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

SC 29/2019
[2019] NZSC Trans 23

BETWEEN **VIVIEN JUDITH MADSEN-RIES**
AND HENRY DAVID LEVIN
(as liquidators of Debut Homes Limited)
First Appellants

DEBUT HOMES LIMITED (In Liquidation)
Second Appellant

AND **LEONARD WAYNE COOPER**
First Respondent

LEONARD WAYNE COOPER
AND TRACEY COOPER
(as trustees of the L & T Cooper Family Trust)
Second Respondents

ATTORNEY-GENERAL
Intervener

Hearing: 1 October 2019

Coram: Winkelmann CJ
Glazebrook J
O'Regan J
Ellen France J
Williams J

Appearances: N H Malarao and P V Shakelton for the Appellants
R B Hucker and R F Selby for the Respondents
H W Ebersohn and C White for the Intervener

CIVIL APPEAL

MR MALARAO:

May it please the Court. Malarao together with Shakelton for the appellants.

WINKELMANN CJ:

Tēnā korua Mr Malarao.

MR HUCKER:

E Te Kōti Mana Nui, ko Hucker ahau. Kei kōnei māua ko Ms Selby. Mō te kaiwhakahē tuatahi. May it please the Court. Hucker for the first respondent. With me is Ms Selby.

WINKELMANN CJ:

Tēnā korua.

MR EBERSOHN:

E Te Kōti, ko Ebersohn ahau. Kei kōnei māua ko Ms White. Mō te Karuna. May it please the Court. Ebersohn and White for the Attorney-General as Intervener.

WINKELMANN CJ:

Tēnā korua. Now Mr Malarao have you had any discussions with counsel about allocations of time?

MR MALARAO:

We haven't had discussions of allocations of time Ma'am. What I was proposing Ma'am was that my address would probably just go over the morning adjournment. That should leave enough time for the others in court, but obviously it depends somewhat on the questions and the like, but that's how much I perceived I'll go in terms of timing.

WINKELMANN CJ:

Well our anticipation is that Mr Ebersohn will be reasonably short and follow on from you, and I should also give an indication that we would like to hear something about compensation. I know that the submissions don't address that in any detail and you've proceeded on the basis that although you're not entirely thrilled with the award in the High Court, that you'd be content to stand on that, but we would need to have, we would be asking Mr Hucker about compensation and so we'd like to hear from you on that.

MR MALARAO:

Yes Ma'am.

WINKELMANN CJ:

Should your appeal be successful in whole or in part, what compensation would be awarded. That's no indication, of course, that's simply us looking down the road as to what would have to occur.

MR MALARAO:

Yes Ma'am. I do plan to address that towards the end of my oral submissions. May it please the Court. Debut Homes Limited now in liquidation went into liquidation in March 2014 on the application of the Inland Revenue Department. It was balance sheet insolvent at least five years earlier, which was March 2009, and being propped up by external and related party funders through the referred order of 2012. By October and around November 2012, some 16 months before it was placed into liquidation, it was insolvent both in a balance sheet and cash flow basis, and it's what happened in those 16 months that is the focus of this appeal–

WINKELMANN CJ:

So it's 16 months do you say?

MR MALARAO:

Yes Ma'am. Ma'am I plan to speak to my written submissions, and I've submitted an outline which I trust that Your Honours have, and I will be essentially going through that outline so that Your Honours can follow where I'm at. There are essentially two critical points that I will address Your Honours on. The first is whether the Court of Appeal heard in interpreting section 136 and secondly whether the Court of Appeal erred in applying section 131 and 135, and the appellant say that the answer to both of those question is yes.

Before I start going to the substantive part of my submissions, I wanted to make three brief introductory comments. It's trite to observe that directors have to be careful when a company enters into troubled waters. These troubled waters for Debut started in March 2009. By November 2012 there was no chance of rescue. Someone was going to lose a lot of money. The appellants say that Mr Cooper ran his company in such a way for those 16 months before liquidation which would guarantee that the vast majority of the loss lay at Inland Revenue's door, and in doing so he breached his duties to the company.

My second comment by way of introduction is that while I've just mentioned Inland Revenue, this is not a tax case and it's not a case which the appellant says hinges on GST priority. GST happens to be what was unpaid and under a liquidation GST has priority status, but the fact that GST has that status is not a material part of the appellant's case. If Debut, through Mr Cooper, just by way of example, if Debut through Mr Cooper had cause to borrow funds from a lender, an equivalent amount of the GST on each sale, and used that borrowing to pay IRD the GST on each sale, and it was that lender who lost money. The case for the appellants would be largely the same based upon that hypothetical fact scenario.

WINKELMANN CJ:

So your submission here I think is that Mr Cooper chose which creditor was going to carry the loss, and he could equally have chosen some other creditor?

MR MALARAO:

Yes Ma'am, and related to that Ma'am was that of course Inland Revenue finds itself in a position where it doesn't decide who to lend credit too and therefore it was essentially easier to lay it at Inland Revenue's door. My example is a rather extreme example.

WINKELMANN CJ:

Yes, it doesn't supply.

MR MALARAO:

My third point, Your Honour, is in relation to time. As I said the focus is on those 16 months which runs from October 2012 through to March 2014. Up until the end of 2012, while Debut was certainly in trouble, the appellants are not submitting there was any breach of duties up to that point. Fast forward through to March 2014 when the company was put into liquidation, the appellants are not saying that just because there were debts in the liquidation, there must be a breach of duties. It's what Mr Cooper did in those intervening 16 months that is at issue.

One final point on the timing point. The appellants say that the Court of Appeal erred in picking a singular point in time, which is early November 2012, as the date upon which to judge Mr Cooper's actions. Directors duties are not framed in that way is an ongoing obligation, and just to underlie that point, two of the properties that Mr Cooper sold was after Inland Revenue had served Debut with a statutory demand, and one of them was after the first call of the liquidation application.

Just in terms of how I will deal with our submissions, Your Honour, I'm proposing now to move to paragraph 3 of my written submissions which the

oral outline essentially follows. I'm going to be skimming over paragraph 2, which contains a narrative of the key facts. I propose to do that because the Court of Appeal didn't disturb any of the factual findings made by Justice Hinton, but of course it did take a different view and placed a different emphasis on a number of points in the evidence, and those points of divergence are something I'll speak to when addressing the Court on the relevant duties.

If there's any particular point on the facts that I can assist with, I'm happy to do so. I am conscious, though, Your Honours that I was not counsel at trial or in the first appeal. Mr Shakelton was and if I find that I can't assist Your Honours with any particular point on the facts, with Your Honour's permission I'm going to ask Mr Shakelton to address the Court on that point.

Finally, Ma'am, I will address the compensation point, but one of the other points which is the section 299 setting aside of securities aspect, I'll ask at the end of my oral presentation whether the Court wants to hear submissions on that point, and if it does Mr Shakelton will address that point.

Your Honours, I'm going to now move as I said to paragraph 3 of my written submissions, and this is point 1 of my oral outline. The submission of the appellants, Your Honours, is that *Peace and Glory Society Ltd (in liq) v Samsa* [2010] 2 NZLR 57 (CA), decided by the Court of Appeal in 2010, was right when it held that there were three key elements to establish a breach of 136, namely that the defendant has to be a director of the company, that an obligation was incurred by the company, and at the time of incurring the obligation the defendant did not honestly believe on reasonable grounds that the company would be able to perform the obligation when required to do so.

Justice Hinton followed the Court of Appeal's approach in *Peace and Glory* when it found that the relevant obligation to pay GST output tax is incurred in terms of section 136 on the signing of a sale agreement and is payable on whatever date the GST return is due. There are two key aspects, Your Honours, in terms of what the Court of Appeal's reasoning.

First, in essentially disagreeing with *Peace and Glory* without actually overruling it, or holding that it was incorrect decided, first it was that by the entry of the company into the relevant sale and purchase agreement did not amount to Mr Cooper as director agreeing to Debut incurring an obligation. The Court of Appeal's view was that GST was not the type of obligation contemplated by section 136 of the Act and for section 136 to apply there needs to be a direct agreement between the company and Inland Revenue.

The second aspect underlying the Court of Appeal's decision, and I'll take Your Honours to the critical paragraphs soon, which is that the relevant GST obligation had its origins in the original purchase of those properties and thus the Court of Appeal regarded the obligation to pay GST was merely incidental, and it's implicit in the Court of Appeal's reasoning that a contingent obligation to pay GST arises on the purchase of the development property by the taxpayer, or when the company claimed a GST input credit on the purchase of the property, which then crystallises upon the sale of that property. It's respectfully submitted that that's wrong Your Honours. So getting into the documents for the first time Your Honours –

WINKELMANN CJ:
But even if it was right wouldn't it still amount to when you enter into the agreement for sale and purchase and thereby crystallise the obligation which may or may not arise, it's incurring it?

MR MALARAO:
Yes.

WINKELMANN CJ:
Anyway, carry on with your other submission.

MR MALARAO:
I'm in the pleadings volumes, Your Honours. Are Your Honours using the electronic bundles or…?

WINKELMANN CJ:

No, I think we're using hard copy I think.

MR MALARAO:

So Ma'am the Court of Appeal judgment is in the folder titled "Pleadings" at tab 15, right at the end. I'll ask Your Honours to turn to paragraph 68 of the judgment. Here Ma'am what I'm trying to do is to set the context for the, or precisely what the Court of Appeal's view was in respect of GST. Firstly, it's that point I made earlier, which is that in the second sentence the Court says, "As we have set out, the arising of obligations to pay GST on the properties had its origins in the original purchase of these properties years earlier, when there is no question about the company's solvency…" at that time. The second aspect is the next sentence which is, "We are unable to see how in that context it can be said that under s 136 Mr Cooper could be said, to 'agree' with the IRD to 'incur' a GST 'obligation'."

The next paragraph, paragraph 69, may it please the Court, shows that the Court of Appeal is beginning to make errors in its judgment at this stage. At paragraph 69 the Court of Appeal refers to the decision in *Peace and Glory* and it makes the comment that is relied on by the IRD, but of course I represent the liquidators in this case. But nonetheless the point is that it refers to the *Peace and Glory* decision and the elements that the plaintiff must prove, and there says that the case was entirely different. In my submission, Your Honour, that case wasn't different on these critical facts.

I'll ask Your Honours to look at *Peace and Glory*, which is in my bundle of authorities, volume 1, right at the end, tab 16, and I invite Your Honours to turn to paragraph 45. Now therein counsel for the liquidators submitted, the judgment records, what the three elements to a claim for a breach of section 136 are, and I've talked about those before. Now if I can get Your Honours to flick over to paragraph 64. At paragraph 64 the Court records that counsel for the director in this case accept that the three elements in section 136 are met. The Court records, "This concession was well made." But then submits that there is to be, "A gloss added to s 136."

The Court says that, “We do not accept that submission,” and goes on to say, “If the three elements set out in s 136 are present then there is a breach of duty.”

Now going back to paragraph 57, which is just referred to by the Court of Appeal, if I could ask Your Honours to turn to that, which is on the previous page, there the submission for –

WINKELMANN CJ:
So this is back in the judgment of the Court of Appeal in this case?

MR MALARAO:
No.

O’REGAN J:
Paragraph 57 of *Peace and Glory*.

MR MALARAO:
Peace and Glory. Now in paragraph 57 their counsel for the director accepts, it’s recorded as it having accepted the three key elements of section 136, but then goes on to say later on in the paragraph, it’s recorded as saying that, “Whether or not Mr Samsa can be found liable for breaching… much be viewed in light of the purpose of s 136.” The case of *Löwer v Traveller* [2005] 3 NZLR 479 (CA) is quoted and it talks about, the submission records of the distinction between, or refers to the concept of illegitimate trading, and the counsel for the director submits that as Mr Samsa didn’t benefit, and in fact incurred a greater personal debt, there could not be any illegitimate trading. So it was precisely this submission of counsel for the director in that case the Court of Appeal is rejecting.

WINKELMANN CJ:
I mean I don’t know that much turns on it, but the Court of Appeal was making the point that really there was a concession that the elements of section 136

were made out and therefore the Court in *Peace and Glory* didn't grapple with it, but –

GLAZEBROOK J:
Is that quite right, because it did say well it was a concession well made.

WINKELMANN CJ:
I was just about to say, that the Court did say it was a concession well-made and obviously the Court did turn its mind to it, so I think that's probably about as high as you can put it, yes.

MR MALARAO:
Absolutely Ma'am.

GLAZEBROOK J:
But weren't you also pointing out that they did concede that but said there should be a gloss, and the gloss is actually fairly similar to the gloss that the respondent in this case is wanting to put on the…

MR MALARAO:
Yes Ma'am, that's precisely the point I –

GLAZEBROOK J:
So it was actually a very similar gloss that's been put forward to the gloss that's now being put forward, and that that was rejected by the Court of Appeal. Was that the point?

MR MALARAO:
Yes Ma'am.

GLAZEBROOK J:
The other point sorry.

WINKELMANN CJ:
Was it really the same point?

GLAZEBROOK J:

Well it's similar because it says he incurred a greater debt, personal debt by the purchase, can't be seen as illegitimate trading and once he realised he took immediate steps to sell at a fair value. It's a similar…

WINKELMANN CJ:

That's the section 301 point that you're addressing?

MR MALARAO:

That's correct Ma'am, but what I want to do now is take Your Honours back to paragraph 69 of the decision under appeal, which is the judgment in this from the Court of Appeal. If I can get Your Honours to go back to that and we were at paragraph 69. Now in paragraph 69 after making the comment that the facts of that case were different, the Court of Appeal then proceeds in the decision under appeal to talk about why the facts were different in *Peace and Glory* as opposed to the present case. Then the Court of Appeal cites a part of the Court of Appeal's decision in *Peace and Glory* at paragraph 69 – sorry, I'm at paragraph 69 on page 101.0161, but just turning over to the next paragraph, which also happens to be paragraph 69 of the *Peace and Glory* judgment. That particular paragraph, Your Honour, is post the Court of Appeal in *Peace and Glory* deciding that breach has been established. It's talking about matters going to compensation, and essentially I'm underlying the point that Justice Glazebrook just made earlier, which is that this is where the Court of Appeal is making errors. It's bringing those factors of compensation into account on its analysis in terms of the breach question.

WINKELMANN CJ:

Well I don't know that it is. It's expressly saying it's in relation to section 301 but anyway.

GLAZEBROOK J:

Well I thought that your point was that what the Court of Appeal was doing was taking factors related to 301 into whether there'd been a breach under

section 136, and your point is that they shouldn't have done so, they should have been looking at those factors when assessing compensation, and they shouldn't be relying on *Peace and Glory*, which was assessing them for compensation, for saying there wasn't a breach of 136.

MR MALARAO:
That's my point Your Honour.

WINKELMANN CJ:
Can you take us to the elements of section 136 then and say how you apply it in the case of your schedulised payments, that are, I think they're in your schedule… if indeed there was an incurring of the obligation – was it the first respondents, then you replied to a schedule. It is your schedule. It's in your outlying submissions.

MR MALARAO:
Ma'am, the schedule that Your Honour refers to is really there for a different point altogether.

WINKELMANN CJ:
I know, but I wanted to ask you a couple of questions about it, because the words of section 136 are they're not concerned with preferences, they're concerned with ability to pay, correct, and when you look at the transactions, just having looked at this it occurred to me that a lot of the time there wasn't an ability to pay because well on some occasions there was no ability to pay because all the money went to the secured creditors in some of those transactions. Or are any of the transactions in that category actually, or did some money go to Debut on each of the transactions, right.

GLAZEBROOK J:
Which schedule are we on?

WINKELMANN CJ:
I was working from Mr Malarao's schedule.

GLAZEBROOK J:

Attached it is. Yes, thank you.

MR MALARAO:

Response to annexure A Your Honour.

GLAZEBROOK J:

Yes.

WINKELMANN CJ:

So if you just, when we look at the first transactions which were at issue, the 48 Penrod?

MR MALARAO:

4 Karika Your Honour.

WINKELMANN CJ:

4 Karika, so you say that on that occasion the company had no ability to pay that GST because all of the money was used up paying the secured creditors and it had no other money available?

MR MALARAO:

Yes, Your Honour, that's what's happened on the facts.

WINKELMANN CJ:

Because it just occurred to me that in some cases, for instance when he's paid the money to DHL or the Cooper Family Trust, the company perhaps did have the ability to pay it but chose not to. It's a preference rather than an inability to pay. That's the question I'm asking you really.

MR MALARAO:

Yes Your Honour. In that sense there was this surplus funds available and choosing to use those funds to pay the company itself and then the Cooper Family Trust, yes there's a preference in that sense, but all of those funds, as I understand it, so far as what went into the company's own bank

account, was essentially used to do the subsequent expenses on the next development, and so far as the money went to the Cooper Family Trust, by this stage a security had been given to the Cooper Family Trust and essentially the point is that on the evidence is that the Cooper Family Trust was insisting that it also be paid just like –

WINKELMANN CJ:

Yes, well just to be clear what I'm asking you, if you look at the words of section 136 the issue is whether the director, Mr Cooper, believed at the time that the obligation was agreed to, which is the time the agreement for sale and purchase was entered into, believed on reasonable grounds that the company would be able to perform the obligation when it's required to do so. If the company had been insolvent but it was going to get these funds in, and they weren't needed to discharge the mortgage, then even if it was insolvent that test wouldn't be met, would it, because he would believe on reasonable grounds he could just use the proceeds of sale. But your point here is that in fact he needed to discharge the mortgages to get the sale achieved so he couldn't pay it. It's just a bit more complicated than simply being insolvent is my point Mr Malarao. It's actually a higher threshold than that for you. You've got to show – because in fact there was a lot of money coming in with these sales. He could've just decided to prefer the IRD over the other creditors.

MR MALARAO:

Well no, Ma'am, because the evidence is that Mr Cooper is saying that my secured creditors were insisting upon taking all of the money from the sales, and the point, Your Honour, is that the critical decision is at the point that the transaction was entered into, and at that point in time was there any reasonable chance that the secured creditor is going to say, no, that's okay, the IRD can have that money, and on the evidence there's just no suggestion that that was in play.

WINKELMANN CJ:

And even when he did apply the money he had some surplus in some cases. For instance with the Penrod he had about 85,000 but he needed that to develop 27a Penrod, didn't he I think, or subsequent purchases.

MR MALARAO:

A subsequent development, so these were properties, were under development, and money from one of the earlier sales, JTJ is the secured creditor, allowed Mr Cooper to keep that money so as to be able to use those funds to go into the next property.

GLAZEBROOK J:

In any event what it looks like is there wasn't enough money to pay the creditors so if he had paid the IRD there would have been somebody else missing out, and if it was a secured creditor presumably by consent, but nevertheless missing out.

MR MALARAO:

Yes, and a central thesis of the appellants' case is that in this particular case, on Mr Cooper's own figures, he knew that there was going to be $300,000 as a shortfall to Inland Revenue. So even after taking into account the surplus that he perceived in November 2012 as capable of being generated, there was going to be a $300,000 shortfall to Inland Revenue on this sale programme.

WILLIAMS J:

I wonder whether this is academic anyway because on the evidence not only did he not believe it, he planned specifically not to. So what does it matter.

MR MALARAO:

That's precisely the point I was just trying to make, perhaps not as eloquently as Your Honour has.

WILLIAMS J:

I don't think it was very eloquent.

MR MALARAO:

But that is the point.

WINKELMANN CJ:

Yes, well I'm just trying to get you to help me, Mr Malarao, with understanding what section 136 requires.

MR MALARAO:

So, Ma'am, the second point that I was going to move to is this concept, there were two particular errors, the appellants say, in the Court of Appeal's analysis. The first is that this requirement for a direct agreement with Inland Revenue. The first point on that, Your Honours, is that's not actually what the section's words say. The wording is clear. It's the entry into the relevant sale and purchase agreement that gave rise to an obligation by the company to pay GST and it's therefore the company that incurred the obligation. Mr Cooper being aware that the company would be required to account for GST on each sale when signing the sale and purchase agreements. So he was, the knowledge aspect is present as well, and thus in executing the sale and purchase agreements he agreed to the company incurring an obligation to pay GST.

WINKELMANN CJ:

So your point is it's not that the company agrees to incur an obligation, it's he agrees to the company incurring the obligation, so it's the company incurring, not agreeing to.

MR MALARAO:

Yes. Your Honour, on this point the next point is that simply this is directly against the Court of Appeal's interpretation in *Peace and Glory*, and I'd earlier referred to the fact that, or I'd referred to the proposition that *Peace and Glory*

and this Debut matter are different on the facts, but on its core analysis in *Peace and Glory* this point is exactly the same.

ELLEN FRANCE J:
Mr Hucker does rely on other cases which suggest that the taxing obligation, if that's the right way of describing it, is in a different category. What do you say about those? I mean if you're coming to that…

MR MALARAO:
Yes, I am coming to that Ma'am, but the simple point on that is that the Australian authorities, which I've quoted in my submissions, should be preferred to the one Australian authority that Mr Hucker has submitted, and there's a reference to an American case as well but the facts of that I'm not presently aware of and I don't think that case is in the bundle.

Just at this point in time I might just turn to one of the points made in my friend's submissions, which is at paragraph 88 of my friend's submissions, and I appreciate that I do have the right of reply but I thought for the assistance if I can address some of the main points in my friend's submissions which I disagree with so we can have a meaningful discussion on this point. It's at paragraph 88 of my friend's submission on page 20 of his written submissions, and he makes the submission there that, "Parliament would have intended a consistent application of the duties between ss 135 and 136," and then makes the point that it must be, section 136 at the end of it must be intended to create a contractual duty or obligation directed to the contractual agreements that resulted in a further contractual obligation required to be performed. And in the middle of that paragraph he refers to the fact that if something is considered to be a legitimate business risk or strategy under 135, then that should not be prevented under 136. My response to that, Your Honours, would be that well that would then render section 136 otiose, because what's the need for 136 if that's the position, that 135 covers.

WINKELMANN CJ:

So section 136, you say, is really about the significance of particular transactions, or what is it about then?

MR MALARAO:

Yes it is about significance to particular transactions and protecting creditors such as Inland Revenue from this type of situation having occurred. We're essentially, Your Honour, even on the respondent's case, we're in the situation of a wind down of the company and the law is consistent on this point. A mortgagee goes into possession. That mortgagee in possession has to pay all of the costs of the realisation process. A liquidator gets appointed. The liquidator has to pay all of the costs of the realisation process. The receiver has to do the same. A voluntary administrator has to do the same, and 136 is essentially saying that, well you decide to close down, sell up, you've got to make sure that you pay the obligations that that process entails.

WINKELMANN CJ:

And you can't rob Peter to pay Paul, as is said several times.

WILLIAMS J:

The flip side of that point is, isn't it, that 136 can be read harmoniously with 135, which kind of overrides your otiose point by ensuring that a decision under, the trading under 135 does not involve a breach of 136 in order for it not to breach 135. So I think your otiose point may be a little wrong, it's just that you're pitching it from the wrong side.

MR MALARAO:

Yes, I think I understand what Your Honour is saying. My point was –

WILLIAMS J:

Not quite as eloquent as my last point but…

MR MALARAO:

My point was simply that 136 has to have its own purpose and that purpose is there, which is that don't incur obligations. Don't agree to the company incurring obligations when you don't have a reasonable ground, when you don't honestly believe that that obligation can be paid, and in this case back in November 2012 –

WILLIAMS J:

But would you agree that the breach of 136 is rather good evidence of a breach of 135? Not alone but if it's trading on that basis.

MR MALARAO:

Yes, and that would be consistent Your Honour, that there are, on the vast majority of section 136 cases, there has been a 135 claim pleaded as well, and a number of first instance in some Court of Appeal authorities as well I think which say, yes, 135 has been breached, 136 has been breached. There are cases, I acknowledge, where 135 in and of itself has been breached and 136 has either not have to be dealt with, or in some cases just not been pleaded.

O'REGAN J:

I think there's also a consistency about the use of the term "agree to" in 135, which just seems to mean go along with, or acquiesce in or consent to. It doesn't connote any kind of contractual commitment to do something, which suggests that when the same term is used in section 136, that's all it's intended to mean.

MR MALARAO:

Yes Your Honour and in fact in the Court of Appeal's judgment, and I'll make sure that I have the reference. It's at paragraph 62, Your Honours, of the Court of Appeal judgment which is at tab 15 of the pleadings bundle. The Court of Appeal here, at least implicitly in paragraph 62, acknowledges that, "A developer needs to trade bearing in mind GST obligations and must act with reasonable belief that…" GST will be paid, and it refers to a first

instance decision at the High Court. So the Court of Appeal's analysis, taking the point that Your Honour Justice O'Regan has made, is that the Court of Appeal was certainly not of the view that GST doesn't get captured by section 135, which Your Honour pointed out, uses the word "agree" that says that despite the same wording in 136 it just doesn't actually fall within the ambit of 136.

If Your Honours have got my friend's submission open still, I invite Your Honours to turn to paragraph 101, which is on page 23 of my friend's submission and much like me in my opening remarks my friend also gives an example of the vineyard and the grapes of the vineyard won't be able to be harvested if this Court disagrees with the Court of Appeal, and these grapes would wither on the vine. My submission to that, Your Honours, is just simply that the proposition is that the grape picker needs to be paid, and that really is it.

GLAZEBROOK J:
What do you want us to take from the grape picker must be paid?

MR MALARAO:
That the Inland Revenue Department and the other creditors in Debut's liquidation, but in particular the Inland Revenue Department because the evidence is clear that it's solely related to the six properties, all the appellants' proposition is that as part of that wind down process section 136 is designed to make sure that those debts are paid. Of if you can't pay it you need to pause and have a good think about what you're going to be doing because –

GLAZEBROOK J:
You would say, though, that if you can't pay it you can't carry on trading, so the grapes would either wither on the vine or something would have to be done like voluntary liquidation where the liquidator could decide to pick them.

MR MALARAO:

And my other proposition on that, Your Honour, is just simply that you need to go and talk to the people that will be affected by your decision. So talk to the, using that example, talk to the grape picker. If there's somebody who's got a security over the vineyard, talk to that person. Say, look, I'm in a difficult position. It's best for everyone if these grapes are going to be picked. Will you allow me to make sure that I pay the grape picker, because it's in no one's interest if these grapes wither on the vine.

WINKELMANN CJ:

I'm just conscious of the time, Mr Malarao, because we don't seem to be moving through the points.

MR MALARAO:

So the next point is –

WINKELMANN CJ:

You were going to take us – when are we coming to this Australian authority that was relied on by Mr Hucker, is that shortly?

MR MALARAO:

It is shortly Ma'am. Just two short points before then. First, Ma'am, is that the GST output tax, the Court of Appeal viewed it as being a mere incidental. In my submission that can't be right because that goes directly against the provisions of the Goods and Services Tax Act 1985. I pick up on one of the points, Your Honour the Chief Justice made right at the start, is that whichever way we think about what happened at the start when the GST was claimed on the purchase of the properties, it is the selling that crystallises the obligation to pay, and the GST Act, section 8, section 9, section 20 is all premised upon that situation.

The next point, Your Honour, is that in terms of this section 136 assessment, on the Court of Appeal's interpretation the GST – well section 136, like what is a director's duty, it's really guide directors as to what to do. Now on the

Court of Appeal's interpretation this section 136 assessment would need to be taken at the point of claiming the relevant GST refund, and it's at this point in time the director doesn't know when, or indeed how much GST the company will have to pay. There are circumstances when a transaction can be zero-rated. Now many creditor claims in a liquidation are going to have their genesis in some way, in some past event pre the company being insolvent, and there shouldn't be an incentive for a director to say, well the genesis of that obligation was so far ago that I can really say that it's already there and I can ignore it.

Coming now to the point that Your Honour Justice France noted. So that point, Ma'am, is really about the authorities on the word "agree". That is really dealt with rather shortly at paragraph 320 of my written submissions. *Peace and Glory* certainly until the Court of Appeal's decision in the present matter under appeal, was very clear. GST is something that's captured by 136. So there isn't a great deal of, certainly my research and Mr Shakelton's research couldn't find any particular discussion on this point in New Zealand, which talks about this concept of an involuntary obligation or anything like that. But the position in Australia does appear to have been discussed on a number of occasions, and under the Australian provisions, that's section 588G, liability to pay tax, there has been arguments in Australia about, well is tax really an obligation that is incurred, and the authorities, or the preponderance of authorities is that it is, the answer is yes, and I rely on the decision of the full Court from South Australia, Supreme Court, *Fryer v Powell* [2001] SASC 59; (2001) 159 FLR 433, which is a 2001 decision which is in my bundle, and also the decision in *Commissioner of State Taxation (WA) v Pollock* (1994) 12 ACLC 28; 27 ATR 109 from 1994, which is from the West Australian Supreme Court, again a full court, and the analysis, in my submission, is that the analysis should be preferred to the analysis in *Castrisios v McManus* [1990] TASCC 77 from the Tasmania Supreme Court decided by a single Judge in 1990, which also appears to be a criminal case somehow.

I do want to take Your Honours to *Fryer v Powell* because both of the decisions I've referred to do, in fact, discuss *Castrisios v McManus*. So that decision is in –

WILLIAMS J:
Are we going to *Fryer v Powell* or to *Castrisios v McManus*?

MR MALARAO:
We're going to *Fryer v Powell* Your Honour.

GLAZEBROOK J:
What volume is that in?

MR MALARAO:
Volume 2, tab 1. The relevant discussion –

GLAZEBROOK J:
Tab what sorry?

WINKELMANN CJ:
17.

WILLIAMS J:
The first tab.

MR MALARAO:
The relevant discussion starts at paragraph 61 and goes through, Your Honours, to paragraph 72, and I don't propose to take Your Honours through the reasoning, just highlight a couple of points. This latest decision in time, which is the *Fryer v Powell* decision, does refer to the, at paragraph 67 to the *Castrisios v McManus* decision, and acknowledges that it comes to a different finding. At paragraph 65 it refers to the earlier case I mentioned, which is the *Pollock* case, and then at paragraph 72 it makes, the Court comes to its conclusion that it is, "Not only is it well-established that a statutory impost is capable of constituting a debt, but it is also the situation

that, if, by reason of the normal, ongoing operations of a company (including the mere passive retention of existing staff or premises) it is rendered liable to pay a statutory impost, then it may properly be said that such impost has been 'incurred', as a debt, by the entity in question."

O'REGAN J:
It's not quite the same as "agree to" though, is it?

MR MALARAO:
No, I acknowledge that Your Honour. That New Zealand legislation does have the wording "agree" whereas the Australian legislation, which is actually in the bundle, it's at tab 2. I don't propose to take Your Honours to it. I acknowledge that the word "agree" isn't there. On the other hand the Australian legislation does talk specifically about a debt and section 136 uses this wider concept of obligation, and that's essentially a bit of a side point. It's not really addressing the point that Your Honour has made.

GLAZEBROOK J:
It does use the word "incurred" though, doesn't it, and that's what the Australian authorities are looking at.

MR MALARAO:
Yes.

GLAZEBROOK J:
These aren't GST cases anyway, are they, which are slightly different in the sense that you have to have a positive action to incur the GST liability, whereas in some of these you just have a passive continuing to trade if there are other types of obligations.

MR MALARAO:
Yes Your Honour except I don't think that any of these cases particularly turned on the type of tax, from my reading.

GLAZEBROOK J:

No I'm sure they don't, but if you did want to turn on the type of tax, I'm sure you could argue, as you do, that GST is a bit different because it requires a positive action of entering into the sale and purchase agreement.

MR MALARAO:

Yes.

WINKELMANN CJ:

Although that was an issue in *Castrisios*, wasn't it? Sales tax.

GLAZEBROOK J:

Yes.

MR MALARAO:

Just picking up on the point that Your Honour Justice Glazebrook made, which is that while it's acknowledged that the word, the element of agreement is not present in Australian legislation, the New Zealand Act does simply say that the director must not agree to the company incurring an obligation.

WINKELMANN CJ:

So a director could stop, for instance, the sale, and then they wouldn't be agreeing.

MR MALARAO:

Yes.

WINKELMANN CJ:

But if they allow the sale to go ahead, on your analysis they are agreeing to the incurring of the obligation.

MR MALARAO:

Yes.

WINKELMANN CJ:

So it's not the obligation they're agreeing to, it's the incurring of it?

MR MALARAO:

Yes.

GLAZEBROOK J:

And the Australian cases are on point on the meaning of "incur".

MR MALARAO:

Moving to, I'm just conscious of the time, so I'm not taking as much time –

WILLIAMS J:

Just before you do, would you mind, on the one hand at 72 the full court of the South Australian Supreme Court basically says, well that can't be right. Does *Castrisios,* does it give any particular reason why it thinks it is?

MR MALARAO:

No Your Honour. *Castrisios v McManus* –

WILLIAMS J:

These are just assertion and counter-assertion?

MR MALARAO:

Yes.

WILLIAMS J:

That's fine, if there's nothing more than that, then that's helpful.

MR MALARAO:

That's correct Your Honour. There was half a page of analysis on that point. As I said before, it was a criminal appeal. The relevant director did get found guilty of a particular offence, and then I believe there was a, but he wasn't found guilty in terms of the tax part of it, and there was a cross-appeal on that point, and that cross-appeal appears to have been dismissed. But just going

off memory, and I read that case quite a few weeks ago so I may have got that slightly wrong, but I've got the broad parameters right.

We were in my friend's submissions Your Honour, so I'll take Your Honour to that. It's at tab 8, which is in the second volume, there is a second volume that the Court has.

GLAZEBROOK J:
I'm not quite sure what…

MR MALARAO:
I'm just taking the Court to *Castrisios v McManus*.

GLAZEBROOK J:
Yes I k now, sorry, I didn't catch the reference.

MR MALARAO:
Tab 8, Your Honour, of my friend's bundle of authorities, which I think is volume 2.

GLAZEBROOK J:
Thank you.

MR MALARAO:
And as best I can see, Your Honour, the relevant discussion around the tax issue starts at paragraph 28 towards the end of the judgment. So as I said before, this was a criminal case and there appears to have been a cross-appeal in terms of the sales, the charges relating to sales tax being dismissed and the Court then dismisses the sentence appeal which was also there and starts this discussion of sales tax at paragraph 30 and the analysis at paragraph 31, 32 and 33. I don't propose to take Your Honours to that, having identified where the relevant discussion because –

WILLIAMS J:

It looks like it's based on the history of that section, its predecessor used the word "a debt contracted".

MR MALARAO:

Yes and it really does turn on the concept of a debt and this Court taking –

WILLIAMS J:

An uncontracted debt was the pre-588G provision and it looks as if the Judge felt that that hadn't really changed when the contracted part of the section fell out.

MR MALARAO:

Yes and both the *Pollock* and the *Fryer* decisions which I refer to both specifically go to acknowledge that *Castrisios v McManus* comes to an opposite view. I'm not particularly sure about how the Australian hierarchy of judicial precedence sits but it does seem to be that it does appear to be overriding that decision and not following that earlier decision.

WINKELMANN CJ:

So he says, "No act on the part of the company can be identified as one which brings a debt into existence", and that's the critical thing you say here, you can identify an act on the part of the company in this case?

MR MALARAO:

Yes Your Honour. My friend, if he was answering that question would say well even if there is an act, the act is signing the sale and purchase agreement so there is no act to agree to pay GST and my response to that is that you can't divide up, that's really cutting the onion too fine on this point. The point is that there was an agreeing to incur the obligation. No one was in any misapprehension that what was going to happen so far as the GST returns or the GST payment was concerned.

Your Honour that is my discussion in terms of the points regarding section 136 in particular. I am going to move now to talk more about the options available to Mr Cooper but before I do so, I'm not stopping my discussion on 136 altogether but my essential submissions on the legal position do come to an end here on 136. Is there anything I can assist Your Honours with further on these points?

WINKELMANN CJ:
No thanks Mr Malarao.

MR MALARAO:
So Your Honours, I am now going to talk about the options available to Mr Cooper which is at paragraph 4 of my written submissions. I'm not inviting Your Honours to go there just yet. The appellants' position is that the wrong here is not necessarily Mr Cooper's decision to complete and sell the remaining development properties but rather the manner in which he did so. The appellants say that it is legitimate for a director of an insolvent company to plan and execute a sell down of assets that sees existing and new liabilities paid. Its planning and creating fresh liabilities and diverting funds in such a way that sees pre-existing liabilities paid, that is illegitimate.

There has been discussion in the authorities, Your Honours, about what a director should do in circumstances such as the present and I do want to go into the authorities to assist the Court. The leading decision in terms of section 135 in New Zealand is the Court of Appeal's decision in *Mason v Lewis* [2006] 3 NZLR 225 (CA) which is tab 11 of my bundle of authorities. So I invite Your Honours to turn to that and I'm going to come to this decision again in one other point in my oral presentation but for the present time I just want Your Honours to turn to paragraph 51. At paragraph 51, it's the fourth bullet point I want to highlight where the Court of Appeal says, "What is required when the company enters troubled financial waters is what Ross accurately described as a sober assessment by the directors." And this is the Court of Appeal then saying, "We would add of an ongoing character as to the company's likely future income and prospects."

If Your Honours then flip to paragraph 50 which is just above paragraph 51, what the Court of Appeal was doing in *Mason v Lewis* and why it is a decision that is often referred to, is that it seeks to distil or order the relevant propositions on the breach question for 135 and there it refers to this concept in 136 of legitimate – this is legitimate and substantial and not substantial and then it talks about the wright of the authority in deciding the particular conduct as inappropriate as to an objective standard and then it quotes from – it refers to the decision of Your Honour Justice O'Regan in *Fatupaito v Bates* [2001] 3 NZLR 386 (High Court) where Your Honour pointed out that where a company has little or no equity, directors would need to consider very carefully whether to continuing to trade has a realistic prospect of generating cash that will service, this is the important point, both pre-existing debt and meet the commitments that such trading inevitably attracts.

Fatupaito v Bates, I will get Your Honours to turn to that which is at tab 1 of my friend's bundle, volume 1, tab 1. If Your Honours could go to paragraph 67 of that judgment. There Justice O'Regan lists some bullet points in respect of section 135 and the fourth bullet point, paragraph 67, the bullet point right at the end of the page, we can see that the Court of Appeal's citation of this dicta is entirely accurate because Your Honour there speaks about being very careful, having realistic prospects of generating cash which will allow the servicing of pre-existing debt and meeting the commitments such trading will inevitably attract.

While on this decision, please turn to paragraph 77. Paragraph 77 makes a point where a company has negative shareholder funds which is what the situation is in relation to the company, the subject of this proceeding and the decision being made to keep trading, the Court is saying there, it is a decision that necessarily involves risk for creditors, both existing creditors and those who will arise from future trading and the Court warns that in these circumstances a director must be very cautious before embarking on such a course of action. Just while I've got Your Honours on this decision, if I could quickly make a very small point by referring you to paragraph 85. In that case

one of the debts that was outstanding was a PAYE it appears, and/or GST. Now there the director makes the point, or his counsel made the point that Mr Bates, the director, did make payment of wages and made sure that all staff were paid and the like, and Your Honour accepts that he did so, but then points out at paragraph 85, "In order to meet the liability for wages, Mr Bates had to make an assessment not to pay some other sums and there was evidence that he had deferred payment of amounts due to the Inland Revenue Department for PAYE and/or GST on that basis." So the point there, Your Honour, is that GST is not being separated from the substantive transaction. PAYE is not being separated from the wages due to employees.

The appellants' submission, Your Honour, is that, "The appellants would likely have no issue with Mr Cooper's conduct, had Mr Cooper, (a) had a proper plan, and *continued* to monitor that plan (our emphasis added)," emphasis on the continued monitoring, "As to the likely net revenue to be generated by completing and selling the remaining properties, and that plan confirmed that the estimated revenue would be sufficient to meet all new debts."

Secondly, importantly, "Negotiated a position with existing creditors, being creditors *[sic]* that might have suffered from a cessation of trading, that saw all fresh debts being met and then any surplus being paid to existing creditors."

The Court of Appeal at paragraph 2 of its judgment seems, in the appellants' submission, regard the critical date of 6 November 2012 as being the date upon which this decision, or this case is decided upon, but the appellants don't agree. The appellants say that Mr Cooper's duty as a director required an ongoing assessment of the position. Mr Cooper was required to satisfy section 136 at the time he entered into each of the sale and purchase agreements.

GLAZEBROOK J:

But isn't your point that he was never going to be able to satisfy it from November because he knew that he couldn’t, even on his plan, and it only got worse?

MR MALARAO:

Yes Your Honour and I suppose what I'm trying to do is I'm trying to defend the appellants’ position. The Court of Appeal comes to this view that these were, this was really the best that Mr Cooper could do, in a wide sense of the word, in the circumstances, so how can he be in breach of his duties, and what the appellants are saying is that, no, what he could have done is he could have done a plan which involved talking to those people who are affected by this plan and getting them on board with his plan. It wasn’t a case that Mr Cooper didn’t have any options, which is the point I'm trying to emphasise.

WINKELMANN CJ:

Well really aren't you saying, because you said you were prepared to concede that he could trade on in November 2012, but aren't you really saying he couldn’t unless he had reached an agreement with the IRD, because in 2012 he didn’t have any realistic plan which saw the IRD paid, did he?

MR MALARAO:

I want to be very clear on this. I'm not conceding that he should have continued trading after November 2012.

WINKELMANN CJ:

He could have?

MR MALARAO:

He could have.

WINKELMANN CJ:

I'm saying are you conceding he could have because I thought, just what you just said, that your submission is that he couldn't, unless he did this deal –

MR MALARAO:

It's the latter Ma'am.

WINKELMANN CJ:

– and comply with the obligations under the Companies Act 1993 and common law.

MR MALARAO:

Yes, yes.

O'REGAN J:

He didn't necessarily have to have a deal with the IRD. It could have been with the secured creditors to allow him to pay the IRD.

MR MALARAO:

That's precisely correct Your Honour and that's more realistic, frankly, as well because, at least in November 2012 there's actually no debt to the IRD. The IRD doesn't know that the first two properties have been sold, the GST return hasn't yet hit the system, so talking to the IRD maybe in a slight vacuum, but Mr Cooper himself knows the GST is going to need to be paid. At the end of that month the first GST return is going to go in. So talking to the secured creditors and putting to them the proposition, well look I'm in a tight spot here…

WINKELMANN CJ:

Is that your case that this is quite an extreme case because he didn't ever have a plan through back to full solvency.

MR MALARAO:

Yes, yes.

WINKELMANN CJ:

Am I correct in that, that the facts that he didn't have a plan which saw the IRD paid?

MR MALARAO:

Yes Ma'am. The evidence is that, and I want to be fair to the evidence on this point, the evidence is that Mr Furlong had suggested to Mr Cooper, and Justice Hinton makes a finding of fact on this point, that things should be okay, and that's as highly as I can put it in terms of the evidence. How exactly it's going to be okay doesn't appear to have been discussed with –

WINKELMANN CJ:

But what is, there is other evidence too about what Mr Cooper understood about whether or not IRD could be paid, isn't there?

MR MALARAO:

I'm sorry Your Honour?

WINKELMANN CJ:

There is other evidence too about whether or not Mr Cooper understood the IRD could be paid.

MR MALARAO:

Is Your Honour referring to the fact that the $300,000 shortfall was discussed in the meeting?

WINKELMANN CJ:

No, I'll have to fish it back out. I think it's referred to in Justice Hinton's judgment.

WILLIAMS J:

Well clearly his forecast that he discussed with Mr Furlong didn't involve paying GST or interest and there was still a shortfall of, what was it, 140, I can't remember the number.

MR MALARAO:

160 I think.

WILLIAMS J:

160, right.

WINKELMANN CJ:

And didn't Justice Hinton find that it might be okay, or something like that, should be okay, was no kind of reassurance in the context of those facts?

MR MALARAO:

Yes, yes Your Honour –

WINKELMANN CJ:

That's what I was looking for, thanks Mr Malarao.

WILLIAMS J:

Now at that stage did Mr Cooper know that Mr Furlong was actually JTJ?

MR MALARAO:

I believe not Your Honour.

WILLIAMS J:

That's not until the following year?

MR MALARAO:

Yes. I think that was the source of his complaint to NZICA afterwards.

WILLIAMS J:

Yes. Is that relevant to your analysis at that point?

MR MALARAO:

No Your Honour, because the point is what Mr Cooper –

WILLIAMS J:

You mean the advice was so bad he couldn't have, he shouldn't have taken any notice of it even though it was given from a conflict of interest point of view?

MR MALARAO:

It's not so much that the advice was so bad, Your Honour, it's more that the advice was so limited in the sense that what it was at that stage was simply that Mr Cooper submitted, produced some figures, ostensibly to get further funding from JTJ, and Mr Cooper looked at those figures and said, look, your best case scenario, even after deducting the surplus that you hope your trading is going to generate, there's going to be $300,000 left at the end of the day, so really there's nothing more than that in this discussion.

WILLIAMS J:

It wasn't advice in the proper sense of section 135?

GLAZEBROOK J:

Well it wasn't advice to think that you could be okay to the extent that you would be not $300,000 in deficit i.e. it wasn't advice that you'll be okay because there'll be some other form of being able to pay that $300,000, and you'll be okay with too vague to be that advice.

MR MALARAO:

I think there was also some reference to, in the evidence itself, I'm unsure what Justice Hinton found on this point, that there was some reference to Inland Revenue being open to do deals.

GLAZEBROOK J:

I think she did. I think she did.

WINKELMANN CJ:

Mr Cooper said that.

GLAZEBROOK J:

Isn't your point also further than this that it really doesn't matter if you have any options, you're just not allowed to do this under the statute, so whatever the business sense there might be in carrying out, the statute has made a decision to say there's a bright line, you can't do these things, you can't trade well insolvent, you can't incur other obligations, and it just says so, and the statute allows things like the voluntary administration, the appointment of receivers and liquidators, but it has a bright line.

MR MALARAO:

Yes Your Honour.

GLAZEBROOK J:

And it has to have a bright line because every insolvent director or every insolvent company, in this case actually not so much, but most of them have a plan to get out of it, it's just that it's not a realistic plan and the legislation says well you can't do that, you've got to have an independent person at that stage and that independent person can decide whether it's a good idea to trade, subject obviously to coming to agreements with creditors in the way we've been talking.

MR MALARAO:

Yes, yes Your Honour and I suppose what I'm really exploring in this part of my submissions is that there is still a relatively large amount of discretion left to directors before that bright line has arrived.

GLAZEBROOK J:

Oh yes.

MR MALARAO:

Which involves having these discussions and the like but yes at the point that –

WINKELMANN CJ:

I suppose what we're testing you on Mr Malarao is that you didn't initially seem to be saying that this was and in fact your submissions aren't very clear but on the evidence I think you're submitting now that this was in fact a bright line point of time and that unless there was a reasonable plan to take this company out of insolvency, the sense of the IRD would be these properties would be sold and the IRD would be paid, then voluntary administration or liquidation was the appropriate path.

MR MALARAO:

Yes Your Honour, on these facts I do submit that the line is arrived at because Mr Cooper didn't go down any of the other options that he had available to him.

WINKELMANN CJ:

In any case, and the next point is but even if that is wrong, it wasn't simply November 2012 or date of liquidation as it happens, it was in fact an obligation to keep on reassessing and there are other critical points where it all became quite hopeless for Mr Cooper, including when he had those cost overruns.

MR MALARAO:

Indeed Your Honour. I mean to take the point to its extreme, the last property had sold after the first call of the liquidation application. There is really no – there's no way that there's any, you know, even a faint glimmer at that stage but nonetheless Mr Cooper just continued as he did.

Your Honours, there's one particular point of the Court of Appeal judgment that I would like Your Honours to turn to, which is tab 15 of the pleadings volume at paragraph 36. So Your Honour at this point in time in the Court of Appeal's judgment, the Court of Appeal is essentially summarising the respondent's case and in particular the respondent's statement of claim and the discussion starts at paragraph 35 and continues on to paragraph 36 and towards the end of paragraph 36, the suggestion is made that it is asserted that the proceeds of sale ought to have been applied differently to ensure IRD

receiving preferential payment of entitlements of secured and other creditors. Before we go any further it is necessary to place the obligation to pay GST in context and Your Honours will recall that one of my – my second opening remark was that the appellants' case is not dependent in any significant way on the fact that the Inland Revenue Department has a preference under schedule 7 of the Companies Act and the statement of claim that the appellants submitted to the High Court is actually in the pleadings volume as well. I won't take Your Honours to it specifically but the relevant part of the statement of claim starts at paragraph 34 and goes through to paragraph 106 and I appreciate it's a lot of paragraphs but nowhere in there is there a suggestion made that this case was all about the Inland Revenue's preference. So I suppose I'm going on about this point because that is how the Court of Appeal has characterised the argument but that's never been the argument and I'm assured by Mr Shackleton that that wasn't the argument that was run at the High Court or at the Court of Appeal, that anything particularly turns on the fact that the IRD has a preference.

WINKELMANN CJ:

Well I mean I must say your submissions seem a little bit unclear exactly what you were saying because the most straightforward thing for you to submit is simply the application of the legislative framework which is insolvency or liquidation or voluntary administration or even an informal compromise with creditors but still a compromise with creditors to enable you to trade on in the circumstance.

MR MALARAO:

Yes. Now we've talked a lot about the options that were available to Mr Cooper already in the discussions so I won't labour that point anymore. The relevant part of my submissions is paragraph 4.6 to 4.11, in my written submissions and those – the entire proposition is summarised therein of all the different options that he had which are really a cascading waterfall of different options that Mr Cooper had and ultimately if he either doesn't choose to exercise any of the options or just doesn't do any of the other options then that bright line is arrived at and ultimately the company has to either be put

into liquidation or go into some other form of statutory compromise, statutory insolvency process.

One point that my oral outline makes which didn't make its way into the submissions is that the Court of Appeal also says that Mr Cooper couldn't resign as a director. That's just simply wrong Your Honour.

WINKELMANN CJ:
I think you do cover that in your submissions don't you?

MR MALARAO:
Not in my written submissions Your Honour, it's just in my oral – in my outline.

WINKELMANN CJ:
I thought it was in your written as well but anyway the point is that you say he could've resigned, it doesn't matter that the company doesn't have a director.

MR MALARAO:
Yes.

WINKELMANN CJ:
But is resigning as director the thing, couldn't he just put it into voluntary liquidation?

MR MALARAO:
I'm not suggesting Your Honour that that's a responsible thing to do, all I'm suggesting, all I'm responding to is the Court of Appeal's point that Mr Cooper didn't have this option available to him.

WINKELMANN CJ:
But isn't the point that voluntary liquidation is the logical thing, yes an insolvent liquidation?

MR MALARAO:
Yes or voluntary administration Your Honour, I think on these particular facts.

O'REGAN J:

Absent a workable deal.

MR MALARAO:

Absent a workable deal.

WINKELMANN CJ:

And he obviously made the assessment that it would all end up better if he put in all this effort and time and liquidator's fees weren't having to be paid and you're saying well and good he made that assessment but it didn't have at the end of it his assessment, the IRD being paid and it wasn't an assessment open to him to make.

MR MALARAO:

Yes Your Honour and of course we haven't arrived at the other point which is that one of factors that was present here was that Mr Cooper had given a personal guarantee to his secured creditors so he is going – I mean he was cross-examined extensively on this point and he constantly says look I was doing this for the company but our submission is that of course in these situations and he does concede at a few points in time that he's going to do everything possible to try and save the family home and the family money and that's understandable human conduct Your Honours but in my submission because of Mr Cooper's position, it wasn't an option available to him as a director of Debut.

O'REGAN J:

Well they were secured creditors anyway, I mean they had to be paid first, didn't they?

MR MALARAO:

Yes. What I'm saying Your Honour is that to be –

O'REGAN J:
And he couldn't sell properties without getting releases of the mortgage. You know, it was inevitable he had to pay them out wasn't it?

MR MALARAO:
Well in a sense that if he said, "I'm not doing anything", they decide to sell the properties themselves, GST would be their obligation, that would be a cost of sale, there'd be a shortfall to the secured creditor and –

O'REGAN J:
And he'd be liable for it.

MR MALARAO:
Be liable for that.

COURT ADJOURNS: 11.30 AM

COURT RESUMES: 11.45 AM

MR MALARAO:
Thank you Your Honours. I want to now just briefly turn to some of the overseas jurisprudence on this point. I'm at number 6 of my oral outline, but I assure you that I'm further along than I would seem from being at number 6.

WINKELMANN CJ:
We were about to lose the will to live when you said that.

MR MALARAO:
So Your Honour there I talk about the, I refer to the English position and particularly the 2016 of decision *Re Ralls Builders Limited (In Liquidation)* [2016] EWHC 243 (Ch), which is factually quite a similar, they have some factual similarities between that case and the present case. So I invite Your Honours to turn to that which is in volume 2 of my bundle of authorities at tab 18.

WILLIAMS J:

Are you going to take us to the go-to points, because it's a big judgment.

MR MALARAO:

Yes, I'll take you to the go-to points Your Honours. The go-to point starts at paragraph 243 Your Honours. Volume 2, tab 18, paragraph 243. This is an English decision which has some factual similarities to the present. The provision under discussion is section 214 of the Insolvency Act in the UK. It is in Your Honour's bundles, it's at tab 4, but I don't need Your Honours to turn to that. The first point, Your Honour, is that section 214, if there was a similar provision in New Zealand, or had some similarities, it is section 135 of our Companies Act, and in there in the UK there is a defence available which is that if a director does everything possible, if he does take a step with a view to minimising the potential loss to company's creditors, that provides a defence. What happened in this case, this is the similarity with the present case, is that at the point that the breach occurred, the bank's liabilities went down and was eliminated, and new creditors such as Her Majesty's Revenue and Customs, that debt shot up. In terms of discussing the defence, the directors there said, well that's us meeting that defence, but the English Court disagreed, and the English Court says at 245, talks about the provision and the words "every step" and in the middle of paragraph 245 it says, "But also that it was designed appropriately so as to minimise the risk of loss to individual creditors." And then at paragraph 246 in the second sentence it makes the point, "That is because the manner in which they chose to continue trading meant that the Bank and some of the existing unsecured creditors were paid at the expense of new creditors who ended up not being paid," and that failure meant that the defence couldn't be made out. The reason for taking Your Honours to this decision is simply that under the English provision on a similar type of fact scenario the English Court found a breach of their equivalent, it's quite a lot of different wording, but their broad equivalent of section 135.

WILLIAMS J:

Every step is a high hurdle though.

MR MALARAO:

It is Your Honour.

WILLIAMS J:

It's not really the hurdle at 135. Unless you say that 135 imposes a counsel of perfection.

MR MALARAO:

No Your Honour I'm not –

WINKELMANN CJ:

Can I just ask, how does 214 operate? Has it got the 135 threshold and then there is an express defence?

MR MALARAO:

That's right. By the time I got to this part of the judgment that I'm talking about the Court had already found that there was a breach of the equivalent of section 135, which is the operative part of 214, and the Court here is discussing the defence that's available to the directors of the company and it was –

WINKELMANN CJ:

I'm not sure it's all that helpful really because it is a different statutory framework. It's not likely to be read back into the –

GLAZEBROOK J:

Well isn't your point rather that one, there isn't a defence in New Zealand, but in any event doing what Mr Cooper did here wouldn't have got him inside that defence if there had been such a defence?

MR MALARAO:

Yes, and certainly underlying the Court of Appeal's rationale is this sense that Mr Cooper, having found himself in a difficult position, did the best he could, and my point is that that defence –

WINKELMANN CJ:

That's not available to him, is your point, because the best he could wasn't, didn't meet the test of section 135?

MR MALARAO:

Yes.

GLAZEBROOK J:

And even if there had been a defence it wouldn't have met that either.

MR MALARAO:

Yes and similar, just while we're on this point Your Honour, the Australian legislation, I covered this in my submissions, albeit very briefly, in Australia the equivalent of section 135 is there, and they have a special carveout provision, which actually broadly says something similar, like if you do every step and it minimises risk and those kind of things, that there's a defence available, but the continuing monitoring is a necessary element of that carveout and that wouldn't be satisfied on these facts either.

WINKELMANN CJ:

And on your case all of this stuff about how good his conduct was on merit, or how merit-worthy he was in putting all his free labour and his family money, goes to a section 301 discretion, it doesn't go to liability?

MR MALARAO:

Yes. Your Honours I'm now going to address the Court on, my submission that the Court of Appeal erred in applying section 131, and this is on the basis that Mr Cooper was in a position of conflict, because his personal interest was in paying off the debts he had guaranteed. His obligations as a director of Debut that the appellants submit, was to consider the interest of all of Debut's creditors because it was in that insolvency state, and GST being collected from purchasers of the properties that Debut developed, being used to reduce his personally guaranteed debts is not –

WINKELMANN CJ:

Can you just assist us exactly how his payments reduced his personal guarantee liability.

MR MALARAO:

Yes Your Honour. The best way I can do that, Your Honour, is if we go back to the position as at 6 November when he has this discussion with Mr Furlong. He needs further funds to develop the remaining properties that he has. The evidence is that, the view is that JTJ, which is the financier, wasn't very happy with the situation and the suggestion is made that Mr Furlong said to Mr Cooper that JTJ will take you out effectively if you don't do this. So at that point in time if Mr Cooper had put aside his personal interests all together, and if that was humanly possible, he has to decide what's in the best interest of the company, and the submission is that the best interest of the company doesn't involve not paying Inland Revenue on all of these, all the GST that's actually collected on these sales. So had that sale happened, or had some kind of insolvency process kicked in at that stage, Mr Cooper was facing a rather large liability because –

WINKELMANN CJ:

Do you have to hand what that figure was in ballpark terms or not?

MR MALARAO:

No I don't Your Honour.

WILLIAMS J:

As at November '12?

WINKELMANN CJ:

Well can you tell us at least how much his personal liability under guarantee was reduced by his conduct between the time of the, you say the bright line date, and the date of liquidation?

MR MALARAO:

There's really two aspects to Your Honour's question. We know what happened at the end in terms of the money flow, so we know that the Family Trust at some point in time came and put money into the properties, and the Family Trust from the last sale of the property got around –

WINKELMANN CJ:

Well that's the Family Trust, that's a different thing, but what about his liability under the guarantees, were they paid down, were they reduced by the dealings?

MR MALARAO:

Absolutely Your Honour.

WINKELMANN CJ:

That's what I'm asking you, how much were they reduced?

MR MALARAO:

Well the figures that my friend has got, so in my friend's submissions at annexure B.

WINKELMANN CJ:

Yes.

MR MALARAO:

The total company losses when it ceased trading in October 2012 is noted to be $608,000.

WINKELMANN CJ:

I suppose what I'm asking is what was he exposed to as at 2012 and what did he actually end up being exposed to at the end under his personal guarantees?

MR MALARAO:

Under his personal guarantees I think there was no shortfall to JTJ.

WINKELMANN CJ:

But as at 2012?

MR MALARAO:

504,000 Your Honour which is, so it's a total loss on sale of properties, two rows up from that 608 figure.

WILLIAMS J:

All to JTJ or some of that to BNZ?

MR MALARAO:

I'll have to come back to you on that question. All to JTJ, Mr Shakelton assures me.

ELLEN FRANCE J:

So nothing to the bank at that point?

MR MALARAO:

The Bank of New Zealand?

ELLEN FRANCE J:

Yes.

MR MALARAO:

The position with Bank of New Zealand was that it's position was secure in the sense that I think there were the Pemberton properties, let me just check that.

WINKELMANN CJ:

I'm just wondering if some of that 608 is actually GST.

GLAZEBROOK J:

That's what I was wondering.

O'REGAN J:

It's 504.

MR MALARAO:

504, yes.

WINKELMANN CJ:

So BNZ is first ranking so it would be paid out.

MR MALARAO:

Yes.

WINKELMANN CJ:

But his liability was under his guarantee for the…

MR MALARAO:

Yes it was, I think he had guarantees to both of the financial organisations, and it was the properties of 78 Pemberton and 28 Coby Sydney Drive which were the two properties, that was the property that was subdivided, it was that property which there wasn't enough funds that were going to be realised and that's the $504,000 figure.

WINKELMANN CJ:

And at the end of the day he had zero personal liability exposure on the guarantees?

MR MALARAO:

Yes.

WINKELMANN CJ:

But against that he'd put in an awful lot of free time.

MR MALARAO:

And, Your Honour, what happened in the end because of these cost overruns is that the Family Trust also put money in.

WINKELMANN CJ:

And how much is that in total?

MR MALARAO:

The Family Trust Your Honour had put in –

WINKELMANN CJ:

Mr Shackleton should know that.

MR SHACKLETON:

It's 376,000 approximately.

WINKELMANN CJ:

And they would've paid back.

MR MALARAO:

Not all of that Your Honour.

WINKELMANN CJ:

No, no I was asking how much. Paid back how much?

MR MALARAO:

It was paid –

WINKELMANN CJ:

Because this is all relevant to relief it seems to me, so it's quite good to get it precise. Well it's in the schedules anyway how much they were paid back.

MR MALARAO:

Yes, it's annexure A, response to annexure A, Your Honour, right at the end, the figure of 146,784.35 and the 17,400.

WINKELMANN CJ:

So it's 164,184.35 and did Mr Cooper quantify how much time he spent?

MR MALARAO:

In his brief of evidence he did Your Honour. I think he was essentially working full-time on those properties.

So in terms of Mr Cooper's conflict, Your Honour, the points that are emphasised is that Mr Cooper was aware right from the outset of this plan that there was going to be a $300,000 shortfall and I just want to clarify one point on that Your Honour which is that $300,000 is the nett figure, so the properties were going to have in very round figures, a GST of around $470,000 and then $170,000 surplus if it was applied to it would have meant $300,000 GST. Of course the end position was somewhat different because it was closer to the original, there was no surplus effectively and the position was that the debt for the IRD was larger.

So Mr Cooper was in a position of conflict and he had his personal guarantee at stack, his wife had provided a security over $200,000 investment that she had, there was a guarantee by the Trust as well and the funding from the Trust, I invite the Court to have a look at it from that perspective as well because the Trust had guaranteed those obligations, it had a lot to lose if these properties didn't fully develop, so it was – if everything came to an end at that point in time the Trust was going to lose money.

WINKELMANN CJ:
Yes, okay, so you are saying he was in a conflict from the get-go but those conflicts only mounted as his wife, because it was after that first bright line date, his wife provided a guarantee over deposit and then it was after that that the Trust gave the money, right.

MR MALARAO:
So because he was in a position of direct conflict with his duties as director, Mr Cooper does, under cross-examination, does say that he wanted to do everything possible to protect and to extinguish his personal liability, to ensure that his wife didn't lose her investment and the bank didn't enforce against the trust's assets. I invite the Court to contrast that position against what an independent director would have done in that type of situation and it's respectfully submitted this is not a counsel of perfection, it's just simply a good way of testing out what an independent director would have done had an

independent director in this same situation, without the conflict, wouldn't have thought that racking up tax debts without agreements with the creditors affected would be a good idea and in the best interests of the company and of course in terms of Mr Cooper's actions, they have to be viewed from the prism that at this stage the company had actually well and truly got within a state of insolvency and the authorities are quite clear that once that point is arrived at directors have to consider the interest of creditors.

WINKELMANN CJ:
Yes we've got that.

MR MALARAO:
The next point Your Honour is that even – this is a case where a salvage plan wasn't really a salvage plan in the normal sense of the word, in the sense that there is a prospect of coming out the other end and having a functional company that continues to trade.

WINKELMANN CJ:
I think we've covered that, so is there anything additional you want to say about that?

MR MALARAO:
No Your Honour.

WINKELMANN CJ:
I mean but you are saying more than that, it's not only that it didn't have a prospect of trading at the end, it wasn't even a conventional solvent sort of liquidation, informal liquidation was it, because it didn't see everybody paid at the end.

MR MALARAO:
Yes.

WINKELMANN CJ:

Mr Hucker may have something else to say about that of course but that's just what your submission is.

MR MALARAO:

Yes and a large, this moves to the next point that I had Your Honour which is a large part of the defence and the question of reasonableness or Mr Cooper's action is on the respondent's case to be viewed in light of the "advice" that Mr Furlong gave and on that point, I'm at paragraph 5.18 of my written submissions and I won't labour the point because I'm conscious of the time but paragraph 5.18 to 5.27 covers off all of the submissions I want to make on Mr Furlong's evidence which is that essentially Mr Furlong's role in all of this was an extremely limited role and care has to be taken to see precisely what the findings of fact the trial Judge who heard both Mr Cooper and Mr Furlong give evidence had found on these points and so just on that I want to just briefly turn to what Her Honour Justice Hinton actually found and that's at tab – it's in the pleadings folder at tab 12 and I invite Your Honours to turn to paragraph 59 and the point I am going to try and make Your Honours is that on most of the contested parts of the evidence because Mr Furlong's and Mr Cooper's evidence were at quite considerable odds with each other. On most of these points Her Honour Justice Hinton found in favour or preferred the evidence of Mr Furlong on this point. The first point on that was that Mr Cooper, this is at paragraph 59, Mr Cooper gave evidence that Mr Furlong never pointed out the IRD deficit of $300,000 and apparently had said that GST could be used for cashflow and either paid later or negotiated with the Inland Revenue Department and Her Honour makes the finding that the statements were very inconsistent with a vagueness somewhat shifting between Mr Cooper's evidence and his counsel's submissions.

WINKELMANN CJ:

But critically she says, finds at 63 that really it's not the kind of advice he was giving that section 138 contemplates because he's really telling him what's going to happen when these people aren't paid, so the consequence of not complying, not that he would comply.

MR MALARAO:

Yes and on this $300,000 point Your Honour, it's at paragraph 13 of Her Honour Justice Hinton's judgment. Effectively Mr Cooper got found out on this point. What happened at trial was that there was a late application to, for the affirmative defence of section 138 to be run. That was ultimately allowed by Justice Hinton, but it was done during the course – sorry, part of the evidence that the respondents wanted to respond with was some evidence that had been obtained from NZICA about a complaint that Mr Cooper had made to Mr Furlong, and when that evidence eventually came out it pointed out some letters that had been written and Mr Furlong in his defence said, I very much pointed out the $300,000 figure to Mr Cooper and then what is telling for Justice Hinton was that in Mr Cooper's lengthy reply to Mr Furlong's letter he doesn't take issue with this proposition that the $300,000 was discussed, so Mr Furlong's evidence was preferred, and then it gets preferred on a number of other occasions as well.

The high point for the respondents is the finding that Mr Cooper did use language such as it might be okay or the like, I'm just trying to find the particular reference.

WINKELMANN CJ:

It's referred to in that part, 59, isn't it?

MR MALARAO:

Yes.

WINKELMANN CJ:

Oh maybe not. But in any case, yes, we have the, I think it's well set out in the judgment.

MR MALARAO:

If I could turn now to paragraph 10 of my written outline Your Honours, because it really develops the submission that is in the written submissions as

opposed to merely summarise it. But this is the point regarding the Court of Appeal erred in applying section 135.

WINKELMANN CJ:
I think we'd already dealt with that Mr Malarao? I thought we were on 131?

MR MALARAO:
I hadn't actually dealt with 135 Your Honour, I talked about it in terms of the options that were available, but I just want to briefly, if I could, just address 135, and it's really not much beyond the point made here, which is that it's this ongoing – well first of all, this isn't a case of substantial risk of serious loss because the serious loss was inherent in Mr Cooper's plan as at November 2012.

WINKELMANN CJ:
I think we really have covered this. We've gone through it quite a bit. That in fact his plan contemplated, so it's not just recklessness, it was known is your submission isn't it? By all means take us to anything additional but is your submission simply that the evidence established that Mr Cooper knew that even if he traded through his plan showed a shortfall to IRD. Is that your submission?

MR MALARAO:
Yes, and there was one slight addition to that, Your Honour, that I wanted to make, by reference to a couple of the authorities, which is that the authorities have discussed this idea of a salvage plan, and on that point I just want to go to the *Re South Pacific Shipping Limited (in liq); Traveller v Löwer* (2004) NZCLC 263,570 (HC) decision which is at tab, this is the first instance decision of Justice William Young. It's at tab 19 in the second volume of my bundle of authorities. I invite Your Honours to go to paragraph 125, it starts at page 21 of the judgement, but if I could get Your Honours to turn to page 22 and look at the point that's, towards the top it's got the number 3 next to it, and in this judgment Justice William Young is discussing this notion that the Court has, "It is not suggested that a company must cease trading the

moment it becomes insolvent… as such cessation of business might inflict serious loss on creditors and where there is a probability of salvage… be regarded as unnecessary." But warns that it's maybe a matter of only months that it is given.

The point there, Your Honours, is that it is probability of salvage, but that is far removed from this particular case because there was really no realistic probability of salvage. I'd earlier taken Your Honours to *Fatupaito v Bates* on this point, paragraph 77 and 78, where His Honour Justice O'Regan made essentially the same point which is that even when you're going down the salvage path, you've got to be very careful with what you do.

I want to just briefly now turn to the responses to the annexures that my friend had to his submissions. So this is the document that's attached to the back end of my oral outline, and it's the last page which is the appellants' response to annexure B. This isn't a large part of the appellants' case at all. What I'm trying to here, Your Honours, is to show that had there been a sale of these properties that Mr Cooper himself had done, on the figures my friend says that the figure is $909,927.91. We say that there are certain errors in that and the errors are characterised by two things. One, ignoring the first one, the first is an adjustment for the sale price of 28b Coby Sydney Drive, and then for the two Penrod properties there was money that actually came out of those properties, they went to Debut and were essentially ploughed back into developing the properties, so we say that wouldn't have happened in this notional scenario in October 2012, so those really shouldn't be deducted. So then that –

WINKELMANN CJ:

Sorry, that's at which note in your schedule? Your adjustments, you explained your adjustments in the notes, so what note in the schedule are you at?

MR MALARAO:

That is note 3 Your Honour.

WINKELMANN CJ:

That's a dollar adjustment.

O'REGAN J:

Note 4 it must be?

WINKELMANN CJ:

It's note 4 is it?

MR MALARAO:

Note 3.

O'REGAN J:

Note 3 just says "ibid".

WINKELMANN CJ:

Note 3 simply says "ibid".

MR MALARAO:

Is Your Honour at –

WINKELMANN CJ:

We're in your schedule to your oral submissions.

MR MALARAO:

Yes, but the response to the annexure B, so it's the last page.

WINKELMANN CJ:

Sorry, right. Note 3. Right, so is there anything else you want to take us to?

MR MALARAO:

No Your Honour. Finally on the point, before I get to compensation, just one last look at the authorities. I said earlier that I'd take Your Honours back to *Mason v Lewis* so I'll take the opportunity to do so. It's in my first volume of my bundle of authorities at tab 11. The broad submission, Your Honours, is

that finding Mr Cooper in breach of his obligations in this case is not going to risk the Court being seen to be deterring responsible directors from taking business risk, because the dicta is already there and it's clear. I want to start at paragraph 47 of *Mason v Lewis*, work through it over the next four paragraphs relatively quickly. The first point to highlight is that in respect of the *Nippon Express (NZ) Ltd v Woodward* (1998) 8 NZCLC 261,765 decision of Justice Anderson, His Honour makes the point that the equivalent of section 135 under the 1955 Act would not be breached, "Until disclosure of a large debt made it clear that the company was hopelessly…" trading, and then talks about the period before that disclosure happens and says, if you're going to carry on trading with few assets, there must be some risk to creditors, but we're talking about a substantial risk of serious loss. It's in the next paragraph Ross talks about what the phrasing "substantial risk" means. The next paragraph –

WINKELMANN CJ:
Are you in *Mason v Lewis*?

MR MALARAO:
Yes. Paragraph 49. And paragraph 49 talks about the distinction that's been drawn in the authorities about legitimate risks, and 50 I've already taken Your Honours to, which is that it's an objective test.

WINKELMANN CJ:
Do you say the Court of Appeal didn't apply it as an objective test? I mean what do you say, why are you taking us to this?

MR MALARAO:
Why I'm taking you to it, Your Honour, is that applying this test is not going to set the bar – sorry. Upholding breach in this case is not going to be setting the bar too high.

WINKELMANN CJ:

Well do you say the Court of Appeal applied an objective test, and just got it wrong, or do you say that they really applied a subjective test?

MR MALARAO:

The Court of Appeal didn't apply an objective test, but I want to explain what I mean by that Your Honour, which is that the Court of Appeal took into account factors of the situation that Mr Cooper found himself in, and had certainly had some sympathy for the predicament that he found himself in, and those factors have gone into its calculus of the breach question, as opposed to the compensation question.

I finally turn, Your Honours, to the question of compensation. The appellants' submission is that compensation should respond to the manner and the breach of the ongoing trading. The net deterioration test maybe the most appropriate approach when the breach is characterised by a director burying their head in the sand and as that is the compensation yardstick that best responds to the breach, but where the breach is characterised by a director taking on liabilities they shouldn't have taken on, the compensation yardstick should focus on the quantum of liabilities –

WINKELMANN CJ:

I mean isn't that fudging up more than somewhat the entire statutory framework because it's all, they shouldn't have taken it on if they're breaching section 135. They shouldn't have made the payment of their in conflict of interest. They shouldn't have incurred the liability unless they had a reasonable basis to believe they could pay it. So say that's somehow different to burying their head in the sand, isn't that quite a difficult argument for you to make?

MR MALARAO:

Yes, Your Honour, what I was meaning by that reference is that in the authorities there is quite a large line of cases that are typified by a situation where a person's company is just not trading profitably enough, and every

month they're falling further and further behind with their GST and their PAYE and the like and other trade creditors, and in those kind of situations the net deterioration test may be the most appropriate. That's the point I was trying to make.

WINKELMANN CJ:

But where, it's here, knowingly going ahead, are you saying that this is different because he knew that the IRD was going be in a shortfall situation anyway?

MR MALARAO:

Yes Your Honour and Justice Hinton approaches it from that perspective. She looks at what the breach was and then assesses compensation that responds directly to the breach that had occurred. That's the submission we're making.

WINKELMANN CJ:

So how to respond ?

MR MALARAO:

How the Court should respond, Your Honour, there are two effective options that the Court had in my respectful submission. One is the approach of Justice Hinton, which is the approach I'm advocating for, that is the most clear example of responding to the breach. Another option that's available in the event that the Court finds that the section 131 best interest was breached, is to have a look at the benefits that were derived by Mr Cooper and assess it on that calculus. That would result in a higher payment Your Honour.

WINKELMANN CJ:

Yes, I –

GLAZEBROOK J:

And you haven't cross-appealed so –

WINKELMANN CJ:

Yes, so that's not available.

GLAZEBROOK J:

You can't, that's not available.

MR MALARAO:

No, and I'm not doing that, I'm seeking to uphold Justice Hinton's decision.

WINKELMANN CJ:

How would you characterise Justice Hinton's approach?

MR MALARAO:

Justice Hinton's approach has just looked at the breach and then found what liabilities shouldn't have been incurred and effectively she goes through something of a sentencing exercise in the criminal sphere by taking into account various mitigating factors. She takes into account first of all that the GST debt that Inland Revenue proved for, included the GST for 2 and 7 Karika, on which, in respect of which Her Honour gave a pass to. So she took the GST in relation to those figures out. Then that arrived at the figure of 316,000. From that Her Honour takes $80,000 for the Trust's contribution, and Mr Cooper's personal exertion, and then Her Honour adds back in a certain component of interest and penalties which she has taken out of her initial calculations.

WINKELMANN CJ:

I mean should interest and penalties be in there? Why should they be in there?

MR MALARAO:

In my submission, Your Honour, it should be because interest and penalties is legislated for and therefore in terms of the compensation question it should be there. I agree with the –

WINKELMANN CJ:

But if you'd had your way and they complied with the statutory duty then there'd be no interest in, there'd be no compensation, no, penalty, would there?

GLAZEBROOK J:

No, but you'd have had the money upfront that's why there'd have been no penalty or interest.

WINKELMANN CJ:

No, I mean in place of a liquidation.

MR MALARAO:

Well Your Honour Justice Lang actually in the *Goatlands (in liquidation) v Borrell* (2007) 203 NTZC 21,107 (HC) case was confronted with this very point and His Honour going go to the conclusion, after having some initial reservations on it, which is that for assessing the section 135 and 136 breach that interest and penalties shouldn't be a part of the calculus there, because obviously it's the counterfactual which is these things shouldn't have happened. But then in terms of assessing the level of contribution that is to be made, interest and penalties can form a component in terms of the starting figure from which the compensation should be calculated.

WINKELMANN CJ:

Right, so we really probably do need to move on to Mr Ebersohn, but just before we do you were going to address the Trust's GSA.

MR MALARAO:

Yes, Mr Shakelton, with Your Honour's leave, was going to address that Your Honour.

WINKELMANN CJ:

Yes.

MR SHACKLETON:

Yes may it please the Court. I'll try and make my points concise in relation to this issue given the timing but from the appellant's point of view they don't see this issue as particularly complex and quite discrete. Section 299 of the Companies Act obviously provides quite a wide discretion for the Court to set aside a security, having regard to the circumstances in which the security was created, the conduct of the related party and any other relevant circumstances and the appellants place some focus on the last part or the last criteria in that list.

I should say just before I jump into my submissions, I just want to make a preliminary point that the appellants obviously, well the Hinton's judgment only sets aside the GSA in respect to the judgment, it's no wider than that. The Trust's security position obviously vis a vis any other tangible or physical assets that the company has, has been maintained but I just want to make the point that in seeking and obtaining this order, the position at law as to what a secured creditor's security interest attaches in respect to sort of recoveries by a liquidator is not entirely settled. The position is much more settled in respect to a voidable transaction case where there is authority but essentially this is only a claim that a liquidator can bring and such that a secured creditor wouldn't be entitled to those proceeds. I don't see the law being settled in respect to a GSA, so the only point I make is I wouldn't want the appellant's submissions in respect to this to be seen as an acknowledgement that the GSA attaches to the compensation for director's duties but rather that the appellants are obviously, have sought the order to ensure that this issue doesn't arise and that it's protected in respect to the compensation awards.

Your Honour, the appellants arguments in respect to what is just and equitable is fairly straightforward. In respect to the claim for breaches of director's duties, the liquidators have brought this claim for the benefit of the company's unsecured creditors. Any compensation which this Court or the compensation that's been awarded is assessed by reference to the losses to the company measured by the losses to those creditors. The appellants would say they would ultimately frustrate the process of the liquidators

bringing a claim, pursuing judgment against Mr Cooper as director. If Mr Cooper or Mr and Ms Cooper as trustees or the Trust were able to claim the benefit of the judgment through the GSA and ultimately directly or indirectly return that money back to Mr Cooper. In my submission that must be the case and it was obviously a key reasoning in Hinton J's judgment. Also important in Hinton J's judgment is –

WINKELMANN CJ:
Justice Hinton.

MR SHACKLETON:
Sorry.

WINKELMANN CJ:
That's all right, I understand how it happens.

MR SHACKLETON:
Justice Hinton's judgment, is her findings that having heard the evidence of all the parties that, her findings that the Trust, if not the alter ego of Mr Cooper, was a closely related third party and she makes the valid point that it's unlikely that the Trust itself would have brought any proceeding against Mr Cooper and indeed it hasn't been suggested at any stage that that has happened. Secondly, of course importantly, the Trust has not sought to claim in the liquidation, such that any losses that it says are caused by breaches of Mr Cooper's director's duties haven't been included in the compensation sought by the liquidators.

The appellants also see, and this is I guess not directly recorded in Justice Hinton's judgment, the following two factors are also relevant in terms of a consideration of what's just and equitable and the first of those is of course Mr Cooper's knowledge, in causing the Trust to advance these funds to the company. He was well aware of all the facts giving rise to what the appellants say were the breaches of his director's duties. He was aware of obviously the shortfall at the end of the proposed sales process, he was of

course aware of the ongoing cost overruns and the, you know, ongoing deterioration in the financial position at all times.

Secondly, in the wider circumstances of course, that in April 2013 the Trust also provided a guarantee to BNZ in respect to BNZ's lending and from that point the Trust itself also in continuing to advance the funds to the company, had a vested interest in those last properties being completed because if they weren't completed, then the BNZ wouldn't be repaid and obviously the Trust would be liable under its guarantee.

It's acknowledged Your Honours that the other, I guess applications under section 299 that have, you know, have come to the Higher Courts, have dealt with an attempt by the director to secure past advances but in my submission that simply reflects the cases that have come before the Court. It doesn't in any way limit the weight I guess of the appellants' submissions in this particular instance.

I think it's, in the appellants' submissions, Your Honour, it's also important not to place any weight or too much weight on the submission that the Court's judgment in this regard will have some sort of adverse deterrent effect. I mean looking at the decision as it stands, I mean this is a case where the Court has set aside a security interest granted to the director's family trust. Certainly in my submission, you know, it should give no cause of concern or doesn't have any application to say an arm's length funder such as a bank. In terms of deterrence or some sort of commercial effect, in my submission it also can't be reasonably suggested that any arm's length lender lending to a company is valuing its security in any way on what compensation it might get for a claim for breaches of director's duties.

WINKELMANN CJ:

But it really turns then on your analysis on this being a related party. It's really an interest of the very director who is being held liable for breach of the duty.

MR SHACKLETON:

Yes Your Honour. I mean that's certainly the key part of the appellants' case and not just that it's a general related party, that in fact it's the director's own trust and Hinton J's findings in respect of –

WINKELMANN CJ:

Justice Hinton's findings.

MR SHACKLETON:

Justice Hinton's, I apologise Your Honour, Justice Hinton's finding in respect of it being either the alter ego of Mr Cooper or a closely related party haven't been disturbed by the Court of Appeal and nor do I see them challenged in my learned friend's submissions. Unless the Court has any questions I think that summarises the appellants' position in respect to that.

WINKELMANN CJ:

Thank you Mr Shackleton.

MR SHACKLETON:

If the Court pleases I'll pass you back to Mr Malarao, if the Court has any final questions?

WINKELMANN CJ:

Have you finished Mr Malarao?

MR MALARAO:

I'm finished.

WINKELMANN CJ:

Right, yes thank you, so it's Mr Ebersohn now thanks.

MR SHACKLETON:

As the Court pleases.

MR EBERSOHN:

Your Honour, as I am mindful of the fact that the Attorney as the Intervener and the time constraints, and so unless the Court wants me to address an issue, I only intend to address three points very briefly in passing. The first relates to the Intervener's, the Attorney's submissions at page 13 where the Attorney sets out the duty to consider the interests of creditors. At paragraph 53, the submissions say, "The duties in the Act are reconciled by reading them together." Now this is a significant difference between the Attorney's submissions and the view expressed by the first respondent and essentially what the first respondent says in his submissions, looking at the Law Commission's report saying it really needs a hierarchy of duties and then it uses that hierarchy to say that the duty, the interest of the company section 131 to act in the interests of the company overrides, well it doesn't use the word "overrides" but effectively overrides the other duties, 135 and 136 and he uses that to read down 136.

What I would like to do is attract the Court's attention essentially to paragraph 52. I would have made this not in a footnote but for the fact that I did not fully appreciate the extent, at the time of writing this, that my learned friend would be making this point and I simply note in that footnote that at first glance the duties can appear to conflict with each other and I quote there one of the quotes that my learned friend relies on from the Law Commission which says, "The Commission also remains of the view that a coherent set of provisions governing director's duties must involve some form of ranking of those duties to avoid a confusion." And then it goes on to say, "Therefore the Commission has provided a hierarchy of duties."

And I go on then to note in that footnote that it is important to keep in mind that what was enacted and what was suggested by the Law Commission is not the same and those bullet points which go onto the next page that follow, set out some of the differences. Those differences include the words "the fundamental duty" was removed and the section dealing with the hierarchy which if you turn the page was section 103 of the Bill which the Law Commission drafted was also removed which basically said that the other

duties can be taken into account or provided they are not inconsistent with the fundamental duty which is a duty.

So if I may, and I have given this to my learned friends, I came across very recently an article written by now Justice Goddard, then just Mr Goddard, on this very issue, if I can hand this up to the Court.

WINKELMANN CJ:
Yes thank you.

MR EBERSOHN:
Now Justice Goddard worked at the Law Commission at the time that the report was done and this is now some years later because it was in 1989, this is some years later, in 1988 I think when this article was written, maybe '97.

WINKELMANN CJ:
1998 it was published anyway.

MR EBERSOHN:
1998 and if I can take – and he sets out some of the issues, some of the experiences from that company law reform. If I can take Your Honours to page 240, he has a heading there which deals with the change that took place on the right-hand column, two-thirds of the way down, he's got the heading, "Legislation is introduction substantially rewritten with serious flaws." And he goes on to say, "In the meantime the law reform division of the Department of Justice was working on a Bill for introduction in Parliament based on the Law Commission's initial draft. This was point at which the process became unstuck. The relationship between the division of the Commission was at the time rather strained. The Commission had worked to involve the division adequately in its work on the company law", sorry, "Had failed to involve the division adequately in its work in company law. The division in turn jealously guarded its role as a source of advice to the Minister on legislation", and so it goes on.

It goes on to criticise the division for not having a good understanding and for drafting a Bill and an Act which he said was irreconcilable with the original policy.

Now if we page on slightly to page 246, he's got a heading which is headed, "Drafting mistakes and policy error", and about half way down, just before the different numbering he says, "I do not have time to go through in any detail all the lesser policy decisions in this Act which are in my view simply wrong. In this category I would place…" And then at 5 he says, "The extraordinary provisions imposing liability into directors where decisions create a substantial risk of serious loss to the company's creditors or if transactions entered into without the director having reasonable grounds for believing the company will not be able to perform the obligations when it is required to do so." Now really that was the only purpose of bringing in this article was to make the point that what was enacted and what the Law Commission is referring to are not the same.

Now a lot of the concerns which Justice Goddard was referring to had to do, and were later addressed, by Justice Young in I think it was *South Pacific*, where he spoke then of illegitimate and legitimate business risks and brought those in which don't appear expressly in the words of the Act but was addressing those very concerns and there were a number of articles written at that time and *South Pacific* came up pretty much at that time of Justice Goddard's article.

Now the point simply is that the only way of reconciling the various provisions that section 131, 135 and 136 is that set out in the quote from Westlaw in the submissions at 14 and that is looking at what interests the company represents at the various times and so generally the best interests of the company are the shareholders but in cases of solvency or near insolvency, it is the company. Now I am not going to cover that in any more detail, it was just –

WINKELMANN CJ:

Can I ask you a question about section 136, can you just say what you say is the point of section 136, given section 135?

MR EBERSOHN:

I think 135 is aimed at general trading, 136 is at particular obligations. It's 136 which protects for example in the winding up the Attorney would say the new creditors such as in this case, in the sense that it requires you not to just look at the general trading, not just to have a consideration of the general body of creditors, but in fact to avoid a situation where you can in fact rob Peter to pay Paul which is the quote put into the submissions.

Now in *Peace and Glory* the Court put in its judgment the quote, I can't remember the professor's name now but it was to do with capital individual transactions as opposed to general trading. I would agree with that quote, save for the fact that I think the capital, bringing in the word "capital" is a bit misleading because it's not a revenue capital context but it's rather focussed on particular transactions.

WINKELMANN CJ:

What I had in my mind was I could see how this could be a positive protection. So for instance if you carry on, you decide to take a risk because you have a plan and you are going to put in place procedures to protect new creditors, you might for instance create a situation where funds that come in are put in a trust account for those new creditors. So even though the company may be overall insolvent, you've got reasonable grounds to believe that those new creditors will be paid.

MR EBERSOHN:

Yes, that would work in that scenario.

WINKELMANN CJ:

But that would address the risk under section 136.

MR EBERSOHN:

Yes.

WINKELMANN CJ:

But I was trying to identify a situation where an individual creditor would be exposed but the general body wouldn't be under section 135 and you don't say that is.

MR EBERSOHN:

So a situation where?

WINKELMANN CJ:

So where you might be liable to a creditor under section 136 but not otherwise liable under section 135 and you say that's not the case, you wouldn't have that.

MR EBERSOHN:

Yes, I think that would be true in most cases. I think that if you took away 136, so you might have a scenario where you could make an argument that the general body of creditors would be better off in for example in a winding up process as my learned friend makes and 136 is really a backstop which prevents that sort of argument, saying you can't essentially know or at least not have reasonable grounds for not knowing otherwise that a particular person is, you know, going to be paid. You've got to be able to say reasonably that that person is going to be paid.

GLAZEBROOK J:

Well you couldn't, for example, say well all of my existing creditors are going to be better off for me continuing but I'm going to incur a new debt in order to make sure that happens, knowing that that person's only going to get 50 cents in the dollar.

MR EBERSOHN:

That's correct, and I think that's –

GLAZEBROOK J:

Along with all of the other creditors who would, instead of getting 25 cents per dollar, get 50 cents per dollar and some are going to be better off.

MR EBERSOHN:

Yes, in this case, in the High Court judgment at paragraph 7 Justice Hinton makes a point that was not disputed at court that the company was cash flow insolvent, or I think it was balance sheet insolvent from 2009, I think it was. The events took place in October/November, the sort of point at which closing down the business, 2012, and she also makes the point, I think it's paragraph 10 of the judgment, that the director had no faith, I think it was the word "faith", that he could trade the business out of the problems that it had. So what we have is very much a case of a winding down. It's really the beginning of liquidating the business and in those circumstances you simply can't say it's sufficient, especially if it's going to take a period of time, you can't say that new creditors will not be prejudiced, and in fact if you look at the proofs of debt, and some of them are at, I can give you a reference, it's at 309.1987, there's a document there of about 48 pages in length.

WILLIAMS J:

Could you just give me the last number. 309 dot?

MR EBERSOHN:

1987, and as you page through them you'll see the different invoices, I also attach the proof of debt. So, for example, at page 22, I'm just picking, in fact let's start at the first one. At page 7, page 9, they've got an invoice from Kitchen Designz and the date of that is 31 October 2013, and all the dates of the unpaid creditors are towards the back end of 2013 and 2014. So these are effectively new creditors coming in, and although they are for relatively small amounts compared to Inland Revenue, it does illustrate the point that it is very much a case of robbing Peter to pay Paul. I'm not going to –

WINKELMANN CJ:

Because it seems to me that there is an underlying philosophy in the Companies Act that once you get into the situation of insolvency, where you know you're not going to be able to pay everybody, then the Act wishes an orderly disposition of the assets to occur. That's the intent of the Act. It should no longer be up to the directors to decide who's going to get paid and who's not.

MR EBERSOHN:

That's correct and it's also to protect, and you see this in liquidation on receiverships or administration, and to protect the new creditors, so that the winding up process, as Your Honour says, is orderly. Now there is, the second point that I wish to – that really wrapped up the first and the second point, but the third point that I think I should deal with is a point that my learned friend made in his written submissions, but I didn't fully appreciate the significance of until I read his oral submissions this morning. So I'll comment very, very briefly on that. In his oral submissions –

WINKELMANN CJ:

This is Mr Malarao's submissions?

MR EBERSOHN:

No, no, Mr Hucker's oral submissions. I assumed that the Court already had them.

WINKELMANN CJ:

Have we got those?

O'REGAN J:

No we haven't got them yet.

WINKELMANN CJ:

No we don't have them.

MR EBERSOHN:

No, no, that's fine Your Honours. The point is made. Now I can talk to it very briefly though. My learned friend is going to make a point that there's a temporal element to section 136 and what he's, well this is based on an English case called *Hawkins & Ors v Bank of China* (1992) 26 NSWLR 562, and in that case the directors had entered into guarantees some period prior to the company's problems, and so the company was a, there was a contingent liability essentially for the company under the guarantees, and then the company got into trouble and the claim was made, well you entered into these obligations at a time, or the obligations came home at a time when the company couldn't pay his debts, and therefore somehow the directors were liable. The Court goes and says, no, with the guarantees, with such liabilities you have to look at the time the actual guarantee was entered into, and that makes a lot of sense because obviously that's when the directors are taking the positive steps. My learned friend is then going to tie that into GST by saying there's a liability to pay output tax as soon as the property is acquired. So it's a contingent liability. So the time you should be assessing 136 is not the time that a property is sold but when the contingent liability comes into effect, which is at the time when you acquire the property. Of course the effect of that is that you don't have to consider the GST component under 136 at all in November 2012. That was effectively the way it plays out.

WINKELMANN CJ:

Why do you not?

MR EBERSOHN:

No, this is –

WINKELMANN CJ:

No, but on Mr Hucker's argument why do you not at that date?

MR EBERSOHN:

Because it was a contingent liability – the theory is that once you buy a property, and you claim an input tax credit, it's part of your taxable activity,

and therefore if you sell the property, it's a given that there's going to be an output tax paid. Likewise, if you change the use or –

WINKELMANN CJ:

I understand the argument but why, if you have to take into account at the time it's incurred, which is when the properties are purchased, why isn't the company insolvent at that date?

MR EBERSOHN:

Well when a property is purchased, like several years earlier, and it's, several years earlier might be before –

WINKELMANN CJ:

Right. On Justice Hinton's analysis it wasn't insolvent until November 2012, but if the liability –

MR EBERSOHN:

Well, no –

GLAZEBROOK J:

Balance sheet insolvent.

WINKELMANN CJ:

Balance sheet insolvent.

MR EBERSOHN:

Yes I mean she made a cut-off of November, I think it was the date of the meeting, I think it was –

WINKELMANN CJ:

2012.

MR EBERSOHN:

November 2012, I think it was about the 4th or 5th 2012.

WINKELMANN CJ:

I'm just saying if she's brought home liabilities –

MR MALARAO:

Yes.

WINKELMANN CJ:

– at that earlier time it might have been more clearly –

MR MALARAO:

Well –

GLAZEBROOK J:

Clearly not cash flow –

O'REGAN J:

But it wasn't a liability. Your point is that it's not a liability.

MR EBERSOHN:

It's not a liability. First of all it's not automatic that from a GST perspective that once it's brought into the taxable activity GST will be paid, that's mostly the case once you acknowledge. Depending on the good, in this case was land, really the only way tax wouldn't be paid, or would be payable was if it was sold for zero-rated, in which case the tax would be calculated as zero-rated and that's covered in the submissions in one of the footnotes, but that essentially is when one property developer sells to another property developer. With perishable goods, of course, if they perish there's no GST payable because the goods just cease to exist, or goods can often be consumed in other goods and then sold, which is part of the manufacturing process. But the bigger reason, I think the more important reason is that these cases such as the guarantee is based on the fact that the director's decision, which is being impugned, is made earlier. It's made when the guarantee is signed and therefore you can't – it's artificial if in this case the director had signed a guarantee in 2005, for example, when the company was

formed, it would be artificial in 2012 to visit that liability to him when he's taken no further steps, it's just that something else has happened and now the company is liable in terms of that guarantee.

With GST you still have to actually take, the director still has to take active steps. He still has to, the company still has to sell the properties, and for that reason the Attorney would say that the point that, or the distinction that my learned friend makes in his, or will be making is not a correct position to take.

There probably is one last thing I should just mention before I sit down and that is that it struck me reading the written submissions that there was a mistake, two mistakes but one is irrelevant, but one which – under the heading, which is on page 21, "What is a director to do?". At paragraph 80 it says, "Other than ceasing to trade at that point in time by selling the incomplete developments or liquidating the company." Well the first portion of that "by selling the incomplete developments" shouldn't in fact be there. It would be crossing what Justice Glazebrook referred to as the bright line test, and which is set out in these submissions, so it should really just read, "Other than ceasing to trade at that point in time, or liquidating the company." Of course there are the other options which are mentioned at 82 which is voluntary administration, but I just wanted to point out that paragraph doesn't, in fact, accurately reflect what I was trying to say when I wrote it.

Those are the primary points bearing in mind that this is not the Attorney-General's case and we need to brief. So unless there's anything the Court would like me to address I'm going to…

WINKELMANN CJ:

No, thank you Mr Ebersohn, that was very helpful. Mr Hucker, after lunch?

MR HUCKER:

Yes Your Honour. Would it be helpful to hand up the outline oral argument at the moment Your Honour?

WINKELMANN CJ:
Yes it would, thank you.

COURT ADJOURNS: 1.01 PM

COURT RESUMES: 2.18 PM

MR HUCKER:
Thank you Your Honour. The starting point in my respectful submission is to assess the commercial decisions that were made by the director in this case and the two relevant commercial decisions were whether to complete the three partially completed houses, one of which was near completion and two of which had significant work completed on them. The second decision was to sell down the remaining properties and the land.

And the first respondent's submission is that this is in reality a case that does not go beyond what the reasonable limits on salvage are in the context of the winding down of the affairs of the company. It is pleaded at paragraph 107 of the statement of claim that what the director should have done is to place the company into some form of insolvency administration in November 2012. If the counter action of what would have happened had that occurred is assessed, we are in a position where there still is no resolution, even if a liquidator had been appointed as to those two key commercial issues, to complete or not complete, to sell or not sell and the liquidation or administration of Debut Homes in October 2012 and of course administration is a remedy that was only introduced after the enactment of the director's duties under the Companies Act, the same decision would have had to have been made, should the liquidation have attempted if he could to sell the sections on an as is where is basis and it is by no means clear that he could because the cost to complete would have become a cost of the liquidation.

WINKELMANN CJ:
Well wouldn't he just have left the secured creditor to sell in those circumstances?

MR HUCKER:

Well that's in effect making a decision to allow those losses to be inflicted on the company and that in my respectful submission would not be in the best interests of the company.

WINKELMANN CJ:

No the liquidator has got a different obligation hasn't he?

MR HUCKER:

Well the liquidator's obligation is under section 253 of the Companies Act and the primary obligation is to realise assets in the most efficient manner.

O'REGAN J:

The voluntary administrator can basically freeze everybody and finish the development in a way that protects the future creditor.

MR HUCKER:

Well if you could find a voluntary administrator Sir, who would be prepared to take on the personal liability because of course the voluntary administrator has a personal liability during that period of time.

O'REGAN J:

But on your thesis it was in the secured creditors' interests to have that occur, to have the properties finished so that they maximised, well they got under their security.

MR HUCKER:

Not only in the secured creditors' interests, everyone's interests because what we would –

WINKELMANN CJ:

Apart from the IRD's.

MR HUCKER:

No with all due respect Your Honour, what we were dealing with here is that there would be a substantial surplus that was intended to be available to the IRD as part of that particular process. The IRD stood to gain greatly by the proper completion of these particular properties.

WINKELMANN CJ:

Well just before you move on to that and that's not what Mr Malarao submitted to us, so we'd be interested to hear how that was the view in November 2012. So if we can just post-it note that. The thing that you have to meet, the argument you have to meet is that your argument is being constructed on the basis that there is room to move and commercial judgments to be made in an insolvency situation.

MR HUCKER:

That's correct.

WINKELMANN CJ:

And then my argument that is made against you is that is not so, the critical issue is whether the threshold in section 135 is met and then if the threshold in section 135 is met, then you proceed to section 301 and all the things you are talking about actually come into the remedy zone.

MR HUCKER:

Well with all due respect those sections are not interpreted within a vacuum and respectfully submitted that it's a matter of ascertaining what is the purpose under the Companies Act, what was the intention of the Law Commission and should this Court continue to give effect to the business judgment rule that's recognised throughout the leading commonwealth and western jurisdictions.

O'REGAN J:

Once you're insolvent it all changes, doesn't it?

WINKELMANN CJ:

So possibly the first question to ask you, we just take us back to the post-it note that I said we should put a post-it note, Mr Malarao submitted that as at November 2012 when the business plan was cast which Mr Cooper then put into effect, that business plan still had the IRD not fully paid.

MR HUCKER:

In terms of the post-it note there, there was a surplus –

WINKELMANN CJ:

Do you accept what Mr Malarao says or not?

MR HUCKER:

In what regard Your Honour?

WINKELMANN CJ:

What I just said to you, which is Mr Malarao said that evidence established that when Mr Cooper looked ahead in 2012, what he was planning to do, the work he had done suggested that once he had run this whole thing through the IRD was still in a shortfall position, not going to be fully paid as GST.

MR HUCKER:

Well at the time, with the affirmative finding of Justice Hinton that Mr –

WINKELMANN CJ:

No I'm asking –

MR HUCKER:

Well I'm endeavouring to answer Your Honour.

WINKELMANN CJ:

I just, I don’t want to cross-examine you Mr Hucker, but it would just assist me if you answered, do you accept what Mr Malarao says or not, and then…

MR HUCKER:

Well no Your Honour because of the finding by Justice Hinton at 78 that Mr Cooper had no idea about the priorities as to how matters worked within the liquidation.

WINKELMANN CJ:

That's a different issue though, isn't it? It's a completely different issue. Did his business plan see everybody fully paid including IRD fully paid its GST?

MR HUCKER:

No Your Honour, but what it provided for was for there to be the completion of the partially completed properties to maximise the benefit for the creditors as a whole of the company to ensure that there was minimal loss to creditors, and any loss to the creditors was minimised.

WINKELMANN CJ:

All right, so it did look forward and still see a shortfall to creditors? It's not a trick question, it's what you've just said, but reformulated.

MR HUCKER:

The reason I hesitate is that the question presupposes that we know ultimately what the sale prices would be for the properties being achieved.

WINKELMANN CJ:

Well he didn't have a plan which saw everybody paid.

MR HUCKER:

He had a plan that saw significant surpluses created and the plan was to negotiate with the creditors afterwards to the extent the company was not able to meet those particular creditors.

WINKELMANN CJ:

Okay, all right.

WILLIAMS J:

Well to negotiate with one creditor?

MR HUCKER:

Well that's because effectively there is a result of the –

WILLIAMS J:

Well, to use his words, to negotiate with the lesser of two evils.

MR HUCKER:

Well that's exactly what the liquidator would have had to have done.

WINKELMANN CJ:

So you accept that his business plan did not see, even at that point in time, debtors fully paid? It's, what you've said you can…

MR HUCKER:

No, I do see it as a debt fully paid because what Mr Cooper said in evidence was that he expected a surplus by completing the partially completed properties, and then he would negotiate thereafter if there were a shortfall to any creditor. That's what the evidence, and indeed that was what the evidence of the, that was the effect of the evidence of the liquidator's own expert in part as to what Mr Cooper should have done in this particular circumstance.

WINKELMANN CJ:

Okay so –

O'REGAN J:

Shouldn't he have negotiated with the IRD first. He was risking their money. He was risking future creditors money. Was he entitled to do that? Was he entitled to basically say I will gamble with other creditors' money to maximise a return to myself and to the –

MR HUCKER:

Well he wasn't gambling with other creditors' money Your Honour because with all due respect there needs to be a comparative analysis of what was the situation –

O'REGAN J:

No, no there doesn't. There's a question of, is he entitled to say I will maximise a return to existing creditors by gambling the money of future creditors.

MR HUCKER:

Well the IRD was an existing creditor at the time so it wasn't future creditors' money being gambled.

O'REGAN J:

No it wasn't.

MR HUCKER:

Well it must have been, it was Your Honour.

O'REGAN J:

No it wasn't. GST didn't arise until he sold the property.

MR HUCKER:

Well it's a little bit like income tax.

O'REGAN J:

No it's not. It's nothing like income tax.

MR HUCKER:

You have a contingent obligation to pay income tax –

O'REGAN J:

No you don't. You have an obligation to pay it when you supply and the contract becomes unconditional.

MR HUCKER:

Well I would respectfully submit, Sir, that I would have –

WINKELMANN CJ:

Well this is your argument, isn't it? This is one of your arguments under section 136.

MR HUCKER:

Under section 136.

GLAZEBROOK J:

Just in terms of saying the liquidator's position would have been the same, in fact it wouldn't have been because a liquidator would have been personally liable to pay the GST, would have paid the GST and the secured creditors would have had less because of it.

MR HUCKER:

With all due respect Your Honour there –

GLAZEBROOK J:

Well there's no all due respect if that is the position.

MR HUCKER:

Well, what if there's not the money in the company for that to be paid by the liquidator.

GLAZEBROOK J:

Well, there will be money in the company because they'll be getting sale proceeds. The GST portion of that will be paid to the IRD by the liquidator because the liquidator is personally liable to do so, and the secured creditors will get less.

MR HUCKER:

Or the trade creditors would get less in this case. The people that are having to pay for the completion of the particular properties.

GLAZEBROOK J:

Well everybody will get less but the secured creditors don't have priority in those circumstances.

MR HUCKER:

Sorry, in what circumstance is Your Honour…

GLAZEBROOK J:

Well if it's a receiver or a liquidator selling, the liquidator and receiver, and I'm not sure about administrator but I imagine the same thing, are personally liable to pay the GST, that will be paid in priority to any other debts because of it being a personal liability and –

MR HUCKER:

With all due respect Your Honour that assumes that you don't have costs of the liquidation because I accept –

GLAZEBROOK J:

Well as part of the costs of the liquidation is paying that. So you're assuming the costs of the liquidation are going to take all of the money including that of the secured creditors.

MR HUCKER:

When I refer to costs and expenses of the liquidation, what you're referring to is the – if there had been a liquidator appointed and if a liquidator had made a decision to complete, all of the unsecured trade debt would have become a cost of the liquidation and that would have ranked pari passu, I accept with the GST debt, that is what the effect of liquidation would have been because as Your Honour quite rightly points out, it's the liquidation who is then completing the partially completed houses at that point in time.

GLAZEBROOK J:

All I was challenging was your assertion that the liquidator, that the situation would have been exactly the same if there had been a liquidation as against this completion and that is just wrong, as you have just indicated.

MR HUCKER:

Well perhaps if I take Your Honour through the steps. Assume the liquidator had decided to complete the partially completed houses.

WINKELMANN CJ:

Yes I suppose we've taken you off path here a bit Mr Hucker because now we're going into hypotheticals, so I mean by all means take us through this if you wish to but if you wanted to give us more of the shape of what you're going to say, you said to date that it's really about two commercial decisions and we've said to you, "Well is it about two commercial decisions and isn't it about whether the section 135 threshold has been met?"

MR HUCKER:

Well the starting point is that it is about two commercial decisions because those are the commercial decisions that are said to be a breach of those particular obligations. The decision to complete the partially completed houses and to sell off those houses is the specifically pleaded breach by the liquidators and if we follow that course through, if these houses had been completed in the liquidation, the liquidator would have entered into a contract with the trade creditors, with the trade suppliers to complete the houses, the liquidator would have had to have paid the council as a cost of the liquidation, all of the costs to complete those houses and yes at the end of the day the liquidator would have had to have paid the GST on that particular transaction but what if the liquidator could not pay any of those expenses or some of the expenses.

WINKELMANN CJ:

It's very hypothetical though isn't it?

GLAZEBROOK J:

But the liquidator wouldn't have gone ahead with that if the liquidator thought that he or she wouldn't be able to pay those expenses. So that would have been part of the decision as to whether it was worthwhile to complete the houses or otherwise worth having a fire sale, wouldn't it?

MR HUCKER:

Precisely and that would be the other side of the coin. That's the other option that the liquidator would have had and that other option would have been for the liquidator not to complete, not to sell and that would have depressed the value of the assets of the company and how can a director's duty require a director to take a step that depresses the value of the assets of the company at the expense of creditors?

O'REGAN J:

I don't think that's what the issue is though. The question is should the director at that point have said I am no longer able to trade without risk to creditors that they will suffer serious loss and so I have to hand over to somebody else, a voluntary, either an administration or a receiver or something else. Basically you get to a point where the director has to face up to a reality of insolvency and leave those decisions to someone else.

MR HUCKER:

With all due respect Sir nowhere it depresses and causes loss to the creditors. Where it causes loss to the creditors, the director does not need to pass that over and we then get into the area –

O'REGAN J:

Well where does it say in section 135 that you can trade with a risk to creditors if you think that a liquidation might be worse?

MR HUCKER:

The two limited exceptions that have been recognised by this Court are firstly the limited exception by Justice Young in *Re South Pacific Shipping* under

125, paragraph 125(3) and also Your Honour's decision in the *Fatupaito v Bates* decision. Your Honour's decision in *Fatupaito v Bates*….
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… paragraph 125(3) and also Your Honour's decision in the *Fatupaito v Bates* decision. Your Honour's decision in *Fatupaito v Bates* at 77 to 78 recognised that there would be circumstances say where a relatively minor amount of expenditure was required to complete contracts or alternatively a minor amount of expenditure was required to be able to, and to be fair to Your Honour, that's paragraph 77 and 78 of Your Honour's judgment, where there is a –

WILLIAMS J:
The difference is the difference that's been pointed out by others and that is that in this case you don't have the kind of warm glow scenario that's been predicted in those sorts of counterfactuals which is at the end of it everyone gets paid because your client didn't think that either, that's your problem and you're really trying to argue that he didn't have to.

MR HUCKER:
No with all due respect Your Honour –

WILLIAMS J:
There's a lot of respect going around here Mr Hucker.

WINKELMANN CJ:
Mr Hucker, you don't need to say "With all due respect".

WILLIAMS J:
We know you respect us and we respect you.

WINKELMANN CJ:

Yes, we're disagreeing with you and you can disagree with us and you don't need to – we assume that you're paying us respect, you don't need to say it.

MR HUCKER:

Thank you Your Honour. Well Your Honour has recognised that there are limited exceptions to Justice Glazebrook's bright line test because the bright line test is in absolute terms as was presented this morning on the case of my learned friend.

WINKELMANN CJ:

Well I mean I think we all agree that Justice Glazebrook has made a good point and the cases make it clear, I mean the test is not a bright line kind of test, it's an assessment, an evaluation to be made.

MR HUCKER:

No but the point is, is that it's in fact not an all or nothing test because it's recognised in *Re South Pacific Shipping* and also *Fatupaito v Bates* that there are –

GLAZEBROOK J:

Well none of which – *South Pacific* is not this Court's decision is it?

O'REGAN J:

No it's Justice Young on the High Court.

GLAZEBROOK J:

In the High Court and I think *Bates* is High Court as well.

MR HUCKER:

I accept none of the decisions are binding on this Court however in my respectful submission the principles articulated in *Re South Pacific Shipping* and *Fatupaito v Bates* in that they recognise that there are limited exceptions to the general rule.

WILLIAMS J:

See I don’t think that’s a right way of articulating the test because the test is belief on reasonable grounds. If there is a plausible, reasonable, sustainable plan by which everyone gets to live at the end, then there's no breach.

WINKELMANN CJ:

That’s not an exception, yes.

WILLIAMS J:

The bright line isn't breached.

WINKELMANN CJ:

Which is another way of saying that *South Pacific* and *Fatupaito* are not exceptions, they're simply an articulation of that rule or an expression of it.

MR HUCKER:

No what Your Honour is articulating is that there are – yes there may be some circumstances but you consider that they ought not to apply to the circumstances in this case.

WILLIAMS J:

Yes, well no I'm not saying that 136 has exceptions, it’s not stated to have exceptions, the question, the grey area, if there is any grey area is about belief and that’s about the quality of the plan at various points, not at the two points you suggest but at the ongoing points, the first point of continuing to complete the developments is not a single point but a daily point isn't it? As things started to turn sour these things sometimes need to be reassessed. Anyway I digress.

MR HUCKER:

The manner in which this case was put by the liquidators in the High Court was that there was no issue with the realisation strategy adopted, no issue with the decisions that were made in terms of the completion of the properties

on a commercial level. The issue put in the High Court in issue, was an issue of financing.

WILLIAMS J:
So you're saying the appellants ran a single point case?

MR HUCKER:
It was a single point case in the High Court.

WILLIAMS J:
Okay fine, fine but the question here where there is room for argument is about belief and the reasonableness of belief.

MR HUCKER:
Well that requires an –

WILLIAMS J:
Your problem is that your client never believed that.

MR HUCKER:
Well that doesn't recognise the limited exceptions in the *Fatupaito v Bates*.

WILLIAMS J:
Yes, so that's where we're disagreeing because I'm suggesting to you they're not exceptions they just make room for reasonable belief on good grounds. Your problem is on the facts unchallenged, your client never had belief on reasonable grounds, he knew someone was going to miss out and it was going to be the IRD because they were the lesser of the two evils.

MR HUCKER:
No but it's a matter of assessing – so is that in the context of 136 Your Honour is referring to or what statutory context when Your Honour is imposing a reasonable belief test?

WILLIAMS J:
Well I'm thinking of 136.

WINKELMANN CJ:
It's both, it's 5.

MR HUCKER:
135 and 136. Well the flipside of it is that you cause commercial paralysis. If you say a director can do nothing to salvage assets and salvage is –

WILLIAMS J:
That's not what I said though.

O'REGAN J:
I don't think it's a salvage if you're not going to come out the other end with everybody being paid. A salvage is when you are in a bad situation, you trade through it, everyone gets paid and then you're no longer insolvent, you keep on trading, that's a salvage. This case was never a salvage.

WINKELMANN CJ:
Yes Mr Hucker, the problem you have is that the Act assumes that once you get into the situation that not everybody is going to be paid, then there are statutory regimes and it is no longer up to the directors to decide how people are paid.

MR HUCKER:
But again for there to be a breach of duty it must be shown, in my respectful submission, that what the director did is different to what the liquidator would do because how is –

WINKELMANN CJ:
That's just not in the statutory scheme. That might have an impact under section 301's compensation but not in terms of whether it was –

WILLIAMS J:

Sorry going back to the – I know we're enjoying firing shots at you from all directions, you may not be, but it's necessary. But if the liquidator came up with a plan that saw one creditor relegated to not getting paid, then the liquidator should probably be looking for a different job.

MR HUCKER:

No that regularly happens in liquidations Your Honour. There's not always 100 percent distribution to creditors in liquidations.

WILLIAMS J:

No but in this case, without having cut a deal, at the time where you are trading yourself down without having cut a deal with creditors such as the IRD, a liquidator who said I have a plan and the plan is the IRD misses out, I haven't spoken to the IRD yet but we will see how we go when the sales are completed, is not a particularly good liquidator I would have thought.

MR HUCKER:

No but a liquidator would say, I either sell the properties or I complete them, those are the two choices that the liquidator has.

WILLIAMS J:

Yes.

MR HUCKER:

You can't get beyond that being the commercial decisions as the Court of Appeal found.

WINKELMANN CJ:

I mean I take you back to the scheme, Mr Hucker, all of us felt what a liquidator might do or might not is quite outside the statutory scheme, the point is that the statutory scheme creates threshold points, at a certain point the decision – at a certain point, it's a test, you can say with all due respect that it's a test under section 135 and it is telling the directors that past that point

they trade at their risk because they are in breach of directors duties and they are liable for a section 301 order to be made against them.

MR HUCKER:

We don’t have the equivalent in the commonwealth legislation dealing with non-payment of PAYE debt and in the commonwealth legislation there is an express provision that provides that if a director does not place a company into liquidation, then they become personally liable for that PAYE debt equivalent. That is the type of statutory scheme in relation to PAYE debt that is in existence in Australia. Our scheme does not have those similar restrictions because our scheme at the point of insolvency still recognises that legitimate risk must be taken because the director still owes the duty to the company under section 169.

WINKELMANN CJ:

But you can't get past the words of section 135 and on the facts as you have accepted them, your client carried on trading when he knew that all creditors weren’t going to be paid.

MR HUCKER:

No what the director did was took the best option to minimise and mitigate loss because the flipside is that if such an absolute rule is provided, there is no incentive for a director to take steps to mitigate loss at the point of insolvency which is quite often difficult to determine.

WINKELMANN CJ:

Well there really isn't any incentive for a director to mitigate loss at the point of insolvency, if it is insolvency in the sense of not being able to pay debts as they fall due because they're on risk then, if it gets worse they're on risk of an order under section 301.

MR HUCKER:

In terms of the director risk, the submission is that it is still a legitimate risk that the director can take and it’s still an assessment of the steps that the

director has in fact taken, otherwise we end up in the situation where we may have commercial paralysis. What if the secured creditor says I'm going to do nothing? What if the –

GLAZEBROOK J:

Well the secured creditor is not going to say that forever because otherwise a secured creditor effectively just increases their loss and their capital that's tied up that. So eventually the secured creditor is going to have to exercise a security if nobody else has. There is no way the secured creditor is going to say well look I'm just sitting here for the next 15 years leaving my money tied up in a property.

MR HUCKER:

But the director can't compel the secured creditor to do anything.

GLAZEBROOK J:

Well no but that's up to the secured creditor then whether the secured creditor actually exercises their security.

MR HUCKER:

Precisely but –

GLAZEBROOK J:

And then if there are unsecured creditors, the unsecured creditors will petition this here to put the thing in liquidation.

MR HUCKER:

And that is the remedy that those creditors have because you create commercial paralysis, even if it's for a temporary period where nothing happens.

WINKELMANN CJ:

This notion of commercial paralysis though is something that's alien to the scheme and I take you back to the scheme. This scheme is constructed

around insolvency and so that's why the avoidable preference, avoidable payment, avoidable security are all a time from insolvency that's a trigger point, the timing of it. You're cutting across it and saying that a company can continue to trade even though the director knows at the end of their wind down, their informal wind down, outside the statutory schemes they won't see all creditors paid which would actually defeat much of the scheme of the legislation.

MR HUCKER:

Well that's not what the Law Commissions said at 138 and 139. The Law Commission at 138 and 139 said that it's a question of reasonableness once good faith is established.

WINKELMANN CJ:

Can I just ask you what's 138 and 139?

MR HUCKER:

I can refer that to Your Honour in the materials.

WINKELMANN CJ:

You mean that's paragraphs 138 and 139?

MR HUCKER:

Paragraphs 138 to 139 of the Law Commission report.

O'REGAN J:

That was about their draft Bill though wasn't it?

MR HUCKER:

Yes it was but nevertheless still the principles within the Law Commission report have largely been incorporated into the Companies Act 1993 in terms of how that operates.

GLAZEBROOK J:

Well there is a reasonableness though in section 135 and 136 in any event, so it certainly is reasonableness which is why I think Justice Williams was saying it's not an exception the *South Pacific* or the *Bates* because it's saying well if you've just got minor expenditure or if it looks as though it's good on a practical basis in that you are going to get out of this, then you can carry on, it's not a sort of as soon as you are a dollar over that's it.

MR HUCKER:

Well Justice Young went further in *Re South Pacific* in my submission in paragraph 125(3) and Justice Young went further to say that it is permissible to continue to trade for a limited period where it avoids the crystallisation of otherwise unavoidable losses. That is the principle that in my submission section 135 and reasonableness is assessed against. So Justice Young has gone further than simply saying on insolvency occurring you must immediately cease trading. That's the whole concept behind this over assessment test.

WINKELMANN CJ:

Yes.

MR HUCKER:

If in fact there was an absolute prohibition on continuing to trade, what purpose is served by the sober assessment test.

WINKELMANN CJ:

But this is not a continue to trade in *South Pacific*, what you're saying is that the *South Pacific* rule can be extended to allow an informal liquidation by the director?

MR HUCKER:

No what I am submitting Your Honour is that –

WINKELMANN CJ:

Well did he see this entity continuing to trade at the end, was that what he thought was going to happen?

MR HUCKER:

No Your Honour.

WINKELMANN CJ:

So he was conducting an informal liquidation, he was winding it up outside the statutory scheme.

MR HUCKER:

He's starting to wind down the affairs of the company and mitigating the loss that the creditors would otherwise have suffered as part of that process. He was doing precisely what Justice Young in *Re South Pacific Shipping* said, attempting to avoid unavoidable loss.

O'REGAN J:

No he wasn't, Justice Young was talking about trying to salvage the business, trying to trade through and avoid losses. In other words he wasn't saying you can cause losses to different creditors to minimise losses to old ones, that's a different thing altogether.

MR HUCKER:

Well that's in fact what has not happened here.

O'REGAN J:

Yes it has. It's exactly what's happened.

MR HUCKER:

The IRD have been an existing creditor.

GLAZEBROOK J:

You perhaps need to take us to why you say that and you'll probably gather from what we've said that at the moment without being convinced of that, you've probably got quite a long way to take us to get to the point.

WINKELMANN CJ:

Perhaps you can start by taking us to the particular parts of *South Pacific* that you say and then we'll move from there Mr Hucker.

MR HUCKER:

Certainly.

GLAZEBROOK J:

At some stage too it might be useful to explain why you say the company was better off with this and that's probably also to do with the compensation issue. So it will be later.

MR HUCKER:

I accept that Your Honour.

GLAZEBROOK J:

But I mention it now so we don't lose sight of that.

MR HUCKER:

Thank you Your Honour. So Your Honour would like me to take you to *South Pacific.*

ELLEN FRANCE J:

It's volume 2, tab 19, page 21, paragraph 125.

MR HUCKER:

It's at paragraph 125 which starts at page 21 and goes on to page 22 and at sub point 3 of His Honour Justice Young –

ELLEN FRANCE J:

My query in relation to that Mr Hucker is that that does seem to be premised on the probability of salvage of there being a probability of salvage.

MR HUCKER:

In relation to specific assets because remember the nature of the business we're dealing with here is not the nature of a consultancy type business as in *Re South Pacific* but the nature of the business we're dealing with here is the sale of land and homes, so it's always contextual as to what is reasonable for salvage, depending on the nature of the business involved and in this business –

WINKELMANN CJ:

Well this is just freewheeling aren't you? Because how is that tied to the test, the statutory test? You can see how Justice Young has tied it to the statutory test but how do you tie what you are saying to the statutory test because he is saying really it is an assessment of risk, section 135.

GLAZEBROOK J:

So if you've got a good probability of at the end of this period of a matter of months that everything is going to turn out okay and that if you pulled the plug immediately that it would mean major, major losses but if within a matter of months, despite being balance sheet insolvent, you're going to be able to turn things around, then of course you can do that but only a matter of months and you have to have a probability that you will be okay at the end.

MR HUCKER:

Well the submission would be to say that there is a probability that the outcome will be successful, adds a gloss to 135 and 136 and is –

GLAZEBROOK J:

But how do you define "successful" because I would have thought he was defining "successful" as being at the end of that period everyone was going to be able to be paid. So say for instance in November 2012 if Mr Cooper had

had a plan that said there are few risks involved in this because we could have cost overruns et cetera but if we actually go through with this plan and sell everything off, everyone is going to be paid, so there won't be a shortfall.

MR HUCKER:

I would adopt the approach of the Supreme Court of Canada that adopts the business judgement rule in terms of director conduct.

GLAZEBROOK J:

Well in that case the business judgement would be I personally wouldn't have thought it would be all okay but I can see that he had reasonable grounds for thinking that it would be and so it's all fine.

MR HUCKER:

Well I would adopt, Your Honour, the statement of the Supreme Court of Canada at page 492, the fact that –

WINKELMANN CJ:

Which case Mr Hucker?

MR HUCKER:

That's the *Peoples Department Stores Inc (Trustee of) v Wise* 2004 SCC 68 case, respondent case tab 11 Your Honour and at page 492 the reference to the fact that alternative transactions were rejected by the directors as irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction.

WINKELMANN CJ:

Sorry what paragraph are you at?

O'REGAN J:

Paragraph 65, right at the bottom of the page, page 492.

MR HUCKER:

And there's also reference on the earlier –

GLAZEBROOK J:

This isn't in the insolvent – was this judgment agreed with by the other Judges in that case, was that test agreed with? It's just that it's only two of the Judges, that's all.

MR HUCKER:

The appeal was dismissed Your Honour based on this judgment.

WINKELMANN CJ:

So what are the facts of this case?

MR HUCKER:

This was effectively the consideration of the Canadian equivalent of our section 131 and 137 and it dealt with effectively a salvage exercise of the implementation of a particular system within the business which ultimately caused loss to the business and ultimately failed and what the Supreme Court of Canada has said and if I can refer Your Honour to 491, they specifically refer to the importance of the judgement, the business judgement rule throughout the United Kingdom, Australia, New Zealand and the United States and have said that they have tended to take an approach with respect to the enforcement of the duty of the care that respects the fact that directors and officers often have business experience that Courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made, business decisions must be made, high stakes, considerable time pressure. It might be tempting to see some unsuccessful business decisions as unreasonable or imprudent in light of information and then refers to risk of hindsight and bias.

WINKELMANN CJ:

Mr Hucker, this case is not to do with the Wise Brothers adopting a winding down of the company, the facts of the case were that they chose a – that they

had a serious inventory management problem and they implemented a joint inventory procurement policy they believed would solve it.

MR HUCKER:

But the principle is the same in terms of the statutory framework that was being articulated by Your Honour. It's different in the Supreme Court of Canada and what I'm inviting the Court is to follow the Supreme Court of Canada in interpreting the statutory framework under our Companies Act.

GLAZEBROOK J:

Yes but it wasn't a business judgement rule that said we are sure that this joint inventory system is going to cause loss but we think it's better than otherwise, it was we think this joint inventory system is going to solve these problems and this pickle we've got ourselves into.

MR HUCKER:

But the director's decision hasn't caused loss. The director's decision has in fact improved the asset base of the company.

GLAZEBROOK J:

Well it's caused loss to the Inland Revenue Department, unless you're going to say it hasn't which might be later when we're talking about compensation.

MR HUCKER:

Well I'm happy to traverse that later.

WINKELMANN CJ:

I mean to the point that's been made to you in a variety of ways is the same point being made, Mr Hucker, is that this case is quite apart from the ones, from the cases you are referring us to because in all of those directors were making decisions in that twilight zone where they're not sure – they think they can actually save this company and see everybody paid, whereas in fact in this case Mr Cooper was not making decisions in that twilight zone, he knew that he was in – he was in a de facto wind up or wind down of his company

and so he knew at the end of the day, in all likelihood there would be people who weren't paid. He knew he was in an insolvency situation.

MR HUCKER:
Well that's difficult to reconcile with the primary duty of the director to act in the best interests of the company because what if it is in the best –

WINKELMANN CJ:
No but I am just saying that's the point that's being put to you that these cases are different. So can you just – what's different? I'm not understanding what you're now saying is difficult to reconcile.

MR HUCKER:
Well what's being submitted Your Honour is to say that the primary obligation of the director is to act in the best interests of the company and what if the best interests of the company, its creditors and all of the stakeholders is for the director to in fact minimise losses, complete the partially completed properties and sell them. If that's in the best interests of the company commercially, respectfully submitted that there can be no breach.

WINKELMANN CJ:
Well the difficulty at our end is that it's often going to be in the best interests of the company for a reputable, decent director to wind it down rather than incur the costs of a liquidation or receivership but that's not the shape of the legislation. The shape of the legislation assumes that when a company is clearly insolvent and it's not going to cease being insolvent, then the statutory regime should kick in, so that it's no longer – decisions as to payment are done in accordance with the statutory regime and not at the whim of the director.

MR HUCKER:
If I just go back to the first point Your Honour made about with the de facto winding down of the company, if that is in fact in the best interests of the company, that is the preferable course to follow, otherwise the Court is

attributing Parliament an intention to a scheme that would say you are required to take a step that may inflict further losses on creditors.

WINKELMANN CJ:
Okay, so your submission is that section 135 contemplates that notwithstanding that as the company is trading, there is a substantial risk that creditors won't be paid. It contemplates that a director may continue trading in that circumstance to minimise the extent of the loss.

MR HUCKER:
What the submission is, is that it's the actual action of the director that needs to be assessed in the first instance from a commercial perspective. Was it a reasonable commercial decision to have made?

WINKELMANN CJ:
It would just help me Mr Hucker if sometimes you responded to the question as to whether or not I'm summarising your submission accurately because I'm trying to do it for a reason.

MR HUCKER:
I understand that there may be a reason Your Honour but –

WINKELMANN CJ:
So then I'm asking you that are you saying that even though the director forms a view that there is a risk –

GLAZEBROOK J:
Or a certainty.

WINKELMANN CJ:
Yes, a certainty that there is a substantial risk of serious loss to the company's creditors from continuing to trade, he or she may do so because they believe there's a possibility they will reduce that loss?

MR HUCKER:

Yes but that requires an assessment of the reasonableness of that business judgement, the extent to which that is taken into account, the interests of creditors as a whole and the potential outcome because the business judgement rule ought, in my respectful submission, to be given primacy in that particular circumstance of assessing was it a reasonable step taken by the director.

WILLIAMS J:

So you say that section 136 should be read as if it says, “Unless it is good business judgement read the rest of the section”?

MR HUCKER:

No, in terms of 136, the submission is that the word “agree” must be given effect to first of all.

WILLIAMS J:

Yes, let's not get into the transactional question but on the facts it appears that client engaged in these processes knowing that in fact planning that IRD would be compromised?

MR HUCKER:

No, no it was never planned that IRD be compromised.

WILLIAMS J:

I thought that all the cash projections indicated that IRD was going to miss out by 300K.

MR HUCKER:

No what the cash projections indicated is that there would be a shortfall to pay the existing debtors or existing creditors of the company in November 2012.

WILLIAMS J:

Yes.

MR HUCKER:

I accept that IRD was one of those existing creditors in November 2012 but in November 2012 there was still a significant liability that was owed to the IRD as an existing creditor.

WILLIAMS J:

Yes all right.

MR HUCKER:

Justice Gilbert in the Court of Appeal calculated the difference of being approximately $30,000 between the ultimate liquidation outcome for the IRD and what would have had to have been paid to the IRD on a November 2012 notional liquidation.

WILLIAMS J:

Right, so coming back to 136 and the test of knowingly incurring an obligation, sorry incurring an obligation knowing that it couldn't be met, it does seem on the cashflow indications that were provided in October or November of 2012, that Mr Cooper knew that someone was going to miss out.

MR HUCKER:

In terms of the global –

WILLIAMS J:

Yes.

MR HUCKER:

Well yes because the evidence was that there was a significant surplus as Justice Asher recognised in the Court of Appeal and there was to be a negotiation thereafter and there is just one aspect of the evidence –

WINKELMANN CJ:

When you say "surplus", do you mean surplus over the secured creditors' debts?

MR HUCKER:

Yes Your Honour. There is one other aspect, of course, and this was the evidence at first instance, and that was that Mr Cooper had the expectation that Mr Furlong was undertaking these negotiations and keeping IRD in touch with what was happening.

ELLEN FRANCE J:

Well that wasn't accepted though was it?

MR HUCKER:

I couldn't see that there was any affirmative finding by Her Honour Justice Hinton on that particular aspect.

ELLEN FRANCE J:

Well she says there seems to have been a strategy put in place for the IRD to carry the risk of the true projected shortfall, in the context of saying Mr Cooper could not reasonably have believed when signing the sale and purchase agreements and incurring the GST obligations that the company would be able to meet the GST debts as they fell due.

MR HUCKER:

But that's something different to the IRD being kept in touch with and Mr Cooper having the view that the IRD was being kept appraised of what was happening. There was contact between Mr Furlong and the IRD in the evidence at different points in time but the evidence of Mr Cooper was that he had the expectation that his accountant was taking care of these particular issues but I accept that there was that finding made by Justice Hinton but there was equally the finding made by Justice Hinton at 78 and that finding at 78 was that Mr Cooper's sole focus was on trying to get these properties finished. He had no idea that there would be a preference that would be claimed by the IRD on the liquidation of the company.

WINKELMANN CJ:

How does it matter whether there was a preference claimed by the IRD on the liquidation of the company? It doesn't matter whether there's a preference or just no preference, they're still not paid.

MR HUCKER:

In what context Your Honour?

WINKELMANN CJ:

Well what is the preferential statement of GSTs? What's the preferential statement of the – what's the significance of the preferential status of the GST? It's just a debt isn't it?

MR HUCKER:

I accept it's a debt and as the Court of Appeal held it's an unsecured debt up to the point of liquidation.

WINKELMANN CJ:

Yes but how is it relevant what Mr Cooper's knowledge was of his preferential status?

MR HUCKER:

Why it's relevant but it is suggested that there was something of a scheme to try and leave the IRD unpaid and that simply is not the case. There was not an attempt to –

WINKELMANN CJ:

But the preferential status doesn't bear on that does it? He didn't need to understand the IRD's preferential status in a liquidation for him to be pushing them out in terms of payment. He was getting the money on account of GST and using it for other purposes.

MR HUCKER:

The company was receiving the sales price and the GST.

WINKELMANN CJ:
Which included GST.

MR HUCKER:
I accept that it included GST.

WINKELMANN CJ:
All right, I think you probably answered me.

MR HUCKER:
So if we look at 135, there's of course 135A and 135B and perhaps if I turn to Justice Williams' question under section 136. The starting point is that 135A and 135B recognises two distinct categories of action by a director, agree and secondly, cause and allow and section 136 needs to be seen in that category of cause and allow.

GLAZEBROOK J:
Sorry, you perhaps need to explain that a bit more if it is important to your point because I'm not quite sure what you mean.

MR HUCKER:
Certainly Your Honour.

GLAZEBROOK J:
I mean I can see that you've got the two words but I thought your point about 136 was it had to be a positive agreement, so I didn't understand what your section – your comment on 136 was in that context because I thought you said it means cause and allow but I thought your submission was there needed to be a positive agreement.

MR HUCKER:
No the submission is there must be a positive agreement.

GLAZEBROOK J:
Okay, so it's not cause and allow?

MR HUCKER:

It's not cause and allow and the submission is that the word "agree" in 135 must be read consistently with the word "agree" in 136 and so what that means is that agree must mean something other than cause and allow. So the submission is that the word "agree" in 136 must be something other than cause and allow and the only way that a director can agree to an obligation being incurred on behalf of a company as opposed to causing or allowing an obligation to be entered into on behalf of a company, is if that director enters into a contractual arrangement.

O'REGAN J:

So in terms of section 135A, are you saying that doesn't apply unless a director enters into a contractual obligation with somebody else to conduct the business?

MR HUCKER:

Yes Sir because otherwise it's cause and allow. You're covered under cause and allow in 135B.

O'REGAN J:

So who does the agreement have to be with under 135A?

MR HUCKER:

135A would be an agreement with any individual creditor as the Court of Appeal identified in terms of 136.

O'REGAN J:

But why would you agree with a creditor how you operated the business? I mean 136, the argument is you've got to agree with a creditor to incur and obligation to that creditor.

MR HUCKER:

Yes I accept that.

O'REGAN J:

Whereas 135A is just talking about conduct of the business. Why would you enter into an agreement with a creditor about the conduct of the business?

MR HUCKER:

Well because entering into contractual agreements with a creditor may, in certain circumstances, constitute a breach of 135, depending on the reasonableness of entering into that agreement.

O'REGAN J:

Can I put an alternative to you that 135B, cause or allow, is actually the director making something happen and 135A is just going along with that, you're agreeing with it. So some directors are, like the managing director might be running the company, other directors just agree to that occurring. It's not a contractual agreement, it's just an acquiescence or consent.

MR HUCKER:

I'd put it the other way Sir, that cause and allow would cover that situation of directors going along with that.

O'REGAN J:

Well not if you were a –

MR HUCKER:

Because allowing, there's no affirmative action on the part of that other director in terms of continuing the – of agreeing to the business being continued to be trade.

O'REGAN J:

So under section 135A, you're saying a director contractually commits to a third party outside the company about how they're going to run the company. Is that what you're saying it applies to?

MR HUCKER:

No, what I am saying is that there might be circumstances where 135A is a broad width where there might be a contract that one director enters into with one particular supplier, one particular customer of the company and that is what 135A is designed towards.

O'REGAN J:

But that's not an agreement about the manner of carrying on the business, that's just an agreement to have a supply or to buy or sell something. That's not an agreement about carrying on the businesses.

MR HUCKER:

But it's still relevant to the carrying on of the business.

O'REGAN J:

Yes but that's not what it says. It says agreeing to the business being carried on in a manner that creates –

MR HUCKER:

And the entry into those types of obligations can relate back to the manner of carrying on the business.

O'REGAN J:

It might relate to it but it isn't an agreement to carry on the business.

WINKELMANN CJ:

I mean isn't the more obvious distinction between section 135 and 136 or relationship than the one you're trying to draw which is the one that Mr Ebersohn identified, that if you could say it's not reckless trading, if someone could make an argument under section 135 that it's not a breach if you're actually, through trading, on improving the position of the pool of creditors as a whole but disadvantaging the new creditors who are coming in, they certainly can't make that argument under section 136.

MR HUCKER:

That of course cuts against the pari passu principle that all unsecured creditors should be treated the same.

WINKELMANN CJ:

Oh sorry I thought your argument was cutting across that because you were saying the director can carry on an insolvency situation of paying out other than in accordance with it.

MR HUCKER:

No that doesn't cut across the pari passu principle because the pari passu principle is a principle as between creditors themselves rather than the relationship of any individual creditor with the company.

WINKELMANN CJ:

And it governs those who pay out to them. It governs those who pay out to them, the creditors, the pari passu principle, they're not fighting amongst themselves, although sometimes they do but the pari passu principle governs how liquidators deal with creditors, doesn't it?

MR HUCKER:

In what sense Your Honour?

WINKELMANN CJ:

In the sense that it governs what liquidators do when they pay out to them. Unsecured creditors are dealt with pari passu by the liquidator. So who does Mr Ebersohn's interpretation offend the pari passu principle?

MR HUCKER:

Because what the proposition is, is that so long as you make sure those new creditors are paid, they should have a priority for that new debt over pre-existing debt.

WINKELMANN CJ:

I don't think that's the argument. I think Mr Ebersohn's point was that even if in the interpretation you're arguing for under section 135 was available to you which is treating the pool of creditors as one and saying look if we carry on trading, when we look at the creditors as whole they're in a better position and that is their argument, you'd still fall foul of section 136 because an individual creditor can say well that might be the case but actually I've been disadvantaged it and it can seek its relief.

MR HUCKER:

Except the duty under section 136 is a duty owed to the company and it's not owed to any individual creditor.

WINKELMANN CJ:

But the creditor can access it through section 301.

MR HUCKER:

I accept the creditor can access it through 301 but it is still a duty owed to the company and not that individual creditor and if it was intended for the interpretation that the Attorney has contended for, that duty would be owed to that creditor directly and there would be remedies available to that creditor directly to enforce a specific duty that is owed to that creditor.

WINKELMANN CJ:

And there is under section 301.

MR HUCKER:

But section 301 doesn't create the duty, section 301 is simply the mechanism that allows relief to be pursued.

WINKELMANN CJ:

Yes.

O'REGAN J:

By a creditor for a breach of the duty owed to them under section 136.

MR HUCKER:

But there is no duty owed to the creditor under 136 because the duty is owned to the company under 169. The 136 duty is a duty to the company and is directed –

O'REGAN J:

But aren't we agreed that when a company is insolvent, for the company you effectively mean the creditors?

MR HUCKER:

No the company means the enterprise in terms of the Law Commission report rather than individual creditors.

O'REGAN J:

Well if you look at *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) though, are you saying *Permakraft* is now not the law?

MR HUCKER:

No Your Honour but *Permakraft* recognises the interests of creditors as a whole, rather than any individual creditor.

O'REGAN J:

No I know that but are we agreed that once you're in an insolvency situation the interest you've got to look out for as a director is no longer just the company an amorphous hole but the creditors.

MR HUCKER:

That's accepted and the submission is that the manner in which you do that is to assess how do your acts affect the company as a whole.

WINKELMANN CJ:

So I suppose you might be right then, Mr Hucker, so that would mean you add section 136 to 135 which would mean that you can't do – you can't carry on the company to improve the lot of individual creditors if you are going to, improve the lot of creditors as a whole, if it is going to entail you incurring an obligation to a particular creditor that the company can't pay.

MR HUCKER:

We say section 136 is directed towards contractual obligations. So that means that you can't –

GLAZEBROOK J:

Well let's have a contractual obligation here. So let's forget the IRD and say that you're contracting with a supplier of building supplies to provide you money and at that stage you know that the only money you are going to get, even with your extra surplus, will only be enough to pay secured creditors, so you know you can't pay the building supplier.

MR HUCKER:

If you ask someone to come and do some work there under a specific contract at the point of insolvency and you can't pay them, yes I accept that. Similarly, if you execute an agreement for sale and purchase that you are unable to obtain a discharge of mortgage, I accept that there could potentially be a breach of section 136 but section 136 does not cover those other obligations that may either be pre-existing contingent obligations because giving effect to the temporal element within 136, nor can 136 apply to those obligations that arise by operation of statute or result in an obligation being imposed on the company as opposed to a director agreeing to that obligation.

GLAZEBROOK J:

I'm now a bit puzzled actually because I thought you said that if it makes commercial sense to carry on, then you can carry on, even if you are not able to pay a particular creditor. So in my situation, why do you accept that you

would have to stop then and go into liquidation when you don't accept – when you have said that there is this gloss over it?

MR HUCKER:

Well section 136 does provide a gloss in terms of 135 but you follow through the hierarchy of duties under 131 through to 135 to 136. So the question, in my respectful submission, firstly is, is the decision in good faith under 131? If it is, you go to 135. Was it a legitimate business risk that was being taken? If it is, you then go to 136 and you then assess and say, is there a contractual obligation that I can enter into that I believe I can fulfil?

GLAZEBROOK J:

That I what, sorry?

MR HUCKER:

Is there a contractual obligation that I can enter into that can be fulfilled? And the best example of that is the entry into an agreement for sale and purchase.

GLAZEBROOK J:

No, no let's have my trade creditor. So I'm Mr Cooper, I've got unfinished properties, I am acting in good faith and I think everyone accepts that is the case in this case, I am acting in good faith, I think it is a legitimate business for us because I think the general body of creditors will be better off if I finish this property rather than not and so under 136 I decide that I will buy this equipment from a trade person with a trade creditor but I know I am not going to be able to pay, what happens then?

MR HUCKER:

You're in breach at that stage under 136.

GLAZEBROOK J:

So at that stage I can't, so –

MR HUCKER:

Which is an added protection.

GLAZEBROOK J:

So the only reason you say it's okay here and I do point out there were trade creditors here who were worse off.

MR HUCKER:

I accept that.

GLAZEBROOK J:

Is because it is the IRD and it's not an actual obligation. So in fact you say he was only in breach of the newly acquired trade creditors in terms 136.

MR HUCKER:

Yes and that's because I come back to the word "agree", as to how do you define the word "agree".

GLAZEBROOK J:

Right well I must say I hadn't actually understood that to be your argument because I had understood your argument to be that you actually had a free pass even if you knew that you were going to land up with more debt for some creditors but you say that's not the case, it's only involuntary creditors?

MR HUCKER:

It's only involuntary creditors.

WINKELMANN CJ:

All right, well I hadn't understood that either. So you say the test under section 135 as well, that this commercial risk that you say *South Pacific* contemplates only applies to involuntary – only allows sort of an informal winding down if it's involuntary creditors in an insolvency situation?

MR HUCKER:

No section 135 requires the assessment of the risk to the business overall, as an assessment of the risk to the company overall and the submission that we made on this side is to say it's not a matter of absolute prohibition but a matter of assessing the reasonableness of the business risk for section 135, the assessment of the reasonableness of the business risk must be firstly to define what is the interest of the company because the duty under section 169 is owed to the company and not individual creditors and we then say that to further the interest of the company, a director must take steps that ensures that the company assets are provided for proper company purposes and that the steps taken by the director are directed towards improving the asset base of the company rather than a step that requires the value of the company assets to be depressed and we say that that is the risk analysis that is undertaken in terms of determining the reasonableness of the risk.

WINKELMANN CJ:

And you say that this discretion under section 135 applies even though the course of conduct that the director sets upon is known to the director to be unlikely to pay all creditors. So they're thinking about it in a moment when they know when they are in an insolvency situation, they're looking ahead, they're saying at the end of the day they'll be in an insolvency situation but their business assessment is that it will be a lesser insolvency situation.

MR HUCKER:

Yes because at the end of the day it's a matter of assessing the risk in any given circumstance. It will be very rare that it will be a legitimate risk to enable the expansion of a business, if say for example Mr Cooper had commenced new builds, that is likely to be an illegitimate risk but it's always a function of risk because that gives effect firstly to the wide discretionary powers that the long title wishes to give to directors but also recognises that the interest of the company is in the maintenance of its corpus.

WINKELMANN CJ:

And is there any, in your conception of the operation of the scheme, is there any limitation upon how the directors can do that? So under section 135, can they swap one trade creditor out for another?

MR HUCKER:

That would depend on the circumstances of any particular given case and the effect of the director's decision but what we had here was a decision to complete partially completed houses.

WINKELMANN CJ:

No I'm asking you, could a director swap one trade creditor out for another so that one trade creditor is paid but a new trade creditor. So Peter is paid, no Paul is paid but Peter ends up unpaid at the end of the day and Peter is a new creditor?

MR HUCKER:

That would depend on an assessment of each individual case.

WINKELMANN CJ:

So you could swap? You could bring new creditors who aren't going to be paid, in?

MR HUCKER:

Yes because there are already remedies there dealing with preferential payments under the Companies Act and there's also the provision under the Property Law Act that provides for remedies against those that have effectively committed a fraud on creditors and there are a raft of remedies dealing with self-interested transactions. The overriding question is always what is in the best interests of the company under 135 to maintain that corpus that's then able to be properly distributed in accordance with the statutory priorities and there's good reason for that because –

WINKELMANN CJ:

So it's all the trick is that you've made your assessment that it's in the best interests of the company to carry on trading really at the expense of creditors.

MR HUCKER:

No it's for the benefit of creditors, that's exactly the analysis.

WINKELMANN CJ:

No but not for the benefit of the new creditor.

MR HUCKER:

Well yes it is. If a higher corpus –

WINKELMANN CJ:

No, no, the new creditor who wasn't a creditor at the time, a new creditor. Peter, Peter comes in and the supply he gives, the money he gives or the supply pays Paul.

MR HUCKER:

But then if there's an untoward preference in terms of the allocation of company assets towards those pre-existing creditors, that's taken care of under the preferential voidable transaction regime or alternatively under the various provisions dealing with related party creditors but it depends on every instance and it may be that – it depends on the business purpose and the steps that are being taken which requires the assessment of the actual steps taken by the director at the time, compared with what would have happened on the notional liquidation.

WINKELMANN CJ:

So this is quite a radical recasting of anyone's conception of this legislative framework and it seems to be far further than the Court of Appeal went.

MR HUCKER:

Well I come back to the Supreme Court of Canada and I know that Your Honour has said it's a different scenario.

WINKELMANN CJ:

That's a different scenario. Well it is a different scenario.

MR HUCKER:

But it is submitted it is not a different scenario in terms of those principles.

WINKELMANN CJ:

No, it's a different factual scenario and you're attempting to extend the principles because it's not a situation where they know they're insolvent and they decide to carry on trading in a wind down situation is it? They were trying to carry on trading.

MR HUCKER:

Buts that's why every situation is so factually dependent in terms of assessing what is the reasonable decision from a business perspective that has been made by the director.

WINKELMANN CJ:

Right, I think we've probably thrashed around through the law quite a bit. Do you feel like you've advanced the legal submissions you wish to because we need the facts really tied to, don't we?

GLAZEBROOK J:

Well we do need you to deal with the GST and the IRD being an existing creditor, the arguments in respect of that because as I was indicating, I think you probably realise you have quite a task on that one.

MR HUCKER:

Well the starting point of course is that the IRD is a creditor in the actual liquidation for $366,000. There was a projected surplus of $170,000 on the liquidator's case and in fact that surplus for Karika was completed at a profit.

GLAZEBROOK J:

I was asking you for the legal side of that and then if you're going to start going through figures, I think you're probably going to have to start a bit further back, at least from my point of view because I have no idea what you're talking about when you just put those figures out that way.

WINKELMANN CJ:

And when you do, if you can be clear about what you mean when you say a surplus.

MR HUCKER:

Yes.

WINKELMANN CJ:

So Justice Glazebrook was asking you the question about your submission that the IRD was an existing creditor and not a new creditor.

MR HUCKER:

I see the point, yes. The point at which the obligation arises with the IRD is when the taxable activity commences and that is because it is a contingent obligation to account for output tax once the input credit has been claimed and –

GLAZEBROOK J:

Well in accounting terms that's not right because you don't have a contingent asset against which to match the contingent credit until you've actually sold it, so in accounting terms it would be quite wrong to treat that as a contingent liability because if you can't sell the property, if it burns down or whatever happens, then you couldn't say well I've got a contingent asset of 300,000

because I'm going to sell it for 300,000 and a contingent liability for GST when I do sell it for 300,000.

MR HUCKER:

But if there was a liquidation that occurred a week after you had claimed the input credit, the Commissioner would be proving as a creditor in the liquidation and would be defined as a creditor.

GLAZEBROOK J:

On what basis?

MR HUCKER:

Section 307 to 309 of the Companies Act.

GLAZEBROOK J:

Tell me why that's the case. If nothing has been sold on what basis would output tax be payable?

MR HUCKER:

Well what the Commissioner would say is that the obligation is unavoidable because if I cease my business activity, if I change the use to a non-taxable activity or I sell the asset, there is a liability to account for output tax.

O'REGAN J:

Only if you sell it to an unregistered person.

MR HUCKER:

Well there's still an obligation to account, it's just zero rated in my respectful submission.

O'REGAN J:

Well that's zero, so what's the debt?

MR HUCKER:

Well it's still a – it's effectively –

O'REGAN J:

And obligation to pay nothing is not a debt.

MR HUCKER:

Well it's an obligation that is assessed at zero in terms of that particular transaction but where you have a situation as here, where you are dealing with residential properties that are being sold –

GLAZEBROOK J:

This assumes you've got a liquidation. We don't have a liquidation, we are carrying on business, we've accepted that. So where does the liability arise from because there's a lot of contingent debts and debts in the future that people claim in a liquidation because after all there isn't an ongoing business to claim them from but none of those contingent debts would be claimed as being existing debts were there not a liquidation.

MR HUCKER:

But it's an existing obligation and the trigger event occurs in the future that crystallises that obligation into a debt.

O'REGAN J:

But it's an obligation to pay an undetermined amount, isn't it, you don't know how much it will be.

MR HUCKER:

But that's exactly like income tax Your Honour. You start trading at the moment, you've got a contingent obligation to –

O'REGAN J:

So how would you show it in your accounts?

WINKELMANN CJ:

You don't have any obligation under income tax until you've actually earnt the money.

MR HUCKER:

But you've earnt the money partway through the year.

O'REGAN J:

You don't have any obligation under the GST Act until you've sold something.

MR HUCKER:

You've got a contingent obligation to account for that output credit.

O'REGAN J:

No you haven't.

MR HUCKER:

Well it's similar to a leave.

O'REGAN J:

You might decide to live in the house.

MR HUCKER:

And then that contingent obligation if I decide to live in the house is a change of use and GST would be payable on that change of use.

O'REGAN J:

Yes but all of these things are predicated on future events. The GST Act says in a case where there is a sale, the time at which the output tax becomes payable is when a sale has been entered into and has become unconditional and until then you don't have any obligation. Have you ever seen a set of accounts which says because I own an asset in which I got an input credit, I have a contingent obligation to pay an output tax when I sell it. I mean how would you account for that if you were a trader that's just constantly turning over, you know, some sort of merchandise in a department store?

MR HUCKER:

We're dealing with duty and duties and obligations rather than the triggering.

O'REGAN J:

No you're not, you're saying there's a contingent liability that makes you a creditor, that's what you are saying and I'm saying if there is you would expect that to be reflected in the company's accounts.

MR HUCKER:

That was the approach taken by Justice Lang in the *Goatlands (in liquidation) v Borrell* (2007) 203 NZTC 21, 107 NZHC 255 decision and submitted that that's for good policy reasons that you are treated as a contingent creditor as soon as you receive the input credit.

O'REGAN J:

Well how do you reconcile that with the Goods and Services Tax Act which says the obligation arises only when you enter into an unconditional sale?

MR HUCKER:

I've got an obligation to account at the time of the commencement of my taxable activity and it's that obligation to account that means I have obligations.

GLAZEBROOK J:

Well it's nothing to do with the taxable activity. I mean I started taxable activity of a retail store, I don't have a contingent liability to account for GST in respect to all of the future things that I might buy and sell in that period, it's just a silly submission, sorry. That is probably not said with respect actually. Is that what the submission is or is just when you've claimed input tax deduction on something?

MR HUCKER:

When you've claimed the input tax credit. Yes I accept the commencement of the taxable activity itself is insufficient.

GLAZEBROOK J:

So you're saying in respect of that particular property?

MR HUCKER:

Yes but in terms of the commencement of the taxable activity that's a pre –

GLAZEBROOK J:

But you can claim an input tax deduction, so if these were commercial properties, if you were going to rent commercially, then of course you have an input tax deduction.

MR HUCKER:

Well you've got an input tax deduction here of course as well because it's the construction and sale of residential properties is the business activity being carried on.

O'REGAN J:

He did also rent properties though didn't he? Didn't he rent some of these properties?

MR HUCKER:

Yes.

GLAZEBROOK J:

They would be zero rated if it was residential rent but if it's actually commercial rent then GST will be payable on the – and it won't be a change of use because it will be part of the taxable activity, just a slightly different one from what it was purchased. So if you buy and sell commercial properties and find that you can't sell it and rent it, you're going to have a GST liability on the rent, it will still be part of your taxable activity.

MR HUCKER:

But once you claim the input credit there's no way to get rid of the obligation to account for the output.

GLAZEBROOK J:

Well eventually, if eventually you decide to sell in 300 years because you've decided to use it for your business premises.

MR HUCKER:

But that's what 136 anticipates. 136 anticipates obligations that may be required to be performed in the future, so the time for assessing the obligation under 136 is when that contingently –

O'REGAN J:

But you're saying section 136 doesn't apply to GST.

MR HUCKER:

This is an alternative argument on the basis that you find against me in terms of the definition of agree, as was found by the Court of Appeal and the time for the assessing of that obligation is of course the time that the contingency is incurred and there is an unavoidable obligation to make a payment at some time in the future. It does not need to be a certain payment because the policy behind 136 is to require a director to take steps or avoid taking steps – sorry the policy behind 136 is to prevent a director assuming contingent contractual obligations that may be required to be performed in the future which he is unable to perform at that future date.

WILLIAMS J:

Wasn't *Goatlands* about, to the extent that you claim and aid Justice Lang, wasn't *Goatlands* about the purchase of a farm?

MR HUCKER:

Yes that's correct.

WILLIAMS J:

In circumstances where the purchaser takes the GST, you know, rebate without any real prospect of being able to settle the deal?

MR HUCKER:
Mmm.

WILLIAMS J:
Isn't that a little different to our situation?

MR HUCKER:
No, what the situation there was, was that the input credit was taken, it wasn't held in a separate account.

WILLIAMS J:
Correct and it was spent.

MR HUCKER:
It was spent.

WILLIAMS J:
But this was a farmer buying, farmers buying their farm. Here we are talking about the trading assets of a development company. Is there a difference there?

MR HUCKER:
No because it's still a transaction that's involved for the acquisition of land.

WILLIAMS J:
Sure it's still a transaction.

MR HUCKER:
It's a transaction to acquire land. The input credit is claimed in both instances and there's still a requirement at the future date to account for the output credit.

WILLIAMS J:
Presumably at the time this company acquires the titles, they were not cashflow insolvent, it was not cashflow insolvent.

MR HUCKER:

That's correct.

GLAZEBROOK J:

Or balance sheet I think probably, in respect of most of them.

MR HUCKER:

That's correct.

GLAZEBROOK J:

Because it was 2009 they got into difficultly, from 2009.

MR HUCKER:

No 2012 onwards because there was always –

GLAZEBROOK J:

No there was some issue.

WILLIAMS J:

In 2009 they were balance sheet.

WINKELMANN CJ:

They were balance sheet insolvent from 2009, they had the support of their shareholders.

MR HUCKER:

And there's the evidence of Mr McKay there in terms of the shareholder support and there were some surpluses that were created within numbers of those years.

WILLIAMS J:

I just expect that Justice Lang was moved to come to the conclusion he came to over the crystallising of the obligation because the purchaser in *Goatlands,* when they made the purchase, never had the ability to settle it. That's not the situation here.

MR HUCKER:

But there's no difference in terms of defining that original obligation.

WILLIAMS J:

I can see structurally why there's no difference but you can see why the Judge took the view he did, otherwise *Goatlands* walks away.

WINKELMANN CJ:

So is your submission that once they had received an input credit, they were within a statutory regime and every door they could walk out to get out of that statutory regime attached either an accounting obligation if it was zero rated or a debt, once they'd received the input?

MR HUCKER:

That's correct, yes, yes Your Honour.

GLAZEBROOK J:

Well is your point really as well that in fact you weren't incurring any additional liability when you finished the properties because if they'd been sold immediately, there was a GST liability, it's just that it would be smaller because of the fire sale aspect than it was later?

MR HUCKER:

That's correct Your Honour.

GLAZEBROOK J:

So in fact it's part of the agreement point really, to say there isn't any new liability because it's actually just a liability that automatically comes up. It would have come up whether you'd sold them immediately or carried on, it would just have been greater when you carried on because of the greater sale price.

MR HUCKER:

It's to do with the temporal point of the reference to at that time in 136.

GLAZEBROOK J:

So just as a matter of fact it would be a higher liability than it would be immediately but not as a result of you doing anything at all, apart from finishing the properties?

MR HUCKER:

What the reference is to, the reference is to incurring an obligation unless the director believes at that time. So we say the obligation was incurred contingently on the input credit being received by the company and at that time of receiving the input credit is when the ability to meet the obligation of the output credit is assessed and at that point in time the company was solvent.

GLAZEBROOK J:

So to put it another way perhaps and to bring it more into line with the case that you rely on in terms of the guarantee, if they had done nothing whatsoever in respect of this, apart from sit on those properties, they didn't actually incur anything further even if by virtue of the market rising, the GST liability rose. So they didn't do anything, they just sat on the properties for five years without doing anything whatsoever.

MR HUCKER:

Yes, yes.

GLAZEBROOK J:

You're saying they haven't incurred anything more even if five years down the track they might be expecting the purchase price to have increased.

MR HUCKER:

That's right because it's assessed at the time that obligation is incurred because there's nothing that a director can do to expunge that obligation.

WILLIAMS J:
Can't you argue it's a different obligation, the obligation at the point where you buy bare land, there's a different obligation in terms of GST to the obligation at the point you sell. GST is higher.

MR HUCKER:
The transaction is still one in the same and the point to assess –

WILLIAMS J:
Yes but I'm just focussing on the obligation. There is the obligation to pay GST but this obligation is a different obligation to the earlier one. It's more and in the business sense, if you're trying to get us to be common sense and business savvy, you would have thought that a common sense approach to this would be to treat this as a different obligation.

MR HUCKER:
Well the submission is that it's in fact the same obligation because the company has always had that contingent liability from day one to meet that.

WILLIAMS J:
Well some kind of liability but you don't know how much until you know what product you sell and to whom.

MR HUCKER:
When that's quantified in the future.

WILLIAMS J:
Yes.

MR HUCKER:
But given that that liability is going to be there regardless of what the director does.

WILLIAMS J:
Well a liability is going to be there.

MR HUCKER:

A liability is going to be there regardless of what the director does.

WILLIAMS J:

The question is really whether an obligation is a reference to a liability or the liability or both.

MR HUCKER:

The submission would be that it should be to the liability because the point in time to assess whether or not the company is able to meet its obligations is at the time the company is bound to perform that obligation at some time in the future. So it's at the time it becomes bound to the obligation that is the basis of the submission.

GLAZEBROOK J:

But if you fall foul of 135 you're in trouble anyway and you say you don't but only on the basis of what I would suggest was a bit of an expansion of *South Pacific.*

MR HUCKER:

It's a matter of assessing the business decisions made and to say what differently would have a liquidator done? What is the effect of the director's decision on the company and I know we've traversed this earlier.

GLAZEBROOK J:

Yes all I was saying is that if you don't win on that then the 136 point doesn't help you terribly much.

MR HUCKER:

I accept that that would open the door to go to the next stage and the submission that would be made in terms of loss is that the loss is still the nett notional deficiency and that causation elements would then need to come into play.

WINKELMANN CJ:

Now you've still got section – we're running out of time, so you've still got section 131 deferring the interest of himself as a personal guarantor and his family trust.

MR HUCKER:

Yes.

WINKELMANN CJ:

Compensation and the security.

MR HUCKER:

Yes Your Honour. At 131 the submission is made that the good faith element has not been breached by the director. All monies were utilised for proper company purposes and were not used for any other purposes as affirmed by the liquidator's expert and I have cross-referenced that to footnote 15 of the written submissions.

The finding of absence of good faith was limited in paragraph 50 by Justice Hinton, solely to the fact that there was an incidental benefit that may be said to have been received as a result of the reduction in the amount of the guaranteed debt by the director. We've referred in the written submissions to the approach adopted by the House of Lords, the Supreme Court of Canada and the High Court of Australia as to how incidental benefits to directors are to be treated. The key test is what was the benefit that the company received in terms of section 131 and submitted here that if there is an incidental benefit that the director receives in terms of reduction of personal guarantee, the fact that that is an incident to the paying down of company debt is the important factor and the analogy is drawn with the *Madsen-Ries v Petera* [2015] NZHC 538 decision in terms of related party transactions where a director provides services to a company, it's always a question of what is fair to the company in terms of that particular transaction and respectfully submitted that in terms of the payment down of the guaranteed debt, there is nothing different in principle with that payment having been made and that's consistent with

various aspects of the steps taken by the director being in good faith. There is nothing untoward in a mortgagee ending up with all of the assets of the company because the primary security of the mortgagee is of course the land itself and there's the reference to Justice Blanchard's decision in *Rob Mitchell Builder Limited (In Liquidation) v National Bank* (2004) 21 NZTC 18, 397.

There is nothing inherently in bad faith by the sale of company assets itself and that is referred to in the *Lion Nathan v Lee* (1997) 8 NZCLC 261, 360 (HC) decision in the materials and equally the granting of a preference from one creditor to another is not an instance of bad faith unless it offends section 348 of the Property Law Act or alternatively the voidable transaction regime and other aspects of the Companies Act are available to make sure that these particular transactions are that for policy reasons ought to be set aside, are in fact set aside.

And what we have here in terms of the key findings of Justice Hinton, is that the motivation, and this is paragraph 78, is that the motivation of Mr Cooper was to attempt to improve the position of unsecured trade creditors by completing buildings, rather than leaving those creditors in the lurch. So there are those affirmative findings of good faith insofar as what was the intention of Mr Cooper in terms of undertaking the work that he did for the company. You've also got the other aspect identified in paragraph 77.

WINKELMANN CJ:
She also made findings against him though didn't she, that he was intending to see himself paid down to some extent.

MR HUCKER:
No I think it was at 78, Her Honour held that it was a mistaken belief but nevertheless a belief in good faith.

WINKELMANN CJ:
"While undoubtedly he was acting over on significant preference for his own credit position."

MR HUCKER:

That's 78 Your Honour is referring to?

WINKELMANN CJ:

77 and 78, "Therefore clearly preferring himself and secured creditors and therefore himself."

MR HUCKER:

But the point is, is that the basis of that finding is that the money went to the mortgagee but the mortgagee would have been entitled to that money in any event.

WINKELMANN CJ:

That's what he thought.

MR HUCKER:

And that was his bona fide belief at the time. Trade creditors and the mortgagee and as the Court of Appeal also held, some of the best evidence of good faith on the part of Mr Cooper is the additional nett $200,000 that was put into the company by the Trust, the number of hours that he's worked within the company to be able to complete the partially completed properties and Her Honour quantified the benefit that was provided by Mr Cooper and the Trust to the company at $320,000 in Her Honour's judgement.

WINKELMANN CJ:

And do you see why, as a matter of scheme in the legislation, it's not left to people to run their own informal insolvencies because they don't understand the preference system?

MR HUCKER:

Well the preference system operates regardless but here –

WINKELMANN CJ:

No it doesn't, it comes in on liquidation under the schedule, schedule 7.

MR HUCKER:

I accept there's a temporal element there in terms of preferential payments but that –

WINKELMANN CJ:

No, no I'm sorry priority, priority. Mr Cooper did understand that in a liquidation the IRD would have priority. So he was proceeding on an assumption as to who was due what which was mistaken.

MR HUCKER:

But here, had there been a liquidation the IRD wouldn't have had priority had the decision been made to complete the partially completed houses, the IRD would've ranked equally as the houses were completed as a creditor in the liquidation.

WINKELMANN CJ:

Yes, no that's not my point. I'm just saying that in liquidation a different order of payment applies which is why it is so critical that people don't do their own informal insolvency wind ups.

MR HUCKER:

The submission would be to agree with the first proposition but to make the submission that there's not necessarily a connection with the second proposition and that that would require an assessment to be undertaken as to what difference was in terms of the second proposition, had there been a liquidation of the company and what we say is that had there been the liquidation of the company, the IRD either would have been unpaid because the value of the assets on an as is where is sale would have been depressed to such a level, they would not have been paid or alternatively had the liquidator decided to complete the assets and complete the partially completed houses, the IRD would not have been a preferential creditor because the secured creditors and the IRD would have been costs of the liquidation being undertaken by the liquidator or the administrator.

GLAZEBROOK J:

That's right, if the liquidator sold, the liquidator would have paid the GST and the secured creditor would have had whatever was secured less GST.

MR HUCKER:

I accept there would have been an obligation on the liquidator to pay but the third party secured creditor could sit there and do nothing, just as the liquidator could sit there and do nothing.

O'REGAN J:

But the third party secured creditor, if it decided to sell, would also have to pay the GST.

MR HUCKER:

I accept that proposition.

O'REGAN J:

Creditors don't sit on their hands when it comes to liquidation, they sell the assets, they get out.

MR HUCKER:

But in the context of director's duties, how can a director have responsibility for the acts, omissions or commercial decisions?

O'REGAN J:

He doesn't, he doesn't have responsibility. All we're saying is, in a liquidation the IRD would have been paid, come hell or high water the IRD would have been paid.

MR HUCKER:

On a sale I accept they would have been, in a liquidation not necessarily.

O'REGAN J:

And a liquidation always involves a sale. The liquidator's job is to sell, that's what they do.

MR HUCKER:

But if the liquidator couldn't sell.

O'REGAN J:

Of course they can sell.

WINKELMANN CJ:

The mortgagee would have to sell and they'd have to pay the GST too.

GLAZEBROOK J:

You can always sell, it's just a matter of price.

MR HUCKER:

That's right. I accept that proposition that of course you can always sel..

GLAZEBROOK J:

And that's why you have the first sale because liquidators gun in and say I want it gone immediately, everybody knows that and –

MR HUCKER:

That's precisely the point and by placing the company in liquidation, what you've immediately done is to depress the value of the company assets and then by saying that there is a duty that a director has because of the statutory scheme to place the company in liquidation, it is then being said that the purpose of director's duties are to require a director to take a step that depresses the value of the company assets, even if that inflicts other losses on creditors.

WINKELMANN CJ:

All right, so the security Mr Hucker.

MR HUCKER:

I'm going to pass to my learned junior for section 299.

WINKELMANN CJ:

Oh okay well before you do that, are you doing the compensation?

MR HUCKER:

I am happy to turn to compensation next Your Honour.

WINKELMANN CJ:

There is logic to that isn't there? So that we don't have Ms Selby stand up and then you have to sit back down and you stand up.

MR HUCKER:

Perhaps if I deal with the compensation in this particular order. There are matters raised in the written submissions on the assumption that it were to be held that the nett asset deficiency approach is not to be accepted where the first respondent has said that learned High Court Judge –

WINKELMANN CJ:

Well can I – well –

MR HUCKER:

Well I'm happy to do it in reverse order, whichever.

WINKELMANN CJ:

No, well the point is do you say were there a finding against you would you say that Justice Hinton's qualification was correct or not?

MR HUCKER:

No Your Honour, the starting point would be that there is no loss that's been suffered and the principle is that the comparison of loss must be what was lost by comparison with the notional liquidation. So had the first respondent placed the company in liquidation in November 2012, what would have been the position compared to the actual liquidation and that's what we've got set out in annexure B to the written submission.

GLAZEBROOK J:

Right, do you want to take us through that?

MR HUCKER:

Yes Your Honour. And the starting point in annexure B is of course the valuation evidence on the October 2012 scenario for the sale of the 78 Pemberton and 28 Coby Syndey Drive as is where is. The 28 Coby Sydney Drive valuation is a forced sale valuation at $280,000. The 78 Pemberton valuation is on a willing buyer, willing seller basis. My learned friend maintains that there should be an adjustment to Coby Sydney to a willing buyer, willing seller basis. Our submission is that the forced sale basis is the correct basis and that if anything there should be a reduction on the $350,000 figure that would have been received on a willing buyer, willing seller basis. The two deductions are then made for the mortgage amount outstanding to JPK on those two properties as at October 2012.

GLAZEBROOK J:

Well nobody's really suggesting there should have been a ceasing of trading, least of the High Court Judge in October, are they? They're saying it was November there should have been a ceasing of trading.

MR HUCKER:

That's correct Your Honour.

GLAZEBROOK J:

So I don't see why your for sale basis on Coby Sydney Drive, if in fact – because you say if they ceased trading in October, well no one is suggesting they should have done.

MR HUCKER:

But this is the counterfactual and if there's a liquidation –

GLAZEBROOK J:

Well the counterfactual is they should have stopped in November, isn't it?

MR HUCKER:
That's correct.

GLAZEBROOK J:
Well why take October?

MR HUCKER:
In terms of the October figures, there's de minimis difference between those particular figures in any event but the two critical – the two dates referred to are the 1st of October and the 11th of October. There is about a $4000 difference between those two figures but I'm happy to take the November figures if that's considered – in principle there's nothing in principle why the November figures should not be utilised instead of the October figures, for present purposes they are comparatively the same or similar or so close that they don't make, in my respectful submission a material difference. And the point that's made about the four odd thousand dollar reduction sought by the liquidators in relation to I think it was the Coby Sydney figures is of course there would be accrued interest to the end of that October period.

What we have then done is to make an allowance for commission on sale that would be incurred. That has been at a rather modest level that that has been assessed at in terms of the various sale prices. What we have then added is the GST balance that was due for the properties at 2 and 7 Karika Ave as at November 2012. Now that obligation did not arise for payment until 28 November. So the submission and 2 Karika Drive is the property that Her Honour Justice Hinton held was sold at the time that the company was able to pay its debts as they fell due.

So that brings us to the $608,000 figure that was referred to in the Court of Appeal judgment that was accepted by the liquidators. What we then have is the remaining properties, the Penrod Drive and Karika Avenue which also had a contingent GST obligation on them at that particular point in time. So had those properties been sold, that would have increased the GST that was paid in respect of each of them and would have added to the total accrued losses

on the notional liquidation. That was a point raised by His Honour Justice Gilbert in the Court of Appeal.

I have then added for completeness sake, the second respondent's current account and of course the second respondent's current account was always in credit throughout the operation of this company. The submission that is made is that the related party current account should not be taken into account for compensation purposes because that is money that could – that is debt that could have been converted into equity at any time by the shareholders and is not a loss to third party creditors.

That then leads us to the contrasting position of the actual liquidation which is taken from the statement of claim. The total GST core debt is $366,000 as outlined in the first section.

GLAZEBROOK J:
What do you say the contrast was between that and what would have been on the liquidation in November?

MR HUCKER:
We say that contrasts, Your Honour, with the $779,000 figure on the earlier page because –

GLAZEBROOK J:
No I don't want to know that, I want to know GST specifically. So how much GST was payable on this fire sale compared to how much was payable on the actual sale price completed which again is a bit odd because you've got a whole pile of input tax deductions available presumably on the completion parts?

MR HUCKER:
That would be the difference of course between the – that would be the difference between the sales, that would really be the difference on the sales

for the Pemberton and the Coby Sydney properties that Your Honour is referring to. Is that the –

GLAZEBROOK J:
See none of this makes any sense to me in terms of any sensible comparison, so frankly –

WINKELMANN CJ:
I have to say I'm struggling too Mr Hucker.

GLAZEBROOK J:
I just don't understand it.

MR HUCKER:
Well the –

WINKELMANN CJ:
Perhaps you can have another go.

MR HUCKER:
Okay.

WINKELMANN CJ:
So what do you say is the contrast?

MR HUCKER:
What we say is the contrast is what would be the position.

WINKELMANN CJ:
Yes as at liquidation if it had occurred in November.

MR HUCKER:
That's right, as opposed to the actual liquidation.

WINKELMANN CJ:

And you say if it had occurred in November there would have been a shortfall of 608,000, would there?

MR HUCKER:

That's correct Your Honour.

WINKELMANN CJ:

And then you say that the liquidation core debt taken from the statement of claim is?

MR HUCKER:

No what I say is that you've got 608,000 as your starting point.

GLAZEBROOK J:

Okay and who was that owed to? Let's do this. All right so you say – well see you don't seem to have all of the properties in there, so that's what I don't understand.

MR HUCKER:

Well the rest of the properties come in on the next side because by that stage –

GLAZEBROOK J:

Well no because, no they don't because if in November you've stopped and sold, what would have been the position?

MR HUCKER:

The position would've been –

GLAZEBROOK J:

Would've been that all of them would've gone at whatever the valuation in November would have been, ie whatever you could have got on a fire sale.

MR HUCKER:

And what we've done is we've treated the actual sales prices for 48 Penrod Drive, 27A Penrod Drive and 4 Karika Avenue as being what the value of those properties would have been at in November 2012.

GLAZEBROOK J:

Well how can you do that if the values were when they were completed?

MR HUCKER:

Because by that point in time 48 –

GLAZEBROOK J:

No in November none of them had been completed.

MR HUCKER:

No with respect they had.

GLAZEBROOK J:

No you're right because it had been rented out, okay.

MR HUCKER:

Yes and with 4 Karika there was very, very little work still required to be undertaken.

GLAZEBROOK J:

Okay, all right, I understand. Well it's just that this doesn't make any sense to me the way it's set out I'm afraid.

MR HUCKER:

How can I make it make sense to Your Honour? Is there a question I could answer to assist with making sense?

GLAZEBROOK J:

Well basically what you need is a balance sheet at one point and then the balance sheet at the next point if you're saying it's a difference in – but I mean

my problem with that basis of saying, because it's basically saying that if you've robbed Peter to pay Paul and you come out with exactly the same, so if on day one you owed 900,000 to Paul and at the end of carrying on trading while insolvent you owed 900,000 to Peter, you say no compensation for the company. I mean that's what you're actually saying is if you owed 900,000 to Paul at day one and then you carried on trading and owed 900,000 to Peter at the end, you're actually home and hosed and you don't pay any compensation.

MR HUCKER:
That's the debate over the nett depreciable value.

GLAZEBROOK J:
No it's not debate over anything, is that the submission that if in fact the company owes exactly the same amount of debt at day one when you should have stopped trading and day 25 or 10 months later when you did stop trading, if in fact the amount of debt owed to different people is the same, then you shouldn't have any award against you?

MR HUCKER:

That's right and that's the approach that was adopted in *Re Ralls Builders Limited* in the English jurisdiction and it was also the approach –

GLAZEBROOK J:
You might need to show me why that's the case. So does the English jurisdiction say if you rob Peter to pay Paul and have exactly the same at the end then you're home and hosed.

WINKELMANN CJ:
So Justice Glazebrook is asking you in that case were there different creditors who were owed, had there been a substitution of creditors in that intervening period?

MR HUCKER:

I believe there had been and the position that was articulated and they are both first instance decisions, was that it's not assessed from the perspective of creditors, it's assessed from the perspective of the company as a whole and perhaps if I would provide those references.

WINKELMANN CJ:

Yes and if you could also provide us where we can find a list of the creditors as at November 2012 and then as at the date of actual liquidation.

MR HUCKER:

You've got the pleadings in the statement of claim.

WINKELMANN CJ:

Yes does that contain a complete list of creditors as at both dates?

MR HUCKER:

Sorry, November 2012 and –

WINKELMANN CJ:

The date of liquidation.

MR HUCKER:

And the date of liquidation. That includes only the creditors as at that date of liquidation at that point in time in the statement of claim.

WINKELMANN CJ:

Yes so I'd like – it would be good for us to be able to compare the –

MR HUCKER:

There were none based on the aging of the proofs of debt with the liquidator. The proofs of debt that the liquidator had – if you age back the proofs of debt –

WINKELMANN CJ:

No, no, this is a simple question, simply comparing contrast, so we want to know who the creditors were as at November 2012 and who they were as at the date of liquidation.

MR HUCKER:

I'm not sure. The only evidence there of what the creditors were in 2012 is firstly in terms of the mortgage debt which is included within this analysis here in terms of the Coby Sydney property and the Pemberton property. The other evidence is in the table that was produced in evidence at 313.2931 which Mr Cooper's table A and there was owing to creditors 29,000 in relation to the 4 Karika Avenue property in terms of trade creditors that had not been paid. There were also $27,000 owing to creditors in the 28B Coby Sydney property on that particular analysis at that time.

WINKELMANN CJ:

We can just look up that table. Do you have the evidential reference for it?

MR HUCKER:

313.2931.

ELLEN FRANCE J:

So that's Mr Cooper's costings document?

MR HUCKER:

That was Mr Cooper's costings document Your Honour.

WINKELMANN CJ:

And then we can look at just the list of creditors and form our own view about whether they're trade creditors because they'll be new if they're trade won't they?

MR HUCKER:

Well no there's - at that time?

WINKELMANN CJ:

No, no, as at the date of liquidation.

MR HUCKER:

As of the date of liquidation they are specifically pleaded but there is a disputed creditor of Love Earth Movers and I don't take my learned friends for the liquidators to disagree with the calculation of trade creditors on the third page of annexure B.

WINKELMANN CJ:

Right okay. So I think we'll just have to work out ourselves Mr Hucker is my sense.

MR HUCKER:

I'm happy to take – if you work through the aging of the proofs of debt.

WINKELMANN CJ:

I did read through the entire statement of claim. It wasn't a thrilling read.

ELLEN FRANCE J:

So the figure you have on that last page of annexure B for your trade – right, so you've taken Love out.

MR HUCKER:

Yes Your Honour.

ELLEN FRANCE J:

And you've taken out the penalties and interest. That makes the difference between your figures and the –

MR HUCKER:

Yes Your Honour.

GLAZEBROOK J:

I must say I would actually like a comparison that actually compares it, so that we actually see what the actual sale prices of these things were compared to what you've put in this one. What the extra costs were in order to get you to that stage. This doesn't actually do much for me because I can't work out how on earth I am to compare the two.

MR HUCKER:

The sales prices, it's not an issue over the sales prices is it Your Honour?

GLAZEBROOK J:

Well I just can't compare the first part of October 2012, contrasted with the actual liquidation position because if I'm comparing I want to compare like with like, not something that's constructed like this that I don't understand how it is constructed. I mean normally if you do a comparison you'll have asset position here, asset position here, debt, debt but none of this does that to me, unless you can explain how it does.

O'REGAN J:

I mean presumably there was interest accruing on these mortgages during that time?

MR HUCKER:

Yes Your Honour that's correct.

O'REGAN J:

And then there was all the costs of actually finishing them, although of course Mr Cooper worked for nothing but there were the other costs of finishing.

MR HUCKER:

Yes Your Honour, that's correct.

O'REGAN J:

So how do we –

MR HUCKER:

The costs that were incurred in terms of the finishing is set out in the table at 313.2931 which explains each of the properties and what we have here is that these are based on Mr Cooper's figures and what you –

GLAZEBROOK J:

Are they based on what he thought he was going to do or what it actually cost?

MR HUCKER:

Both, Your Honour. You've got two columns here, costs to complete –

GLAZEBROOK J:

Let's go to it then, I haven't gone to that.

WINKELMANN CJ:

He's got actual and –

GLAZEBROOK J:

Okay that's fine, I just didn't have it in front of me. So what tab is it?

MR HUCKER:

Volume 13 Your Honour. And how this table has been created is that Mr Cooper has gone through the various invoices in terms of the build costs. Those invoices were –

GLAZEBROOK J:

Can I just see if I can see if I can find this, volume 13 and what do I go to?

MR HUCKER:

Tab 195 Your Honour, 313.2931.

WINKELMANN CJ:

I mean what do you say about the evidence called for the liquidator about the financial situation of the company? For instance Mr Killick who says that

accumulated losses had ballooned out from 24,000 to 420,000 from 2012 to 2013. Was that disputed through cross-examination?

MR HUCKER:

I believe so but I can't point to the exact reference but this table is not contested because what was not contested at first instance was the realisation strategy. No valuation evidence was contested and it was never put to Mr Cooper that this table was an error in terms of the cross-examination and the process that Mr Cooper had taken in terms of completing this table was to go through all of the invoices that substantiated the additional build costs for 4 Karika and 78 Pemberton. He had undertaken that process to the extent possible for 28B and 28C Coby Sydney but it is noted that there was some estimates of the costs that were required for that and what then appears at 313.2933 is Mr Cooper's summary in relation to each of those additional build costs in relation to each of those properties, noting of course again that the Coby Sydney is partly based on estimate there but what was not put to Mr Cooper was that any of these additional costs were avoidable.

GLAZEBROOK J:

I'm actually not really worried about that, I just want something that gives me a comparison so I can see what the submission is. So a comparison with what would have happened had there been a liquidation in November compared to what actually happened but with actual – not summaries of GST or anything like that but actually saying well here is what would have happened, here is what did happen, there were these additional costs, there were these additional creditors, these additional amounts received for the sale price of certain of these properties, only two are explained.

WINKELMANN CJ:

Well perhaps we can deal with it by Mr Malarao and Mr Hucker filing a short, one or two-page memoranda that gives us the evidential references that will assist us with that.

MR HUCKER:

Happy to do that Your Honour if that's of assistance.

WINKELMANN CJ:

And if you could do that Mr Malarao by next, what's today, Tuesday, so by next Tuesday and you by next Friday Mr Hucker.

MR HUCKER:

Yes Your Honour.

GLAZEBROOK J:

Just so that I've got a comparison that compares like with like, rather than saying this is – well it just doesn't compare like with like to me.

WINKELMANN CJ:

Anyway Mr Hucker.

MR HUCKER:

So as I understand it what Your Honour is after is these are the sale prices for the properties that would have been achieved at this date.

WINKELMANN CJ:

And the creditor situation.

MR HUCKER:

This is the creditor situation. This is the cost complete figure from the point onwards.

GLAZEBROOK J:

These are increased sale prices or whatever because of them being completed.

WINKELMANN CJ:

It's effectively a balance sheet as at each date.

MR HUCKER:

And then these are the creditors in the liquidation.

WILLIAMS J:

And if you and Mr Malarao are in disagreement over any particular figure, as I suspect you will be occasionally, you just point that out and explain what the difference is.

WINKELMANN CJ:

It would actually be helpful if it was just effectively balance sheet type scenario between one date and the next and if counsel could confer to try and sort that would be very helpful.

GLAZEBROOK J:

And in that you can't ignore related party debt.

MR HUCKER:

I'm happy to include that in there. In terms of the question of penalties and interest –

WINKELMANN CJ:

Well you can just identify those Mr Hucker. I appreciate that that's your argument, that they shouldn't be included.

MR HUCKER:

I just wanted to make one point in response to the point made by a question put by Her Honour Justice Glazebrook and that was to say that the money of course has not been received until a later point in time but that of course isn't a function of the penalties and interest under the penalties regime because if compensation is ordered, interest of course can then be awarded under the High Court jurisdiction, the Interest on Monies Act or the old Judicature Act and that's where the compensation is provided for. If interest is allowed on penalties and interest, you've effectively got a double counting in terms of that compensatory aspect.

GLAZEBROOK J:

Can you just give me a ballpark figure, how much better off was the asset position by finishing those properties because it seems to be that it wasn't better off in respect of most of them because they were finished anyway.

MR HUCKER:

It was much better off but the analysis needs to be property by property as Mr Cooper has done that because he had reached the point where there had been significant monies expended on –

GLAZEBROOK J:

No just a ballpark figure. So he delayed doing anything because they were going to be better off, how much better off?

MR HUCKER:

I think it was a couple of hundred thousand dollars.

GLAZEBROOK J:

Thank you, right, okay.

MR HUCKER:

I am happy to check that and come back on that.

GLAZEBROOK J:

Well I mean that's the sort of thing that this analysis will show, just a ballpark was useful, thank you.

MR HUCKER:

Perhaps if I give Your Honours the references to the various cases in support of the proposition.

WINKELMANN CJ:

Yes so we really need to – I can't carry on sitting past 5 o'clock so we need to wind things up.

MR HUCKER:

Yes Your Honour. The starting point is in the *Morgenstern v Jeffreys* [2014] NZCA 449 case tab 13.

WILLIAMS J:

Are you talking still about compensation?

MR HUCKER:

Talking about compensation and the submission is that the nett deficiency approach is the correct approach to adopt in terms of on a principled basis rather than on the –

WINKELMANN CJ:

So it's effectively compensatory, it's not punitive, it's compensatory?

MR HUCKER:

Compensatory and there's the various useful discussion in the Vinelott decision which maintains that it is not a matter of preference, it is because the duty is owed to the company as a whole, and the compensation is assessed to the company as a whole, that the net deficiency approach is taken, rather than an approach of saying what are the creditors proving in the liquidation and that is because there is some pre-existing debt that will have been in place in November 2012.

WINKELMANN CJ:

Okay, so it is compensatory measured by reference to the shortfall to the creditor group as a whole and not measured by the loss of a particular creditor.

MR HUCKER:

Yes and that of course requires the assessment between the notional liquidation and the actual liquidation to be carried out.

GLAZEBROOK J:
If it is under 136, how is that right?

MR HUCKER:
Because the duty is still owed to the company under 136 and the question is what loss has the company suffered as a result of the decision being made under 136.

GLAZEBROOK J:
So in fact you can with impunity, ignore 136 in the situation where the company as a whole is going to be better off?

MR HUCKER:
No that's the function of the loss that has been caused to the company as a whole.

GLAZEBROOK J:
No but you can effectively ignore it and say it doesn't matter if I have got Peter to come in and he is bearing all of the loss because actually the company as a whole is better off.

MR HUCKER:
That's what the approach is in the Vinelott decision.

WINKELMANN CJ:
So the case you are giving us, *Morgenstern*?

MR HUCKER:
There is also the *Delegat v Norman* [2012] NZHC 2358 decision referred to in the written submissions which is the decision of Justice Woolford at first instance, page 115. There is also the *Re Ralls Builders Limited* which is appellant's case tab 18 and at 236 the Court expressly holds that the purpose is not to provide differential redress for individual creditors over the period of wrongful trading. At 238 the wrongful trading must make the company's

position worse before it becomes appropriate for the Court to order the directors to make a contribution. 240 and 241 should not be used to grant a remedy simply because of a preferential payment. 242 refers to need for there to be some cause or connection and 244 is that the test is to restore the company to the position it would have been in had wrongful trading not occurred. 250 to 251 emphasises the difficulty of reconciling competing interests between creditors and turning to the Vinelott decision which is tab 10 of the first respondent's, page 295, the relevant paragraphs are 6 and 7, 8 and 9 and the point in 8 and 9 is that the nett deficiency approach is adopted on the basis that it is not the individual creditor but the company that has made the loss, so it is a company loss. Page 357, paragraphs 99 and 100, page 409, paragraphs 281 and 283. Page 410, paragraphs 294 to 296 and that refers to the approach of setting a maximum which is the overall loss to the creditors and then deducting back from the maximum for accounting for compensation purposes.

WINKELMANN CJ:

Can I query this with you and I won't be long, but you have a discretion under section 301 and if a particular creditor can show that they would not have – that this company should have ceased trading beforehand, because they wouldn't have been there, should have been trading for a year, grossly insolvent say, is it truly the case that they can only recover pari passu as if that was the liquidation?

MR HUCKER:

Well you come back to the restitutionary principle in *Morgenstern* which is what has the defendant, what is the actual loss to the company that the defendant has actually caused.

WINKELMANN CJ:

All right, that's the answer.

MR HUCKER:

Yes, it is what is the actual loss.

WINKELMANN CJ:

I think you've said it.

MR HUCKER:

Caused there, but you've then got to read that with the Vinelott decision of setting the maximum level against which discounts are being undertaken.

WILLIAMS J:

Do you say that Vinelott was tab 10?

MR HUCKER:

Vinelott is tab 10.

WINKELMANN CJ:

Of the first respondent's authorities.

WILLIAMS J:

I've got *Continental Assurance*.

MR HUCKER:

Sorry.

WINKELMANN CJ:

I'm sure we'll find it.

MR HUCKER:

I can look for it.

WINKELMANN CJ:

While you can look for it while your junior's on her feet I think.

WILLIAMS J:

I'm not seeing it in your list.

MR HUCKER:

I may not have provided a copy. It may have been referred to simply in the *Continental*.

WINKELMANN CJ:

You can find us the reference while your junior is on her feet Mr Hucker.

MR HUCKER:

Thank you Your Honour.

WINKELMANN CJ:

Are there any other cases to refer us to?

MR HUCKER:

I was just also wanting to refer you to –

GLAZEBROOK J:

I can't even find the *Morgenstern* one.

MR HUCKER:

Page 436, paragraphs 367 to 381. Just finally in terms of the quantum issues in terms of compensation.

WILLIAMS J:

Sorry, did you say 376 to 381 or and 381?

MR HUCKER:

376 to 381 Sir.

WILLIAMS J:

Out of Vinelott?

MR HUCKER:

Out of Vinelott.

WILLIAMS J:

Thank you.

MR HUCKER:

And there are those remaining compensation issues that are referred to in the submissions, which have an impact on quantum. There are –

WINKELMANN CJ:

What paragraphs are they?

MR HUCKER:

128 to 131 of the written submissions.

WINKELMANN CJ:

138 to 131.

MR HUCKER:

Yes Your Honour and in summary what they are effectively to say that there are some properties that should have been moved into that same category of 2 Karika, as determined by Justice Hinton on the basis that they fell within the reasonable period of sober assessment because effectively the learned High Court Judge in assessing compensation allowed no period of sober assessment to be undertaken, or for any delay to occur. There are also the 4 and 7 Karika properties where the agreements for sale and purpose were entered in October and the payment for any – the first time that GST was not met was the 28th of November 2012, so it's said that those two properties should have been in that same category of 2 Karika as a result of that as well. The other aspect in approaching compensation is that Her Honour made a finding that this is not one of the worst cases of director responsibility and despite submission did not adopt the approach of Justice Lang in *Goatlands* where His Honour Justice Lang made the director's responsible for only a proportion of the GST debt that had not been paid in percentage terms, and given the finding that this was not one of the most serious cases of director

breach, it was submitted that there should be a reduction on that basis following the *Goatlands* approach there.

WILLIAMS J:
I thought she came up with the same number as Justice Lang proportionally. Didn't Justice Lang take off 25%?

MR HUCKER:
Her Honour didn't take anything off.

WILLIAMS J:
I thought she made a deduction of $80,000 on –

MR HUCKER:
Yes, but that was for different considerations. Justice Lang's deduction was made for questions of culpability.

WILLIAMS J:
Ah.

MR HUCKER:
Whereas Her Honour Justice Hinton's $80,000 deduction was made for the services that had been provided to the company.

GLAZEBROOK J:
So you're saying even if you've caused loss to the company if you didn't really mean to you could have a deduction and you don't pay it back. I'm not sure you can have it both ways. Either it's just compensatory for the loss.

MR HUCKER:
It's an alternative submission Your Honour.

GLAZEBROOK J:
Okay.

WINKELMANN CJ:

All right, we're running out of time here, you just have to stand on your – unless there's something that you want to clarify in your written submissions, you need to move on.

MR HUCKER:

Unless Your Honours have any questions those are the submissions on behalf of Mr Cooper. Does Your Honour wish to hear on section 299 from Ms Selby?

WINKELMANN CJ:

Yes, thank you Ms Selby. Just quickly Ms Selby. So you heard that Mr Shakelton said it will turn on the fact that this security was related party security?

MS SELBY:

Yes.

GLAZEBROOK J:

And also only to stop the compensation being claimed under the security.

MS SELBY:

Yes I understand. One point from my learned friend's submissions was that Justice Hinton didn't find that the Trust was an alter ego of Mr Cooper. She did find it was a related party, not that it was an alter ego. Justice Hinton noted that the funds were advanced at a time when Debut was in a perilous financial situation, and the funds would not have been provided without security being granted. From a policy perspective uncertainty in bone fide transactions and a denial of credit from related parties to companies at the time of their greatest need or to be avoided when new consideration is involved. Equally, Mrs Cooper, the other trustee of the Trust –

WINKELMANN CJ:

So what's your point about that sorry?

MS SELBY:

That if related party securities are set aside, just because they are related party securities, that will stop other small businesses from having funding in the same way.

GLAZEBROOK J:

But it's a very limited setting aside was what the submission is against you. To say it's only to stop the compensation coming back, being claimed under that security and effectively going around in a circle.

MS SELBY:

Yes Ma'am. It's more just about the principle of the matter. That you shouldn't –

GLAZEBROOK J:

But if it's only in that sense, and in fact not even accepted that that would occur, what's the problem with it.

MS SELBY:

It's –

GLAZEBROOK J:

Do you say the compensation should go around in a circle and be able to be claimed under the security?

MS SELBY:

No, I think what we're saying is that the –

WINKELMANN CJ:

It's not the same thing as him. It may be a related party but it's not his alter ego.

MS SELBY:

Exactly and it's also the other trustee, Mrs Cooper, who shouldn't be caught in that as well.

WINKELMANN CJ:
And the beneficiaries.

MS SELBY:
And the beneficiaries and –

WINKELMANN CJ:
Who are the beneficiaries?

MS SELBY:
Family members Ma'am, and of course Mr Cooper as a trustee would have trustee obligations.

WILLIAMS J:
Your point is don't kill related party bailouts.

MS SELBY:
Exactly Sir.

WILLIAMS J:
Sometimes they're the only difference between this and disaster.

MS SELBY:
Often, particularly –

GLAZEBROOK J:
So the compensation – because the bailout was because it was trading while insolvent, wrongly, and so it's fine for them to have a related party bailout, and for the compensation to come back in and go straight back to the related party, and the possible benefit of Mr Cooper.

MS SELBY:
Well the benefit of –

GLAZEBROOK J:

Who's presumably a beneficiary or if not his family members are.

MS SELBY:

Yes, well it's not directly Mr Cooper. It's the Trust.

WINKELMANN CJ:

I mean that's your critical submission, isn't it? I mean there are two submissions. The first is, it's quite a punitive thing, they're a creditor, they might be related, but it's they are still nevertheless as represented by their trustees representing other interests, and your second submission is, and moreover it's often the case that funding to these small companies will come from related parties, and if they're going to be treated in this way, it will be, there's a policy consideration against that because it will stop – and those are your submissions?

MS SELBY:

Yes.

GLAZEBROOK J:

So they should be able to claim under the security the compensation that comes back from their participation in the wrongful carrying on of an insolvent business.

MS SELBY:

The trust who hold the security should, yes Ma'am.

GLAZEBROOK J:

Even though they knew that the Trust was insolvent at the time and still provided the funds.

MS SELBY:

The company.

GLAZEBROOK J:

No the Trust did, it knew it was insolvent.

MS SELBY:

Yes, the company was insolvent.

WINKELMANN CJ:

Yes, that's what Justice Glazebrook meant.

MS SELBY:

Sorry. If there are no other questions?

WINKELMANN CJ:

Those are your submissions?

MS SELBY:

Thank you Your Honour.

WINKELMANN CJ:

Thank you Ms Selby. That was very helpful thank you.

MR MALARAO:

Ma'am, I assure you that I will be finished by 5 o'clock and I hope to be beating that relatively significantly. Ma'am, first point is just one piece of the evidence, if I could get Your Honours to turn to the exhibit volume 4 at tab 84. This is responding to the point about –

WINKELMANN CJ:

Sorry, what is the reference?

MR MALARAO:

Sorry, it's volume 4, tab 84. This is responding to the point that what were the actual projections of Mr Cooper at the relevant time, and this is the best evidence of it. So it's at tab 84, if Your Honours flick through three pages, which contain a bunch of emails between Mr Furlong and Mr Cooper, this is a

schedule that had been prepared by Mr Cooper ahead of that meeting on the 6th of November, which there's been quite a lot of discussion about. The point I wanted to make specifically in relation to this, Your Honours, is two points. Firstly, that the figure that you see of 169,375 on the right-hand side, towards the middle of the document, that is the expected surplus, or what's been referred to as the "surplus". What this document doesn't contain at all is the GST on these properties, and that figure in round about terms is 469,00 and the $300,000 is then going to be what is left over, and this was what Mr Furlong told Mr Cooper at this meeting.

The second point that I wanted to make in relation to this document was that the way that the figures have been calculated is that there is no additional cost in terms of the interest component in these transactions. So it's a snapshot at that point. Sale prices are factored in but the time lag towards getting those sale prices, and the cost of carrying that credit, is not factored in.

WINKELMANN CJ:
So the cost of getting what credit are not factored in? What's not factored in?

MR MALARAO:
The company had borrowed from –

WINKELMANN CJ:
All right, the borrowings. The cost of credit on the borrowings are not factored in.

MR MALARAO:
Yes, no, it just drew down the net amount of the borrowing as at that date. It didn't calculate through what the costs of, say, holding a property for six months, what the interest cost on it would be.

WILLIAMS J:
Do you know what that was?

MR MALARAO:

No, I won't be able to say it with any precision Your Honour.

GLAZEBROOK J:

We might be able to work that out in the material that you put in.

MR MALARAO:

Yes, I'm hoping that I'll be able to get some certainty around that. The point regarding that is also that other schedule that my friend took you to. There was, in fact, a contest on the evidence in terms of that schedule, but it was a relatively minor contest, but there was a concession made in there in respect of that which is that that table also didn't factor into account interest costs. So this was the comparison done between the document I just took Your Honours too, and the actual outcome. That document also didn't factor in the interest costs, and the –

WINKELMANN CJ:

That's Mr Cooper made that concession?

MR MALARAO:

Yes and the reference, Your Honours, is page 202.0341, lines 32, 33 and 34.

WILLIAMS J:

0341, 32 to 34?

MR MALARAO:

Yes. It's right at the bottom of the document. There was another point made, Your Honour, about my friend made the submission that Mr Cooper thought that Mr Furlong had been in touch with Inland Revenue and there was a response from the Bench that Justice Hinton may have made a finding on that point.

WINKELMANN CJ:

Made no finding against it.

MR MALARAO:

No. In fact there is a finding on that point Your Honour. So tab 12, Your Honour, paragraph 65 of the pleadings bundle, second sentence, "Mr Cooper says he understood Mr Furlong had been in touch with IRD but that is implausible. There would have been evidence of Mr Cooper at least seeking assurance from Mr Furlong on that front. Instead there was complete silence vis à vis the IRD until it followed up."

There was quite a lot of discussion on the word "agree" in section 135 and 136. One of the points that I ought to have made in my written submissions, but I hadn't, was that the word "agree" does also appear in schedule 3 of the Companies Act, and this is a schedule that has some prescriptions about how proceedings of a board of a company is to be conducted. This point, perhaps, didn't dawn on me at the time, but it's dawned on me now. In terms of the voting provision, which is at paragraph 5 of schedule 3, subpart (3) says, "A resolution of the board is passed if it is agreed to by all directors present without dissent or if a majority of the votes cast on it are in favour of it.' Then number (4) says, "A director present at a meeting of the board is presumed to have agreed to, and to have voted in favour of, a resolution of the board unless he or she expressly dissents from or votes against the resolution at the meeting."

WINKELMANN CJ:

I don't really see that that's relevant. It's a different context.

MR MALARAO:

It is a different context, Your Honour, but what I suppose I'm trying to say is that the word "agree" is used in the rules containing how meetings are to be conducted, but of course we're talking about a one person company here, so…

WINKELMANN CJ:

And this doesn't, we're not talking about a board meeting, are we?

MR MALARAO:

No.

WINKELMANN CJ:

You're not trying to say, which would be against your interests, are you, this requires someone to either sit by or vote in a board meeting?

MR MALARAO:

Not at all.

WILLIAMS J:

You're not aware of any commentary on that rather curious difference in choice between "cause" and "allow" and "agree"?

MR MALARAO:

I'm not aware of it Your Honour. That's not to say that it doesn't exist but I'm not aware of it.

WILLIAMS J:

It must have some legacy somewhere. It looks like it was intentional but the intention is not obvious to me.

GLAZEBROOK J:

It may be it just means doesn't stop, on matters where it's not a board decision but a management decision possibly.

WILLIAMS J:

Mmm.

MR MALARAO:

One other point –

WINKELMANN CJ:

Is this your final point?

MR MALARAO:

Two more points remaining, one is that the submission was made about the liquidation that follows a week following the claiming of a GST input credit from the IRD. A submission was made that at that point in time Inland Revenue on the liquidation would be claiming for GST. That's not correct. The property is being handled by the liquidator. When and if the property is sold, well it's actually more if the property is sold, the GST arises at that point in time. That's what the IRD is going to be entitled to be claiming, or not entitled to be claiming for, entitled to be paid by the liquidator.

WILLIAMS J:

What do you say about –

GLAZEBROOK J:

So it's a future debt, you say, not a contingent debt?

MR MALARAO:

Yes.

GLAZEBROOK J:

At the time of the liquidation?

MR MALARAO:

Yes.

WILLIAMS J:

What do you say about *Goatlands* then? Wrong?

MR MALARAO:

No, I'm not saying *Goatlands* is wrong but what I'm saying, Your Honour, is that the fact scenario in front of Justice Lang would have been what the Borrells did but except that they didn't lose their deposit, or they didn't use the GST refund to pay the deposit and then, but actually develop or settled on the property, and then that property got sold but the GST wasn't paid. I don't take

Justice Lang to be saying, well no, that obligation would have been right from the outset. It stands for what it stands for but it doesn't stand in the way of the *Peace and Glory* judgment that has been decided.

Your Honour, my friend made a reference to *Re Ralls*. The only thing, in respect of that, I would encourage Your Honours to do is two points. One is *Re Ralls* is the English jurisprudence. It seems to be relatively different to New Zealand and there is an article by Gabriel Moss QC, who was at least a leading insolvency practitioner in England, and he has put in a scathing attack on, or a scathing review of the English jurisprudence. That is right at the end of my volumes of authorities, and I would encourage Your Honours to read that and respectfully submit that New Zealand shouldn't make the mistake that the UK, or the situation that the UK finds itself in.

WILLIAMS J:
The mistake in rules or…

MR MALARAO:
No the position that jurisprudence is just developed in such a way in England, it appears that Justice Snowden in *Re Ralls* finds himself constrained by the very fact that all of these cases in the past have all decided to apply this test of net deterioration stringently and Justice Snowden has some obvious sympathy for the new creditors but says, my hands are tied, and Gabriel Moss QC says, well actually all of these cases are wrong. That wasn't the intent of the Cork Committee which came up with section 214 and we should, of course compensation should follow the nature of the breach and he uses some rather extreme examples to illustrate the point, which is very similar to the point that Justice Glazebrook made.

WILLIAMS J:
Does it have the same ends of justice test that is contained in 301?

MR MALARAO:

Mr Moss' view is that the rule should be that the compensation should respond to the breach. So if new creditors –

WILLIAMS J:

Yes, yes, but I'm talking about, is there a statutory test in the English legislation and is it as broad as the statutory test in New Zealand or is it narrower?

MR MALARAO:

It doesn't appear to be expressed much in the actual section itself, so the Courts have made up how to approach it.

WILLIAMS J:

I see, right.

WINKELMANN CJ:

Is that your last point Mr Malarao?

MR MALARAO:

Last point Ma'am is that on Mr Hucker's submission he asked for a further pass on two of the properties. Respectful submission is that two of the properties is sufficient because these properties were sold in October, the finding of insolvency at that point in time, the GST never got paid on those two properties, Mr Cooper got a pass on those and that should be where it stops.

Those are my submissions, Your Honour, unless I can help further.

WINKELMANN CJ:

And are you content with what you need to do in terms of filing memorandum?

MR MALARAO:

Yes I am content Your Honour.

WINKELMANN CJ:

And Mr Hucker, you were going to give us that reference for Vinelott?

MR HUCKER:

I haven't located it Your Honour but I'm happy to email that through to the registry if that's of assistance.

WINKELMANN CJ:

That would be very helpful, thank you Mr Hucker. Thank you counsel for your submissions. Sorry, Mr Hucker, if you seemed to get a bit of a hard time, but you're advancing something that we all understand to be a change in the law in New Zealand so we tested you in relation to it. But thank you for your very –

MR HUCKER:

Robust exchanges are always useful, Your Honour, I accept that.

WINKELMANN CJ:

Thank you all for you helpful submissions. We'll take some time to consider out decision, as you will appreciate, and let you have that in the usual course.