acknowledged that one need not get to and may not be able to get to one single figure outcome and that's not unusual in any event when assessing damages.

Then on 135 we again just support the Court of Appeal finding of liability and the High Court finding of liability, but for the reasons I have tried to articulate, invite your Honours to conclude that a new debt approach to liability under 135 is open at least in a case like this where there is an extended period of trading whilst insolvent and a suite of new creditors and new debt obligations are incurred during that insolvent trading and as to quantum on our 135, Mr Kennedy will get to this, but we invite your Honours to adopt the claim that was made in the pleading supported by Mr Apps' workings which were not challenged by the no appellants.

WINKELMANN CJ:

Sorry, what's that submission about you've just made, Mr O'Brien?

MR O'BRIEN QC:

Sorry, your Honour, we support the High Court and Court of Appeal liability finding on 135 obviously. The Court of Appeal didn't enter a judgment, a quantum judgment on 135, saying that we had pursued a net efficiency approach and hadn't proved it. We are not suggesting now, we're not appealing that a question of net deficiency but we are cross-appealing saying

that we also pursued a new debt claim under 135 which I took your Honours to in the pleadings yesterday and that was supported by workings of Mr Apps showing a new debt accumulation of 75 million and we submit that that's sufficient to allow the entry of judgment for that amount under section 135 because it wasn't challenged. Yesterday or the day before my friend suggested well, Mr Apps' workings may include things like lease obligations. Well, with respect, if they did, they could've pointed all that out in the High Court or the Court of Appeal or even now and identified what they were, but we haven't seen any of that.

So your Honours, that concludes my part of the submission and I'm ready to pass the baton to my learned friend Mr Kennedy, but I see it's four minutes to one.

WINKELMANN CJ:
No questions? Well perhaps we will take the lunch adjournment then and come back at 2.15.

COURT ADJOURNS: 12.56 PM

COURT RESUMES: 2.18 PM

WINKELMANN CJ:
Mr Kennedy?

MR KENNEDY:
Good afternoon your Honours. So for the balance of the day, I expect your Honours, you're going to hear from me on section F of the respondents' submissions, which is headed "Quantum". That's at paragraph 13 of the written submissions. As my learned friend Mr O'Brien did I'm planning on tracking through the submissions and going to the documents as I hope they will be helpful to your Honours. But just so we can orient ourselves at the outset you'll see at paragraph 13 that we set out three sections that I'm going to be addressing, and the first one is the quantum which we say can be and

should, with respect, be assessed by this Court under section 136. So that obviously picks up on the fact that the Court of Appeal upheld the liquidators' claims under section 136, but remitted the issue of quantum back to the High Court, and we have appealed against that finding on the basis that the evidence is, in fact, before the Court and was before the Court of Appeal at the time.

The second section of the submissions which I'm going to be addressing relates to the breach of section 135, and as your Honours know the Court of Appeal held that the directors had breached section 135, but found as a consequence of the application of the usual net deterioration principles, the determination of compensation, there was, in fact, no loss, and the reason for that was because the position of the company, in fact, improved between the breach date, being January 2011, and the ultimate date of the liquidation, which was in early 2013. So the submission that we will be making to your Honours is that in fact the new debt approach to the assessment of loss ought to be available as well in respect of section 135, and the reason for that is because it is necessary to apply that approach to the assessment of compensation in this case, to ensure that there is a remedy in respect of the breach of section 135, and in order to address the conduct which has led to the very significant losses which are then incurred by the new creditors, and if your Honours agree with that submission, I will be inviting you as well to enter judgment on quantum in respect of new debt under section 135 on the basis, as my learned friend Mr O'Brien said before lunchtime, on the basis of the evidence which was called and proved at the High Court trial.

Then the final aspect of my submissions relates to section 301 and the grant of relief under that section, and I will be submitting there that there shouldn't be any material reduction in the directors' liability for breaches of 135 and 136 for two primary reasons. The first one is that the residual discretion available to the Court under section 301 should be narrow for the reason that have been identified by the Court of Appeal in this matter, and secondly, should your Honours nonetheless confirm that there is a broad discretion, then there

is no basis for a material reduction on the basis of the usual considerations of causation, culpability and duration.

GLAZEBROOK J:
Can I – I apprehended, although they skated away from this a bit back and forth, that the appellants were essentially saying that the – well essentially seeking to overturn the findings in *Debut* that there was a possibility of damages under 136 anyway on a new debt basis, especially where there hadn't been net deterioration. So are you going to deal with that under 136 or is it really similar to the submissions that you're making about 135?

MR KENNEDY:
I will deal with that, your Honour, briefly at the end of my 136 submissions on quantum, but it won't surprise your Honour to hear, of course, that we say that the findings and the approach in *Debut Homes* is entirely correct and orthodox and in accordance with legal principle, and we say that the same findings apply in this case for reasons that I will touch on briefly.

So against that background your Honours, now turning to paragraph 14 of my submissions, and this is the submissions made in respect of the fixing of compensation in this Court, for the breach of section 136, and what I'm going to do here is just go to the documents that do establish the evidential basis for the fixing of that loss. So by way of recap the Court of Appeal identified three categories of obligations in respect of which the directors breached section 136. The first was obligations to principals and bond providers who indemnified those principals in respect of four substantial construction contracts entered into after the 31st of January 2011, and I'll ask Mr Leggat just to take us briefly to the reference in the Court of Appeal judgment to those four contracts.

So these are the admitted claims by principals in respect of these contracts, and you'll see that there's both principal claims and bond claims made in respect of two of the four contracts totalling $20.28 million. At 467 the Court found that the same reasoning, and that is that there was simply no basis

upon which the directors could have found that there was, or could have considered there to be a reasonable prospect of letting longer-term debts at this point in time, following the breach date of January 2011, that the same reasoning applied to longer-term obligations to subcontractors on these projects, and the Court set out the subcontractors which totalled just over $11 million.

The Court also went on to say at 468 that some of these claims may relate to payment obligations incurred from July 2012 onwards – that category of obligations is discussed separately; we'll get to that in a minute – but some may also relate to retentions accruing from February 2011, and again for the same reasons as in respect of the four substantial contracts. The directors agreed to these obligations being incurred without reasonable grounds for considering or concluding that the company could meet them.

From here we'll just go down to paragraph 476, and this is the next class of obligations that the Court of Appeal concluded were entered into by the directors at a time when they did not have a reasonable basis for considering that the company could meet them and they are all of the obligations from the 5th of July 2012. My friend, Mr O'Brien, has taken you through some of the documents at the time which explains why the directors could not have been confident these obligations would be met when they fell due.

So then just moving on to 477, the Court concluded that it wasn't in a position to quantify this category of claims, and that was one of the reasons why it remitted the issue of quantum back to the High Court, and then it summarised at 480 its findings in respect of quantum.

So head back to my submissions, your Honours, at 14.2, the other aspect that the Court considered it wasn't in a position to quantify were the dividends paid or payable to the creditors from liquidation recoveries, and the reference to that in the judgment because it's not in that footnote, your Honours, is paragraph 536 of the Court of Appeal's judgment.

So the proposition that I'm putting forward to your Honours, however, is on the evidence there is sufficient evidence for the Court to conclude the loss which has been sustained by the creditors as a consequence of the section 136 breach.

I start then with that at 14.3 of my submissions.

Claims by principals and bond providers. Well, they were set out by the Court of Appeal. That's the $20.3-odd million.

Then we have claims by subcontractors and trade creditors in respect of debts incurred after the 5th of July, and there are two categories: obviously subcontractors' claims and trade creditors' claims. If we can go to the footnote at 247, so this is Mr Bethell's primary brief of evidence, your Honours. So in this brief he goes through the process of explaining how the liquidation was conducted, how the proofs of debt were considered and admitted or rejected, what the categories of creditors were and how they were streamed into those categories.

So we can see just at 187 that is a table that summarises the claims that were admitted by the liquidators in the liquidation. You can see from that that admitted subcontractor claims are the $45.38 million and admitted trade creditor claims are $9.459 million, and off to the right, just while we're here, your Honours will note how much of those debts or how many of those debts were rejected as part of the proof admission process. So the total claims at that point, $116 million.

So returning back to my submissions at 14.3. I've added up all those numbers and they come to just a little bit over $75 million and from that, as the Court of Appeal has recorded the liquidators' acceptance of the point in the Court of Appeal, the related party advances which were made by entities associated with the parent company or with the related parties of Mainzeal, the sum of $11.659 million is deducted because that is not being pursued in

the liquidation. So that is the sum or part of the sums that were advanced. So that then brings us, your Honours, to a total of just over $63 million.

At 14.4 I set out the position as to retentions. Now the Court of Appeal concluded that subcontractor retentions relating to the four substantial contracts should be included in the compensation recoverable from the directors.

Now the evidence is, your Honours, that the total sum for retentions that was held by Mainzeal at the date of liquidation is just over $18 million. It's the 18.1 you see at subparagraph (b) of the submissions there, and included within that sum of retentions will be subcontractor retentions that relate to the four substantial contracts that I took your Honours to at the start of this section, admitted subcontractors' claims that relate to the period post-5 July, the longer term subcontractors' claims made after the breach date of the 31st of January 2011 but prior to 5 July, and then there will also be included in that sum of retentions claims that accrued prior to the breach date of the 31st of January 2011, and there is no easy way for the liquidators to identify that last category of retentions that's included within the $18 million. There was a way but it involved an awful lot of steps which we decided that we would not subject your Honours to.

So as a consequence and in order to avoid the cost and delay of the case being referred back to the High Court and in the interests of achieving finality and certainty for the creditors who are yet to receive anything from this liquidation – I think we're seven years in in this litigation so far and we've just ticked over nine years since Mainzeal was first placed in liquidation – the liquidators are prepared to effectively extend a credit to the directors in respect of all retentions held, the full $18 million.

Now there can be no question, in my submission, that is a very conservative approach for the liquidators to take because of those four categories of retentions that I took your Honours through it's only last that would not be

properly recoverable by the liquidators in accordance with the 136 finding of the Court of Appeal.

So on that basis, the new debt claim then reduces to just over $45 million and I've also noted in my submissions that the fact that it is very conservative is underlined by the fact that just the claims in respect of the four substantial contracts alone total some $31 million, 31 and a half million dollars.

Now the Court of Appeal considered there was insufficient evidence to determine whether all the admitted claims by the subcontractors and the trade creditors related to obligations incurred after the 5th of July. However, on the evidence it was common ground between the accounting experts that Mainzeal's creditors were largely paid when current and in any event not significantly overdue, and in my submissions there, your Honour, it says "June/July 2012". That should be "December 2012", if you wouldn't mind noting that.

So in order to illustrate the point we can go to Mr Graham, who is the directors' accounting expert, and his analysis of the aging of the debts. You see that at footnote 256. So Mr Graham gave evidence, as you can see your Honours, that the subcontractor and creditor aging through to December 2012, so it's only a month or so before the wheels fall off, demonstrates that the vast majority of the debts that were owed by Mainzeal were, in fact, up-to-date.

So I'm just looking at the percentages, which is the second half of the chart. 52% for accruals, current creditors are 36.8%, one to 30 days past due, 8.5%, and only 1.5% was more than 61 days overdue, and you can see from the top half of the table, that the 61 days past due totals $432,000. So anything which was older than two months before December 2012, was limited to around about $400,000 out of a total of $28.4 million.

Now Mr Bethell didn't agree with everything that Mr Graham said, but what he disagreed with was the extent to which they were up-to-date at the start of this

period in June and July, and he produced the graph which your Honours have already been taken to, which is attached to the Court of Appeal's judgment, and that showed that there were definitely cash flow issues in around about June 2012. But he didn't take issue with the prop that as at December 2012 there was a very small proportion of the debts which were more than two months old, and the point that I make here your Honours is that the credit of the $18 million for retentions is going to more than outweigh any realistic prejudice which the directors can claim was a consequence of what is plainly a very small proportion of debts being outstanding for, or could be said to be outstanding prior to 5 July.

We did actually have a look at the debts in, because again this is all in the evidence your Honours, but there is an Excel spreadsheet in the evidence which tracks all of the debts, and as you'll see from the footnote that I've made at 258, it was possible to see that the majority of the $430,000 that was outstanding related to two debts that were well after the 5th of July. So it reduced the sum which was potentially older than that down to $155-odd thousand. In other words an immaterial amount in the scheme of the numbers that we're talking about.

So given that both expert witnesses had agreed, your Honours, that there were no material proportion of the subcontractors and creditors outstanding more than 61 days, there would simply be no point in carrying out a more detailed aging exercise, which is what was suggested in the submissions of my learned friend Mr Hodder QC, and nor is there anything in the criticism which was made in those same submissions that there was insufficient detail, or no meaningful evidence as to the assessment of the claims by the liquidators. The claim review process is described in detail by Mr Bethell in his evidence at paragraph 189 and onwards, and there was very little cross-examination on the point at the trial. Mr Bethell explained that he was assisted in the proof admission process by senior ex-Mainzeal staff and external consultants as required.

Finally, even the directors accept that the liquidation processes, including section 301, permit some imprecision in calculations, and I'm referring there to the cross-appeal submissions of my learned friend, Mr Hodder, at paragraph 2.22.

Now the other issue which was raised – sorry, your Honours, that's all I wanted to say about the assessment or the quantification of those aspects of the claim.

The other aspect raised by the Court of Appeal related to dividends that were paid or payable to creditors from the liquidation. The Court said at paragraph 536 the net deficit to creditors recoverable after payments received from the liquidation, that's what the directors were going to be liable for. So in other words, the Court was identifying that to the extent there was to be a distribution to the creditors from the liquidation then the directors would get a credit in that amount of money which, of course, makes perfect sense, that that's necessary to identify the directors' loss. It does not make the directors liable for the costs of the liquidation which was one of the submissions made by my learned friends. The costs of the liquidation are costs the creditors themselves must bear and to the extent they get something back at the end of the day then obviously the directors have a credit in respect of that amount because otherwise the creditors would be over-compensated. That's a very different situation from *Shaw v Owens* which was a case that was referred to your Honours by my learned friend, Mr Hodder, where directors had been ordered by the High Court to pay the liquidation costs as part of an order for compensation under section 301.

At this stage, the statutory reports filed by the liquidators at the Companies Office show that no distributions have been made to unsecured creditors. There's currently $5.593 million which is held in the liquidation that's potentially available for distribution. Further liquidation costs and expenses will need to be deducted from this sum. Now these costs aren't material in the context of the claim but again if necessary, and again, for the purposes of

persuading your Honours that judgment ought to be entered on quantum, the liquidators will extend a credit for the full sum currently held.

The last point I would make just on this particular aspect, your Honours, is that another way of dealing with this issue is in fact suggested by Professor Watts at page 385 of his *Directors Powers and Duties* book where he says it would be possible to subrogate to the directors the creditors' rights to receive any dividends, and I respectfully suggest that is another acceptable way forward on this particular issue.

ELLEN FRANCE J:
Mr Kennedy, one of the other issues the Court of Appeal raised was the question of interest.

MR KENNEDY:
Yes, so interest is claimed, your Honour, on the outstanding amount under the Judicature Act 1908.

WILLIAM YOUNG J:
What's the current rate?

MR KENNEDY:
The current rate is on a sliding scale but under the Judicature Act which this claim falls under I believe it's 5% per annum, your Honour.

ELLEN FRANCE J:
And the Court also talked about possibility of reduction in the exercise of the section 301 discretion. I'm looking at paragraph 539. What do you say about that?

MR KENNEDY:
I will come to that, your Honour, but there's several questions that need to be discussed in respect of that and the first one is the nature of the discretion which ought to be available under section 301 given that it is a proxy for a

direct claim which could be made by the company against its directors under the relevant sections here, in this case 135, 136.

So the first question is whether there is a broad discretion of the type which some cases have contemplated where issues of causation, culpability and duration can be applied for the purposes of reducing the director's liability, and, secondly, to the extent that your Honours do find that there is that type of discretion then the submission will be that it's not appropriate to exercise any material reductions for reasons that I will come to, but one of them will be the fact that a very conservative approach has been taken to the assessment of a loss for the reasons I've just taken your Honours through, including the $18 million credit on retention. So it would not be a right or just to apply a further discount on top of a discount under section 301.

ELLEN FRANCE J:
But might issues like that not require further evidence?

MR KENNEDY:
Well that, of course there's already been argument about section 301 your Honour before the High Court and the Court of Appeal. So these issues have already been canvassed and –

WILLIAM YOUNG J:
The High Court judge may order the final orders.

MR KENNEDY:
Yes he did.

WILLIAM YOUNG J:
So final orders were on the table at the end of the trial?

MR KENNEDY:
That's right, so they were overturned by the Court of Appeal, but all of these issues have been fully canvassed in submissions by the parties in front of the

High Court, and then canvassed again in front of the Court of Appeal. So we would resist, your Honour, the idea that it's necessary to go back essentially to rerun some of these issues, especially at this stage of the litigation.

So where I end up, your Honours, is that the evidence, and this is at 14.8, the evidence shows that the loss, the breaches of at least $39.753 million, which is the 45 less the sums that are currently held in the liquidation, and then interest on top of that would need to be calculated from the date of the liquidation to the date of payment under section 87 of the Judicature Act .

Now submissions have been made by my learned friends for Mr Yan suggesting that this is an entirely new assessment of loss, which was not before the Courts below, and it should be sent back for the purposes of assessing quantum based on this new assessment. But that really does disregard the fact that from the outset the new debt approach to the assessment of loss was front and centre on the liquidators' pleading, or this is their preferred approach to the assessment of loss from the outset, and it was proved in the High Court, and the approach from the Court of Appeal is effectively a subset of that loss. The essential distinction was that a termination that all debts from the 5th of July 2012 would be recoverable. But there's no other substantial change which means that the evidence which was before the High Court, and which was relied upon by the liquidators for the purposes of establishing the loss, is no longer appropriate, and the fact is is that, as my learned friend Mr O'Brien submitted, there was a deliberate agreement by the directors to not engage with this aspect of the liquidators' case.

So Mr Graham, the appellants' accounting expert, gave evidence at paragraph 152 of his brief that he was not instructed to prepare a loss calculation and that he understood it would be a matter for legal submission. The cross-examination of Mr Apps in respect of this approach did not engage with his detailed calculation. So the defendants made a - defendants, the directors I should say, made a tactical decision that they would not engage with the new debt analysis, and that they would deal with it as a matter of

legal submission. So that being the case, in our respectful submission, it's not appropriate that it should go back to the High Court so they can have a second go in respect of these issues that they've chosen previously to not engage with.

WINKELMANN CJ:
Mr Kennedy, can you just refer me again to Professor Watts' article where you said an alternative way of dealing with it was subrogation?

MR KENNEDY:
Page 385 of his most recent textbook, your Honour. So I think we've got that in the bundle. Tab 136 and page 385 my notes say. You see that in the second to last paragraph, your Honour?

WINKELMANN CJ:
Yes. My authorities seem – the hyperlinks seem to have disappeared so I can't get to it, so it's all right.

MR KENNEDY:
That's not our folders that your Honour – we have made some mistakes in our hyperlinks, I was going to say.

WINKELMANN CJ:
I don't think it's your fault, so I can find it later.

MR KENNEDY:
I'm always delighted when it's not my fault, your Honour. Has your Honour been able to see that?

WINKELMANN CJ:
No, it's okay. I'll see it later. On the screen?

MR KENNEDY:
Sorry, it's on the screen, yes.

WINKELMANN CJ:
Good, thank you.

MR KENNEDY:
So it seemed to me to be a rather elegant approach to dealing with that issue in any event, but, as I say, if it really is an issue or if it's a complication that your Honours prefer to take off the table then the liquidators will agree to simply extend the credit for the full sum which they are currently holding.

So we say, your Honours, that the new debt has been established on the evidence before the Court. There's no need to go back, and it's also not right to suggest, as my learned friends for Mr Yan did, that the Court of Appeal considered that proof of debt could not be relied upon in respect of the new debt calculation as against the net deterioration calculation where the Court was undoubtedly sceptical because of the approach which had been taken by the liquidators in looking to address the calculation of net deterioration. That approach proceeded on the basis that a correlation had been identified by the liquidators' expert between bonds and admitted proofs of debt for principals in the liquidation and that correlation was sought to be applied to the counterfactual for the purposes of trying to identify a rational basis to determine the extent by which the company's position had deteriorated, and the reason it was done like that is because we were trying to avoid getting into what we got dragged into anyway which was a very detailed assessment of what might have happened in the counterfactual in respect of the more than 20, as I recall, major construction contracts that were on foot at the counterfactual date.

But the Court of Appeal was very sceptical about that as an approach and the Court was also sceptical about relying on proofs for the purposes of establishing the company's financial position in a net deterioration but the reason why, and this is at 514 of the Court of Appeal's decision, the Court considered that admitted proofs would almost always understate the actual position of the company because many principals, particularly in respect of complicated construction contracts, would not go through the process of

preparing a proof of debt claim and dealing with the issues that the liquidators would raise in respect of that.

But in respect of a new debt assessment of loss, it's very difficult to see what other measure you would use if it wasn't admitted proofs of debt in the liquidation, and if you were to simply identify all of the claimed debts based on the company's own internal records and any claims that were made in a liquidation without them being tested through the admission process, the number would be an awful lot higher than admitted proofs of debt. So it's difficult to understand the nature of the objection which is being raised by my friends for Mr Yan on that.

So without wishing to repeat anything, your Honours, this case has been on foot now for seven years, the liquidation has been on foot for over nine years, and the creditors have not, at this stage, have not received anything form it. So the liquidators are obviously concerned, if your Honours are able to see your way through based on the evidence to enter a judgment, the liquidators are concerned to achieve that outcome so they can refund some funds to creditors in preference to the matter going back to the High Court and almost inevitably it would appear, given how hard fought this case has been to date, ending up if not back here, then in front of the Court of Appeal some years down the track. It is submitted that would be contrary to the interests of justice.

WILLIAM YOUNG J:
Just pause. I take it there are stays in place at the moment are there?

MR KENNEDY:
Yes. Well, no, I answered too quickly your Honour, because of course there was a judgment that was entered against the directors by the High Court judge, but that was then overturned –

WILLIAM YOUNG J:
I see, because there's no judgment in place now?

MR KENNEDY:

There's no monetary sum which has been entered by way of judgment. So at this stage there is a judgment in favour of the liquidators on liability under section 136, but an order from the Court of Appeal that it be remitted back to the High Court for the purposes of determining loss.

WILLIAM YOUNG J:

Okay. And there were stays from the High Court judgment were there?

MR KENNEDY:

Yes I believe that's right.

WILLIAM YOUNG J:

So no money was ever paid across?

MR KENNEDY:

No money has been paid across, apart from costs. So a costs award of approximately $2.3 million has been paid, and that's been paid by the directors' insurer.

WILLIAM YOUNG J:

Thank you.

MR KENNEDY:

So the final point, your Honour, simply is that the concessions that I've made, for the purposes of having quantum entered here today, if your Honours were not minded to do that those concessions would not extend, obviously, to any High Court process if it goes back there to have loss determined. I just wanted to make that clear.

So that's all I was going to say on the first aspect of the submissions, your Honours, unless there's any other questions in that?

That then leads me – here I've dealt with by way of a response to my friends' appeal against he entry of judgment on section 136, and the one in which they've sought to attack the Court of Appeal's entry of judgment is to seek to read down the fact of *Debut Homes*. So they've sought to argue that the principles that were identified in that case simply don't apply in this case, and they don't say this but they are essentially saying that it is a case that is constrained according to its particular facts and unless there are facts which are very similar, then in fact there is nothing in the Act to support the conclusion that loss to a specific class of creditors can be deemed to be a loss to the company, and those facts that they identified, as I apprehend it, is first an abuse of power by directors of an unsalvageable company who knew that as a result of their actions the new creditors would be at a loss. Our response to that, your Honours, is that this submission is simply not supported by either the wording of 136 or *Debut Homes* and the principles that were established in that case.

Obviously section 136 does not require that the directors know that the creditors will not be paid, although clearly that's a breach, but the test is whether there are reasonable grounds for a belief that they will be paid.

Now in this case the continued trading of Mainzeal was only possible because old creditors were paid with new creditors money. This balance sheet insolvency which reflected a policy on Mainzeal's part was plainly illegitimate and it was consistent and supported the Court of Appeal's assessment of loss for a 136 breach by reference to the obligations that the directors agreed to the company undertaking and then failed to perform.

Their conduct, apart from being in plain breach of section 136, was exacerbated by the fact that they approved financial statements that were misleading and suggested that the company had financial strength and substance which it plainly did not. That, of course, led to new creditors being entirely unaware that they were dealing with a company which had been balance sheet insolvent since, on the High Court Judge's finding, confirmed by the Court of Appeal, at least 2005.

What is worse is that it is absolutely plain, in my submission, that this was a company which was unsalvageable in the *Debut Homes* sense. There was no prospect of this company ever trading its way out of the position that it was in, absent its parent companies or related companies remedying the balance sheet hole which had been created over the preceding 10 or 15 years, 10 years.

Now this is a risk that new creditors had no idea of and this amounts to an abuse of the directors' position. It must have been apparent to the directors, and if it wasn't then it ought to have been, that the new creditors would bear the loss when the music stopped and that was just a matter of time for the reasons that the Court of Appeal went through in some detail. The Court did actually set out the reasons why it considered that Mainzeal was not salvageable at paragraph 446 of the Court of Appeal's decision.

So even on the directors' narrow interpretation of *Debut Homes*, the new debt approach is available here and we say that because there aren't any reasonable grounds to believe that the obligations would have been performed when they were incurred by an unsalvageable company being traded in breach of the directors' duties.

So I'm not planning on saying an awful lot more in respect of their appeal against section 136 liability, your Honours, and that's because we say that *Debut Homes* explains exactly why it needs to succeed in this case. It is a situation where a restitutionary remedy is necessary to address the wrong which is the ongoing trading of a company which is hopelessly insolvent and encouraging new creditor to trade with it for the purposes of meeting its old obligation.

So, your Honours, those are the submissions I was planning on making on section 136 unless there are any further questions on that.

WINKELMANN CJ:
No, thanks, Mr Kennedy.

MR KENNEDY:
Thank you, your Honour. So what I'd like to do now if I can then is turn to 135 and our appeal that in fact a new debt approach to the assessment of loss under 135 should equally be available in this case because of the particular circumstances of the case.

So just to elaborate on that, the circumstances of this case do bring it outside of the more usual type of reckless trading case where the debts continue to pile up, the creditors get stretched out, it becomes clear and obvious to people who are dealing with the company that it's in financial trouble. In this case, from the creditors' perspective, they simply had no idea and would not have know that Mainzeal was trading on its new creditors' money for some seven years before it went under, and what that inevitably meant was that the old creditors – and when I say "old creditors" I mean pre-breach creditors, so creditors that were incurred prior to the 31st of January 2011 – the old creditors were paid with the new creditors' money as part of this process where there was churn, new money coming in and then being applied to old debts.

So the Court of Appeal's findings on this, we find them at footnote 263. I might just quickly go there if we can. Now I want to draw your Honours' attention to the last paragraph of 452. "It was their striking failure over an extended period to engage with the realities of the company's situation and take any meaningful action to address those issues that leads us to confirm the Judge's finding that they breached s 135 no later than 31 January 2011."

So the Court accepted that compensation based on a net deterioration approach was appropriate, that being one of the two pleaded approaches that the liquidators had brought before it, but it found that there was no such net deterioration, and as a consequence the claim under section 135 failed.

The Court considered in respect of the new debt approach that although it had been pleaded and argued by the liquidators, it was not available on the law as it currently then stood, and just for the sake of completeness, the Court of Appeal also found that the entire deficiency claim, which was the basis upon which the High Court judge had entered judgment, was not available on the pleadings on the evidence or on the law for that matter. There's no appeal against that.

I should also just say your Honours that in the submissions, and as I'm sure you've already picked up, we use the term "net deterioration" the same way that the Court of Appeal does, but your Honours use the term "net deficiency" in *Debut Homes* to mean the same thing. So the terms don't entirely match up but when we say "net deterioration" we mean "net deficiency" within the meaning of that term in *Debut Homes*.

So that leads me then to the proper approach to compensation under section 135, and there's really two fundamental propositions that I don't imagine are going to be at all contentious here. The first one is that compensation depends on the nature of the breach under section 135 and 136. The second one is that just as obviously directors cannot be liable for loss which was not caused by their breach.

Then that leads us back to section 135 and its words which prohibit a director of a company from permitting the business of a company being carried on in manner likely to create a substantial risk of serious loss to the company's creditors. So I say what that means is that the enquiry into compensation for a breach of section 135 should be centred on the loss caused to creditors, and by extension the company, by the carrying on of a business in breach. Just on this topic I've noted that in *Debut Homes* the Court observed that there was nothing in the wording of section 135 that envisaged a comparative exercised between immediate liquidation and continue trading, where continued trading would still result in a deficit. So in other words simply improving the deficit does not mean that there's not a breach of section 135, and of course that must be so when you look at the words of 135, which is not

at all concerned with whether there is a deficit and doesn't contemplate a comparative test between two points in time. The net deterioration test does, and in this case of course for the same reasons there as no – well for similar reasons – there was no reasonable basis upon which the directors could have expected to correct the company's insolvency and avoid a serious deficit by trading on. The company was unsalvageable in the same way that *Debut Homes* was, based on the Court of Appeal's decision at paragraph 446.

WINKELMANN CJ:

Once you're insolvent/liquidation, the only people who have a legitimate interest in the company, and can benefit from it, are the creditors. I'm just thinking it does seem strange when you say that it's only the interest of the company not the creditors that can be taken into account under section 301 the fiction that the net deterioration model has because really there is only the creditors.

MR KENNEDY:

And that's the issue that we have with it, your Honour, in a nutshell, that the problem with the net deterioration test, of course, is that it's focused on the company, and the company only, and because it more or less disregards or obscures the make-up of the creditor body of the company at any given time then you could well conclude, as indeed both the High Court and the Court of Appeal did in this case, that there is no net deterioration and therefore no loss for what was a clear, admitted, and I might suggest egregious breach of section 135 despite the fact that the creditor body completely changed, and you had new creditors who for literally years were trading with a company that they did not know was insolvent and whose money was then – I say "money" but, of course, I'm talking about the revenue which is generated from the services and the products that these new creditors provided to the company – but the money was then used to pay the old creditors, the legitimately incurred creditors, at the breach date.

And that, in a nutshell, is why we say it just can't be right, your Honours, because what that means by applying a net deterioration test is that you're

saying this is fine, there's no problem for directors in this case to trade like that, to encourage new creditors to trade with their company despite the fact that it's hopelessly insolvent and there's no problem with the new creditors subsidising the old creditors which is necessarily the way in which the net deterioration test actually works.

I know your Honours know this but, you know, you look at the position of the company in liquidation and from that position, which is, as your Honour, the Chief Justice has pointed out, it's really just a list of creditors and you deduct the creditors, or the amount of the creditors, as at the breach date, and then what you're left with is really an approximation of how much the company's position has deteriorated over that period of time, and that amounts to the high point of the directors' liability.

So in a very real sense you've got the new creditors subsidising the old creditors and in turn the directors for their unlawful trading conduct, and we say that just simply can't be right because that necessarily eviscerates section 135. There's no protection for creditors at all on that approach, and that is the whole point of the section, in my respectful submission.

To be clear, your Honours, we're not saying that the net deterioration approach never works and, of course, we couldn't. It really is what is often described as the usual approach. I might have described it as the default approach in these submissions, and it does work in many cases where you might have –

WILLIAM YOUNG J:
Probably it would not – wouldn't it normally be, sorry, for the future, if you're right, wouldn't new creditors become the standard approach?

MR KENNEDY:
That's my own view, your Honour. My own view is that if the focus is on new creditors then what you can do is ensure justice to the extent the new creditors were also old creditors. So to the extent you've got the same

creditors on both sides of the breach date, you can actually give a credit in respect of the old debt that they got paid as part of the ongoing process, and that's exactly what Mr Apps has done here.

Now his Honour, Justice Cooke, in the High Court, didn't look very kindly upon the approach that Mr Apps took but we always thought it was just and it was sophisticated because what he did is he looked at the debts that were outstanding at the breach date and he looked at what there was at the liquidation date, and to the extent the same creditors were represented at both dates he included only the increase in their debt and then he also added up the new creditors that weren't present at the breach date but which existed at the liquidation date, and in that way he came to a determination of what the new debt was, which meant that no creditors could be said to have been improperly advantaged by receiving both their pre-breach debts as well as their post-breach debts.

O'REGAN J:
You're assuming that the amount paid into the company will go to the creditors on exactly the basis that the creditors would have got if they'd claimed individually aren't you?

MR KENNEDY:
No, I'm not assuming that of course, your Honour, because we all have to accept that the policy of the Companies Act is to provide for pari passu distribution to creditors and –

O'REGAN J:
But if you're talking about giving credits in relation to creditors, when in fact that's got nothing to do with the amount creditors receive, there is a bit of a mixed metaphor there, isn't there?

MR KENNEDY:
Yes I can see the point, your Honour. I guess the reason why credits as such are being given is not for any purpose other than to ensure that you don't end

up with creditors receiving more through this process than they would have done had, in fact, the company ceased trading at the breach date. So it's allowing for the fact that, and again we're talking hypothetically, but if you have a breach date by definition the creditors before then have been subject only to the usual business risks that are associated with commercial trading. But those who incur post the breach date, they are subject to the illegitimate business risk that the directors are responsible for in breaches of 136 and 136. So your Honour is quite right, there is something to be said for an argument that say under 135 it should be simply a claim for the debts incurred in breach of 135 after the breach date, and there's no need to take into account the extent to which those same creditors might have been owed debts prior to the breach date. But here we've taken a conservative approaoch and we've sought to bring that to account. So it can't be argued from a restitutionary basis that those creditors received more than they were entitled to.

Sor Mr Apps went through quite a detailed calculation to identify the extent of the credit, which he was able to extend in respect of the debts outstanding at the breach date, but this is the calculation that the defendants did not engage with, or the directors did not engage with.

WINKELMANN CJ:

So say the breach under section 135 consisted of the directors carrying on trading simply to pay away their cash, the people they particularly wanted them to, so doing their own little pay away secured creditors, that they've given guarantees in respect of, that kind of thing, then a different measure would be appropriate to respond to that breach, wouldn't it, that'd be the amount the directors had paid away.

MR KENNEDY:

Yes because I would have thought in that situation, your Honour, you're really getting close to a fiduciary breach, or something similar, under 301 – not 301, 131.

WINKELMANN CJ:

But it may not be self-dealing, it could just be stupidity.

MR KENNEDY:

Yes, and look there's no question your Honour I think it's very, very difficult to come up with a one size fits all approach to the assessment of compensation because it will always depend on the circumstances.

WINKELMANN CJ:

Well isn't that what this Court said in *Debut Homes*? I think.

MR KENNEDY:

I'm sure they did your Honour, but what I meant by that is even if you look at the breach of 135, it's quite easy to conceive of a breach of 135 where the directors imprudently make a decision, which actually threatens the solvency of the whole company, and therefore all of the existing creditors in those circumstances lose out, and that is a situation where the entire body of creditors is affected by the breach of 135. When you're talking about reckless trading, like we are here, it's inevitable that you have a breach date, that's the way these things are proved, and it's only the creditors who are incurred in breach of the directors' obligations as from the breach date that have a claim under 135.

O'REGAN J:

Well, they don't have a claim, though, do they? It's the company that has the claim.

MR KENNEDY:

Sorry, it's only those creditors in respect of which a claim can be brought for loss to the company. You're quite right, your Honour, I went too far then. But the point I was trying to illustrate is that the particular facts of the breach will give rise to different approaches, depending on the nature of the breach and the affected creditors and 135. Although it might be the entire body of creditors who are affected by the breach, it doesn't have to be, and more often

than not, where there is a breach on a reckless trading basis, the old creditors who were incurred at the time when there was no breach of the directors' obligations, they can't form the basis of a claim against the directors for breach. It can only be the body of creditors who were incurred after the breach date.

So I think we've covered quite a bit of what I've set out in my submissions, your Honour, just in that exchange.

O'REGAN J:
How do you deal with the overlap of the compensation under 136 and 135 if you're successful on both?

MR KENNEDY:
If I can respectfully adopt my learned friend, Mr O'Brien's, submission, I think it isn't right to set out from the assumption that these sections do something different and it's necessary to obtain or to identify a clear bright dividing line between the way in which these sections work in any given facts situation. So they really are statutory expressions of the principle which was identified in *Walker v Wimborne* first up, and *Permakraft* and so on, that on the doorstep of solvency or in actual insolvency the directors have to have regard to the creditors' interests because they effectively are the only interests in the company at that point in time. So, you know, we can conceive of situations where 135 and 136 won't overlap but there are also circumstances where they will overlap and there are concurrent breaches, much in the same way as there was in *Debut Homes*.

O'REGAN J:
But are you accepting that in the case where there is an overlap there's one lot of compensation awarded, not two?

MR KENNEDY:

Yes, we can't ever get more than the actual loss but what I am saying, your Honour, is that the approach to compensation is not necessarily always going to be the same.

O'REGAN J:

Well, they wouldn't be on the – I mean if you're successful here but the Court of Appeal's assessment of 136 compensation stands, they are different amounts, aren't they, but how do you then reconcile them because the Court of Appeal's – it's still talking about an award to the company even though it's by reference to particular creditors, isn't it?

MR KENNEDY:

Yes, it's always an award to the company, that's quite right, but it's determined by reference to the losses that the creditors suffered in breach of 135 and 136. So in this case there is an award made under 136 by the Court of Appeal which I've invited your Honours to quantify but I'm also going to invite your Honours to quantify the claim under 135 based on the approach that Mr Apps took and which was proved in the High Court, and that produces a different number, a higher number, but obviously to the extent there is overlap you can't ever receive or recover more than the loss.

GLAZEBROOK J:

So there would be complete overlap here or…

MR KENNEDY:

It's not complete overlap because one of the issues here with the Court of Appeal's approach is the identification of that 5 July time period.

GLAZEBROOK J:

No, I understand that but what I'm saying is that I would have thought the 135 would go from a different time period, so if you're successful on 135 that would be the figure and we would ignore the 136 –

MR KENNEDY:

That's right.

GLAZEBROOK J:

– or alternatively say it's the higher of those two figures, is that the submission?

MR KENNEDY:

Yes, it is. That's the practical effect. So I think we've covered off your Honours – sorry?

GLAZEBROOK J:

Is there any – the argument for your friends wasn't put this way but is there any possibility of deduction for the measures that they did put in place, like the pre-purchase agreement, and I'm not sure whether there were other ones they were mentioning, that were designed to fill the hole?

MR KENNEDY:

Well, of course, your Honour, the loss to the creditors is determined by reference to those creditors that are out of pocket and whose proofs have been admitted in the liquidation. So to the extent that they took any steps that might have improved the company's position, that's already been reflected and taken into account in the total body of creditors that have lost money.

WINKELMANN CJ:

It's been reflected in what's available to them already, you mean?

MR KENNEDY:

Yes. Yes, because presumably if in fact – and there's obviously a very real question mark as to the value in the prepaid goods agreement at all; it appeared to actually cost the company much more than it received – but if, just supposing, there was a benefit to the company, then that's already been taken into account in the context of what was available for the creditors as the company ultimately simply stopped trading, but it's difficult to see how they

could get another credit for whatever benefit was introduced to the company by them in its last few months.

GLAZEBROOK J:
Well, is it a credit that you could argue in terms of how culpable they were? I'm having some trouble articulating it because I don't think it was quite put this way but that seemed to be the flavour of what was being argued. They were arguing it I think to say there was no liability but assuming that was wrong.

MR KENNEDY:
Yes, well, we would say that there isn't any basis for a reduction as a consequence of those, of whatever sums were introduced, because it was far too little too late and, of course, much larger amounts of money were taken out in the years before and never repaid. So what small sums came back didn't even cover the interest on these loans which had never been repaid. So it's really not right, we would say, your Honour, to characterise any of either the sums that came in or the prepaid goods agreement as any form of support because it was only a small fraction of what was owed by the wider group back to Mainzeal following the money that had been taken out over a sustained period of time.

So just returning to the submissions at page 58. I'm not going to go through this in any detail but I've just simply pointed out that there was a real disconnect or is a disconnect between the Court's finding that there's no loss under the net deterioration approach and their findings on breach which were very clear and quite damning. For years the directors adopted a deliberate policy of trading while balance sheet insolvent, using creditors' funds as working capital. It wasn't reasonable for them to proceed on this basis, and section 135 did not condone a policy of "robbing Peter to pay Paul", on condition Peter's losses are exceeded by Paul's gains, and that must be so.

WINKELMANN CJ:

Has anyone traced the net deterioration standard method of calculation and – under section 320 – and how longstanding is that principle? I should have asked Mr O'Brien that probably.

MR KENNEDY:

Well, he's been around a long time, your Honour, so he'll know a lot more than me.

WINKELMANN CJ:

Not back to the 18th century as Professor Watts would have him.

MR KENNEDY:

He won't talk to me now. Mr O'Brien is telling me that the two leading cases are *South Pacific* and *Mason v Lewis*, which are actually, *Mason v Lewis* is relatively recent, but certainly that's the case that everyone defaults to. In fact it's even come to be known as the *Mason v Lewis* test, the net deterioration test. But certainly the Court of Appeal in that case did say that this is the usual –

WINKELMANN CJ:

That wasn't really what I was asking. I was really asking under the measure under the predecessor legislation, the UK legislation, you know, following the measure that was applied back in the 1930s, '40s, '50s…

MR KENNEDY:

Yes, I'm not sure that we've gone back to look at those cases under the preceding Act. Of course, *South Pacific* was under the old Act.

I see I've actually gone – just thinking we might have had a break but, of course, we don't.

WINKELMANN CJ:

That's right. You're not in the High Court.

MR KENNEDY:

I was going to suggest we could look at that over the break but, of course, that's not happening. I'll ask Mr O'Brien to perhaps have a quick look and see if he can find an answer to that question.

WINKELMANN CJ:

Well, Professor Watts says in his textbook that you took us to that the measure is now settled after a long period of uncertainty, or something like that.

MR KENNEDY:

Yes…

GLAZEBROOK J:

I remember reading an article, I'm not sure whether it's in these materials, that actually traces some of that and what they call a restitutionary approach, and I think the restitutionary approach was particularly related to thefts from companies but not always. But I can't remember whether I've seen that in these materials or, indeed, who wrote it or what it was called – which is really helpful.

WINKELMANN CJ:

No, no. We read a lot of material, to be fair.

MR KENNEDY:

There's a lot of material on this case. The issue with a net deterioration test is that it's a simple proxy for determining the extent to which the company's fortunes have declined following a breach of section 135 in a reckless trading context, and you can see that that's not surprising because in many instances, and I know my learned friend, Mr Hodder, for example, referred you to Mr Graham's evidence where he said, well, in almost all reckless trading cases you have a situation where the debts blow up and it becomes absolutely obvious, people are being stretched out, you know, the company's starting to fall over, and that's immediately clear that the company's in deep

trouble and in those circumstances it is likely that there will be some debts from before the breach date that aren't paid, and applying the net deterioration test in a case like that is a simple, easy way of determining the debts that can't be recovered or the loss that can't be recovered from the directors because it related to that period prior to the breach. But in a case like this one, and this is unusual because you don't, at least in my experience and in my submission, you don't often get cases that trade, where companies have traded for years, on negative equity.

WINKELMANN CJ:
Your simple submission is that the net deterioration measure does not respond to the harm that is caused by a particular breach.

MR KENNEDY:
Precisely, and what we say is the new debt approach does exactly that, and that's what we've set out. This is at paragraph 15.24 of my submissions. So the new debt approach is designed instead just to identify what the new debts were after the breach date for the purposes of determining what the loss suffered by the creditors who dealt with a company in breach of the directors' duties actually is. As I say, we've taken what we say is a conservative approach by identifying the extent to which there's creditors on both sides of the line and we've taken off, or we haven't included, what they were owed prior to the breach date, only the increase in those debts after the breach date. Then obviously we've included the new debts that existed at the date of liquidation but not from creditors who existed at the breach date. We say what this does is respond to the breach, substantial risk of serious loss to the creditors, that the company traded within breach of section 135 is identified by the new debt approach, and I've set out what that is, your Honours, at paragraph 15.33 onwards, in fact 15.34, and I've referred there to the evidence of Mr Apps.

I won't take you to the amount pleaded because you've already seen that, but at footnote 300 of my submissions, we're going here to the primary evidence from the liquidators' accounting expert, Mr Apps, and he explains how he went

about calculating what he described as a section 136 method, and then at 371 your Honours will see that that is a table which summarises what he's done. All of the detailed calculations are in his evidence but they are brought together in this table.

Just to briefly talk you through it, you'll see that the first column "January 2011" he's identified the debts that existed as at January 2011, and these are from specific creditors, and then he's identified how much those creditors were owed at the liquidation. That's under the column "Admitted". Then you see the next column which is "Increase". That's the amount that he has taken into account for the purposes of loss. So he hasn't taken into account anything from the first column, he's only taken into account the difference between those two columns. You can see, just by way of example, where it says principal $5.2 million, that exists at January 2011, it's been admitted in the liquidation, that means that there is zero increase, so it does not get added to the assessment of loss. Then you have the second to last column which is "Existed at the factual" which is just the liquidation, of course, "but not the counterfactual", being the breach date, and then what he's done is he's added that column along with the "Increase" column and that brings you to the total loss, which in this case is $75 million.

Now, your Honours, I should note that Mr Apps did in his reply brief make a very small adjustment to this. He reduced the employee debt by $136,000. So the subtotal comes to $75,210,000. I just bring that to your Honours' attention in the interests of accuracy but I won't take you to the same table in the reply evidence.

So that's the loss that he has assessed. All of the detail, as I say, is contained in his evidence, including a line-by-line assessment of the individual creditors.

So when the directors say they need to have the opportunity to analyse when the obligations were entered into and what quantum to be attributed to them, that's in the submissions for my friends representing Mr Yan. We say they've had that opportunity. All this information was before the High Court and they

took no issue with it. They didn't examine it. They didn't challenge Mr Apps on his calculations. They just simply chose to proceed on the basis that it was not a lawfully valid approach to the assessment of loss.

But the other issue too is that even now they're not able to point to any basis upon which Mr Apps' calculations can be materially criticised. So in the submissions my friends for Mr Yan they say that there's no assessment of long-term and latent obligations, like leaky building claims and lease debts, but they stopped short of asserting that those obligations have, in fact, been included. But it's also it's simply a theoretical objection, and I say that because none of the legacy leaky building claims were taken into account in Mr Apps new debt assessment. So your Honours will recall, the table that we've got at 371, if I could just ask your Honours in particular to note first the principal debt of $5.206 million, which is in the first two columns, January 2011 and the admitted column, and then note the last two columns there under principal $17,441 million.

Then I'll ask Mr Leggat just to take us up to page 892. So you'll see this is the source of the 17.441 million accepted in the principal column, and you'll see the heading "Non legacy principal claims". In other words there are no legacy claims associated with that figure. So the theoretical objection that's been made simply is wrong on the evidence.

Just to finalise it, if we can just go to 889. So you'll see, your Honours, this is the table "Loss arising from construction claims on completed projects." This is the legacy claims table, and you'll sees in the factual $5.206 million. So that's the amount in the original table I took your Honours too, which was not carried through into the assessment of loss, because it was taken as an existing obligation at the counterfactual date in January 2011.

Now the other objection which has been raised by my friends is that the figures might well contain lease liabilities, that's put forward was a possibility. But because the schedules contain every single debt that's been calculated, every creditor that goes into Mr Apps' calculation, they've made no attempt to

actually identify any particular entries which they say would constitute less obligations that might relate to a deed of lease incurred into – entered into prior to January 2011. Now we say that if they still can't point to any issues, even now, it's all a bit too late to be seeking to have these issues put back in front of the High Court.

There is also an issue raised in respect of a bond by my friends for Mr Yan, but that seems to be just simply a misunderstanding as to the nature of the bond, which is included in the original table, which was a bond, a liability issue by AssetInsure and relating to the Baypoint remediation, and not a bond issued by Vero AAI as being suggested by my friends. So because Mr Apps proceeded on the basis that any debts or creditors that were owed money at the counterfactual debt, whose debts reduced between the counterfactual and the date of liquidation, they were not included in the assessment of loss. Vero, which was a substantial provider of bonds to Mainzeal, has not had any of its liabilities included in the assessment of his loss.

So your Honours that's all I was going to say, I think, about 135 unless there are any other questions on that. I know we've gone through it quite quickly.

WINKELMANN CJ:
Fine thank you Mr Kennedy.

MR KENNEDY:
Well that leads me now to the final section of my submissions, which is "Relief under s 301" and I've set out at 16.1 just a bit of the history of 301 but your Honours, of course, have been through that in detail, so I'm not going to labour that. But it has been described by the Court of Appeal on a number of occasions as "a procedural short cut by which a liquidator, creditor or shareholder may pursue the claims which a company in liquidation may have against its directors." So what is clear on the authorities, I think it's settled law your Honours, is that 301 does not impose any new duty or create a new cause of action.

Now the principals were addressed by this Court in *Debut Homes* and your Honours endorsed the usual considerations of causation, duration and culpability in assessing the directors' liability under section 301. Now the Court of Appeal spent some time considering the way in which 301 ought to be interpreted in the context of this case, and I think I might just take your Honours to that at footnote 307. Paragraph 298 of the Court of Appeal judgment. So the Court refers to the "procedural short cut". Over at 299 that's where the Court confirms: "Section 31 does not impose any new duty - "

WINKELMANN CJ:
It's a little bit counterintuitive there to be arguing that it's not a broad remedial discretion because really aren't you saying that we should be interpreting it as being a – giving a court the room to move to make sure that the remedy responds to the wrong?

MR KENNEDY:
What I'm saying here, your Honour, is the extent to which there is a discretion that enables the Court to discount the loss which would otherwise flow from breach of 135/136. So where, and this is what the Court of Appeal says in this case, and it does echo comments as well made by the Court of Appeal in *Sojourner v Robb* [2007] NZCA 493; [2008] 1 NZLR 751 (CA), that where section 301 is a proxy for a direct claim by the company against its directors for a breach of a statutory duty, it is difficult to see why bringing a claim that follows that procedural route should result in a claim that is significantly discounted by comparison with a direct claim by the company against the directors under those same sections. So what we're saying here, your Honour, is that where this is just a procedural route, the loss which followed a breach of 135/136 should not be subject to significant discounting on the basis of culpability, causation or duration.

So what I was doing, your Honours, was stepping through the Court of Appeal's reasoning, but I'm not going to dwell on this because I know that your Honours can read it as well as I can read it to you. But the Court does say at 302…

WINKELMANN CJ:

Sorry to be dim Mr Kennedy, but does your argument depend, does your notion that it's something procedural depend on the notion that you can't just proceed – that you can also just proceed under s 135 without reference to section 301, because that doesn't seem to me to be how the Act reads.

MR KENNEDY:

I think it's, as I understand it your Honour, it's reasonably, or it has been accepted that the company itself could bring a claim against the directors directly under 135 and 136.

WINKELMANN CJ:

All right.

MR KENNEDY:

So section 301 is simply a procedural route that enables a number of identified individuals, including a liquidator or a creditor, to bring a claim on behalf of the company in liquidation.

WINKELMANN CJ:

So for them it's not an alternative route?

MR KENNEDY:

Well, the liquidators can, of course, control the company, so they could actually bring a claim in the company's name.

WINKELMANN CJ:

That's a really peculiar reading of the Act, isn't it? Doesn't it suggest that this is the route for the liquidator and the parties named here? It seems to me to suggest that, and then that shapes relief that suggests that because of the very different circumstances that arise in a liquidation, perhaps in this, creditors suing, et cetera, that you do have a broader remedial discretion, because there are other provisions in the Companies Act, aren't there, which give courts power to do what they think just in the voidable transaction area?

WILLIAM YOUNG J:

Haven't they gone?

WINKELMANN CJ:

No. Section 295?

WILLIAM YOUNG J:

In terms of relieving directors.

WINKELMANN CJ:

In terms of relieving directors? No, I don't think so. I think section 295.

MR KENNEDY:

Well, this is one of the points that I think Justice Goddard, writing for the panel in the Court of Appeal, noted that there had been in the previous Companies Act, so they are a broad discretion to effectively relieve directors of liability in circumstances where they'd acted honestly and reasonably, and that wasn't carried through or an equivalent wasn't carried through into the 1993 Act.

WINKELMANN CJ:

Yes, yes, I'm not talking about breach of directors' duties. I'm talking about section 295, about where a charge is set aside and there's power to do justice. I think it's the section that – because there is a section. Is it 299?

MR KENNEDY:

I'll see if I can find it, your Honours. You say 299, your Honour?

WINKELMANN CJ:

Yes.

MR KENNEDY:

295?

WINKELMANN CJ:

Yes, I might be wrong about that. I've sent you down a rabbit hole. I'm sorry, Mr Kennedy. I can't see it in the section.

MR KENNEDY:

Not at all, your Honour. I was…

WINKELMANN CJ:

I think it might have been the argument that was made. It's been ringing bells in my head, the point is, and I think the argument was made and it was rejected. The argument was made that there was sort of a just and equitable discretion floating around the general discretion.

MR KENNEDY:

Yes, the point I was making here, your Honour, is made by the Court of Appeal in this case but also made by the Court of Appeal in *Sojourner v Robb* which was referred to by the Court of Appeal. That's at footnote 314, Mr Leggat.

WINKELMANN CJ:

It's just very peculiar drafting though, isn't it?

MR KENNEDY:

I think there's quite a bit that's peculiar about the Companies Act, your Honour.

WILLIAM YOUNG J:

Is there any reason why the claim just couldn't have been brought by the company in receivership under, in liquidation under, directly as a plaintiff?

MR KENNEDY:

Well, that's the submission I was making, your Honour. It could be made.

WILLIAM YOUNG J:

And if it were there would be no basis for a reduction in the award.

MR KENNEDY:

And that's the point that is made by the Court of Appeal in this case and that's a point that your Honour, Justice Young, made in *Sojourner v Robb* which you see at paragraph 55.

WINKELMANN CJ:

Yes, and the point I'm making is if you actually have express provision for it, it's bizarre to read it as allowing that direct route because it seems to displace it, but maybe that's not – well, that's obviously what the Court of Appeal said so…

MR KENNEDY:

And your Honours will recall that this is where you have sort of a little bit of a lacuna in the history of the development of the Companies Act because no one's quite sure why that got placed, that section 301 got placed into the Act, but it wasn't there in the Law Commission's recommended statute and for this very reason, because the Law Commission did not see that it was necessary for the liquidator to have a specific ability to pursue a breach of these sections because it could have been done directly through the company. So you end up with this position where if it is just a procedural shortcut, which is what the law seems clear that it is, and given that the ultimate beneficiaries of the claim are the creditors, it doesn't seem to make sense that significant discounts ought to be applied on the basis of culpability, causation, duration et cetera if that is simply to reduce the benefit of the ultimate judgment and recovery to the creditors. So the selection of the procedural route ends up with, on that basis, having a significant impact on recovery, and that's the issue that the Court of Appeal raised as querying the extent to which it could be said that a broad discretion was appropriate –

WINKELMANN CJ:

Or perhaps on the authorities to date, another alternative is the one I've said, which is it's intended to be the pathway for the liquidator. Because why would you enact it otherwise.

MR KENNEDY:

I suppose what it does do, your Honour, is it does provide a route for the other identified individuals as well, including creditors, directors, shareholders, so it does seem to be a bit of an amalgam. It's a catchall which enables a number of different identified individuals with different interests to pursue a claim against the company, against the directors, sorry, that relates to the company, and it was used to that effect again in the *Sojourner v Robb* case, where a claim was brough directly by a creditor, that case Sojourner against the directors, and effectively is akin to a derivative action on behalf of the company. So that wouldn't otherwise have been available but for section 301.

Then finally your Honours in the submissions I then move on to causation, culpability and duration on the basis that there is a broad discretion, if your Honours determine that there is a broad discretion rather than a narrow one, which I've submitted is all that ought to be available. So I'm moving through page 67 of my submissions. We say here that Mr Yan has very high culpability given the nature of his relationship and beneficial interest in the remainder of the group and that the fact that he clearly has benefited as a consequences of the funds that were removed from Mainzeal. I've set out at 68 the other factors that we rely upon. Position of conflict, misleading the other directors, he resisted formalising support, and the amount that he was ordered to contribute was materially less tan the value extracted from Mainzeal and used to assist in acquiring this wealth.

We also say that Dame Jenny's culpability is of a higher level than Messrs Tilby and Gomm. She was the chair, she was a director of RPL before 2004 and 2009. She had a greater understanding of what was happening in RPL because of that directorship, and your Honours will recall that Mr O'Brien took you to the document at 310.05696 where she voted against capitalising Mainzeal with the preference share arrangement for US$13.5 million on the basis that that wasn't prudent for RPL at that point in time. She actually held shares in Richina Pacific. They were sold for $150,000 in 2017 but nonetheless she had a financial interest in that entity, and as a former Prime Minister she gave assurance to the company's

counterparties, and in my submission your Honours that can't be overlooked. Mainzeal was an established company, it wasn't a start-up, and the presence of a former Prime Minister would have given counterparties a great deal of comfort that the company was being run in a lawful and transparent manner, prudently, and being up-front about the risks. Dame Jenny's personal reputation and credibility meant that she should have greater culpability to those who justifiably took comfort from her role as Chair and implied endorsement of the company.

WINKELMANN CJ:
How far are you from finishing, Mr Kennedy?

MR KENNEDY:
Probably about two minutes. Sorry, your Honour, I see that we've just gone over.

WINKELMANN CJ:
That's all right. You carry on and finish.

MR KENNEDY:
The point I was going to make as well, your Honour, is that it's been said that the directors, Mr Hodder's clients, had no conflict of interest more generally and I'm just questioning whether that actually is so in circumstances where just at a usual level directors are interested generally in remaining on the board but they serve at the pleasure of the shareholders, and where they don't do what the shareholders wish them to do they run the risk of having their tenure brought to an end. So it's not exactly right to say that directors don't have a conflict of interest. The interests are aligned more with shareholders than with anyone else.

O'REGAN J:
But that means that in every case the directors have conflict.

MR KENNEDY:

There may be in circumstances where you have a greater personal reputation, your Honour, that you may be more concerned about what the fallout might be for a company which trades insolvent and goes into an insolvent liquidation and in those circumstances again you might be more inclined to throw the dice in the hope of retrieving the position. But I don't put it any more highly than that.

ELLEN FRANCE J:

In terms of Mr Hodder's clients, there are findings against you in relation to that, aren't there, that there's a conflict?

MR KENNEDY:

Yes, I'd need to check that, your Honour. I wasn't sure that was the case. As I say, I don't put it any more highly than that in any event but I accept it's a relatively low-level conflict.

WINKELMANN CJ:

Well, Mr Yan, you would say, had a conflict arising from his interests in the parent and his interests in the subsidiary?

MR KENNEDY:

He had a clear conflict, your Honour. There's no question about that.

WINKELMANN CJ:

And you would say: "And Dame Jenny was a shareholder in a parent at that time also"?

MR KENNEDY:

Yes, she was.

WINKELMANN CJ:

But that was the extent of the involvement of the directors in the business affairs of the parent?

MR KENNEDY:

Yes, that's right.

ELLEN FRANCE J:

When did she cease being…

MR KENNEDY:

A director of RPL, your Honour?

ELLEN FRANCE J:

Yes.

MR KENNEDY:

I think in the latter part of 2009.

ELLEN FRANCE J:

2009?

MR KENNEDY:

2009, that's right.

ELLEN FRANCE J:

So not at the relevant time then?

MR KENNEDY:

Well, certainly before the breach date.

WINKELMANN CJ:

But she had shareholding at the relevant date?

MR KENNEDY:

She had a shareholding on the relevant date which was disposed of as we understand, so there was no evidence on this point but it got addressed after that. But I think it was disposed of –

WINKELMANN CJ:

So there's no evidence on this point? No evidence?

MR KENNEDY:

Yes, what happened is that her shareholding came up but the detail of her shareholding was not in evidence as I recall.

WILLIAM YOUNG J:

There's a footnote to your 16.21(d).

MR KENNEDY:

Sorry, your Honour?

WILLIAM YOUNG J:

There's a footnote 327. What does that say? That might be a reference to it. I see, it's to the High Court judgment: "Largely immaterial".

MR KENNEDY:

Yes, apparently it was sold for about $150,000, your Honours.

Then there's the length of the insolvent trading which is obviously very significant in the context of this company. Trading whilst insolvent from December 2005 and in breach of duty from at least mid-2010.

So I think that was all I was going to cover on that, your Honours, unless you have any questions on it.

WINKELMANN CJ:

Does that conclude the respondents' submissions?

MR O'BRIEN QC:

If I may, your Honour, I was going to answer that question you asked.

WINKELMANN CJ:

Do you want to do it now or do you want to do it in the morning?

MR O'BRIEN QC:

In the morning.

WINKELMANN CJ:

Right, but you won't take more than about five or 10 minutes, will you?

MR O'BRIEN QC:

No, I won't, your Honour.

WINKELMANN CJ:

We'll retire, thanks.

COURT ADJOURNS: 4.05 PM

COURT RESUMES ON FRIDAY 11 MARCH 2022 AT 10.03 AM

WINKELMANN CJ:
Good morning.

MR O'BRIEN QC:
Your Honours, good morning. There were just two matters that I wanted to cover, albeit briefly in each case. The first one concerned your Honours' question re authorities on the approaches to loss and in particular early authorities, and the second concerned the question about finding in respect of conflict in the High Court. So I'll deal with those in that way and in turn.

Your Honours, in terms of authorities under the legislation which pre-date the 1981 amendment when we saw the introduction of what had morphed into sections 135 and 136, the authorities are few and far between, and there's only three that we have identified of any note, and I'll give your Honours a reference to them. I think one of them is in the bundle. The first one is *Re William C Leith Brothers Ltd* (1932) 2 Ch 71, so an English case, and there the Court took the view that the equivalent English section allowed remedy in the nature of a penalty, and that it was a punitive provision, but nonetheless a discretionary in terms of remedy and the Court there ordered the defendants to pay part of the company's debt. So that's the first case of any note.

The next one is a New Zealand case, which I think is in the bundle –

GLAZEBROOK J:
So that was just the debts that were owing at liquidation I assume.

MR O'BRIEN QC:
Yes, it was debts owing at liquidation your Honour, but not all of them by the look of it. Then the next case is *Re J E Hurdley and Son (in liquidation)* [1941] NZLR 686, and there by majority the Court of Appeal took the view that the New Zealand section was compensatory in object and the minority, and I think

that was the Chief Justice, took the view that it was punitive. At any rate the award made was compensatory and again it seems effectively based on the debts that were owing at the debt of liquidation, but not all.

GLAZEBROOK J:
With no, just because we're looking at that net deficit, but just basically the debts owing, did it say anything about deterioration?

MR O'BRIEN QC:
Well, I think the answer is yes and no your Honour but – sorry.

GLAZEBROOK J:
Yes, no, that's fine. It's just a question.

MR O'BRIEN QC:
Remembering that at this stage, of course, the legislation was focused on fraudulent trading so it was the debts incurred as a consequences of the fraudulent trading, and actually that's why the case is pre the 1981 Amendment, terribly useful, but they are focused on the debts incurred as a consequences of the breach i.e. as a consequences of the fraudulent trading.

The third one in that series which I just wanted to mention to your Honours is, I do have others but I'll come to them, the third one is *Re Maney & Sons Deluxe Service Station* [1968] NZLR 624, and there the Court, I think it was the then Supreme Court, one of the objects of section 320 is to enable the Court in a proper case to strip away the shield of limited liability where a company's business is being carried on with intent to defraud, and it took an entire deficiency approach. So all of the debts in the liquidation, but presumably caused as a consequences of the fraudulent trading.

WILLIAM YOUNG J:
There's a discussion in that case, at least an argument about who the duty is owed to, and who can sue. In the Court of Appeal –

MR O'BRIEN QC:

I must admit Sir I haven't read that case recently. I have read it, but a long time ago. I think not from memory but…

WILLIAM YOUNG J:

Well in the Court of Appeal the only issue was limitation.

MR O'BRIEN QC:

Yes.

WILLIAM YOUNG J:

And the Court of Appeal held that the start date for the limitation period was the date of liquidation.

MR O'BRIEN QC:

That's my recollection Sir.

WILLIAM YOUNG J:

But there was sort of discussion and argument about who, if anyone, could have sued before liquidation. That I don't recall your Honour so I'm sorry I can't help with that, or at least not immediately.

WILLIAM YOUNG J:

It's quite a dense case.

MR O'BRIEN QC:

Again, that's my recollection, yes, and quite well-known. So with that, your Honours, could I then take you to the index for the case, and you see here at tab 28 – sorry, tab 25 of the Supreme Court index.

WINKELMANN CJ:

So the case on appeal is post the authorities you mean?

MR O'BRIEN QC:

Yes, sorry, case on appeal.

O'REGAN J:
Is it *Löwer v Traveller* you want to take us to?

MR O'BRIEN QC:
No Sir it wasn't. Not yet anyway.

WINKELMANN CJ:
Are you onto the conflict point now, or not?

MR O'BRIEN QC:
No, I'm still on lost cases. So this, at tab 25 of the index to the case on appeal in this court, you'll find our opening submissions from the High Court. You may wonder why and the reason is the Court of Appeal asked for these both opening and closing submissions because of the submissions being made to it about what was and wasn't pled and put and so on. So here we have this and if I could ask Ms Holtz, please, to go to paragraph 84 which should be page 24 of the PDF.

So we're starting at 84 and you'll see there, your Honours, we had a reference to relief under section 301, and if we just scroll down, please, you'll see – I'm not going to take you all through this obviously but just the next page, please – paragraph 86. We have the well-known quote from *Mason v Lewis* where it was said that the standard approach has been to begin by looking at the deterioration in the company's financial position. So the net deterioration approach which is also known sometimes as the *Mason v Lewis* approach.

But if we could just continue scrolling, please, we'll see at paragraph 92, if I can just ask you to go there for a moment, there's further mention of *Mason v Lewis* and we say there that the defendants contend that's the only applicable approach to which we said, well, the so-called standard approach has been focused on 135 and not 136 and it's not of long-standing, and that's one of the key points I wanted to bring to your Honours' attention. It is not of long-standing, at least not when *Mason v Lewis* came out, and in fact, if one looks at the various authorities to which reference has been made in the

Courts below and in our submission there is no standard approach. It is a standard and it is referred to *Mason v Lewis* as the standard but there are multiple approaches and I'll take you to that quickly as I work my way through. Indeed, we say that it's evident really even from *Mason v Lewis* itself and if I just ask Ms Holtz to take us back up to paragraph 88.

GLAZEBROOK J:
Were those quotes there from *Mason v Lewis*, the equitable nature ones that –

MR O'BRIEN QC:
Yes, your Honour. So 88, and there noting that in *Löwer v Traveller* in the Court of Appeal Justice McGrath, writing on behalf of the panel, saying that the principal purpose of the predecessor section to 135 and 136, ie, section 320 of the '55 Act, was to compensate those who suffer loss as a result of illegitimate trading, and I just ask your Honour to note the words. There's no suggestion, and there needn't have been under section 320, as we've seen, no suggestion that this had to be focused solely on the company or that it had to be focused solely on the loss which the company may have suffered.

Then, your Honours, if I could just give your Honour a reference, if we go back to the index, please, you will see our High Court closing submissions are at tab 35 and I won't take you right through this but if we go into there, please, and go to – I don't have a PDF page number for you, Ms Holtz, but it's paragraph 5.1 to 5.36, and I won't go through all this but just to give your Honours a reference there's some degree of additional detail in there about the approach that has been taken and acknowledging again that *Mason v Lewis* calls net deterioration standard, but as your Honour, Justice Glazebrook noted, they are also looking at what is an equitable approach to relief, ie – and I should have mentioned *Löwer v Traveller* I think in the Court of Appeal called net deterioration the usual approach, but again there's a multiplicity of approaches and I'm about to take you to that. I won't run you through all of these sections, but if we just scroll down quickly, you'll

see it runs through to 536, but at I think it's 5.13/5.14 we made the same submission in the High Court you'll see that effectively we're making here.

Then, your Honours, if we go so schedule 8, not 7 which is mentioned in the body of the submissions, but schedule 8 which is on page 103.01159. there's examples of cases more recent so not, your Honour Chief Justice Winkelmann, cases pre-1981, but examples of cases where loss has been assessed other than by reference to a notion or liquidators and serendipitously starting with *Debut Homes* in the High Court, which was the authority then available. Then you'll see for example a reference to a case *Hansa Ltd (in liq) v Hibbs* [2017] NZHC 2014 on that page, where effectively the defendant was operating a Ponzi scheme and a new debt approach was taken, perfectly appropriate in those circumstances.

Then over the page please other cases, I won't take your Honours through all this, but the short point is that even since *Löwer v Traveller*'s reference to the usual approach and *Mason v Lewis* reference to the standard approach, the Courts have, in fact, taken a variety of approaches to the question of remedy settling on whatever the Court saw as that most appropriate for the circumstances of the case it was dealing with, and that has included, in effect, in some cases, a new debt type approach, and as I say, usual and standard, well, yes, that's what the two Court of Appeal cases say, and so describe them as, but it's relatively thin. It's not intended to be, and as your Honours noted in *Debut Homes*, it's not intended to be the only approach, certainly not a straightjacket.

GLAZEBROOK J:
Is there any case that you found that does actually use net deterioration?

MR O'BRIEN QC:
Well, *Löwer v Traveller* did, for example, your Honour, in a way, and *Mason v Lewis v Lewis* did, but *Mason v Lewis* involved a printing company, and we surmise from the facts of the case that that printing company had a relatively stable body of creditors, unlike this case where you've got a construction

company taking on new projects every month, or every couple of months, and a huge churn in the body of creditors over the extended period of breach, i.e. two years.

GLAZEBROOK J:
So your submission would be that net deterioration obviously makes some sense in that case because effectively it's just the same creditors with different amount of debt, and when the wheel stops they're actually in the same position.

MR O'BRIEN QC:
Yes.

GLAZEBROOK J:
Sorry, yes, they've got the same, they might have had the same amount of debt beforehand.

MR O'BRIEN QC:
Yes, well at least it's largely the same body of creditors, perhaps not perfectly the same, but largely, and the cases, the authorities make it clear, all of the authorities to which I've referred your Honours and in these passages which I've taken you to, but the Court need not be concerned with seeking to achieve perfection. There's a degree of, I think your Honour Justice Young called it rough justice, but others have framed it differently, in a sense to say that we do not need to get to the perfect, or the last, the perfect accounting outcome. We need to get a remedy which suits the wrong.

Now, your Honours, in particular your Honour, Justice Glazebrook, I think the article and I guess, of course, but I think the article to which you may have referred or been recalling is an article by Chris Noonan and Susan Watson.

GLAZEBROOK J:
Could well be, yes.

MR O'BRIEN QC:

And this isn't in the bundle but it has been in our earlier bundles, for example, the Court of Appeal bundle, and I'm pretty sure it was in the High Court bundle. I'll just give your Honours the name of it and the reference. Well, the reference first because that's what you most need. It's 21 NZULR 26. It's from June 2004 and it's by Chris Noonan and Susan Watson and it's called *Rethinking the misunderstood and much maligned remedies for reckless and insolvent trading*. Your Honours, using that, we had a one-page schedule 2 in our Court of Appeal cross-appeal submissions. They are not in the bundle but if I could just take you through the points made there relatively briefly.

We said early cases took a variety of approaches to the exercise of loss, and indeed they did. First, there was a punitive approach in cases such as *Nippon Express v Woodward* which was a judgment of Justice Anderson's, I think, and there were other cases which took that too. Then there was a total loss approach which we saw in cases like *Re Hilltop Group* and that is a 2001 High Court judgment. Third, we saw an approach which was centred primarily on causation, culpability and duration, and we saw that in, for example, *Re B M Jackson*. Your Honours will find all of these in the Noonan and Watson article so I won't give you all the references but some of them will be familiar to you, at least by name.

Subsumed within that total loss approach was, I think, both actual total loss, full net deficiency and also net deterioration. Then, as I mentioned to you, *South Pacific Shipping*, Court of Appeal, where Justice McGrath commented that the principal purpose of the section was to compensate those who suffered loss as a result of illegitimate trading, the extent of the required contribution being a matter for the Court's judgment, the factors of particular relevance being causation, culpability and duration.

Then *Mason v Lewis* we also mentioned and this was the reference I was looking for at *Mason v Lewis* – I'm not sure I've got the paragraph number. I think it's 50 to 52 or it could be 109 to 110. In fact, 118, sorry. The Court

said this, firstly: “Claims of this character necessarily have to be approached in a relatively broad-brush way. The jurisdiction to order recompense is of an ‘equitable’ character.”

So the short point, your Honour, Chief Justice Winkelmann, is pre-1981 cases, of course, were focused on loss caused to creditors as a consequence of fraudulent trading and therefore really not focused at all on net deterioration so far as we can see, and after that there’s been a variety of approaches, partly dependent on whether it’s 135 or 136 or the section 320 equivalents and partly just dependent upon the circumstances, and we see this variety of approaches but yes, a so-called usual or standard approach but with the caveat that I just mentioned, or caveats I just mentioned where the Courts make it clear that they’re looking for orders that will provide compensation of an equitable character and remedy the wrong.

WINKELMANN CJ:
So Mr Hodder is going to say that the change in the law to the 1993 Act was intended to remove the punitive aspect of this jurisdiction.

MR O’BRIEN QC:
That’s right your Honour, it was, at least at Law Commission level it was, and we’re not seeking a punitive remedy. We’re seeking partial and only partial compensation. Well we’re seeking compensation and I say “we” the liquidators are on behalf of the creditors and obviously we’re not seeking the full net deterioration at the time of collapse, they’re seeking a contribution, albeit a significant contribution.

GLAZEBROOK J:
And it’s a contribution because you’re effectively taking off the debts that would’ve been there at that notional liquidation, is that the…

MR O’BRIEN QC:
Well for two reasons your Honour. Under our 135 proposal or submission where we start with the $75 million that Mr Apps calculated, and then deduct

the $11 million owed to related parties. The answer to your Honour's question, yes exactly right, and then under the Court of Appeal's approach to section 136, it's partial because it's only capturing subset of the new debt and the liquidators, in order to invite and hopefully persuade your Honours to enter judgment for a number now rather than subject the liquidators to several more years of litigation, they are discounting again.

So Mr Hodder will also, no doubt, say that of course after 1993 the focus on creditors which we saw in section 320 was removed in favour of the clear focus on the company. Of course we acknowledge that, but as to that I say yes, but the Law Commission made it very clear that the provision, then proposed as 135, was intended to protect creditors. Well you cannot properly protect creditors if you focus on a net deficiency approach to the exclusion of others in appropriate cases, and then of course the long title tells us again that part of the purpose of the legislation is to achieve a measure of protection for creditors and then sections 135 and 136 tell us that again, because they mention, they're focused on creditors, they are for creditors. So we say, as your Honours did in *Debut Homes*, that in order to achieve that one treats, and we say Parliament treated, the interests of the company in the words of Lord Sumption as synonymous with the interests of the creditors, because the creditors at the point of insolvency, and particularly longstanding insolvency, are the only parties with interests remaining.

So your Honours, just to cap that off, we say this case is, just on liability, it's just an orthodox application of orthodox principle to a completely unorthodox and illegitimate trading pattern and compensation should follow accordingly.

So that's all I wanted to say on that your Honours and then very briefly on conflicts first there was some evidence about a shareholding, or a beneficial shareholding of Dame Jenny Shipley, and I'll give your Honours a couple of references if I might, but we needn't go there. The first is to cross-examination on bundle page 207.02647, and it's page 1296 of the notes at about line 8, and also Mr Yan's cross-examination at page 207.02647 and it's notes page 1615.

ELLEN FRANCE J:
That must be a different number, mustn't it?

MR O'BRIEN QC:
Line 28. Yes, that's odd. That's the same reference as before. It's probably the entry. But anyway, of the notes it's page 1615, or so I'm told. I didn't check this myself last night but it should be that.

Now just also, your Honours, two other references. Well, I'll just give you one. You only need one. The 2007 Richina annual report which is at 305.02415, and within that document at page .02466, one fee is. So that's 02466, one fee is reported, that Dame Jenny held beneficially 143,658 shares in Richina Pacific, but just to give you some idea of the scale of that it's nothing compared to Mr Yan's who held just under 60 million.

Now I don't think it's in the record, your Honours, but I think there was an exchange, as I recall, between counsel about the sale of those shares, and figures were provided and we can give you those if you wish but I'd like to just check that with my friends if necessary. But Justice Cooke, it's probably as far as we need to go at paragraph 431, said that he regarded – well, he characterised it as the small shareholding that Dame Jenny and her family trust had as largely immaterial for this purpose of culpability. So that's Justice Cooke at paragraph 431.

Your Honours, we say on the conflict point first on this and generally we would just really refer your Honours back to your judgment in *Debut Homes*. We noted the dangers of and the inherent risks of directors carrying on the business of an insolvent company for the purpose of a wind-down. Now that's not what was happening here. In fact, they were trying to carry on indefinitely. But nonetheless the same concerns arise, we submit.

Otherwise, on the conflict point, yes, it was Mr Yan who had the acute conflict plainly but that is why it is so important and was so important that the independent directors put a check on him and put a handbrake on him and

properly discharge their duties under the Act which we say they completely failed to do. An abject failure to discharge that duty.

That's all, unless your Honours have questions.

WINKELMANN CJ:
Thank you, Mr O'Brien.

MR O'BRIEN QC:
Thank you, your Honour.

WINKELMANN CJ:
Now who is handling – I see Mr Chisholm moving.

MR CHISHOLM QC:
I think I'm now, your Honour.

WINKELMANN CJ:
So as we look ahead to the rest of the day…

MR CHISHOLM QC:
I hope to be no more than an hour. I've prepared a, or I've assisted in preparing –

WINKELMANN CJ:
If you can just wait until you get to the microphone.

MR CHISHOLM QC:
– a schedule of references to save time which is up on the screen now, and some of these references I will take your Honours to but a lot of them can simply be referred to and at least there's a record of what we're referring to. What I propose to do, and I hope to go through this quite quickly, these are some of the factual reference or comments I wish to make and then I'll make, hopefully quite quickly, some comments in respect of the loss and the quantum issues which are central to the appeal.

The first point in my summary is I simply make a reference to the concurrent findings that Mainzeal's financial statements or accounts weren't generally available, the references are given –

WINKELMANN CJ:
What does that mean?

MR CHISHOLM QC:
Well simply that they weren't generally available to creditors.

WINKELMANN CJ:
Okay.

WILLIAM YOUNG J:
But they were presumably available to those principals who asked for them?

MR CHISHOLM QC:
Well if someone asked for them, yes. That's simply the finding that was made.

ELLEN FRANCE J:
Well the Court of Appeal says at 378: "But they were presented as part of tendering for construction works."

MR CHISHOLM QC:
Well I think for particular creditors.

WINKELMANN CJ:
Well it's quite usual for companies, when they're tendering for multimillion dollar construction projects to tender their accounts, aren't they?

MR CHISHOLM QC:
Well all I can say is I'm referring to the findings of fact that were made and this wasn't put to Mr Yan, and obviously there's no claim for misleading directors,

but obviously – misleading creditors, but obviously there could be a claim or a remedy available for any principal that thought they were misled. That would be a separate cause of action.

GLAZEBROOK J:
It wouldn't be part of the findings that you could take into account in respect of culpability, because one, if you're looking at causation, culpability – actually both causation and culpability.

MR CHISHOLM QC:
Sorry, you could or you couldn't your Honour?

GLAZEBROOK J:
Well, if you're looking at culpability and saying, why did you get these steps, and why did creditors lend to the company, then the fact that there were misleading accounts wouldn't need a separate cause of action, would it, it would just be part of looking at causation and culpability?

MR CHISHOLM QC:
I understand that that's the test for section 321 your Honours, I'm simply saying that there would be a separate cause of action available, if creditors actually thought they were misled. But certainly one could look at it as culpability but not causation. It was simply –

GLAZEBROOK J:
Well it could be causation because if, in fact, the accounts had said this is a company that is hopelessly insolvent because we can't rely on those related party debts as current assets, or as debts at all that will be repaid, then that has to – that could well be causation, couldn't it? I can't imagine that you'd say, well that's okay, we'll just enter into this contract anyway.

MR CHISHOLM QC:
Your Honour, all I can say is there was simply no evidence of anyone being misled. Your Honour –

GLAZEBROOK J:
Well –

MR CHISHOLM QC:
I'm sorry?

WINKELMANN CJ:
There was evidence of them having consciousness of the need to make – I mean…

WILLIAM YOUNG J:
Window dressing.

WINKELMANN CJ:
Window dressing, that, you know, it's not, it's, and we know that the accounts are provided in tendering documents. That's a reasonably straightforward inference to draw from window dressing to accounts being provided in tendering documents, that people relied on those accounts.

MR CHISHOLM QC:
I think the window dressing related, I think, to the payments at the end of each year I think. It was more that comment.

WINKELMANN CJ:
Isn't that relevant to how the accounts looked at the end of year, which would be the accounts that were presented?

MR CHISHOLM QC:
Your Honour, all I can say is what the evidence said, and that's simply the references I'm drawing your Honours to. The reference to these, the next point I make is simply the references that the liquidators' made to their schedule 3, which was effectively a balance sheet comparison. Just simply making the point, it doesn't reflect cash in and out and I make the point too that, and again it's not an issue, but of the $33 million MGL debt, effectively

$20 million of it was accrued in capitalised interest. I refer, and I don't need to take your Honours to it, but there's a reference to Mr Yan's closing submissions in the High Court to refer to adjustments that necessarily needed to be made to those balance sheet items. For example, the current account referred to or included things like the $6.1 million prepaid credits and things like that, so it's not quite as accurate as it seems on its face.

GLAZEBROOK J:
What's the point about the capitalised interest that you're making?

MR CHISHOLM QC:
Simply, your Honour, just to say how the make up of the debt is, that's all.

GLAZEBROOK J:
But does that make a difference, still owing or should have been?

MR CHISHOLM QC:
I accept that it's still owing, your Honour, but it's not, it doesn't reflect the cash position going in and out.

GLAZEBROOK J:
It effects the time value of money.

MR CHISHOLM QC:
Yes, it does, but it's – I think it was being relied on the liquidators as showing cash in and out.

WINKELMANN CJ:
It could actually be an exacerbating factor because you could make the case that there's not much evidence to suggest that anyone expected interest to ever be paid and yet it was being booked as if it was an asset.

MR CHISHOLM QC:
I accept that, it was certainly being shown as income.

WILLIAM YOUNG J:

They were treated as current, weren't they, up until the replacement deal?

MR CHISHOLM QC:

Correct.

O'REGAN J:

And as it was capitalised, it was shown as an asset, wasn't it?

MR CHISHOLM QC:

Sorry?

O'REGAN J:

As the interest was capitalised, it was shown as an asset?

MR CHISHOLM QC:

Correct. Just on that, and my point was more going to the cash flow point and that's the next point I referred to and again, simply reinforcing the accuracy of the schedule that I put in 1.2 of the outline, Mr Bethell's red box analysis, I give the reference to at 441.00001, Mr Bethell was also cross-examined on that. That was his evidence and so that showed the net position year by year and it shows that from 2007 onwards more net cash went in overall than cash went out. And, of course, for the last two years or the period post 31 January 2011, we've got counsel's agreement on that point. I refer to that as well.

Going on to the analysis, the new debt analysis, it was never accepted that Mr Apps analysis of new debt was correct. The methodology was always disputed and you may recall, and it's common ground effectively, it was the comparison between simply accounts payable at a particular time and proofs of debt in the liquidation. We had cross-examination on these points. First of all Mr Bethell was – and what Mr Bethell did was give a couple of examples of the proofs of debts and it became apparent he didn't have personal knowledge of them. If I could take or have come up on the screen his cross-examination at 201.00305.

WINKELMANN CJ:

But is your point that the proofs of debt might've overstated the debt? What is your point about this?

MR CHISHOLM QC:

Well, there wasn't the evidence, the proofs of debt, it was absolutely unclear what the proofs of debt actually involved and what the link was between the obligations incurred and the proofs of debt. We have, for example, we have Mr Apps doing the analysis, which he acknowledged was he simply took the proofs of debt as he found them. He had no input into those themselves, and we see the sort of things - we never could compare the proofs of debt to what the obligations incurred actually were, and we have an example which I could take your Honours to.

GLAZEBROOK J:

Isn't the argument rather that you would've agreed to incur whatever you would agree to incur under the contracts and the proofs of debt could never be anything other than what was incurred under the contracts including, if there had been default in respect of those contracts which I understand is your point?

MR CHISHOLM QC:

Well, they seem to be. That's the point, that they go further –

GLAZEBROOK J:

In terms of what debts are incurred, if you take a very straightforward example that says, well, there's this interest rate unless you're in default in which case there's a penalty interest rate of X. It's difficult to say that you're not agreeing when you enter into the contract to that penalty interest rate as well as the ordinary interest rate, isn't it?

MR CHISHOLM QC:

Well, you're right on your example, but normally your starting point, your Honour, if you're comparing what the obligation is, you know precisely what that interest rate is.

GLAZEBROOK J:

The same under a contract, you will know that you will incur whatever comes under that contract and if it says you'll incur the additional costs of having to fix it up then – so do you say you can't have a debt unless it's a fixed sum, is that the submission?

MR CHISHOLM QC:

No it's not. One has to incur, one has to understand precisely what the obligation is. In the case of a construction contract, for example, one of the issues, it's slightly more complex when an interest calculation, but one of the enquiries, for example, would be the scope of the contract, the scope of the works that would be required to be undertaken. None of these things were before the Court, and if we look – a

WINKELMANN CJ:

Can you just tell me what was your general approach, what was your line in cross-examining Mr Bethell in relation to this?

MR CHISHOLM QC:

Well first of all, trying to understand his knowledge, and if I could take your Honour –

WINKELMANN CJ:

Yes but to show what?

MR CHISHOLM QC:

So that we could understand precisely what was undertaken to, how the proofs of debt actually were approved or otherwise –

WINKELMANN CJ:

I know, I'm just talking your cross-examination line in terms of your defence was that he didn't understand the debt out of the proofs of debt and therefore he could not give evidence, he could not provide assurance that, what?

MR CHISHOLM QC:

Well he couldn't give assurance on what the obligations incurred actually were, or putting in terms here, what the fresh debt actually was, and one can see that from the examples that he put to. If you go to –

GLAZEBROOK J:

So the proof of debt were improperly accepted, is that the submission?

WINKELMANN CJ:

No, that's not your submission is it?

MR CHISHOLM QC:

Well –

WINKELMANN CJ:

I think your submission is that he couldn't say well this is fresh debt, this is an existing creditor, and that debt is real, is that your point?

MR CHISHOLM QC:

Well no, it goes to precisely the make up of what was being approved. If we actually use an example, and there were only a couple of examples put in, so we didn't have anything to be able to test any of this, but we had a couple of examples before the Court. We have Mr Bethell at paragraph 220 to 224 of his brief of evidence, which is referred to, that we should have a…

WINKELMANN CJ:

Well that doesn't seem to be your point, because really that's challenging whether or not it should have been accepted, which is a different point all together.

GLAZEBROOK J:

Well that's what I thought, the point you were making but…

MR CHISHOLM QC:

But we can't, there were proofs of debt accepted, but there is no means of ascertaining how that linked back to the obligation actually assumed. If we go, your Honour, to –

GLAZEBROOK J:

Well it has to link back to some obligations assumed, or it wouldn't be accepted, would it?

MR CHISHOLM QC:

Well, but your Honour, we're entitled to test that.

GLAZEBROOK J:

Well maybe, but there was a whole lot of debt that wasn't accepted. I mean more than from the schedules that were given.

WINKELMANN CJ:

What I'm just trying to get clear from you, Mr Chisholm, is are you testing whether the proof should be accepted, or are you testing whether the proofs were of the category that Mr Apps was saying they were?

MR CHISHOLM QC:

Well both your Honour. Mr Apps, what Mr Apps said they were was simply a comparison between account payables and the proofs of debt. When he was asked what he did, was he said, well I can't give you an answer on whether this was done good, bad or indifferently. That's what he said in cross-examination. He couldn't comment on the quality or otherwise of the proofs of debt.

WINKELMANN CJ:

So it was really the first point really, whether they should have been accepted.

MR CHISHOLM QC:

Well, yes, precisely, and the example that we refer to, we have examples from what we see, and I'll take your Honour to them. The reference is to their knowledge, Mr Bethell didn't really have personal knowledge, that was what was up on the screen on page 201.00305. Mr Apps' evidence as to what he did is the next reference, 204.01492, and you see that line 11: "I didn't make those recoveries and I didn't admit the claims, so I don't comment on whether his administration of the liquidation was good, bad or indifferent. I simply assume that he has done a professional job, and it is the experience achieved by the liquidators…" et cetera. Then we go to what –

O'REGAN J:

Sorry, who is this talking here?

GLAZEBROOK J:

Mr Apps.

MR CHISHOLM QC:

That's Mr Apps.

GLAZEBROOK J:

Mr Apps took the figures as he saw them as were in the liquidation. One can understand that because it wasn't – I'm assuming he wasn't asked to do anything other than that.

MR CHISHOLM QC:

No. But if we go, for example, to schedule 15 to Mr Bethell's evidence, and again Mr Bethell wasn't qualified. He admitted he didn't know how this occurred. But if we go to schedule 15 – sorry, that is schedule 14. You may need to go to it through the paragraph number in brief.

Before you go to it, one can see what – he talks about it generally. This is the information that we were provided with. We don't know, the contracts weren't

before the Court so we don't know what the obligations were. We have, for example, items costs to complete –

GLAZEBROOK J:
I thought we were told that the liquidators couldn't find half of the contracts. Was that not right or did I misunderstand that?

MR CHISHOLM QC:
Well, that was what was said but also in Mr Bethell's evidence he said they had regard to the contracts, but ultimately we couldn't get information when we cross-examined him because he didn't have personal knowledge of what went on.

WINKELMANN CJ:
No, but the directors knew why there weren't any contracts, I imagine, why there were only a few contracts that could be found. Wasn't it the directors' obligations to keep proper records?

MR CHISHOLM QC:
Well, I'm sure they would've but there was no question of the directors not keeping proper records. That wasn't put to them. But on this point, your Honours, there was simply not the evidence to prove what the obligations were. We don't know how this calculation occurred and only a couple of contracts were put in as examples. "Costs to Complete – justified sums", we don't know. Mr Bethell couldn't assist us.

WINKELMANN CJ:
So are you saying they should've put in all the supporting documentation for every proof of debt ?

MR CHISHOLM QC:
Well, your Honour, any plaintiff proving loss, there are two parts to that. Proving what the obligation was, establishing what the obligation – even fundamental things such as scope of the contract, for example, and then

comparing that to the proof of debt so one can establish what the fresh debt actually is. The issues that I've – I said previously issues of –

GLAZEBROOK J:

Well, you're saying that the liquidators may have accepted debt that was dishonestly put to them by the creditors?

MR CHISHOLM QC:

Well, it's not dishonestly. I'm not suggesting –

GLAZEBROOK J:

Well, it must be related to something then, mustn't it, and therefore must have been related to the works that they'd been doing, either on a quantum meruit or a contractual basis?

MR CHISHOLM QC:

Your Honour, it's not surprising for people to put in proofs of debt for more than they are entitled to.

WINKELMANN CJ:

But Mr Bethell presumably set out his – that he, you know, he's a professional liquidator exercising a professional standard of care. I imagine he'd said something of his processes.

MR CHISHOLM QC:

He did but he had no knowledge of it. He acknowledged that. There were other people that did it. So we couldn't challenge these matters. We didn't have both sides even. We didn't have the obligations to find that we had to meet and we didn't know what the proofs of debt actually covered.

WINKELMANN CJ:

So you're saying the risk – so what you were saying is you were – exposed in the lack of proof was the possibility that debts that weren't properly claimable had been claimed and what else?

MR CHISHOLM QC:

Well, that's right and we have examples done in this –

WINKELMANN CJ:

Anything else though?

MR CHISHOLM QC:

It's simply we couldn't, as a matter of quantum, the information simply wasn't before the Court to establish what the so-called fresh debt was.

GLAZEBROOK J:

Well, these are all on costs to complete, so to the extent that they're on the contract they'll be losses because the contracts stops, wouldn't it? So it will be basically damages. I'm just assuming because it says, cost to complete, amounts paid to subcontractors, well, presumably no one's going to accept that without actually seeing what that was.

MR CHISHOLM QC:

But, your Honour, a plaintiff has the onus of proof and this is the difficulty that we were put in because remember, the obligations weren't put to the directors and we had Mr Apps –

GLAZEBROOK J:

Apps' schedule was there, wasn't it?

MR CHISHOLM QC:

But Mr Apps' schedule, your Honour, as Mr Apps acknowledged, he simply took the numbers as were given to him.

WILLIAM YOUNG J:

But they were there for the directors to comment on if they wanted to.

MR CHISHOLM QC:

Beg your pardon, your Honour?

WILLIAM YOUNG J:

The material was there for the directors to comment on if they wanted to. Why should it have to be put to them if they hadn't challenged it?

MR CHISHOLM QC:

Well, your Honour, because a plaintiff has the onus.

WILLIAM YOUNG J:

Yes, but if a plaintiff calls evidence then, and it's not challenged, then that's it. Now, I understand that there are areas of challenge advanced in cross-examination, but that's a different issue. But if the directors wanted to say there was something wrong with it, it was for them to do so, wasn't it?

MR CHISHOLM QC:

But, your Honour, all that was put was an analysis between accounts payable at a particular point in time, and proofs of debt.

WILLIAM YOUNG J:

It's going to be pretty rough, isn't it?

MR CHISHOLM QC:

Well, it's more than rough.

WILLIAM YOUNG J:

But is it going to be – it will be rough in relation to the particular examples but will it be rough in the large, and will it be unacceptably rough in the large? What else were they meant do, re-call every creditor?

MR CHISHOLM QC:

Well, no, call the creditor to start with, one for example, one could've called the quantity surveyors who actually were doing the task to actually ascertain what was done. We know on the, I think, on one of the other examples that there was definition as to whether or not proof of debt included matters

beyond scope. Whether or not the scope was slightly different. These are the issues that a plaintiff has the onus on.

WINKELMANN CJ:

Did you say to them, this is not proof, did you put to them that it's unreliable? Did you put to Mr Bethell that it was unreliable?

MR CHISHOLM QC:

We, about putting to proof, Mr Bethell acknowledged that from the cross-examination that he didn't have knowledge of the matters.

GLAZEBROOK J:

That would be normal, wouldn't it?

WINKELMANN CJ:

Yes.

GLAZEBROOK J:

You would have staff who would be performing that. And he would have, and he might check one or two, but on the whole you'd be relying on your staff because you're not going to, well, I mean, have dogs and bark yourself, I guess.

WINKELMANN CJ:

I'm just conscious of what it would like in litigation if we actually did have – unless you're going to clearly put this at issue and saying we're challenging whether you've proved this and, therefore, you'd have to re-call these people which is what I've seen done in cases that I've been involved in, unless you're going to do that, expecting people to front up with that kind of proof would just absolutely cripple the whole litigation system. And, of course, if you do put people to that level of proof, then you bear the cost, the risk of a very adverse cost award against you.

MR CHISHOLM QC:

Your Honour, the problem is here, on both sides we don't have proof. It's not just the proofs of debts side, trying to ascertain what the proof of debt includes. But it's also on the obligation side as well. This is the difficulty. The other example, I think it's in –

WINKELMANN CJ:

So you've got your examples and your chart there, have you, which is the MIT and the Anchorage Body Corporate?

MR CHISHOLM QC:

Well, we've put them both there, simply they were the examples that Mr Bethell referred to, and I think if one goes back, for example, with MIT, if one goes there was an interim paper that identified some of the issues, that's the paper or the document at 330.18066, and you have some questions being raised. If you could perhaps roll through it. I think we had an "other costs" section further on. Yes, for example, the other costs, and it's matters like this that we see in the other costs, but internal management costs, we have Simpson Grierson invoices. Again, it's this sort of information we know nothing about.

WINKELMANN CJ:

Okay, right, well, I think we've got the point, Mr Chisholm.

MR CHISHOLM QC:

Thank you, and Anchorage Body Corporate I've referred to. That's referred to in the body of Mr Bethell's brief. That's referred to in the body of Mr Bethell's brief. Same point again. But it was simply the point that was made yesterday that there wasn't a challenge on the evidence. The general point is one doesn't know how much consequential loss has been embodied in this, whether there is liquidated damage –

GLAZEBROOK J:

Well, if that's the case, what's the submission in respect of that because if you enter into a construction contract just in the same way if you enter into a loan with penalty interest rates, et cetera, you will know from the contract what will be payable if you breach, both in terms of damages or otherwise. Are you saying they're not debts or they're not related to the initial debt or they're not related to the insolvent trading? What's the submission?

MR CHISHOLM QC:

The submission is one should focus on the obligation incurred and the obligation incurred –

GLAZEBROOK J:

For what though? So if you were looking at having – well, because what is the universe in which we are arguing this at the moment? We're assuming, are we, that the liquidators are right and that every debt, new debt that arises out of the insolvent trading or, alternatively, the debts that were incurred without knowing, is able to be as damages subject to arguments on reductions, et cetera, or what's the starting point of your submissions?

MR CHISHOLM QC:

Well, the starting point, your Honour, is whether when one is talking about fresh debt or compensation that arises after the event. In my submission one actually has to look and ascertain what the obligation incurred by the company at the relevant time actually was. That's distinct from issues of six months or a year or two years down the track when the company may have suffered damage by reason of various matters, including the liquidation itself, and that's what the proof of debts will presumably be looking at. We have the matters of, as I said, the Simpson Grierson costs. We had matters of whether or not costs went beyond –

GLAZEBROOK J:

So the argument is that any damages related to – just so I understand – any damages that might be related to the breaches that have occurred because

liquidation stopped construction and stopped payment don't come within the new debt?

MR CHISHOLM QC:
Correct.

GLAZEBROOK J:
And why is that?

MR CHISHOLM QC:
Well, your Honour, then it's becoming a damages calculation.

O'REGAN J:
But it's just a matter of what they came to as a result of entering into new obligations, whether it's a liquidated sum or damages, it's all a consequence of the company entering into new obligations at a time when, according to the Court of Appeal, it shouldn't have been doing.

MR CHISHOLM QC:
But, your Honour, that's almost like a "but for". You're liable for everything that occurs after the event.

WILLIAM YOUNG J:
But why not? Why not if it's all within the set of obligations incurred after a particular date?

MR CHISHOLM QC:
Well, your Honour, for example, the English cases refer to examples, and I think they are construction companies as well. Some of the losses would have been unrelated to that. For example, the example that is given I think in *Grant v Ralls* was loss that is incurred by delays because of bad weather and the like. That –

WINKELMANN CJ:

Who's saying there's claims for loss caused by bad weather? I mean wasn't it – there's nothing to indicate that.

MR CHISHOLM QC:

Your Honour, I'm using that as an example.

WINKELMANN CJ:

Wouldn't the liquidator – the liquidator would be on to that because that's just their standard bread and butter that they go through and check out that people aren't claiming things that they can't claim.

MR CHISHOLM QC:

Well, your Honour, we're entitled to test it.

WINKELMANN CJ:

Yes, you're entitled to test it.

MR CHISHOLM QC:

And we're also entitled to test what the obligations were. We haven't had those put to us. We haven't had those put in evidence.

WINKELMANN CJ:

Well we'll read the transcript Mr Chisholm.

MR CHISHOLM QC:

Yes. Your Honour, you can simply go to, the references are there but simply go to the nature of some of the things, and I accept that at liquidator will try and knock out some of the matters, but in my submission one still has to look at the nature of the obligation that was incurred.

WINKELMANN CJ:

Mr O'Brien did tell us that the liquidator gave evidence he had the assistance of Mainzeal personnel in assessing proofs of debt.

MR CHISHOLM QC:

He did, and you would expect that to be the case.

WINKELMANN CJ:

Or it might have ben Mr Kennedy told us that.

MR CHISHOLM QC:

But it seems that the primary people doing the big ones, and Mr Bethell wasn't certain. We could only put these two examples because we had no information on any others.

WINKELMANN CJ:

All right.

MR CHISHOLM QC:

But it seemed that it was primarily a QS firm that was doing some of the work. So that's in respect of the quantum issue, and again these are simply small factual points.

WILLIAM YOUNG J:

So what are you saying, that we shouldn't decide quantum ourselves but on this footing send it back to the High Court?

MR CHISHOLM QC:

Well that's correct. Remember, your Honour, because of Justice Cooke's findings too that remember Justice Cooke found that there was no 136 calculation based like this. There were no findings of fact made –

WINKELMANN CJ:

That's all right, though, we've got the records.

GLAZEBROOK J:

Well there mightn't have been findings of fact but the evidence was all there.

WINKELMANN CJ:

Yes, that's my point. We have the evidence though.

MR CHISHOLM QC:

Yes, well –

GLAZEBROOK J:

And one would expect that you would put whatever evidence you wanted to be put at that stage, and not rely on some possibility of going back later.

MR CHISHOLM QC:

I'm not saying that we need to put in more evidence your Honour.

GLAZEBROOK J:

But you may well do because if you didn't challenge it at that stage, then unless you say there's just no proof…

MR CHISHOLM QC:

But we – as your Honour read, we did challenge it, and we challenged the methodology.

GLAZEBROOK J:

All right. I understand.

WINKELMANN CJ:

I think we have that. So what we have to do is we have to go through it, as you say, we need to, as I said, we'll go through the transcript carefully Mr Chisholm.

MR CHISHOLM QC:

Your Honour, the next point, quite unrelated, simply there was reference to Mr Yan 13 August 2010 email, and it's acknowledged –

WINKELMANN CJ:

Can you just briefly remind us of the content of that one?

MR CHISHOLM QC:

That was the one, your Honour, I think was plainly there was an incorrect statement, I think, about a guarantee or something like that, and my point is, simply again I think there was a suggestion at the time that that may be relevant to causation or culpability. My short point was is simply that it was –

WINKELMANN CJ:

What was corrected.

MR CHISHOLM QC:

It was corrected very shortly after –

WINKELMANN CJ:

No, but what are you saying was corrected? I'm just interested to know that.

MR CHISHOLM QC:

Your Honour, you may recall Mr Walker's email shortly afterwards.

WILLIAM YOUNG J:

It's the, ultimately the shareholders who were on the hook for everything.

WINKELMANN CJ:

Yes, I mean is that the point that was corrected?

MR CHISHOLM QC:

Correct.

WILLIAM YOUNG J:

What did Mr Walker say?

MR CHISHOLM QC:

Your Honour, that's at 310.5707, at next page 08, I think towards the bottom of the page. However, we believe that it is the role and responsibility of the Mainzeal board to make going concern, solvency and similar determinations…"

WILLIAM YOUNG J:

Sorry, whereabouts is it?

MR CHISHOLM QC:

That's at the very bottom of the page.

WILLIAM YOUNG J:

It's not exactly a – it's a rejection of what Mr Yan said, it's pretty much concealed in there, isn't it?

WINKELMANN CJ:

And isn't it kind of against your interests anyway, because you were saying ultimately the shareholders are on the hook for everything which might make you feel reassured that really there was some sort of standing behind it. Here it's saying it's all your responsibility.

MR CHISHOLM QC:

Well he's simply stating what the responsibility of the board was, that's all.

WINKELMANN CJ:

So he's corrected as to law, is that your point?

MR CHISHOLM QC:

Correct.

WILLIAM YOUNG J:

Where is he saying that they're not on the hook?

MR CHISHOLM QC:

No, he doesn't say that your Honour.

O'REGAN J:

But Mr Yan said it was guaranteed debt, didn't he?

MR CHISHOLM QC:

Correct.

WILLIAM YOUNG J:

Did he? I thought he said we were on the – I thought he was correcting the statement: "The directors are on the hook for everything".

MR CHISHOLM QC:

No, he never said that.

O'REGAN J:

No, he – Mr Yan was saying you don't have to worry because it's guaranteed.

GLAZEBROOK J:

No, other way round. He's saying they are on the hook for everything and Yan said they weren't.

O'REGAN J:

Operated under a shareholder parent guarantee.

WINKELMANN CJ:

So Mr Yan says they are on the hook? Yes. Mr Yan says they are on the hook for everything and Mr Walker says no.

WILLIAM YOUNG J:

Yes, yes, so I'm looking a little bit further. It's the third bit that's underlined in pink. "The shareholders who are on the hook for everything."

O'REGAN J:

Yes, but it's the shareholders, not the directors.

WILLIAM YOUNG J:

Yes, yes. I see.

GLAZEBROOK J:

Yes, so the shareholders – so there is a guarantee and Walker says no, there's not.

WINKELMANN CJ:

So how does that help your case is my point if Mr Walker says there's no guarantee?

MR CHISHOLM QC:

All I'm saying, to the extent that I think there were criticism made of Mr Yan making the comment, it's acknowledged that it's factually or legally not correct, but nothing causative flowed from that. That's simply the point, nothing more.

The next point is simply there was reference I think yesterday or the day before to Mr Yan's – I'm sorry, I make reference but I don't need to go to it. The extent of the cross-examination of obligations, I'd simply recorded or referred to, this is the only single document or obligation that was referred to was a passing obligation to the MIT contract that was put to Mr Yan and there was no cross-examination as to the extent or what the obligations were. It was actually Mr Yan inviting the comment that he was involved in tendering. So that's the only reference to any contracts.

GLAZEBROOK J:

I'm sorry, I didn't – okay, sorry.

MR CHISHOLM QC:

The personal guarantee point, I think there was reference to Mr Yan wishing to have his guarantee removed. It actually wasn't his guarantee. It was his wife's guarantee, and if I could perhaps take –

WINKELMANN CJ:

So he never wanted his guarantee withdrawn, or he does, doesn't he, when he writes that letter, the precipitating letter?

MR CHISHOLM QC:

Well, no. He had understood he had agreed to give a guarantee personally and for his trust and unfortunately his wife was a trustee as well and was prepared to give a guarantee as a trustee so the –

WINKELMANN CJ:

But the precipitating letter, the one that precipitates the receivership, does he withdraw his personal guarantee at that time or does he –

MR CHISHOLM QC:

No, this letter was prior in time, a few days prior in time.

WILLIAM YOUNG J:

It's about 10 days earlier, isn't it?

MR CHISHOLM QC:

About five or six days before.

WINKELMANN CJ:

Okay, all right.

MR CHISHOLM QC:

And ultimately wasn't causative of anything. I've made a reference to it. But essentially after asking to have his wife's guarantee withdrawn, then he proceeded and confirmed commitment. Unfortunately then –

WINKELMANN CJ:

Can you take us to the precipitating communication, the one that sets the events in motion?

MR CHISHOLM QC:

That's…

WILLIAM YOUNG J:

It's the 29th of January, isn't it?

MR CHISHOLM QC:

29th of January, yes.

WINKELMANN CJ:

Is that in there? It's not? You don't have it, won't be on here?

MR CHISHOLM QC:

I can find the reference.

WINKELMANN CJ:

I think we're there, Mr Chisholm.

MR CHISHOLM QC:

You've made it?

WINKELMANN CJ:

Right, thank you.

MR CHISHOLM QC:

The guarantee issue had passed by then. It was really the inability to get the funds from the CHC by this time. Just while we're on this point, you may recall, and I think Mr O'Brien may have taken the Court to the subsequent correspondence, including correspondence from Mr Walker, in that Mr Yan, a day or two after writing this letter, withdrew it. They couldn't get money out but then started looking at trying to think of other ways, whether or not they could sell properties and the like, to see as an alternative way of raising cash.

The next factual matter is just explaining the nature of the improvement in the company position. I think, you would've seen from both the High Court and the Court of Appeal's judgment, including at 517 of the Court of Appeal judgement that I took your Honours too on Tuesday, there was reference to why the debts significantly reduced, debts claimed, and why the position improved. The Court referred to the money that went in, the reduction of the book. One of the other factors that I've referred to include a reference too is

effectively the legacy claims too, because while losses were incurred during that time, the directors were still ensuring that legacy losses were being reduced, and as between the experts, and I've referred to Mr Graham's schedule A, which we don't need to go to, but that establishes that Mr Graham believed that the legacy claims had reduced effectively by repairing the leaky building issues and things by about 16 million. Mr Apps thought it was round about 12 million and ultimately the judge I think found that there was about a 13 million improvement in the company's position. So again this is real benefit that was going to the creditors collectively –

WILLIAM YOUNG J:
This is sort of off balance sheet I take it though, was it?

MR CHISHOLM QC:
Beg your pardon?

WILLIAM YOUNG J:
Because the legacy claims had only been factored in year at a time, is that right?

MR CHISHOLM QC:
Correct. But as a matter of fact, your Honour, this was still improving the company position between the counterfactual and the actual date of the liquidation. It's just really another explanation showing why, as the Court of Appeal noted, there was a significant reduction in losses in claims, and again when one looks at the creditors collectively, the position was significantly improving.

Just on that point and the counterfactual, I think my learned friend Mr O'Brien kept saying that this wasn't a counterfactual case, that we were trying to lock him in on that. If I can perhaps take you to what the Court of Appeal confirmed at paragraphs 322 and 323.

GLAZEBROOK J:

I think he said it wasn't just a counterfactual case, didn't he, because he did say they did want to prove net deterioration, they just did not end up being able to do so.

MR CHISHOLM QC:

Your Honour, even if one proceeds on a fresh step basis, one is still needing a counterfactual date as well.

GLAZEBROOK J:

Their counterfactual date was somewhere around 2009 or 2007 or 2004, I can't remember what, but that wasn't what was found.

MR CHISHOLM QC:

Well no, the counterfactual date for that breach was still 31 January 2011.

GLAZEBROOK J:

Well it was according to the findings, I'm not sure it was according to their case.

MR CHISHOLM QC:

Well the case, your Honour, I think was to have regard to the interest of creditors from 2008, but the breach date, and it's set out by the Court of Appeal, you'll see what the Court of Appeal summaries how the directors were prepared to treat the case at 322, and then at 323 we have the liquidators opening referred to. We have 237: "The liquidators should have ceased trading from January 2011 if not before. The plaintiffs' case is that by no later than that date, the directors allowed [Mainzeal] to carry on business (s 135) and agreed to incur specific obligations (s 136) that involved – "

GLAZEBROOK J:

Is the opening submissions in the Court of Appeal…

MR CHISHOLM QC:

Beg your pardon your Honour?

GLAZEBROOK J:

Sorry. The opening submissions in the Court of Appeal or the High Court?

MR CHISHOLM QC:

No, that was opening in the High Court, and again the counterfactual in respect of both 136 and 135 are in 307 and 317.

WINKELMANN CJ:

These are bits and pieces and we've been taken to other bits and pieces so we'll just have a look at it all together.

GLAZEBROOK J:

So what was the point there?

MR CHISHOLM QC:

Well, simply confirming that this is a counterfactual case and as is any breach of duty case. In respect of bond exposure –

GLAZEBROOK J:

So what flows from that, sorry?

MR CHISHOLM QC:

Well, your Honour, it's simply that that's the comparison. Normally with a counterfactual case like this, it's not a case in equity, one is going to compare what happened in fact to what would have been the case if the directors or the defendants had complied with their duties. So one then looks at the position at the counterfactual.

WILLIAM YOUNG J:

But here it's counterfactual but in a different way. What would have happened to the new creditors if the company had stopped trading earlier? Well, they

wouldn't've wound up being owed money. That's counterfactual; it's just a different counterfactual.

MR CHISHOLM QC:

It's a counterfactual but that then begs the question on the damages submissions as to –

WILLIAM YOUNG J:

Well, that's a question of what the law is, whether that's an appropriate basis for it.

MR CHISHOLM QC:

Correct. I make one other point actually in respect of the financial position and it's in the bottom box. It was Mr Apps' evidence and it's common ground that all the third party bond exposures went down after the counterfactual date with the exception of RPL. So RPL's own bond exposure actually grew. It was taking on more responsibility from that point in time. So again, reinforcing still a commitment to the company. We know that as at the date of receivership and liquidation in February 2013 ultimately RPL had about $19 million worth of – or $19 million worth of bond exposure and ultimately went into provisional liquidation for about a year, or a bit less than a year, to enable it to restructure its affairs so it could pay that bond exposure over time.

WILLIAM YOUNG J:

Were the other receivables ever paid, although I suppose they were all mopped up in the King Façade deal?

MR CHISHOLM QC:

Well, some of them were. There was an RGREL receivable paid. There was an Isola receivable paid. These were paid, and I think one other reference – I make a reference to some of those I think in the reference in paragraph 8.5 I think in the High Court submission earlier on, on about the fourth box – I'm sorry – the second box down. So there was a reduction. That was one of the

points that we were making. One can't treat those balance sheets quite on face value.

O'REGAN J:
So are you saying they were paid between the counterfactual date and the liquidation or after the liquidation?

MR CHISHOLM QC:
After receivership and liquidation.

O'REGAN J:
After liquidation. Thank you.

MR CHISHOLM QC:
Simply what occurred, your Honour, some of the liabilities had cross-guarantees or guarantees and so other companies in the group ultimately, I think in respect of Isola, there may have been a voluntary sale of property that ended up going to either the receivers or the liquidators. Can't quite remember how the RGREL liability – but there was money accounted for.

At the bottom of the page, and this relates to the fresh debt calculation, if I could just correct paragraph 87 of our cross-appeal submissions and remove – you'll see at paragraph 87 it says: "In addition, for both section 136 and the Court of Appeal's 136 formulation," if the words "both the 136". It simply should read: "For the Court of Appeal's section 136 formulation," but this is material because the Court of Appeal at 466 –

GLAZEBROOK J:
Sorry, what do you want us to correct?

MR CHISHOLM QC:
Simply remove the reference to section 135. There was a slightly different –

GLAZEBROOK J:

Whereabouts? I've just got your cross-appeal submissions, so where…

MR CHISHOLM QC:

Sorry your Honour.

WINKELMANN CJ:

If you go back to that paragraph on the screen.

O'REGAN J:

Paragraph 87.

MR CHISHOLM QC:

Paragraph 87. What the liquidators do, have a slightly different fresh debt for 135 and 136, and they rely on 466 of the Court of Appeal's judgment as establishing loss, and one sees this at 14.3(a) of their written submissions. You'll see that these claims total 20 million 281,000. In fact Mr Apps' evidence was that the bonds sums for MIT and the Ministry of Justice were Vero or AAI bonds, and were accordingly not fresh debt, and the AA claim itself is at 331.18653.

WINKELMANN CJ:

Yes, so didn't Mr Kennedy you were just wrong about this? That it didn't include these?

MR CHISHOLM QC:

Well he did, and we say he's wrong.

WINKELMANN CJ:

Okay.

MR CHISHOLM QC:

And you'll see, so this is simply the AAI claim. We see the big one, Manukau, second from the bottom, 3.250, then about half way down 4 December 2012, you have Manukau Precinct, 500,000. So we have Mr Apps at paragraph 391

of his brief, that's at 203.00797, paragraph 391 where he confirms that the only surety that we assess increases – that we assess increases exposure between the two dates. It's the AssetInsure 3.375 bond and one can also see that that's the one that's being referred to in Mr Apps P4 schedule, or table, which is at 203.00881, and you'll see that's the very bottom one. Vero is the same as AAI, and one can see from the counterfactual to the factual their bonds have reduced by about 15, or a bit less than 15, or a bit more than 15 million, and it's only the AssetInsure, and so it's plain, in my submission, that…

GLAZEBROOK J:
So this only applies if it's only a 136 claim, doesn't it, your point here?

MR CHISHOLM QC:
Well we say it applies to the extent – I think the liquidators acknowledge, and I'm not quite sure of the reasoning, that it doesn't apply to the 135 claim, but they've included in their calculation in resect of the 136 claim because they simply take the Court of Appeal's table at 466.

GLAZEBROOK J:
But on those larger contracts doesn't it go back to the December date, it's not the July date?

MR CHISHOLM QC:
But the dates that we're referring to go all the way back to January 2011, and that's Mr Apps' evidence.

GLAZEBROOK J:
Well that's right but wasn't the finding of the Court of Appeal on those larger contracts that was the right date? For 136?

MR CHISHOLM QC:
Yes, but, well your Honour that's the point. If ones goes back to that date, one can't include those bonds.

GLAZEBROOK J:
And why not?

MR CHISHOLM QC:
Because they've reduced, and that's Mr Apps' evidence at the last paragraph I took you to. That's Mr Apps at paragraph 391.

WINKELMANN CJ:
We'll take the adjournment now but, Mr Chisholm, we're just worried about time, because we're taking an awfully long time. Can I suggest that you reformulate how you're articulating your main proposition because we seem to be struggling to understand your main proposition, which maybe our fault.

MR CHISHOLM QC:
I'm simply making the factual points, your Honour. Hopefully it won't take too much longer.

COURT ADJOURNS: 11.32 AM

COURT RESUMES: 11.50 AM

WINKELMANN CJ:
Mr Chisholm.

MR CHISHOLM QC:
Thank you your Honour. Just in respect of these factual matters, I will simply leave the references as they are simply, in particular given that time is marching on.

WINKELMANN CJ:
Thank you.

MR CHISHOLM QC:
But they are what they are. Just the references. We essentially say that RPL did all they could have reasonably done, and there are some references, but

ultimately it wasn't enough and at the end of the day even RPL went into provisional liquidation. I think it took about three years before it could actually pay off its bond exposure, which was both bonds and guarantees, about 19 million.

I'll make very brief submissions so that Mr Hodder can get to his feet in respect of the, just the damages issues. Firstly, damages or less suffered by a plaintiff is normally a question of fact as to what loss is suffered, and certainly in the context of liquidation cases, as a matter of fact that loss could conceivably be more than the actual proofs of debt in the liquidation, that's what occurred in *Morgenstern v Jeffreys* [2014] NZCA 449 for example, but it's still a question of fact as to ascertaining what loss was suffered by the company. Again that comes back to section 169(3).

I think a reference my friend referred to some of the earlier UK cases that suggested at least when they were penal the UK position now is unequivocally, but that does not recognise a fresh debt type formulation, and references have already been made to *Continental* and *Grant v Ralls*, and these are simply a causation approach, what loss has been suffered by the company. Both those cases refer to the voidable preference provisions in their legislation to effectively balance the difference between what would be described as old and new creditors. Those provisions we also have in our Act from sections 292 to 296, and what we say, we've tried to say that the company's significant financial improvement, or the converse of that, the significant reduction and losses and claims between the counterfactual and the factual can't simply be ignored, and you've heard many times now, the reduction in the book, the 8.56 million inflow of cash, approximately improving the company's position by reducing legacy or leaky building claims by 13-odd million and, of course, post-liquidation or post-receivership too, that the contribution of 19 million by RPL to the ultimate losses suffered.

What we say, and it's reinforced by not only section 169 but also even the liquidation regime, is that one has to look at the creditors collectively rather than individually, and in particular in a counterfactual case, if one can do a

logic check and simply ask if the directors did what the plaintiffs said they should have done, what would be the position, and here we know that if the directors did what the plaintiffs plead, there would be significantly more claims and losses in a hypothetical liquidation, and thus as a matter of fact a worse outcome for creditors collectively.

So essentially the plaintiffs' case is putting directors or defendants in an impossible position, in my submission. Do they stop and cause greater losses, and we submit that that's not logical, and ultimately what they did as a matter of fact created a better result and they significantly improved the position collectively for creditors generally.

If I could quickly take your Honours to paragraph 295 of the Court of Appeal judgment, because this is essentially how rightly or wrongly the Court of Appeal analysed *Debut Homes*, and it says: "On this approach no allowance would normally be appropriate for benefits to the company as a result of undertaking the relevant obligations: for example, the value of goods or services…" and the Court correctly notes, in my submission, "… If the focus was on the loss to the company caused by entry into the new obligations as a matter of fact, such an adjustment would be necessary."

In my submission that's what occurs for every damage assessment. Damage is an assessment in fact, in my submission, one shouldn't and the Court of Appeal described it later down in the same paragraph as "deemed harm" and in my submission a damages calculation has to be a calculation as a matter of fact rather than deemed or fictional loss, and I say that is the principled way that damages should be assessed and consistent with 169.

So the Court of Appeal justifiably referred to the difficulties with this approach, and that's in 297, and it's the points that have been raised a number of times before. The fact of pari passu, sharing in liquidation and so on. But that is the issue when one moves away from fact into deemed loss. So –

WINKELMANN CJ:

Well I mean it's all a fiction though, isn't it? The whole fiction of the company being the format through which you must translate these losses, leaves you a very fictional kind of a narrative, that the true loss is this, whereas by the time of an insolvent liquidation the only interests in the company are the interests of the creditors, but we're pretending that the loss is simply the diminution in the net value of the company across a period of time in which creditors would come in and out. There's a fictive kind of element to it all.

MR CHISHOLM QC:

Your Honour, one can't ignore, the law or the Act expressly says that the victim or the plaintiff is the company. One could say a company is a fictional being in any event, but it's a legal person and that is how we asses it, and this is the difficulty we have in this case because as a matter of fact collectively creditors are significantly better off now – sorry, now if one looks at the factual then the counterfactual, and that's the opposite, and that's the analysis that the United Kingdom courts do.

Moving quickly to section 301 and the discretion issues. I think the test in 301, it's common ground, and I think your Honours in *Debut Homes* referred, there's a number of cases before it, to, and I may not have this in the right order, but duration, culpability and causation. But it's in respect of breach, and that's *Debut Homes* at 158. So one is referring to conduct related to the breach by the director as a director. So that's the conduct one is looking at when one is looking at culpability and causation and so on. Necessarily a focus on breach as a duty and what we say, certainly not other conduct that may have been much earlier in time. From Mr Yan's perspective, for example, he wasn't a director until April 2009 and the breaches that have been found to have taken place by the High Court and Court of Appeal started at January 2011. So there needs to be a focus to the breach as a director, in my submission.

WILLIAM YOUNG J:

Why shouldn't the starting point just be pay the lot?

MR CHISHOLM QC:

I beg your pardon your Honour?

WILLIAM YOUNG J:

Why shouldn't the starting point just be the loss is assessed, in the absence of something extraordinary the director should pay the lot.

MR CHISHOLM QC:

Well, your Honour –

WILLIAM YOUNG J:

That's what would happen if the claim had been brought in the name of the company under section 136.

MR CHISHOLM QC:

Correct.

WILLIAM YOUNG J:

So why should they get a better deal because the claim is brought under section 301?

MR CHISHOLM QC:

Well, your Honour, I accept your point, this could've been brought direct.

WILLIAM YOUNG J:

So why should there be a better deal under section 301?

MR CHISHOLM QC:

Because the legislature has placed a discretion under section 301.

WILLIAM YOUNG J:

Well, yes, but is it a discretion that's meant to displace what would be the ordinary course of events if the claim had been prosecuted under section 136? I can think of others that have been – section 301 is a very broad section, covers a wide range of situations, but in a situation that's bang

within, where there's a complete overlap between the basis of relief under section 301 and section 136, why not just apply section 136? Isn't this all just too elaborate?

MR CHISHOLM QC:
Well, your Honour, certainly one could ask the question why section 301 is there, but it is there, and I accept a plaintiff, in particular a liquidator, would have the choice to come directly under 136 or 135. But if one is going to take strict views in respect of damages calculation, whether it be the 301 and simply say what loss was caused, then it's all the more important, in my submission, that one doesn't use a deemed loss situation. One should play, in my submission, and show what loss flowed from the breach as a matter of fact.

But certainly even this Court in *Debut Homes*, and again certainly Justice Goddard expressed perhaps a different opinion to the other members of the panel in the Court of Appeal but –

WILLIAM YOUNG J:
He was expressing a view that's pretty close to mine, I think.

MR CHISHOLM QC:
Sorry? Close to yours?

WILLIAM YOUNG J:
He was expressing a view that's pretty close to the one I've just put to you.

MR CHISHOLM QC:
I understand that, Sir. Certainly it's preferable from a plaintiff's perspective to proceed under the section and go direct.

WILLIAM YOUNG J:
So why – okay.

WINKELMANN CJ:

How could that possibly be the law really, though?

MR CHISHOLM QC:

What…

WINKELMANN CJ:

Well, it seems a strange outcome that a plaintiff is prejudiced by proceeding under the section that is provided procedurally for them to go under as opposed to another route. It seems a strange outcome.

MR CHISHOLM QC:

Well, it's simply a discretion. Your Honours certainly accepted the exercise of the discretion that Justice Hinton exercised in *Debut Homes* on this point and that's at paragraph 171 of *Debut Homes* where allowances were made in respect of I think some contributions had been made and so on. He'd made some payments and I think he'd worked for free for a period of time. But my point is if a strict view on section 301 is to be taken then a strict view on causation and loss as a matter of fact should be taken if one proceeded under 136.

In respect of Justice Young's point though, it's certainly been the law that one can't recover more under section 301, and it would be surprising, coming back to the references to section 301(1)(c), a creditor coming or resolving to bring an application, whether it be under (1)(c) or (1)(b), that an individual creditor could recover more than the company could recover if the company proceeded under 136, and that seemed to be, and I'm not sure whether this is what your Honour was suggesting, that if an individual creditor when under (1)(c) they could somehow get a different and better remedy than the company could otherwise get if it sued direct, because either way the plaintiff, whether it be the liquidators under 301 or a creditor under 301, is simply prosecuting a company cause of action.

WILLIAM YOUNG J:

Well, I confess to having reservations about that, so I'll put that right up front. I think we've got a very confused legislative scheme. Section 301 doesn't sit very easily with 135, 136, and I think 168. But if you look at the predecessor to section 136 and 320 of the Companies Act as introduced in 1981, they do look like provisions that were there to protect creditors.

MR CHISHOLM QC:

But remember section 301 did not follow on from 320.

WILLIAM YOUNG J:

I know that, but so section 320, if this litigation had been under section 320 I don't think this argument – these arguments wouldn't have been available because it was a provision pretty clearly there to protect creditors.

MR CHISHOLM QC:

Correct.

WILLIAM YOUNG J:

And whether – whatever the legislature did, I think it is unlikely that it was motivated by the purpose of reducing the entitlements of creditors in this situation. Now it's made a right mess of it because it's left what you might call the operative provisions or what were two of the three operative provisions of section 20 as separate duties which they weren't under the 1955 Act, left out fraudulent trading a third of them, and then in a different section, what's now 301, it's provided for sort of a remedial approach which was sort of previously tucked into section 320 itself. So section 320 didn't – the old section 320 didn't impose duties. It just said if there's a liquidation and something has happened then this can be done.

MR CHISHOLM QC:

You mean the old section?

WILLIAM YOUNG J:

I mean the old section 320.

MR CHISHOLM QC:

But the old section 320 was still a self-contained claim.

WILLIAM YOUNG J:

Yes, yes, it was. Everything was in there. It didn't impose a duty on people not to do things or anything. It just said if people have done this, then this can happen. I think it's all got scrambled by the way, the process that resulted in the Act coming into place in its current form, but for me I don't necessarily see the claim as being one that must be mediated through a loss attributed to the company.

MR CHISHOLM QC:

But in my submission, your Honour, one can't ignore 169.

WILLIAM YOUNG J:

So this is heresy. What? I'm not ignoring 301.

MR CHISHOLM QC:

Sorry, I said 169, your Honour.

WILLIAM YOUNG J:

Yes, well, is it 168 or 169? I can't remember.

MR CHISHOLM QC:

169(3).

WILLIAM YOUNG J:

Okay, so I would be inclined to see that as distinguishing between – I agree and I'd quite like to follow, go through the history. It says some duties are duties owed to the shareholders, some duties are duties owed to the company. I'm not sure that it's necessarily to be taken as saying that these are duties that may not also be owed to creditors.

WINKELMANN CJ:

When one looks at the pre-existing case law that was being carried through into this new reform is the thing that colours my thinking.

MR CHISHOLM QC:

But, your Honour, removing that remedy must mean something because it went back to –

WILLIAM YOUNG J:

Yes, they put it back into section 301 but they got it back to front.

WINKELMANN CJ:

Just badly.

WILLIAM YOUNG J:

Inside out.

MR CHISHOLM QC:

They're not the words and remember that remedy is still there for proper accounting records which suggests that it still has a purpose –

WILLIAM YOUNG J:

It suggests that someone lost the thread of the legislative policy. That's what it says to me, that there was a particular policy represented in the draft report, in the report of the Law Commission, which is broadly consistent with your approach. It then got changed in the parliamentary process without clear explanation why and result is we have a pretty scrambled set of provisions which we probably should try and make commercial sense of. Anyway, I'm sorry to introduce that disheartening proposition but –

MR CHISHOLM QC:

No, well –

WINKELMANN CJ:

I don't think it should be disheartening to you. It's really been in play the whole hearing, hasn't it, I think? It's what has been the submission of the respondents.

MR CHISHOLM QC:

There's no doubt about that, your Honour, but the wording of the Act can't be ignored.

WILLIAM YOUNG J:

No, we try not to.

WINKELMANN CJ:

Well, I mean you have been – the appellants have asked us to ignore parts of the wording of the Act because it doesn't really make sense. I mean we all know that it's scrambled. So both parties want us to ignore the wording of the Act to some extent.

MR CHISHOLM QC:

Well, your Honour, I'm not sure what I'm ignoring in the Act.

WINKELMANN CJ:

Not you so much, Mr Chisholm. It's Mr Hodder.

MR CHISHOLM QC:

Well, you know, don't…

WINKELMANN CJ:

Okay, you disassociate yourself from him. You won't be the first counsel to have –

MR CHISHOLM QC:

No, I don't disassociate myself with anything Mr Hodder says. But I'm not trying to add anything to 135 or 136. There's been a deliberate decision by the legislature to move away from a liquidation cause of action.

WINKELMANN CJ:

From a punitive approach.

MR CHISHOLM QC:

And a punitive.

WINKELMANN CJ:

A punitive approach. That's the driving thing, isn't it, not to punish directors, but it doesn't follow that it means that the next step is that they have lost the intention to have creditors compensated?

MR CHISHOLM QC:

Well, your Honour, if that was the case then the duty should have been stated to be to creditors.

WINKELMANN CJ:

But it never has been.

MR CHISHOLM QC:

Well, but it never had been but now it's expressly stated to be to the company.

WINKELMANN CJ:

Right.

MR CHISHOLM QC:

But we came back onto that for the –

GLAZEBROOK J:

Well, it was never suggested anyway that there was actually a duty to creditors, was it?

WINKELMANN CJ:

No, it never – apart from in *Nicholson* –

GLAZEBROOK J:
Lord Sumption gets close to it but prior to that it was taking – there was that earlier case I think but –

WILLIAM YOUNG J:
But if you look at section 320, the original version, it provides a –

MR CHISHOLM QC:
Pre-1980.

WILLIAM YOUNG J:
Sorry?

MR CHISHOLM QC:
Pre-1980, that version, Sir.

WILLIAM YOUNG J:
Yes. It provides a remedy for the affairs, where the affairs of a company have been carried out with a view to defrauding creditors. It's a remedy that can be made in favour of a creditor. Now it doesn't impose a duty not to defraud creditors, because that would be a slightly odd duty to have. It just says that where something has happened, (a) there's been a liquidation and (b) before the liquidation there was a policy of defrauding creditors, there is a remedy which can be compensation to creditors. Now this whole business of duty is something that isn't really in the 1955 Act provisions. It comes in under the 1993 Act because of the statutes being reformulated. But if you look at the old section, the old 320, and then look at the 1981 version, they look like provisions that are there to protect creditors and they provide for a remedy in favour of creditors.

MR CHISHOLM QC:
Correct.

WILLIAM YOUNG J:

Now it's possible to read the current provisions once you get section 301 tucked in and try to make sense of section 301(1)(c) to see that it too is a set of provisions that are intended to protect creditors. In fact, they plainly are to protect creditors. You say it's a protection that's got to be mediated through a notional loss to the company, but that doesn't seem that logical to me.

MR CHISHOLM QC:

But, your Honour, with respect to 3 – I was going to say 321 – section 301(1)(c), in my submission you can't use a bootstrap argument with that because it's still – it's certainly been the understood law up until now that it is procedural only, that it can't be – you can't be in a better position than the company would have been in if it had brought the claim itself.

WILLIAM YOUNG J:

Well, that's your argument.

MR CHISHOLM QC:

Well, Sir, but that's been stated in cases up until now.

WILLIAM YOUNG J:

Yes, I know –

WINKELMANN CJ:

But you say that you can be in a worse position.

MR CHISHOLM QC:

Beg your pardon?

WINKELMANN CJ:

You say you could be in a worse position though is your other –

MR CHISHOLM QC:

You mean – well, the way the discretion has always been exercised until now is that it –

WINKELMANN CJ:

It's very strange.

MR CHISHOLM QC:

– it can only go down.

WINKELMANN CJ:

What a strange construct.

MR CHISHOLM QC:

Your starting point is the damages or the –

GLAZEBROOK J:

So what do you say it goes down by here that would be different from 135 and 136? I suppose I've lost the plot altogether in terms of your argument, I'm afraid.

MR CHISHOLM QC:

Well, your Honour, if the –

GLAZEBROOK J:

So under 135 and 136 what would you be able to have recovered? Nothing you say because the position of the company had improved. Is that the submission? So in fact under – you're not – under 301 you still recover nothing because it's the same thing or is there some different argument I'm missing?

MR CHISHOLM QC:

Your Honour, 301 is procedural only. So a liquidator could choose to go under simply suers in the name of the company under 135 or 136 or alternatively sue in his or her own name under 301. So that's simply procedural.

The starting point, or at least until now under 301, is that the maximum recovery is what the liquidator would have recovered under a claim for section – under 135 or 136. So the same damages or remedy issues under 135 or 136 have to be addressed under 301. It's purely procedural. My simple point or proposition in respect of (1)(c) is one can't use a bootstrap argument with that if section 301 is purely procedural. It can't put a plaintiff, whoever it is, in a better position than the –

WINKELMANN CJ:
But you do say it can put a plaintiff in a worse position than a company would be?

MR CHISHOLM QC:
Well that's the way the discretion has been exercised to date.

WINKELMANN CJ:
It sits uncomfortably with your notion it's purely procedural, doesn't it?

MR CHISHOLM QC:
But it's – well when I say it's procedural, that's how it's been interpreted to say it's simply a means of advancing a company cause of action. So it's not a stand-alone cause of action for example like section 320 was. Remember 320 had a predecessor to 301. The 1955 Act had section 321 as well, which was similar, or very similar except, as Justice Young has said, the additional of (1)(c).

WINKELMANN CJ:
Can I perhaps just clarify what you mean by "truly procedural". You mean it simply creates procedure or do you encompass within truly procedural that it actually creates remedial discretion?

MR CHISHOLM QC:
It's the latter. It's purely procedural but a discretion has been found to exist as to the relief. But that has been interpreted to date on the basis that the

discretion – one can't recover more than the loss caused by breach, but that the Court will take into account factors to reduce the liability. For example, in *Debut Homes*, as I said, this Court, well, simply affirming what was stated in the High Court, had regard to factors such as Mr Cooper advancing money to the company, or working for free, those sorts of matters.

So to date, and I accept the point that Justice Young made, and Justice Goddard in the Court of Appeal, as to why there should be a difference, but to date there has been those three factors duration, culpability, causation of breach. Again it's the reference to "breach". One can't refer to unrelated matters. And assuming that this Court finds that there is still that discretion under section 301, that the points that I would make is first of all, conduct that is prior to an individual being a director, and well prior to breach plainly, in my submission, can't be relevant. Other factors such as analogous factors to the discretion in *Debut Homes*, the fact that the directors procured RPL to advance, for example, close breach, 8.54 or .56 million dollars. The fact that the material thing provided. The fact that RPL has already paid $19 million to bonds.

GLAZEBROOK J:
The answer when I asked you friend that was well that actually just reduced the amount of the debts and so was actually taken into account in any event in the calculation, as I understood his reply to me.

MR CHISHOLM QC:
But, well, as it's been – those matters, your Honour, because it's not comparing apples with apples, because we're saying it's, as a matter of fact these matters have caused the company not to suffer loss, so they've improved the –

GLAZEBROOK J:
And therefore improved the position of the creditors and so it had already been taken into account in respect of the measure of damages that the liquidators are claiming. That was his answer to me, as I understood it.

MR CHISHOLM QC:

But your Honour, and this is why we say it's artificial, because my friend is only concerned about new creditors, not creditors collectively.

GLAZEBROOK J:

Well those new creditors' position was assisted by the fact that this money had come in, because there was more money for them to pay whatever their new debts were. That's what I understood his answer to be.

MR CHISHOLM QC:

It maybe your Honour, but I say that that's not logical, because the money doesn't go them. The money goes across the board, pari passu, to all creditors, whether they're old or new. The Act is concerned with protecting creditors collectively.

WILLIAM YOUNG J:

That's the whole issue. I mean in a sensible world a fraudulent trading case, the money would be directed to be paid by the Court to the creditors who'd been adversely affected, not to say the receiver. So doesn't section 301 provide at least a basis for sensible outcomes?

MR CHISHOLM QC:

In my submission it's not as easy as that, and I know there may be a different opinion in respect of (1)(c) if you have a creditor.

WILLIAM YOUNG J:

Yes, it depends on how you construe (1)(c). I would construe it perhaps quite radically.

MR CHISHOLM QC:

Well, your Honour, it doesn't say that in my submission.

WILLIAM YOUNG J:

Look, I know that, I know that.

MR CHISHOLM QC:

Yes, and these are really factors, in my submission, if there is a problem it's for the legislature to change the law and I think that was Justice Goddard's point. But the factors that I am referring to now, assuming there is the discretion as the Court including at least this Court to an extent in *Debut Homes* found that there was, because remember *Debut Homes*, I think in that case even though Mr Cooper was liable for the GST component –

WINKELMANN CJ:

He provided his labour free.

MR CHISHOLM QC:

He provided his labour free and I think he gave – although he put in a couple of hundred or 320,000 or something, he was still given a benefit back I think of 80 or something like that. So there was a credit. So that's not part of some sort of damages calculation, and when one looks at all of these cases, *Goatlands Ltd v Borrell* (2007) 23 NZTC 21,107 (HC), for example, which I think there was a GST issue in that, I think ultimately it was quite an extreme finding of culpability that effectively the director in question was liable for a quarter of the relevant increase.

So my submission is that if there is this discretion available and one gets to that stage, the factors such as as a matter of fact collectively all creditors have been improved, as a matter of fact directors procured money to go into the company, as a matter of fact RPL has effectively contributed to some creditors in the sum of 19 million, these are all factors that can go to the discretion.

I've probably taken too much time. I have put in just in respect of (1)(c) the case that I referred to previously. That was *J M Sanders v Flay*.

WINKELMANN CJ:

Yes, where's that in your handout?

MR CHISHOLM QC:

That's now been put in the – it's not in a handout, your Honour. I'm just –

WINKELMANN CJ:

Okay, thank you.

MR CHISHOLM QC:

Sorry, that was just a factual hand-up. That was the case I referred to. It's a case of Justice Heath and I submit that that's the type of case, a creditor case, that truly falls in to (1)(c), that's at tab 145. It may be worth quickly going to. I think you can see in the headnote it was a misappropriation, a dishonest director who misappropriated funds. One can see above the finding: "The proceedings were, in essence, based on the ground that Mrs Flay received company funds and misapplied them for her own benefit thereby depriving the estate…" The estate was essentially the plaintiff creditor.

If I could take you to what Justice Heath said at paragraphs 18 and 19, if your Honours can read those. In my submission it's that type of case that does fit squarely into (1)(c), and that's consistent with Justice Denning's finding in *Mitchell v Hesketh* which I took you to.

So, your Honours, I say that if there is a discretion these sorts of factors, the contributions, the real contributions in money and assets that actually went into the company, are factors that can be taken into account. This is not a case, a self-dealing case or anything like this. On the contrary, and that was the point in respect of the inflow of cash, it wasn't just the inflow of cash. Money was going in. Liabilities were being –

WINKELMANN CJ:

Are you replying now or is this repeating your submissions?

MR CHISHOLM QC:

I'm just simply referring to those points. I was simply going to make the point, this is not a self-dealing type case. There seemed to be a suggestion that Mr Yan had made a profit out of this. Quite the opposite.

WINKELMANN CJ:

Well not of this, of the parent.

MR CHISHOLM QC:

But that's, again your Honour, that was the point I made before, going back to something that happened in 2005 is not duration, culpability, causation of breach. There must be a link to the breach in question.

WINKELMANN CJ:

Thank you.

MR CHISHOLM QC:

Which is later in time. Your Honours I've probably taken far too much time, unless you have any further questions?

WINKELMANN CJ:

No thanks Mr Chisholm.

MR HODDER QC:

As your Honours please. I should say that I'm conscious of your Honour the Chief Justice's commitments this afternoon, but I don't realistically think I'm going to finish by one.

WINKELMANN CJ:

No. Well we've got an hour after.

MR HODDER QC:

We do, but I am very conscious that we will finish within that hour, hopefully with a bit of room to spare.

WINKELMANN CJ:

Okay.

MR HODDER QC:

But if we started at two, that would make it easier?

WINKELMANN CJ:

Well we could continue I think until 3.30 because I think the webinar is at 4 o'clock.

MR HODDER QC:

Hopefully not that long, but yes your Honour.

WINKELMANN CJ:

So what was your suggestion, we start again at two?

MR HODDER QC:

Starting at two.

WINKELMANN CJ:

Yes, that's fine.

MR HODDER QC:

That's just a suggestion your Honour. So if I may make a few non-controversial comments by way of reply. Firstly, I think it's useful to focus on the matters of agreed I think this may turn out to be a not entirely non-controversial proposition, but I think the number of critical matters that were agreed by my learned friend Mr O'Brien said, and which I will pick up on because I think it then leads to a different route to the one that he took in his submissions to you, firstly, as I understand it, neither of us can find any case where directors who were acting diligently, in good faith, honestly, with no material conflicts of interest, having held liable for trading while insolvent.

Secondly, we can't find any case where the new debt approach has been used to assess loss to the company from trading on outside some quasi-fraud environment such as *Debut Homes.*

Thirdly, it's agreed that the Richina group had very substantial assets held principally in the China holding company.

Next it's agreed, I think, that Mr Yan was understood to exercise control of the Richina group, that he was the benevolent dictator and that he was able to control the central treasury operation inside the group. Also I think I understood that he had provided assurances of group support, including after the 2009 restructuring, and had done so on a not infrequent basis.

I think it's also common round that Mainzeal wasn't a stand-alone operation. It was a subsidiary in the larger Richina group. I think, but I stand to be corrected on this, because I think my learned friend qualified his position that the letters of comfort were not necessarily, or not thought to be enforceable as such, why not now thought to be enforceable as such, at all times before and after the restructuring.

Then the question that the creditors were largely paid when current, and were not significantly overdue in late 2012. That was my learned friend Mr Kennedy addressing submissions on the point, that's in paragraph 14.6 of the liquidators' written submissions. It's also the point made by Mr Graham in his evidence at paragraph 37, if I can just give the reference for the record, 210.04100. His comment was that that state of affairs, that is to say that the creditors were current, indicated that support was being provided as required.

WINKELMANN CJ:
What paragraph is it? Is it of his evidence?

MR HODDER QC:
Yes, paragraph 37 of Mr Graham's evidence, your Honour.

It's also agreed that Mainzeal received unqualified audits in, relevantly, 2010, 2011, 2012, and I'll come back to that question of audit in due course.

The last point that I think we have effectively agreement on is that the key period is after the 2009 group restructuring when the connection with the direct – where corporate diagram connection with the CHC disappears or is obscured.

So against those propositions, that leaves a number of matters in dispute but one of them is whether Mr Yan could be taken to be committed personally and reputationally to Mainzeal and New Zealand and the relevance of that being to whether or not those assurances could be relied upon.

In terms of his commitment, can I refer the Court, without taking us there unless the Court wants to, to Mr Yan's reply evidence which is at 207.02637 and at paragraph 7, which is page 02640, he explains over a page the nature of his personal and reputational commitment to Mainzeal and New Zealand.

I'll come to the question of the question of the comfort letters when I come to a couple of emails that attracted some attention, partly this morning but more particularly when my learned friend, Mr O'Brien, took us through them, but the basic proposition I'll be putting is that Mr Yan's assurances were not qualified and insofar as there was reference to –

GLAZEBROOK J:
You mean verbal assurances at that stage?

MR HODDER QC:
I'm certain that both his verbal assurances and the assurances that are given in the comfort letters, as it were, for the audit are unqualified. I appreciate, of course, that the entity on whose letterhead those written assurances appears is insufficiently capitalised to support them itself.

But in terms of the 2004 shareholder letters by Mr Yan where there's talk about competition for capital – but perhaps I don't even need to make this point – but it's reasonably clear that Mr Yan is talking about anything but an insolvency scenario; he's talking about various different companies in the operations and if they're making a better return they'll get more capital to keep on doing that. He wasn't, in my submission, can't be taken fairly to be meaning anything else than that.

GLAZEBROOK J:
So that's new capital rather than repayment of debts?

MR HODDER QC:
Yes. In terms of his position as the central treasurer/dictator, he's saying: "I'll ensure that the money in the company that we have access to for the different divisions will go to the ones that are making the most return on the capital," which is an entirely rational thing to do but not focusing on the question of insolvency. Because it…

GLAZEBROOK J:
He said that they'd be supported but only as long as there wasn't insolvency, didn't he?

MR HODDER QC:
Not in those letters. Not in those shareholder letters.

GLAZEBROOK J:
No, no, I understand that.

MR HODDER QC:
Yes. There were some other statements but I'm simply referring to those shareholder letters which were, as it were, the public statements, and it's not clear to me that there's any point at which he says that to my client directors, that is it's only contingent on solvency and that in the event of lack of,

continuing lack of profitability then there would be a disappearance by the group.

Can I take us, please, and bring up if we could, please, 310.05683? This is Mr Yan's 13 August 2010 email. So it does a number of things. The first says, and I can pick this up in the third paragraph: "Mainzeal has always operated and continue to operate under a shareholder/parent guarantee and all the cash are shareholders' cash." Now Mr Yan isn't writing a legal statement, that's obvious, he's not a lawyer. This has no particular indication of having been legally drafted. We respectfully submit it can properly be read as indicating what his intention was, what his assurance was, that there would be the group standing behind Mainzeal, and that's why he goes on to say: "… the group has always been willing and so far able and will only be more able going forward to guaranty all its obligations," that Mainzeal has.

He does refer to the fact there are issues about taking money out of China, which in a sense is the core problem that this entire enterprise faced during the period we're concerned with. Then he goes on with the famous line about "it is ultimately the shareholders who are on the hook" but in my respectful submission all he's really doing is underlying what he said two paragraphs above. That the group is standing behind the company. Then he goes on to talk about operations being centralised and discussion about cash flows.

If we could bring up 326.15491. Now this is just one example, I probably should have picked the 2010, but they're effectively in the same – 2011 – but they're all in the same form. What the actual letter of, that the directors received from Mr Yan in this case in 2012, but the wording is essentially the same. The acknowledgement is at the bottom in the last bullet point: "… responsibility… to provide sufficient financial assistance to MZL as and when it is needed to enable MZL to continue its operations and fulfil all of its obligations now and in the future."

Our submission to the Court is that when one takes the documents, and really what he's saying in the email of 13 August 2010, is no more and no less than

is being said in the letter of this case, April 2002, but it's the annual letter in this case addressed to the directors.

So what does Mr Walker say? Mr Walker's email is a couple of weeks later than the first one we looked at, and that we find at 310.05707. Now this is written by a lawyer, and in a lawyerly fashion, probably at one point say a New York lawyerly fashion, because it is rather dense, but in any event what he's doing is responding, as the Court well understands, to the earlier concerns expressed on behalf of the other directors by Dame Jenny Shipley. So the first thing he does is to say that's what he's doing, he's responding to those sorts of issues, and then he goes on to describe the group structure. Now why would you do that? Well, let's see what the point of the group structure is. What goes on under that section heading "Group Structure" is to say: "The shareholders of RPL and Richina Holdings are currently identical." That is to say, both sides of the wiring diagram have the same shareholders.

He goes on to explain the ownership propositions and then says in terms of, this is in terms of the third paragraph beginning Richina Holdings owns 100%. "Wallace," that's Mr Mathai-Davis who was a New York financier, or financial person, "and I are the two members of the Audit Committee of Richina Holdings." That is to say, they're independent of Mr Yan. He then goes on in the next paragraph to explain that's the same position with RPL, that both, in the Audit Committee on both those sides of the proposition there are two independent, two New York individuals, who are the members of the Audit Committee, Mr Yan is not. But goes on to emphasise the common shareholding as earlier on.

The significance of that we say is, insofar as any questions raised that the Court's heard about cash flow being shuffled around by Mr Yan causing Mr Pearce, at least in his emails, a certain amount of concern, then what they're saying is we on the Audit Committee are on both sides of this group which runs and has, as it were, parallel audit committees.

Then at the bottom of the page he says, we're going to review the cash flows. "Wallace and I have reviewed the most recent registers of cash flows," about five lines up from the bottom. Goes on and talks about the resolutions about cash flows, and I agree, as Justice O'Regan pointed out, they're rather odd but the basic message appears to be "we", Mathai-Davis and Walker, will be keeping an eye on the cash flows, so it's not going to be just Mr Yan with his hand on the tiller. Then at the bottom of the page…

WINKELMANN CJ:
It's a rather confused position though, isn't it, Mr Hodder? You've told us that Mr Yan was in effective control but here's Mr Walker saying, well, actually, Mr Yan isn't in effective control of cash flows.

MR HODDER QC:
Here's, I think, Mr Walker saying: "We have some guidelines here and some comfort for you." I don't think it denies he has control.

Then there should be – go to the next page, please, down towards the bottom, down to "Reporting Expectations". Just above "Reporting Expectations" there's a statement that says that if it was necessary for Mainzeal to win business, the audited financial statements of the relevant entities, ie, both sides, that's RPL and Richina Holdings as they are described in the earlier part of the email, can be made available to parties on a confidential basis. That was what was being sought and it was being sought to show that Mainzeal did have behind it groups with substantial assets or very healthy balance sheets and consistent with the idea that there were, in fact, going to be support.

Then the famous sentence at the bottom of the page: "However, we believe it is the role and responsibility of the Mainzeal board to make going concern, solvency and similar determinations with respect to Mainzeal," and we respectfully suggest that is simply to be read as a legal statement. As a matter of company law the directors are responsible for making those decisions.

The rest of the letter, we say, is entirely consistent with the idea that the directors can be comforted by the fact that this is not only a large group but it has audit committee sort of processes in control which will be kept on by the people who the directors have some knowledge of, namely Mr Walker and Mr Mathai-Davis, and it's entirely consistent with both Mr Yan's earlier email talking about shareholders on the hook and it's consistent with the regular letters that come through in relation to the audit process in particular but also as the evidence of Dame Jenny Shipley, Mr Tilby and Mr Gomm is there were assurances on a regular basis orally by Mr Yan to the same effect, and, as I said, there's no dispute – well, as I understand –

GLAZEBROOK J:
It doesn't say the left-hand side assets are available to the right-hand side or to Mainzeal, does it? If anything, bit obscurely but would suggest the opposite.

MR HODDER QC:
Well, the evidence, it doesn't say that explicitly although the implication of that we say is.

GLAZEBROOK J:
I can't see an implication either. Where's it implied that the left-hand side is available to the right-hand side?

MR HODDER QC:
Otherwise there's no point in talking about RPL. The only logic of talking about RPL and them as having common shareholders and common audit committee is to say that it's relevant. How is it relevant? Well, it's relevant because it's part of a wider group and the wider group is what is being understood to be providing the support. Mr Walker's evidence says that in his brief and I think I took you to a couple of places in my earlier submissions.

GLAZEBROOK J:
So that's his post facto evidence but I don't think you took us – so there's nothing other than this that suggests he was backing up Mr Yan's assertion that there would be support from the left-hand side?

MR HODDER QC:
Not in terms of specific communications with Mr Walker or the board but he says it in his evidence.

GLAZEBROOK J:
And I understand after the fact.

MR HODDER QC:
And our directors say they understood that from their conversations with him as well when he attended board meetings and otherwise.

Although the word hasn't been used very much, the Court will appreciate that what we're really talking about here is the question of recapitalisation of Mainzeal, partly reflecting, as became clearer, that it wasn't that straightforward to get money out of China, and so when we have been putting, for some years now, the proposition that the directors are facing a case that says: "You should have ceased trading end of January 2011," it had become somewhat ritualistic and my learned friend, Mr O'Brien, equally regularly says: "No, we're not," what we are saying, as he said to you, is: "Fix it or cease trading." So the question was, well, how do you fix it?

Following the 2009 restructuring the directors had management powers over Mainzeal but they weren't operating a stand-alone company which had its own assets. The assets were in the group, the principal assets were in the CHC, and the directors had no power themselves to recapitalise Mainzeal. They had no power to direct assets to come from China in a capital sum, and they operated within a regime where there was cash distributed as and when required from the centre by Mr Yan and his team. Now the directors encouraged, and they expected, that the group was working towards creating

a New Zealand asset base which meant that ultimate Mainzeal could be stand-alone, and there were assurances and actions were taken to that end, although it was taking time. That again is –

GLAZEBROOK J:
Well the submission that you are meeting there is that this was never going to be profitable, if you look at the trading history, because it was operating on very thin margins. So it was never going to be able to rebuild that hole in the asset base.

MR HODDER QC:
Well there's two aspects of that your Honour. The first is was it ever going to be profitable? We say that's a question of judgment, and I took the Court to, I think it's appendix B of the Court of Appeal judgment, which shows that profits go up and down. That's operation and profits. I don't want to go back there but that was the general point of the exercise. They were operating profits and they were difficult times. Were they also going to be difficult times? Would it never make profits? That's a matter of judgement. We say that was the question. But, your Honour, the second point was the asset was never going to be filled. Well that was the logic of having a New Zealand group, as it were, that had sufficient assets that it was an asset base. So things like section – there wasn't a reason for it, I don't imagine, but section 271 pooling could apply to the other assets in the group that we haven't spent time on, but there's a range of other companies that are set up. There's that development of Mainzeal House and various other assets.

So it isn't just a case, as most cases were, and where there had been criticism, the idea that says well if you're going to trade your way out of your balance sheet problem, that wasn't the issue. The issue was that there were two streams of activity going on. One was to try and improve the profitabilities of cash flow solvency was more secure, it was, and that was the question that was being addressed by people with a lot of experience, a lot of expertise, and applying their judgement about what could or couldn't happen and I'll use

the word “hindsight” probably for the first time now, because in hindsight it didn’t work, isn't really the answer to the point.

The second is that as far as the balance sheet was concerned there were adverse, a series of assets being built up in New Zealand to which Mainzeal was expected to have access for the purposes of its balance sheet, and it would’ve had access, or others would have had access of 271 should the exercise be required.

So in those circumstances the High Court came up with the idea that what should have happened was that the directors should have threatened to resign as a tactic. The word “tactic” comes from paragraph 293 of the High Court judgment. What happened, of course, is the directors didn’t threaten to resign. They took a less aggressive approach. They sought to encourage the moves that I've just been describing. Now in the end both the High Court at 416, and the Court of Appeal at 450, say it’s speculating to know what would have happened had there been a threat to resign, and so we can't go much further than that. But what we do is that it was a legitimate exercise of business judgement to decide not to threaten to resign, but to pursue a less aggressive approach and try and encourage this transition and that, if it’s an error at all, is an error of judgement. It’s not in any sense a concept of something that’s in bad faith or that is designed to further the interests of anybody else other than the operation of Mainzeal and all who were its stakeholders in it.

It was clear enough in the, I don’t want to labour the point, but the pleaded breach was continuing to trade. That’s in the statement of claim we’ve been looking at paragraph 61 of the section 136 claim, and section 66 for the 135 claim. In fact, as the Court will appreciate, it was pleaded as a section 135 and 136 being interchangeable, that the common aspect of it was to say you were continuing to trade and that’s, of course, what Mainzeal had to do, it was a trading company. If it stopped trading, it was gone. On that there was agreement in the joint experts’ report that both I and Mr O’Brien took you to in issue 8. Where that takes you too then is the question about, well if there is,

and this becomes more evident in 2012, if there's a question mark about ceasing to trades, don't you have to consider the implications of ceasing to trade, and that gets you into the unenviable dilemma that's described by Justice Park in the *Re Continental Assurance* [2001] BPIR 733 (Ch) case. It's an issue – it's at number 72 in the bundle of authorities in paragraph 281. I won't go there but the same point is picked up in *Grant v Ralls* as well where it is an endorsement of the approach taken in *Continental*. That's what you have to do, and we say again that is a question of business judgement, for directors' judgement, but it's not a wrongdoing exercise.

Now my learned friend, Mr O'Brien, was critical of our expert, Mr Westlake. Well, he had to be. But what he did emphasise is that Mr Westlake's view was based on the idea that there were expressions and tangible signs of support from the group from time to time as and when required, and as I apprehended the submissions made for the liquidators it was he was simply wrong about that. Well, we say, actually, that's not correct, the Courts having had various kinds of material about the funds in and out at the time of the Vector exercise, there's the results that are seen in the appendix over the Court of Appeal judgment and also in the joint memorandum that you were taken to which is at 102.00441. There were all sorts of material and cash coming in during the relevant period which underpinned Mr Westlake saying, well, there were signs of support and there were expressions of support, and there were.

In terms of auditors, my learned friend said, well, they're the directors' accounts. The auditors, by implication, didn't have much to add to the process. In our respectful submission that does misunderstand or insufficiently acknowledge the significance of the audit process in Mainzeal. I've taken your Honours to some of this.

So the process involved an audit plan. We don't seem to have an audit plan for whatever reason before this but there's one for 2012 at 324.14245. Again, given the time, I don't think I'll take the Court to it but if you want to you'll see it's quite a detailed report and it has a discussion of what the

auditors were planning to do in relation to satisfying themselves on the going concern matter.

Then after that there's an engagement with management, or probably before and after that there's an ongoing engagement with Mr Gomm as CEO and Mr Pearce as CFO, and there are various discussions until you get to an audit report and I took the Court to the 4 April 2011 report.

That then gets dealt with in a board meeting and I described Dame Jenny Shipley's discussion of that in her evidence at paragraphs 56 to 59. I should also have referred on to 60 and 61 because that process in which the auditors, Mr Yan and the directors were involved gave them comfort that they were a going concern because there would be group support. It wasn't just a random letter that came from Mr Yan from time to time. As Dame Jenny and Mr Tilby explain, this was considered by the board, including Mr Yan.

Then that leads to the letter of representation by the directors to auditors, signed by Mr Yan, saying there's a good basis for going concern, and then the letter of support of the kind that we were looking at a few minutes ago.

So were the auditors just along for a quiet life? Well, according to the evidence that we haven't been taken to, the answer was no, they were involved in material. I don't want to go into the detail of it but reference – before one discounts the auditors one should have regard to the evidence of the liquidators' own evidence, auditor, Mr Schubert. Mr Schubert's evidence was that there is a critical evaluation of going concern, that is the directors' assessment isn't taken at face value. Mr Schubert's evidence is 202.00608, and I would refer to his paragraph 39 and also his cross-examination about that.

There was evidence from both Mr Schubert and from Professor Van Zijl about ISA (NZ) 570 about "going concern". The Court may be spared doing this but I will mention that it's in the bundle at 602.00058 and it shows what an auditor

is supposed to do about going concern. Mr Schubert did say – I won't go through the cross-examination – that there will be a more detailed review where there is uncertainty and that it should be a rigorous and demanding exercise to satisfy about going concern.

As I mentioned I think earlier on, the Mainzeal auditors did travel to China to assess the assets in China back in the group. Mr Tilby's evidence at 54 refers to that. It's also mentioned in Dame Jenny's evidence-in-chief, ie, in the transcript, around 206.02173, and they sought copies of the CHC accounts as part of the audit process.

So importantly, in their evidence, both those experts, Mr Schubert and Professor Van Zijl, agree that the directors could take some comfort from the fact that Mainzeal received an unqualified audit. That's noted in passing by the High Court but the fact that it was said by Professor Van Zijl at paragraph 19 and by Mr Schubert in cross-examination – the notes of evidence reference I'll have to come back to but it's at transcript 463; it's only got "line 16" – all go to the fact that that was a significant process.

So could I turn briefly then to some aspects of the common law as that received a certain amount of attention and –

WINKELMANN CJ:
Did Professor Van Zijl say that the directors could take comfort from the fact it was a positive audit?

MR HODDER QC:
Yes. Paragraph 39 – sorry, paragraph 19.

WINKELMANN CJ:
And Mr Schubert said the same?

MR HODDER QC:
He did. The reference I've got – and I need to get the bundle reference of that after lunch but it's in the notes of evidence at transcript 463, lines 16 to 23.

The Court no doubt has or will read Dame Jenny's evidence and Mr Tilby's evidence but it's clear that they did put weight on the audit process. It's clear they put weight on the fact that they carefully considered, as a board with their officers, including Mr Yan, with the auditors, that it was appropriate to describe the company as a going concern for the 12 months ahead and then it became more frequent as 2012 proceeded.

Now, your Honours, I'm about to turn to discuss *Sequana* and briefly *Bilta* and also say something very mild about the Law Commission's report, but it may be that if we –

WINKELMANN CJ:
Mild or wild?

MR HODDER QC:
Only mild, your Honour, with an M.

WINKELMANN CJ:
We'll leave the wild stuff to Justice Young. All right, so we'll take the luncheon adjournment then.

MR HODDER QC:
I think that's convenient, your Honour, thank you.

WINKELMANN CJ:
2 o'clock.

COURT ADJOURNS: 12.57 PM

COURT RESUMES: 2.03 PM

WINKELMANN CJ:
Just clarifying Mr Hodder, Mr O'Brien also has a right of reply does he? Does he wish to exercise it I suppose.

MR HODDER QC:
The arrangement we had was that I would confine remarks about matters subject of the cross-appeal, and if there was something – the basic idea was there wouldn't need to be a reply to reply but if my learned friends feel a need to reply to reply, I wouldn't object. That's if I've gone beyond the scope of our own reply.

WINKELMANN CJ:
Okay. So you see yourself being finished by three?

MR HODDER QC:
I see myself being finished, I hope to finish by three. That's an ambition.

WINKELMANN CJ:
Good. Okay.

MR HODDER QC:
Two brief matters that follow from this morning, the first is I mentioned -

GLAZEBROOK J:
Can we just wait a moment please.

TECHNICAL DIFFICULTIES (14:04:45)

GLAZEBROOK J:
Just carry on.

MR HODDER QC:

Thank you. firstly I mentioned the question of comfort in terms of unqualified audit reports, and I mentioned Mr Schubert and Professor Van Zijl. Mr Schubert's evidence is to be found at 202.00670, and with a bit of nudging in cross-examination he accepted there was some comfort to be taken from the fact that there was unqualified audit report. Mr Van Zijl wasn't so qualified. Secondly, I really should have made it clear when I was talking about Mr Yan this morning, that we in no way seek to detract from what was said by the High Court at paragraph 432, that Mr Yan acted honestly and was genuinely committed to Mainzeal. That kind of goes with the genuineness of the assurances, we say.

Now I was going to then touch briefly on *Sequana*, which my learned friends spent a bit of time on yesterday, as a way of demonstrating the common law principles about where the interface between directors and creditors is. For myself I'm not sure it's a particularly relevant aspect of this case, but in any event we probably agree to quite a large extent on *Sequana*. Firstly, it's a careful judgment by Lord Justice David Richards. Secondly, it traces through the common law cases on the presumption that *West Mercia* was rightly decided, and is binding. Thirdly, it's critical of various aspects of Justice Cooke's judgment in *Permakraft*. Fourthly, it talks in terms of a duty to have regard to the interests of creditors. It doesn't see them as substituting. They simply, they factor in as the interests of the company taken into account, that's really the context for it, and the entitlement is for the company to recover compensation. One of the interesting passages –

WINKELMANN CJ:

What use does the corporate form have in that circumstance really where it's completely insolvent, the only interest really that continues in its shape is the interest of creditors. What use is that fiction of a corporate entity in those circumstances?

MR HODDER QC:

It's the structure that recognises it as a separately legal personality.

WINKELMANN CJ:

I know but a lot of your submission was –

MR HODDER QC:

If your Honour is asking is there a practical effect as opposed to a conceptual effect, then it becomes harder, but there may be other interests, and as I'm going to come to later on, it's not just about insolvency, it's not just about creditors in terms of the sections we're concerned with namely 135 and 136.

One of the passages that are of some interest in the judgment is, and I don't need to take you there, but there's a reference at paragraph 197 where there's a description between what the facts of that case were that were outlined by Mr O'Brien yesterday about a dividend, and one of the things that's said at paragraph 197 is the contrast between a dividend, which was incapable of providing benefit to the company or its creditors, as opposed to investment in a new business which might have benefit for the company and its creditors, it was drawing that kind of distinction. As I'll come to, one of the problem areas that's identified through the case law and various reform bodies, including the Law Commission, is this concern about assets being transferred by way of distribution or some form away from the company so that they are harder to get by the creditors. There was also reference in terms of the wider issues to a chilling effect of the duty at paragraphs 199 to 200.

Insofar as the question is, what was the common law, there's a more fulsome and much more critical analysis in the Watts article in 2021 Journal of Business Law 143 which is number 120 in the bundle of authorities, but I don't intend to spend time on that. One of the points that is mentioned in *Sequana* and was mentioned a number of times in the written and oral submissions for the liquidators, is Lord Sumption's remark in the *Bilta* case, and on that this is, Lord Sumption talks about the interests of the company being synonymous with the interests of creditors. Now that's obiter and what he's doing in part in this case is the whole judgment, as the Court may recall, is about the ex turpi causa principle, and what he's doing is criticising the way in which Lords Toulson and Hodge used a duty relating to creditors in a company

context for disapplying the ex turpi causa principle. That's the reason he's discussing it at all, it's got nothing to do with company law, nobody cites any authority, it's simply one sentence, and the language used by Lords Toulson and Hodge is slightly different. They use the word "embraces". It's not completely clear what they mean by "embraces" but it's open to the reading that they're talking about, it's not limited to creditors interest, and that is the way that the Goode text, which I took the Court to earlier, reads it at paragraph 14-21. But in any event we say if you take Lord Sumption's one liner out of his paragraph 104 as being the definitive description of where things are at, does really do too much credit to Lord Sumption in that particular circumstance.

That brings me, if the Court pleases, to some of the main issues in – actually, no, sorry, there was one other aspect I was going to touch on, which was the Law Commission. My learned friend took the Court to paragraph 214 of the Law Commission's report and we can bring that up, it's at the end of the bundle of authorities, it will be number 130. If we can get to page 52 of the document, and it's an important paragraph in the Law Commission's judgment. But it demonstrates a number of things, in our submission.

Firstly, the first matter that's mentioned is that to protect creditors "all company distributions are subject to compliance with a solvency test". Now that's the double-barrelled solvency test balance sheet and cash flow, and as it says there, and it says elsewhere, it's a pivotal provision of the Act. It's the key protection for creditors. And it goes with the point that's in the next report, the '16 report, I won't go there but I took you to it the other day, that says what the Commission thought it was doing was to focus on the problem areas, and so this was the particular problem area, and that survives, that remains the case for distributions, but it's the only part of the Act that's expressly subject to the solvency test. Or not just that, it certainly doesn't apply in most general terms, and it certainly doesn't apply explicitly to part 16 about liquidation.

WILLIAM YOUNG J:

So what was the restriction on section 320?

MR HODDER QC:

I'm sorry your Honour?

WILLIAM YOUNG J:

So the second bullet point says: “This provision restricts the scope of the existing section 320.”

MR HODDER QC:

Which is considered to go too far, yes.

WILLIAM YOUNG J:

In what way did it restrict it?

MR HODDER QC:

I haven't done an analysis of section 320 to compare with the Law Commission’s 105 to be absolutely clear, but I think the implication must be that they thought that it wasn’t possible, or was possible to have too much inhibition on the taking of business risk under 320, and this was meant to have, a clear-cut rule that if you supply the balance sheet you could take business risks, and if you didn’t, you couldn't. Whereas the business, whereas section 320 didn’t make that clear. That’s what I take from this.

It’s interesting what is actually specified in the second bullet point. An unreasonable risk with the solvency of the company, that is taking the company from solvency to insolvency, or trading knowing the company to be insolvent. Now the first of those is recklessness, and the second of those is close to fraud, and those are the kinds of abuses that were clearly, we say, contemplated by the Commission and reflected in the long title, of which I won’t say more on I don’t think.

So that’s the – and also again the proposition in paragraph 3 was that there be, continue to have a duty to act in the best interests of the company, which partly goes to the Chief Justice’s point, it was a concept that there would be

the company as something completely distinct from creditors, so that would continue to a large extent.

The other section, if we can go please to page, if we have it, to page 78 of the document, which is paragraph 330, if we can get there. So at paragraph 330 there's a discussion of the solvency test. I wasn't proposing to read it to your Honours but I mention it because it does describe how it sees cash flow solvency working, particularly in the – if we go to the top of 79 – talking about: "The test ensures that decisions are based on cash flow analysis showing that known obligations of the company can reasonably be expected to be satisfied during the time they will fall due." Now it's not a perfect, it's not a complete description. It's sort of an indicator of some of the thinking that underpinned the idea of how the solvency test would work, but in fact, in the end result, the 1993 Act doesn't apply the solvency Act *[sic]* more widely than distributions and self-dealing.

So at this point, your Honour, I turn into slightly more, well, it's probably the same territory, addressing what is the company for these purposes to some extent and what are section 135 and 136 about. My learned friend to a large extent, I think, endorses the concepts from this Court's discussion in *Debut*, but can I start with a proposition which isn't, I hope, particularly controversial, that these duties were meant to be enforced by, among others, shareholders. Now why would shareholders want to enforce 135 and 136? Well, if you recall that passage about risking the company's solvency, then that's a basis for an injunction, for example, if you know what the plan is and you're a shareholder. Secondly, if you manage to undertake the exercise under either 135 but more likely 136 as a director and you run the risk of running the company to a point where it can't perform its obligations, you don't quite succeed, as it were, so the company doesn't become insolvent but it's lost a great deal of its asset base. There's no reason why that couldn't be a claim by a shareholder as well.

So the sections are designed to work for shareholder claims, not just creditor claims, not just liquidation claims, but that's a feature of the Act –

WILLIAM YOUNG J:

These are sections that are said to be – duties are said to be owed to the company, not the shareholders?

MR HODDER QC:

They're owed to the company but the shareholder can enforce them as in derivative basis –

WILLIAM YOUNG J:

All right, okay. So the shareholder can enforce it using the name of the company?

MR HODDER QC:

On behalf of the company, yes, not for the shareholder's interest. But if the shareholder had a very profitable company or a lot of assets and they've all gone because somebody took a gamble, thinking in terms of section 136, there's scope, theoretically, for a claim that says the assets need to be restored to the position they would have been in, and that, we say, is significant in thinking about these matters. So that – and that those, the injunctions, can be sought by shareholders, 164. The general derivative claim would be available to shareholders if there's a genuine case to be made, notwithstanding the directors might oppose it, and therefore those sections are not related solely to a company in liquidation. They're not solely related to question of creditors.

WINKELMANN CJ:

But in reality it's mainly used in liquidation, isn't it? Are you aware of it being used by a shareholder?

MR HODDER QC:

I'm not, your Honour, but I'm –

WINKELMANN CJ:

You know, section 136.

MR HODDER QC:

– I'm taking the construct and the structure of the Act at its conceptual basis. There's no reason why that couldn't be. I appreciate that it's normally going to be that case but what is being described in 135 and 136, that is to say when the company has a substantial risk of serious loss to the company's creditors or unable to perform obligation, is insolvent liquidation. That's the end result where liquidators will have a role. If you don't get there but you've made a destructive attempt to get there, as it were, then there is still the question of claiming and there's still a breach.

So what is the loss to the company is obviously the question that's pretty much at the heart of much of this case and we respectfully submit that if we're talking about an insolvent situation then the question is, well, we have therefore directors' breaches would have caused or compounded an insolvent situation and the loss suffered by the company is conceptually the same as it is if it doesn't go into insolvency. Its assets have been reduced. Its ability to satisfy legal claims against it, whether they're debts or other obligations, has been reduced. That's the loss that's been suffered by virtue of the conduct that should not have happened. That's the basic position that's taken in the *Continental* case that I have referred the Court to from the UK and it's effectively what happens or is described in *Mason v Lewis*. So the loss being one to the company which impacts on all creditors, it might be secured creditors, it might be unsecured, indicates that what's being talked about is something that applies to the creditors as a body. The stereotype that says this is the unsecured creditors, the unprotected, the most vulnerable, may or may not apply, maybe the secured creditor gets the benefit of the entire exercise, we simply don't – or preferred creditors do, but it isn't designed specifically to deal with those who are in the least sophisticated unsecured creditor category.

So how do we assess the company's position to meet its obligations? Well that comes from what the state of its net assets is, and how do we determine that from a course of conduct by, or any conduct by directors?

Well we say it's the standard with or without, or otherwise called a counterfactual analysis. That is what the net deterioration exercise involves.

So it's nothing and, as we know, the counterfactual with or without analysis is used in a variety of areas to try and establish what the causative loss is because it does stream out the stuff that isn't caused by the conduct. That's the beauty of it. It's also degrees, unquestionably, it involves a degree of complexity in certain cases and again it requires a good faith assessment in the end, and we say that's effectively what his Honour Justice Cooke did in the High Court in this case, and the suggestion from my learned friend that this is an impossible task for liquidators, with respect, we say isn't correct. The Courts can deal with those issues, and do deal with them in a range of cases.

So in terms of section 135, *Mason v Lewis* et cetera has recognised that as being the standard approach, as this Court mentioned in the *Debut Homes* case. The case of section 136, at least in relation to a trading case like this, the position is the same because cessation of incurring obligations would mean the cessation of trading, so you can take the same counterfactual with or without approach. There may be other cases in section 136 that are more complicated, but that's not this case. This case is a company with ongoing trading operations, and the complaint against the – the claim against the directors is based on their continuing to trade under 135 and 136.

Now the fact that old creditors may have been paid with new creditors money is explicitly addressed in various ways by the Act, but in particular through the clawbacks on various preferences, whether they're fraudulent preferences, they're self-interested preferences, or there's just a time factor, and that is there for that very reason, to recognise that then those matters should go into the pot, and we say all that's consistent with the idea that the section 136's duty is owed to the company, and any recovery from the director goes into the assets available for distribution in accordance with firstly, the priorities, and then after they've been satisfied, the pari passu, and of course that means that there's no correlation between the claim of any individual creditor

and what they get from the end result, because it has to go through those processes of priority and pari passu. All that was the approach that was taken by the High Court in this case, in relation section 136, and we respectfully endorse that.

In terms of section 301, it's sort of a fraught area, and there's a limited amount that I can add to the discussion that's gone on before. I have no insight to offer as to what we make of section 301(1)(c) except it shouldn't drive the interpretation of everything else , and insofar as there is a discretion, then the Courts to date have recognised that the discretion is involving something different, or beyond the ordinary straightforward claim that's recognised in *Re Continental* at 296, and is also recognised in various other authorities mentioned by my learned friend Mr Chisholm. Does that seem odd? Yes, I can't dissent from the proposition it seems odd that if you decide to sue using a direct claim under section 136, you finish up with a claim that might not be subject to a discretionary reduction under section 301, although the purpose of 301 is to come up with something that the Court thinks just, and in most cases, not necessarily all, but in most cases hope that either way you'd finish up with a just result, having regard to things like culpability and causation.

WINKELMANN CJ:

That's what I think is odd about it, because it's framed in terms of remedial generality – it's framed in those terms, but the way that you say the Courts have interpreted it, and you urge us to interpret it, is that it's not fully remedial, it's only remedial to reduce directors' liabilities but never to increase it.

MR HODDER QC:

I think there's two concepts in there, your Honour. One is that it's not meant to be punitive which is why you wouldn't go upwards.

WINKELMANN CJ:

But why could it now be allowed to be compensatory?

MR HODDER QC:

Well, I think that's, going upwards is a big thought because it would then be punitive rather than compensatory. That's what I've understood the authorities to be saying, and so both *Continental* and I think –

WINKELMANN CJ:

Simply, and it comes back to the same point that you're making which is about the company being –

MR HODDER QC:

It is, but the reason as I understand it for not going above the compensatory level is at that point you're going into punitive territory.

WINKELMANN CJ:

Not going above the net deficit level on your analysis?

MR HODDER QC:

Yes, if that's the loss to the company, yes.

WINKELMANN CJ:

Net deficiency?

MR HODDER QC:

Yes, which we say it is. Related to that, and my friend developed the point somewhat in his argument, is this idea that the creditors were misled by the very fact that Mainzeal kept on trading and the Court of Appeal gives weight to that. It says there are information asymmetries at paragraph 230 of the Court of Appeal judgment. There probably are, almost certainly there are. It then goes on to say, well, there's a risk then that new creditors are misled, at paragraph 237, and that rather presupposes that it's just those particular categories of new creditors who don't know what's going on inside the company but the fact is that the company has a separate legal personality, it has capacity to do all the things that the Companies Act enables it to do, and

most people dealing with a company have no idea about those things either unless they take the time and have the incentive to dig them out.

Then that sort of really leads on to the idea that –

GLAZEBROOK J:
Well, what do you say about the misleading accounts that had current assets and current income turned into an asset of loans that the directors knew were not going to be repaid?

MR HODDER QC:
Well, that – two propositions.

GLAZEBROOK J:
And with no notice to impairment of those assets.

MR HODDER QC:
Well, two propositions, your Honour. The first is they were audited.

GLAZEBROOK J:
I don't really care whether they were audited. They were certainly never going to be repaid and nobody suggested they were, did they?

MR HODDER QC:
Well, that point, I'm afraid, we do take a different position, your Honour. Whether they're going to be paid or not depends on whether the guarantees though that I was talking about beforehand would operate in the event of insolvency, and so when the warranties and letters said all obligations at all times, then, in my respectful submission, that does cover precisely those things. It's what meant by being on the hook and it's what is meant in those letters of comfort that says all future obligations as and when they become due. If it comes to insolvency they're still company obligations.

WILLIAM YOUNG J:

Sorry, I didn't read the letters of comfort as directly warranting that the intercompany debts would be paid. Do you say that that's what they mean?

MR HODDER QC:

Yes.

WILLIAM YOUNG J:

I just thought they read them as saying: "We will make available to you whatever is necessary."

MR HODDER QC:

For all financial obligations "now and in the future". Those financial obligations –

WILLIAM YOUNG J:

But – sorry?

O'REGAN J:

They're of Mainzeal, are they?

WILLIAM YOUNG J:

Aren't they of Mainzeal?

GLAZEBROOK J:

Yes, they're not –

MR HODDER QC:

Yes.

O'REGAN J:

Not of – they're not to Mainzeal. It doesn't say: "We'll make sure the companies that owe you money are put into funds so they can be."

MR HODDER QC:

But that is if – if Mainzeal has an obligation now and in the future then the warranty says, the letter of comfort says: "We will provide all the support that's required," and if that means going up to the level of refunding or repaying the sums covered by the related party receivables, then that includes those.

O'REGAN J:

Well, it could just say: "We'll lend you some money." I mean that would still be providing support. But that doesn't say: "We're –

MR HODDER QC:

No.

O'REGAN J:

It doesn't give any form of comfort about repayment of intercompany loans. It's a separate description, isn't it? It's just saying: "We'll make sure you've got some money to keep trading."

MR HODDER QC:

Yes, I can't dispute that. It doesn't say that specifically, but you come back to the group context. As a company – it's an intercompany arrangement which at any time could have been dealt with by intercompany transaction to obliterate those things in some way or other. It wasn't done. But does that make the accounts misleading? In our submission no. The key point is that they were a going concern based on the assurances.

WINKELMANN CJ:

It's hard to imagine what accounts wouldn't be misleading in that circumstance because no one was ever paying that interest. Debts had gone past due date, hadn't they, well and truly?

MR HODDER QC:

As a matter of arrangement between the companies and the group, yes.

It wasn't a matter where Mainzeal had been trying to get the money actually paid and making demands on it. There was an informal understanding they wouldn't be called, and that's in a sense the nature of a group regime.

GLAZEBROOK J:
Well, it's slightly difficult to have them as current assets then, isn't it?

MR HODDER QC:
Well, as a matter of formality that's how they were recorded, but I can't say more than that, your Honour.

GLAZEBROOK J:
If somebody shows me accounts that say "current assets" I expect they would be current assets and will be repayable within the year or whatever the current issue is in terms of being able to put something in a current asset.

MR HODDER QC:
All I think I can say, your Honour, is if you were inquiring as a creditor and were shown the accounts you would expect that you would be able to recover to the extent of those assets any obligations that were made to you by Mainzeal and that then gets you back to the scope of what the obligations that are covered by the assurance is. You get to the same economic outcome as far as the creditor is concerned if that's right.

So what we say about the misleading idea is that directors do have a duty to the company to comply with the Act. That's to be found in section 133, but in cases where there are questions of judgement that's going to be a matter of real-time clarity and that's one of the assumptions that, with respect, underpins the analysis my learned friend offered you about these provisions, that there will be real-time clarity about things like capital asset insolvency or balance sheet insolvency or solvency.

Now it's the case, and I don't want to return to territory that you covered with my learned friend, Mr Chisholm, but there may be claims under the general

law, and so why would I say that the general law is relevant here? Well, I say that because the Act is about core company law and, as I said the other day, it assumes that general law applies, whether it's the securities law for companies that are raising money on the market or whether it's the Fair Trading Act or it's negligent misstatement or it's fraud, that general law applies of its own volition. It isn't written into the Companies Act because the Companies Act was, as the Law Commission's general approach was and I think survives into the 1993 Act, it takes all that stuff out. It's focused on the relationship of the company to, in particular, shareholders but, to a degree, to creditors.

Related to that is the idea of, and I've already mentioned this, that the company is a separate legal entity, so that underpins, as I understand it, what Justice Cooke was saying in *Permakraft*, about taking the company as you find it. It is a separate legal entity. I mean we could describe how much of a fiction or how many fictions probably are involved in company law as a matter but the statute is where it enshrines the fiction as a core part of New Zealand's commercial activities, and the fact is that you are dealing with a separate legal entity and there is no expectation you have claims against anybody else unless something has gone particularly wrong. You are dealing with a company and as a matter of common knowledge almost all companies are going to have, firstly, limited liability and, secondly, there's no minimum capital requirements.

So related to that, one can accept that insolvency (a) is highly desirable, (b) not always achieved which is what I mentioned the other day, about seven and a half per cent of companies going off the register in any particular year, and it's also the fact that it is a harm to the company if it becomes insolvent. If the company has become insolvent the shareholders have lost everything and some of the creditors are likely to have lost something. So of course it's a harm to the company if we accept that as a fiction which in our submission we must. But it's not necessarily directly connected to creditors or creditors alone and particularly new creditors alone outside the question of the deficiency of

the assets available to meet the obligations which gets it back to where we were before.

There's also the point which I don't think has been touched on particularly but if you go to focus on particular creditors or even particular subclasses then you need to assess the harm to the particular creditor or subclass and the same sort of issues that will arise in a negligent misstatement claim, for example, which go to the questions of reliance and causation.

So in all that sort of the large pachyderm perhaps in the room is what are we saying about the Court's *Debut* decision. We agree with quite a lot of the Court's *Debut* decision, if I can say that. We accept that where the directors actually know the company is unsalvageable then trading should cease pronto, trading by the directors should cease pronto, but there is a proper distinction between unsalvageable and salvageable companies. There are reasons not to second-guess directors' judgements. These are all points made in your Honours' judgment. Section 135 and 136 are duties owed to the company, and I appreciate the point that says in part the Act decided to distinguish between the company and its shareholders, but it's a reasonably clear statement that the directors owe duties to the company and where creditors have a special feature they're mentioned as creditors as if they have status in certain points in the Act.

Pari passu is a key principle of the Act's insolvency provision and trading out by fraudulent conduct which involves either trading or otherwise by a director may justify something in the nature of a restitutionary remedy.

WILLIAM YOUNG J:
What's the statutory provision that would be engaged by fraudulent trading? Section 136?

MR HODDER QC:
Yes. If you were to enter into an obligation knowing full well that at the end you would only leave an empty shell, that would be fraud.

WILLIAM YOUNG J:

Okay, but it's the same section that is relied on here.

MR HODDER QC:

Yes.

WILLIAM YOUNG J:

So if you enter into a transaction without a reasonable belief that the obligation will be paid isn't that going to sound in the same way in compensation?

MR HODDER QC:

No, not if it's fraud. Fraud changes everything we would say.

WILLIAM YOUNG J:

But it's the same statutory claim. I mean the concept of fraudulent trading is taken out of the Act and presumably because it's treated as being subsumed in section 136.

MR HODDER QC:

Actually, I probably should backtrack one step. I presume there's probably, and I haven't had to plead any of this, but there may be simply a simple common law claim for fraud.

WILLIAM YOUNG J:

Yes, it could be a fraudulent…

MR HODDER QC:

It's deceit or it's Fair Trading Act or something along those –

WILLIAM YOUNG J:

The case which was cited this morning, *Maney*, is the only one that I can think of where the chap ran a petrol station and he diverted cash so that there was, when it came to be liquidated after 10 years of trading, two large creditors, the oil company and the IRD. Now I'm not sure that he could have been sued for

deceit. He was sued under the original section 320. Now I assume he would be sued under section 136.

MR HODDER QC:

Yes, and what I think we would say is that section 136, although I think there could be a claim at common law which might be the more direct way to do it, insofar as section 136 exists then it would be a case different to a standard trading case of the kind that we have here where the pleading is that you carry on trading and if it involved fraud then you might finish up with a different analysis, and I'm not suggesting there's only one size of our calculation fits a 136 claim. Fraud may justify something quite different.

WINKELMANN CJ:

So you accept as a matter of principle then that you can have a different measure of compensation under section 301 in the net deficiency, just not on these facts?

MR HODDER QC:

Well, whether it's 301 or whether it's outside 301.

GLAZEBROOK J:

I'm just having trouble working out the standard trading case. I know that Mr Cooper was actually conducting a rundown but if he hadn't been conducting a rundown and was just considering taking on new business in the same way that happened here, are you saying that would be different even if he knew at the end of the day that when the music stopped, which it was going to, he wasn't going to be able to pay the GST?

MR HODDER QC:

I probably would add to the fact that it's kind of, as it were, good faith trading, your Honour. That wouldn't be good faith trading in the way that Mr Cooper's activities were described in the judgments of the various courts.

GLAZEBROOK J:

Well, only not good faith because he knew the music was going to stop but assuming your clients were not able to rely on that guarantee then they knew, or at least should have known, that the music would stop at some stage which is what the Court of Appeal found.

MR HODDER QC:

We say there's a very substantial and significant difference between a situation where you have knowledge that the company will go into liquidation before the obligation can be met and where there is a conscious attempt to distribute, as it were, a preferential arrangement in this case to, in the *Debut* case, to avoid the IRD's claims. It's quite different to good faith trading which might be based on some error of judgement.

GLAZEBROOK J:

Well good faith trading when you should have known full well the music was going to stop. Is that really good faith trading?

MR HODDER QC:

Well we say it isn't – well we –

GLAZEBROOK J:

I understand the submission absolutely totally if there was an ability to rely on the letter of comfort, but this is, assuming we find that wasn't the case, what's the difference?

MR HODDER QC:

Then I would still say that as it were a, there's a difference between wilful, as it were, conduct and knowing conduct of the kind that we're talking about as I understand it in *Debut* and conduct which is not done in a wilful knowing way, which would be done in this case, and that –

GLAZEBROOK J:

So you say you should have known that you were insolvent and a prudent director would clearly know they were insolvent, but that's different from Mr Cooper knowing that he couldn't pay the IRD?

MR HODDER QC:

Yes I do. I say one is a deliberate conscious conduct.

GLAZEBROOK J:

All right, so should have known, so reckless is not part of this, it has to be fraudulent, is that the submission?

MR HODDER QC:

Reckless is something less than fraud, yes.

GLAZEBROOK J:

Okay.

MR HODDER QC:

Because that's what we got to.

GLAZEBROOK J:

So if you're just reckless you don't, and if you're fraudulent you do?

MR HODDER QC:

Fraudulent, fraud for both –

GLAZEBROOK J:

Well quasi-fraud or…

MR HODDER QC:

– historical and good reasons, takes you into a different territory, but insofar as we are relying on what was found as matters of fact about our directors' conduct, and the trading that they were carrying on, we say that it's remote

from fraud, and it sort of stretches the language too far to talk about misleading creditors or fraud and what's happening here.

GLAZEBROOK J:
So despite the window dressing, and despite the no notes to the account…

MR HODDER QC:
Well there are notes to the account your Honour, the question is whether they could be sustained on the basis of the assurances that the directors believed they were.

GLAZEBROOK J:
I understand.

MR HODDER QC:
Including Mr Yan signing off on the accounts on that basis. And we, I was just obviously listing matters which we agree with, respect with the *Debut* analysis that in 135 the net deterioration is the usual methodology but I accept that it won't always be the case, there will be exceptions, but having a standard methodology is helpful for everybody, as Mr Graham effectively explains in his evidence, people know where they are, advice could be given about it, as opposed to saying, well anything can happen. That doesn't help anybody in terms of carrying on their conduct, and in precarious circumstances, of course the interests of the creditors need to be considered. That happens when the directors sit down and consider whether they're a going concern, because it's the very thing they're focused on, and that's what these directors were focused on.

The last point on which, again, there's no dissent from us, is that section 136 obligations are not limited to contractual debts. Of course they're not. The use of the word "obligations" is clearly meaningful. But we have some issues, where no doubt our analysis parts company with my learned friends' analysis, which in turn relies heavily on this Court's analysis. Firstly we say insolvency is not necessarily clear cut in real time, and that's a matter that the Court

should, is entitled to and should take into account, and that the harm is to the company, as I've explained before. The company's position effectively is the same whether the end result is solvency or is a miss of insolvency because it's a question of what assets are available to meet obligations.

WINKELMANN CJ:

I mean this is a little bit of an unusual case, isn't it, because in fact in real tie the issues were crystallised so clearly. In most real time situations there are lots of things going on, directors having to weigh them, but these directors knew that the critical issue for them was the support that was available.

MR HODDER QC:

Well they knew that was the issue but in real time the question was how that was evolving as to whether or not the recapitalisation process was taking track and whether the, as it were, reprofitalisation case, if that's not a terrible mangling of language, was also advancing, as was intended. Those weren't real time, weren't distinguished in real time. But perhaps the core proposition that we are respectfully not comfortable with where the *Debut* reasoning would take us, and which my learned friends rely on, is that the interests of all creditors mean that all must be benefited by any particular decision or judgement. That presupposes that all creditors, and the logic of the proposition put forward, as I understand it, is that some creditors are going to be worse off i.e. new creditors, as they're described, then that can't be having regard to the interests of creditors, which must mean all creditors, but it presupposes that all creditors have the same interest and there's no conflict between them and, as I mentioned before and my learned friend didn't respond to, what about the position of employees, they're creditors, what's the position they're going to take? And the same will apply to a range of other, as it were, repeat business people. So –

GLAZEBROOK J:

But of course what *Debut* says, also if you do want to carry on you've got mechanisms to consult those creditors and take those interests into account, and they do vote differently according to what class of creditor they are.

There are mechanisms in the Act, both informal and otherwise, to deal with the situations where otherwise the directors would be in breach of 135 or 136.

MR HODDER QC:

And I understand entirely that it's appropriate to look at the scheme of the Act, including those alternative mechanisms. In this case the evidence was that – well, there was no evidence that said anybody thought that the alternative mechanisms were available here because as soon as the reputational damage was suffered by something like that then Mainzeal's operations were toast, that's effectively what the joint experts say on issue 8.

GLAZEBROOK J:

Well, that might just say that unfortunately that was the situation and the directors therefore didn't have options and liquidation was the only option *unless* they could get the proper assurances as to capital.

MR HODDER QC:

And your Honour's right to identify that as a key issue. That gets you back into the unenviable dilemma territory and the question about those conflicting considerations.

GLAZEBROOK J:

Well, it's not very unenviable. Either that support was actually real or it wasn't real. If it wasn't real then Mainzeal was insolvent, if it was real then it wasn't. It's not much of a dilemma to say "make it real", is it?

MR HODDER QC:

Well, that goes back to what I was talking to the Court before in terms of resignation threats. There's a choice.

GLAZEBROOK J:

Well, it's nothing to do with resignation, it's just saying is this support real? If it is: "Show me it is. Either give me a guarantee that those debts will be repaid if we need them," or…

MR HODDER QC:

Well, that's two different propositions, with respect.

GLAZEBROOK J:

Or: "You'll put capital in if we need it up to a certain point."

MR HODDER QC:

And we would say they had already – well, you know our case, our case says there was assurances of support, including up to that point.

GLAZEBROOK J:

Yes. This is on the assumption that that's not enough, that's not good enough?

MR HODDER QC:

Well, if that's not enough then obviously there are difficulties for this case, for this appeal. But the basic proposition is that there was assurance up to that. There wasn't an assurance that those loans would be specifically repaid at a particular time, that's unquestionably the case. But the question was would there be funding as an when required for all obligations when they were required to be met, that's what creditors are interested in, that's what the assurances said, that's the case for the appellant.

GLAZEBROOK J:

I was just putting to you in case that's found not to be sufficient it didn't seem to me terribly difficult to say that what the directors should have done is make sure they were sufficient by doing whatever needed to be done to make sure they were legally enforceable.

MR HODDER QC:

Well, the only option they had was to resign.

GLAZEBROOK J:

Well, that's assuming they weren't real then, because if they were real why wouldn't somebody give them a proper assurance?

MR HODDER QC:

But your Honour's hypothesising they weren't real, with respect, that wasn't the hypothesis that the directors were working on, they were assuming they –

GLAZEBROOK J:

Well, what, they were working on the basis that actually they wouldn't get anything better, in which case they should have wondered whether those assurances were real, shouldn't they?

MR HODDER QC:

Well, your Honour's heard the evidence from both my learned friends for Mr Yan and for us saying there was a substantial cash inflow coming through when it was needed. And so at the end of 2012, as Mr Graham says, and it's not in doubt, Mr Kennedy said it, the creditors were effectively being kept up to date, and that was being done with support from the group, that was evidence for it. And what you get and what my learned friends naturally focus on is a series of fairly stressed emails particularly from Mr Yan during the period when there was the biggest cash flow crisis arising from Siemens in the middle part of 2012. But they're actually getting through that, they're looking as if they're going to get out the other side until the 29 January letter comes along, and then at that point the BNZ gives up and the end follows shortly after that.

So, your Honours, I was going to address the question of calculating any new debt and do it very briefly if I could. There are a series of matters that the liquidators make their claim under 136 under claims in the liquidation by principals and bond providers, claims in the liquidation by some contractors, all those from January 2011, and then all obligations from 5 July 2012 onwards, and that, in a sense, is problematic, we say, for a number of reasons, one of which is that this Court's being asked to make findings of fact

that weren't made in the Courts below and not only were they not made in the Courts below but there was criticism in the High Court judgment in paragraphs 304 to 311 about the evidence that now the Court's being invited to rely on, notwithstanding the absence of any findings in the Courts below.

I won't, given the time is now 10 to 3, won't go through it, but can I just draw the Court's attention to 304 to 311 of the High Court judgment, particularly 308 where his Honour, Justice Cooke, isn't persuaded by the evidence that's there. There are a variety of issues in relation to that but what we say is that those numbers include consequential losses, that is to say costs that came about by the disruption caused to various contracts because the fact of liquidation caused the disruption. That would apply whenever the liquidation took place, and so it's a consequence of the liquidation, not from the conduct, and that's partly discussed by Mr Millard's evidence at paragraph 34 and you'd find that at 209.03510. He was a quantity surveyor called by the defendants, the appellants.

But things that are matters in the liquidation that weren't caused by the culpable conduct, we say, can't be claimed and they are matters – that's one of the reasons why there does need to be proof. These matters were not admitted on the pleadings.

GLAZEBROOK J:
So why do you say that's not covered?

MR HODDER QC:
Because there is a distinction. If there was going to be a – if you hypothesise liquidation at an earlier point, or a later point, then the costs of liquidation –

GLAZEBROOK J:
Is that that you're saying they would have been incurred anyway and then have to be subtracted off or are you saying they don't result from the breach?

MR HODDER QC:

They're consequential losses caused by the liquidation. They would have been caused whenever – if whenever a liquidation took place there would be disruptions to existing contracts adding additional costs that would occur whenever the liquidation occurred, notional date or actual date.

GLAZEBROOK J:

So it's a subtraction issue?

MR HODDER QC:

Yes. The evidence being relied was adduced for the purposes of a 135 claim effectively, particularly Mr Bethell's evidence, and I appreciate Mr Apps' did his 136 analysis, but it doesn't really focus on the question of timing. My learned friend, Mr Chisholm, has addressed that with you to some extent and there's no analysis of the specific creditor to the extent that that is relevant in the exercise. The end result was, as far as the High Court was concerned, and this is, as I say, in those paragraphs you to, particularly paragraph 308, there was a failure by the plaintiffs to establish the evidence for their case under section 136, they didn't put the issues to the defendants, and we respectfully say that that is right.

WINKELMANN CJ:

Sorry, who said that? Was that Justice Cooke?

MR HODDER QC:

Justice Cooke, yes, your Honour, at paragraph –

GLAZEBROOK J:

In those paragraphs you were talking about. Were they 304 to 311?

MR HODDER QC:

Yes, in the middle of that section. Paragraph 308, your Honour.

So the High Court declined to find those analyses proven and now you're being asked to say: "Well, that doesn't matter; this Court can act as a fact-finder," which we respectfully say: "No."

There's a question mark about deductions of various matters. If you deduct the net amount held as is proposed then that puts, we say, the whole of the costs of the liquidation to the benefit of – or puts it against the directors, and there is authority which I think I referred to in the first round about liquidations, directors not responsible for liquidation itself, including litigation work by the liquidators and the like, but just with respect it's a difficult proposition to say that this Court is in a position to wrestle with those issues. They would take a great deal of time when the matter goes back to the High Court and there really isn't either time or appropriate for this Court to do that.

Briefly on Dame Jenny Shipley, our directors' cross-appeal submissions at page 27, paragraph 3.43, explain, and I don't think that's, well I hope it's not contested, but what my learned friend referred to, they were sold for about $150,000, this is the trust's shareholding, the family trust shareholding in RPL in 2017, and frankly in the scheme of the company they were de minimis, and the idea that that has some relevance to anything we respectfully say has not force to it at all. In fact my learned friend Mr Kennedy said the directs were conflicted because they wanted to stay on as directors. Well, Dame Jenny's evidence says that on a couple of occasions she was wanting to resign, people prevailed on her to stay on while they worked their way through what was thought to be the restructuring process leading to a stronger asset base in New Zealand. Mr Gomm was there on the basis that he was chief executive and Mr Tilby doesn't discuss that particular issue, and the idea that because Dame Jenny had particular prominence in her previous life that gave assurances to counter-parties, with respect that doesn't seem likely at the highest level or the lowest level. At the highest level people were taking, seeking bonds, not seeking comfort from her presence, at the lowest level they may well not know that she's involved in the exercise at all. But this is all speculation because was called to say: "I relied on her presence on the board to trade with Mainzeal."

So my final remarks, if I may, is that what my learned friend's submissions amount to is that this is an opportunity for this Court to create a very helpful liquidator's charter out of section 136. He doesn't really dispute the proposition that section 136. He doesn't really dispute the proposition that section 135 would become redundant in most cases, which we say is not a promising start, and with our respectful submission we say that the consequences in practice have not been factored into that analysis, that is to say that if there's any question of uncertain future prospects then you stop trading, and that means you lose going concern value and that means that in fact any good-faith salvage work is completely at the risk of directors and therefore it isn't going to happen, that's really what Mr Graham's evidence says. But that's effectively the result that my learned friend's analysis will take you to. It also would mean that business judgement and the way it's used in the Companies Act along title outside at least blue chip companies is not going to be a source of comfort in any discretionary decisions made by directors. That seems an odd result to get from the careful enactment of a long title.

WINKELMANN CJ:
How does that come from the respondents' analysis of section 316 because aren't you complaining different issues, which is the point at which it kicks in and whether it, you know, how does that – I'm not sure…

MR HODDER QC:
It's the liquidator's charter issue ties back. Section 136 interpreted the way that's being suggested by my learned friend for the liquidators would become a director's, I'm going to say guillotine.

WINKELMANN CJ:
Yes, but it all depends upon how far you're going in second-guessing the directors, doesn't it?

MR HODDER QC:
It does, it does.

WINKELMANN CJ:
But that doesn't necessarily flow from the other point, which is whether it's, which is the major thing in relation to the interpretation of 136 which is whether or not you have to be thinking about every creditor or whether you get to the point where, you know, it's not reasonable/rational in your interpretation to take this risk, whether all creditors from that point on are caught within section 136.

MR HODDER QC:
The submission is that it goes to the question of assessing reasonable grounds in terms of section 136.

WINKELMANN CJ:
Right. And that would be 135 as well.

MR HODDER QC:
Yes. So the concern is that you finish up with directors undertaking in a marginal case, and knowing it's marginal case, good-faith salvage work would be done at their risk, they would because guarantors of new credit, that's the analysis, exact analysis, that the liquidators are looking for and, with respect, that's difficult.

So, at 2.59 can I say and remind the Court, if I may, of Professor Oesterle's piece, which is at tab 109 of the bundle of authorities, and say that my learned friends' arguments, both my learned friends, Mr Kennedy and Mr O'Brien, would rather confirm what might be described as the savage pessimism that Professional Oesterle exhibits, or articulates in that particular exercise, and it's not necessary, with respect. It is a long title that regard can be had to, to interpret these provisions, and also the fact is that *Mason v Lewis*, in its approach to 135, it can also extend to 136, because it can be applied to trading situations at least, provides that it should be a sober assessment and

there should be alertness to the literal risks of section 135 and 136 wording place, in terms of the concept of illegitimate trading, but our submission to the Court is that we do not here have illegitimate trading, and that is the, where it comes down to the heart of the appeal.

Now your Honours, grateful to you for extending the time to enable those remarks in reply. Unless there are any questions that's all I was proposing to say.

WINKELMANN CJ:
Thank you Mr Hodder. I suspect that Mr O'Brien does want to reply about something there, judging by his body language?

MR O'BRIEN QC:
Yes, I'm very conscious of the time, but I will be brief. We did have an arrangement which would limit it not excluding any reply from me, but that presupposed my friends wouldn't comment on matters arising in the cross-appeal, I think they have, and in any event the two are so linked I would like to make a limited number of points. First up, Mr Hodder's, if I might call it this, Chicken Licken approach to our central points in our case, we say is unjustified. We have not said at any stage, or submitted at any stage, that those cases which suggest that directors faced with insolvency, actual or impending, would not be entitled to take a limited period in which to assess the position, a real time assessment, nor indeed to conduct a salvage operation if it appears that salvage is likely in the short-term. That it's "likely" in the short-term. We don't have to make a submission that that's not the law, in fact on the cases it is the law, but this is not such a case.

It's not such a case because the real time clarity which my learned friend was suggesting directors need time to seek was, in fact, given to them in our case. It was given to them through all of 2009 and 2010, and our primary case, at trial at least, was by end of January or by January 2011 you were past the point where you could continue without fixing. So they had plenty of time and that's not in issue at all.

Then, your Honours, just a series of smaller points. My friend Mr Chisholm complains that the plaintiffs didn't prove the loss on the new debt claim. Well with respect we did because Mr Apps put in a calculation. We put in a claim, I took your Honours to it, in the pleadings and it was $75 million of new obligations, that's how it was described in the pleading, and then Mr Apps provided his workings well before trial and the defendants chose not to engage with them. So that claim, now less the 11 million which has been allowed in respect of money to be credited to related parties, was not tested by friends, or by the defendants, and it's too late. One can assume, that they accepted the broad mathematics of it.

The complaint that obligations weren't put, well I've been through that. Yes, not each and every one was put, but that's because the evidence showed that the directors were well aware of them. It was in each months, or each set of board papers, which the board got, and the directors did confirm that they had the board papers, that they were aware the company was bidding for contracts, that they're aware the company was entering into contracts, and indeed the directors were encouraging it. There was absolutely no point in putting each and every one of those obligations or principal obligations to them, and of course it's self-evident that from each one of those obligations a series of other obligations would flow. I'm not going to answer every point. I'm going to try and keep it brief.

On the audit question, can I just give your Honours a couple of references, in particular to Mr Schubert, and you'll find his evidence, of course, in the index and I'd just refer your Honours to his paragraphs 52 onwards where he very clearly says that in his opinion the directors could take very little, if any, comfort from the Ernst & Young audit because ultimately the Ernst & Young audit opinions were based on the directors' own assessments of the recoverability of the loans. So EY were relying on the directors, and I took your Honours to the representation letter, and, of course –

WINKELMANN CJ:

I think you're covering the same ground, Mr O'Brien.

MR O'BRIEN QC:

Okay, thank you, your Honour. Another point which Mr Hodder raised, Mr Yan's commitment to Mainzeal. Can I just give you two references there? One is to page 2400 of the notes of evidence where it was put to Sir Paul Collins that Mr Yan was committed to Mainzeal, indeed passionate about it, and Sir Paul said, well, he thought that Mainzeal was very important and then he went on and said: "But passionate? I'm not sure I'd use that term. He was a businessman, yes," and there was a limit to his commitment, and he said that himself, and I didn't give your Honours this reference. He said that himself at paragraph 257 of his evidence, that's Mr Yan's evidence, paragraph 257, where he said that the group was committed to Mainzeal so long as it was a going concern, and I did take your Honours to the references in the pleading.

WINKELMANN CJ:

We've got that in the findings anyway, haven't we? Justice Cooke in the Court of Appeal made that finding.

MR O'BRIEN QC:

Thank you. Justice Cooke's findings about the assessment of loss under 136, yes, and we appealed that and we were successful and we support the Court of Appeal judgment, but his concern there was – well, he had a different view of section 136 than did the Court of Appeal and did this Court in *Debut*. I think that's everything, thank you, your Honours.

WINKELMANN CJ:

Excellent. Well, thank you all counsel for the excellent assistance we've received on this appeal. We will take some time to consider our decisions.

COURT ADJOURNS: 3.08 PM