High Court of New Zealand

26 February 2019

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MAINZEAL PROPERTY AND CONSTRUCTION LIMITED v YAN
[2019] NZHC 255

MEDIA RELEASE

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

The High Court has upheld claims of reckless trading made against the former directors of Mainzeal Property and Construction Limited (in liquidation). The Court has ordered that the directors pay compensation of various amounts totalling $36 million.

Mainzeal went into liquidation in early 2013. The unsecured creditors are owed approximately $110 million. This comprises unpaid sub-contractors ($45.4 million), construction contract claimants ($43.8 million), employees not covered by statutory preferences ($12 million) and other general creditors ($9.5 million). The proceeding was bought by the liquidators seeking orders against the former directors that they contribute between $32.8 and $75.3 million to the company in liquidation.

Justice Cooke has upheld the claim that the directors breached s 135 of the Companies Act 1993. This imposes a statutory duty on directors not to cause, allow, or agree to the business of the company to be carried on in a manner likely to cause a substantial risk of serious loss to the company's creditors. The Court took into account a range of considerations, but held that there were three key matters that cumulatively led it to conclude that the duty had been breached:

(a) The directors had adopted a policy of insolvent trading. The shareholding group — the Richina Pacific Group — had extracted significant funds forming part of Mainzeal's capital base for use elsewhere by the group, particularly for investment in China, leaving the company balance sheet insolvent. The directors then agreed to continue trading in this state as part of the company's *modus operandi* over a number of years. In order that it could trade it used money owed to trade creditors — particularly sub-contractors — as its working capital.

(b) The Court held that this approach alone would not have meant the duties were breached if the directors could reasonably have been assured that Richina Pacific group support would have been provided in the event of adverse financial circumstances. But the Court held that no such assurance arose in the facts of the case. The assurances relied upon were ambiguous, conditional, and subject to the constraints of Chinese law, which restricted the ability to return money to New Zealand from China.

(c) The Court held that the above two factors would not have led to breach if the trading performance of the company was sufficiently strong so that it did not need to rely on significant financial resources to avoid collapse. But this was not the case. Mainzeal's performance was generally poor, often involving annual trading losses, and it was also prone to significant one-off losses arising from particular projects.

The amount the directors are required to pay was determined under s 301 of the Act. This authorises the Court to order the directors to contribute such a sum to the assets of the company as it thinks just.

The Court rejected the liquidators' claim that the directors should contribute an amount representing the difference in the loss to creditors between the 2013 liquidation and what would have occurred if Mainzeal had been liquidated in 2011, when the breach of duties arose. The Court rejected this approach because it did not reflect the way the directors had breached their duties. The directors had not breached their duty by trading on a company that was destined to fail in any event. Rather, their breach involved trading the company in a manner that made it vulnerable to collapse.

The Court also rejected an alternative method for calculating the level of compensation described as the "new debt" approach, which had been advocated by a prominent overseas commentator. It held that such an approach was not appropriate under the New Zealand provisions for a breach of s 135.

Justice Cooke assessed the appropriate amount of compensation based on the total loss on liquidation ($110 million) as the starting point. This was on the basis that Mainzeal would not have failed at all were it not for the vulnerable trading approach that the directors had adopted. The Court held that it was not necessary to find that the directors could have successfully stopped this approach had they performed their duties, but nevertheless found that it was likely that the Richina Pacific group would have taken steps to stop the vulnerable trading approach had the directors declined to agree to it, if necessary by threatening to resign.

The Court then allowed a substantial discount from the starting point of $110 million given that there were many other factors that contributed to the failure of the company. The Court arrived at a total figure of $36 million, being approximately one third of the total loss to creditors, and being similar to the balance of funds that the directors had allowed the shareholder group to extract from Mainzeal.

The Court also held that there was a difference in the positions of the directors even though they had all breached their duties. Dame Jenny Shipley, Mr Clive Tilby and Mr Peter Gomm had all acted in good faith, and with honesty, and they had done so throughout. It was of no personal advantage to them to engage in trade in the infringing manner. Mr Richard Yan was

in a different position as he was a significant personal shareholder of Richina Pacific, who benefitted very significantly from the funds extracted from Mainzeal. The assets acquired in China are now very valuable. Mr Yan had also acted honestly and was genuinely committed to Mainzeal but he had induced the other directors to breach their duties, including by making misleading representations to them. These differences were recognised by limiting the liability of Dame Jenny, Mr Tilby and Mr Gomm to $6 million each, while holding Mr Yan liable for the full $36 million.

The Court considered, but ultimately did not take into account, the insurance cover held collectively by the directors, which potentially involves $20 million of liability cover. The Court made no findings on the extent and operation of this insurance cover.

The Court rejected all other claims advanced by the liquidators with the exception of a claim against a related company, Isola Vineyards Limited, for an amount of $2,164,474.09 in relation to a transaction for inadequate consideration under s 298(2) of the Companies Act, which arose from a restructuring of the group's intercompany debts. As a consequence, all claims against Sir Paul Collins failed, and the other directors faced no additional liability associated with these claims.