IN THE HIGH COURT OF NEW ZEALAND
TAURANGA REGISTRY

I TE KŌTI MATUA O AOTEAROA
TAURANGA MOANA ROHE

CIV 2016-470-184
[2017] NZHC 3040

UNDER	the Companies Act 1993
IN THE MATTER	of the liquidation of Ulsterman Holdings Limited (in liquidation)
BETWEEN	ULSTERMAN HOLDINGS LIMITED (IN LIQUIDATION) First Plaintiff
	VIVIEN MADSEN-RIES and DAVID LEVIN Second Plaintiffs
AND	RIKI SCOTT STEEN WALLS Defendant

Hearing:	7 March 2017
Appearances:	K M Wakelin and G A Campbell for Plaintiffs No appearance for or by the Defendant
Judgment:	7 December 2017

JUDGMENT OF PETERS J

This judgment was delivered by Justice Peters on 7 December 2017 at 4.30 pm pursuant to r 11.5 of the High Court Rules

Registrar/Deputy Registrar

Date: .....

Solicitors: Meredith Connell, Auckland

Introduction

[1] The liquidators of Ulsterman Holdings Limited (in liquidation), Ms Vivien Madsen-Ries and Mr David Levin ("company" and "the liquidators"), seek relief against the defendant, Mr Riki Walls.

[2] Mr Walls was the sole director of the company at all material times. Mr Walls and Ms Rebekeh Doney, apparently his partner, each owned 50 per cent of the shares in the company ("shareholders"). Ms Doney is not a party to the proceeding.

[3] The liquidators seek:

(a) declarations that Mr Walls breached the duties imposed upon him by ss 131, 135, 136 and 137 Companies Act 1993 ("Act"), and an order that he contribute such sum to the assets of the company by way of compensation as the Court thinks fit;[1] and

(b) directions pursuant to s 284 of the Act.

[4] An earlier claim for compensation pursuant to s 348(2)(b) Property Law Act 2007 was abandoned.[2] Given that, it is unnecessary for me to address the extensive evidence as to drawings that Mr Walls and arguably Ms Doney took from the company, in so far as it relates to that claim.

[5] Mr Walls did not file a statement of defence and the matter proceeded by way of formal proof. I have determined the proceeding in accordance with High Court Rules 2016, r 15.9, and having regard to the principles of formal proof referred to in *Chen v Zhong*; *Neumayer v Kapiti Coast District Council*; *Ferreira v Stockinger*; *Kim v Cho*; and *Superior Blocklayers Ltd (in liq) v Bacon*.[3]

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1 Companies Act 1993, s 301.

2 Memorandum of Counsel for the Plaintiffs dated 19 July 2017.

3 *Chen v Zhong* HC Auckland CIV-2010-404-1995, 14 November 2011; *Neumayer v Kapiti Coast District Council* [2013] NZHC 1106; *Ferreira v Stockinger* [2015] NZHC 2916; *Kim v Cho* [2016] NZHC 1771, [2016] NZAR 1134; and *Superior Blocklayers Ltd (in liq) v Bacon* [2016] NZHC 2601, (2016) 14 TCLR 425.

Background

[6] The company was incorporated on 11 October 2010. It commenced trading in December 2010, operating a bar and restaurant in Tauranga. As best as can be ascertained, the company ceased trading in April 2013.

[7] By agreement dated 28 June 2013, the company agreed to sell its assets to an unrelated third party for $120,000 ("proceeds of sale"). The sale was settled in August 2013.

[8] By application dated 22 June 2016, the Commissioner of Inland Revenue ("Commissioner") sought an order that the company be wound up. That order was made on 29 August 2016 and the liquidators appointed.

[9] By affidavit sworn on 1 March 2017, Mr Levin gives evidence that creditors' claims in the liquidation, which the liquidators have accepted, total $552,614.82 and comprise:

(a) a claim by the Commissioner for her costs in the proceedings to wind up the company, being $3,941.36;

(b) a preferential claim by the Commissioner for $198,451.44. This sum is the "core tax" (defined below) owed at the date of liquidation;

(c) a non-preferential claim by the Commissioner for $325,388.28 being accrued penalties and interest on the core tax; and

(d) a claim by Stonegrill (New Zealand) Limited ("Stonegrill") for $24,833.74.

[10] The shareholders have not lodged a claim, even though the company's (unsigned) financial statements to 31 March 2014 record a debt to them of $161,711.

[11] Mr Levin's evidence is that the company has no realisable assets apart from any legal claims it may have.

Mr Levin's analysis

[12] Mr Levin is a specialist in insolvency and company liquidation. He has reviewed the company's (unsigned) financial statements ("financial statements"), general ledgers and bank statements. On the basis of these documents, Mr Levin's evidence is that the company was insolvent from 30 June 2011 at the latest.

[13] The company first defaulted on its obligations to pay PAYE for the period ending 30 June 2011. Thereafter it defaulted on its PAYE obligations until 31 August 2013, by which time it had ceased trading. Taking into account modest sums credited for PAYE ($5,927.19), as at the date of liquidation the company owed $95,312.30 in PAYE arrears, together with penalties of $145,961.85 and interest of $70,177.27 accrued on the same.

[14] The company also defaulted on its obligations in respect of:

(a) Student Loan Employer Contributions from 31 August 2011 onwards. As at the date of liquidation, the company owed $7,548.20 in respect of these Contributions. Accrued penalties and interest brought the total sum owed to $18,649.20.

(b) KiwiSaver Employer Contributions from 31 October 2011 onwards and KiwiSaver Employee Deductions from 30 November 2011 onwards. As at the date of liquidation, the company owed $2,940.46 and $4,887.57 in respect of these items respectively, and a total of $5,225.49 and $12,692.63 including penalties and interest.

(c) Child Support Employer Contributions of $1,006.53 between 31 December 2011 and 31 May 2012. As at the date of liquidation, the outstanding Contributions totalled $4,201.86, including penalties and interest.

(d) GST in each (six-month) period from the period ending 31 March 2012 onwards. As at the date of liquidation, the company owed $86,838.36

in respect of GST, plus penalties of $50,767.93 and interest of $33,602.65.

(e) Employer Superannuation Contributions from 31 May 2012, totalling $410.18.

[15] The PAYE, GST, Contributions and Deductions to which I have referred constitute the "core tax" owed to the Commissioner. By the date of the order to wind up, the core tax that the company owed the Commissioner comprised $198,451.44. Accrued penalties and interest to that date brought the total to $523,839.72.

[16] Mr Levin's experience has been that a continuing failure to pay tax over an extended period is evidence of insolvency. That is because sums held on account of the obligations to which I have referred should be retained for a short period only.

[17] Stonegrill's claim of $24,833.74 arises from several unpaid invoices it rendered to the company in 2013, for services provided.

Debts due to third parties/personal guarantees

[18] The company's financial statements and general ledger record debts due to third parties.

Lion Nathan

[19] On or about 1 November 2010, Lion Nathan advanced $400,000 to the company. Mr Walls and his parents guaranteed repayment of the debt. The debt was also secured by a mortgage registered against a property owned by Mr Walls' parents or in which they had an interest.

[20] As at 31 March 2011, the company's debt to Lion Nathan was $373,333. A deed of variation, executed by Mr Walls as director but not by Lion Nathan, records a repayment of $299,999.98, with a sum due of $60,000. The company's general ledger to 31 March 2012 records that the $299,999.98 was introduced by the shareholders.

Advances from parents

[21] The company's general ledger records that Mr Walls' parents advanced $120,000 to the company in the year ended 31 March 2012. However, I shall proceed on the basis that Mr Walls' parents advanced the funds to the shareholders who advanced them to the company, as the funds appear to have been credited to the shareholders' current account. It makes no difference in the final analysis.

Shareholders' current account

[22] The company's financial statements record that it owed the shareholders $366,176 as at 31 March 2012. Although the shareholders introduced funds thereafter, the company subsequently made numerous payments to or for their benefit. These payments had the effect of reducing the company's debt to the shareholders to $161,711 as at 31 March 2014. The net sum that the company paid the shareholders after 1 April 2012 was $204,465.

Proceeds of sale

[23] The company applied the proceeds of sale, net of agent's commission and legal fees, as follows:

(a) $10,000 to its lessor to secure a surrender of the lease. Mr Walls had guaranteed the payment of sums due under the lease. The Deed of Surrender of Lease recorded that the company and Mr Walls were to be released from their obligations in consideration of this payment.

(b) $35,653.29 to Lion Nathan, which Mr Walls had also guaranteed.

(c) $50,000 directly to Mr Walls' parents, this payment being treated by the company as a partial reduction of its debt to Mr Walls.

[24] In short, some $95,000 of the net proceeds were applied to pay debts in which Mr Walls was interested.

First cause of action: Section 301 Companies Act 1993

[25] Section 301(1) permits the Court to order a director to contribute a sum to the assets of the company by way of compensation if it appears that he or she has breached a duty owed to the company. The liquidators contend that Mr Walls breached the duties imposed on him by ss 131(1), 135, 136 and 137 of the Act.

[26] The material parts of s 301 are as follows:

> **301 Power of court to require persons to repay money or return property**
>
> (1) If, in the course of the liquidation of a company, it appears to the court that ... a past or present director ... has ... been guilty of ... breach of duty ... in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—
>
> (a) inquire into the conduct of the ... director ... and
>
> (b) order that person—
>
> (i) …
>
> (ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or
>
> ...

[27] A claim for compensation under s 301(1) is to be assessed in two stages.[4] The Court should first determine whether there has been a breach of duty or duties. If so, the Court should determine whether the director should be required to contribute to the assets of the company and, if so, in what sum. The nature of the duty or duties breached affects the principles to be applied when determining the compensation to be paid.[5]

[28] I turn now to the duties that the liquidators allege that Mr Walls breached, addressing s 135 first.

Section 135 – reckless trading

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4 *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396, [2010] 2 NZLR 57 at [48].

5 *FXHT Fund Managers Ltd (in liq) v Oberholster* [2010] NZCA 197 at [28]-[30]; *Owens v Coleman* [2016] NZHC 2644 at [20]-[23].

[29] Section 135 provides:

> **135 Reckless trading**
>
> A director of a company must not—
>
> (a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[30] The duty is owed by a director to the company, rather than to a particular creditor. The test is an objective one. The focus is not on the director's belief but whether the manner in which the company's business has been carried on has created a substantial risk of serious loss. A director is required to make a "sober assessment" of the company's position if it enters "troubled financial waters".[6] The assessment must be of an ongoing nature as to the company's likely future income and prospects.[7]

[31] As I have said, Mr Levin's view is that the company was insolvent from 30 June 2011 at the latest, being the date on which the company first defaulted on its obligations to the Commissioner. However, a director may be permitted time to see whether trading improves. In *Syntax Holdings (Auckland) Ltd (in liq) v Bishop*, Heath J allowed the directors six months to take stock of the company's position.[8]

[32] If I allow Mr Walls the same six months, then he could have been expected to assess the company's prospects as at 31 December 2011 or, at the absolute latest, as at the next balance date of 31 March 2012. That was the end of the company's six month GST period and the end of its first full financial year of trading. Mr Levin's evidence is that the company's unsigned financial statements at that date reveal a net trading deficit of $206,734, a working capital deficit of $198,537 and net liabilities of

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6 *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [51].

7 At [51].

8 *Syntax Holdings (Auckland) Ltd (in liq) v Bishop* [2013] NZHC 2171. A period of six months was also allowed in *Richard Geewiz Gee Consultants Ltd (in liq) v Gee* [2014] NZHC 1483 at [102] and a period of five months in *M J Pidgeon Builder Ltd (in liq) v Pidgeon* [2016] NZHC 1566 at [50].

$289,036. Had he made the necessary assessment, Mr Walls would have recognised that the company was insolvent and that it must to cease trading.

[33] Given that, I am satisfied that Mr Walls breached his duty under s 135 by allowing the company to trade after 31 March 2012 at the latest, and that the manner in which the business of the company was conducted thereafter created a substantial risk of serious loss to the company's creditors.

Section 131(1) – duty to act in good faith and in the best interests of the company

[34] Section 131(1) provides:

> **131 Duty of directors to act in good faith and in best interests of company**
>
> (1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.

[35] A director is in breach of s 131 if he or she puts their own interests, or those of some other person, ahead of those of the company.[9]

[36] Although the duty imposed under s 131(1) is subjective, a director will generally be regarded as having breached the duty if he or she causes a company to enter a transaction that would have been inconceivable had the director appreciated their fiduciary responsibilities.[10] Moreover, acting in the best interests of the company encompasses discharging its obligations to creditors in some circumstances.[11]

[37] I accept the liquidators' submission that Mr Walls breached his duty under s 131 by causing or allowing the company to continue to trade after 31 March 2012, when it must have been apparent to him that the company was unable to meet its obligations to the Commissioner as they fell due.

[38] Moreover, Mr Walls breached s 131(1) by causing the company to reduce the debt owed to the shareholders under the current account by $204,465 from 1 April

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9 Peter Watts *Directors' Powers and Duties* (2nd ed, LexisNexis, Wellington, 2015) at 146.
10 *Australian Growth Resources Corp Pty Ltd v Van Reesema* (1988) 13 ACLR 261 (SASC) at 270.
11 *Sojourner v Robb* [2006] 3 NZLR 808 (HC) at [102].

2012 onwards. By this time the company had been insolvent for nine months. In doing so, Mr Walls preferred his interests, and those of others, ahead of the company's.

Section 136 – duty in relation to obligations

[39] Section 136 provides:

> **136 Duty in relation to obligations**
>
> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

[40] Views differ as to whether a liability or obligation accrued or incurred in the course of trading, such as to account for PAYE, can be described as one "agreed to" by a director, in contrast to, say, borrowing or agreeing to purchase or lease.[12] Although I expect that Mr Walls breached this duty by engaging Stonegrill to undertake work – even if not in respect of the mounting debt to the Commissioner – a finding that he did so adds nothing to the liquidators' claim. I prefer to base my decision on the other duties alleged to have been breached.

Section 137 – duty of care

[41] Section 137 provides:

> **137 Director's duty of care**
>
> A director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,—
>
> (a) the nature of the company; and
>
> (b) the nature of the decision; and
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> (c) the position of the director and the nature of the responsibilities undertaken by him or her.

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[12] *Richard Geewiz Consultants Ltd (in liq) v Gee*, above n 8, at [109]; *Auckland Crash Repairs Ltd (in liq) v van Rooy* [2015] NZHC 2640 at [66]; *Superior Blocklayers Ltd (in liq) v Bacon*, above n 3; *Bay Kiwifruit Contractors Ltd (in liq) v Ladher* [2015] NZHC 63 at [48]; *Mizeen Painters Ltd (in liq) v Tapusoa* [2015] NZHC 826, [2016] NZAR 423 at [46]; *Bay Metal Fabricators Ltd (in liq) v Steenson* [2016] NZHC 1634 at [46]; and *Kiwi Best Realty Ltd (in liq) v Kashari* [2016] NZHC 2738 at [30].

[42] The test under s 137 is objective. A director is required to meet the standard of a reasonable director.[13] As appears from the matters listed in s 137(a) to (c), the circumstances of the director are relevant to the inquiry. In the present case, as in *Boutique Tanneries Ltd (in liquidation) v Handley*, Mr Walls was acting as the sole director of a small trading business, without the opportunity for guidance from a detached board.[14]

[43] That said, for reasons given, Mr Walls did not exercise the care, diligence and skill that a reasonable director in the same circumstances would have exercised. A reasonable director in Mr Walls' circumstances would have ceased trading on or before 31 March 2012. Mr Walls breached the duty owed under s 137 as a result.

[44] For the reasons given, I am satisfied that Mr Walls breached his duties to the company under ss 131, 135 and 137 of the Act and made declarations to that effect.

Section 301 – relief

[45] I turn now to consider whether Mr Walls should be required to contribute to the assets of the company and, if so, in what sum.

[46] Subject to the exercise of the Court's discretion, relief under s 301(1)(b) will be calculated by examining the nature of the breach of duty and by judging the appropriate amount of compensation to be awarded based on common law and equitable principles.[15]

[47] The usual approach is to begin by determining the extent to which the company's financial position worsened between the date of breach and the date of liquidation.[16]

[48] For the reasons given, I consider that Mr Walls was in breach of the various duties to which I have referred from 31 March 2012 at the latest. Mr Walls should have caused the company to cease trading then. To compound matters, thereafter

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13 *Grant v Johnson* [2016] NZCA 157 at [46].
14 *Boutique Tanneries Ltd (in liq) v Handley* HC Auckland CIV 2006-404-2713, 24 July 2008 at [31].
15 *Morgenstern v Jeffreys* [2014] NZCA 449, (2014) 11 NZCLC 98-024 at [99].
16 *Mason v Lewis*, above n 6, at [109]; *Morgenstern v Jeffreys*, above n 15.

Mr Walls caused the company to repay part of the sum it owed to shareholders, thereby preferring his own interests and those of others ahead of the company's.

[49] The losses that accrued after 1 April 2012 total $489,810.06, comprising:

(a) core taxes of $153,743.71 and penalties and interest of $188,677.29 thereon; and

(b) penalties and interest of $122,555.32 due on core taxes that accrued prior to 1 April 2012;

(c) $24,833.74 due to Stonegrill.

[50] In so far as concerns a breach of s 131, in *Morgenstern v Jeffreys*, the Court of Appeal said:[17]

> [99] … A breach of s 131 involves the breach of a fiduciary obligation, requiring a strict standard of causation and imposition of the fiduciary measure of damages, including on a "restitutionary" or notional account of profits basis. A company's loss, where "loss" is in any event the appropriate measure of compensation, is calculated based on the deterioration of its financial position between the date of the breach and the date of liquidation. The onus is on the delinquent director to prove that the loss, or part of it, would have been caused regardless of the breach.
>
> (footnotes omitted)

[51] Accordingly, *prima facie* a director in breach of s 131(1) is liable for all loss that accrues after the breach, subject to the director proving that the loss would have been caused regardless of the breach.[18] This strict standard of causation is adopted because breach of s 131(1) involves the breach of a fiduciary obligation.[19]

[52] Compensation for a breach of ss 135 or 137 is determined having regard to the extent of the deterioration in the company's financial position after the breach, the

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17 *Morgenstern v Jeffreys*, above n 15.

18 *Morgenstern v Jeffreys*, above n 15, at [99]; *FXHT Fund Managers Ltd (in liq) v Oberholster*, above n 5, at [28].

19 *Morgenstern v Jeffreys*, above n 15, at [99]; *FXHT Fund Managers Ltd (in liq) v Oberholster*, above n 5, at [28].

extent to which the breach caused that deterioration, the director's culpability and the duration of trading, at least in so far as s 135 is concerned.[20]

[53] I am satisfied that at the very least Mr Walls should compensate the company for the losses referred to in [49](a) and [49](c). The loss referred to in [49](b) is in a different category because it arises from a liability that had accrued by the date of breach. I am satisfied that Mr Walls should pay that additional sum given the strict nature of liability for a breach of s 131. I would have excluded that sum if I were determining compensation on the basis of a breach of ss 135 or 137 but not s 131.

[54] Accordingly, I order Mr Walls to contribute $489,810.06 to the assets of the company.

[55] The liquidators also sought compensation in the sum of the shareholders' current account, being $161,711. However, neither shareholder has filed a claim in the liquidation. As discussed with counsel at the hearing, I decline to award compensation at present but the liquidators may apply for further relief if the position changes.

[56] I record that the liquidators abandoned their claim for an order that Mr Walls should pay the costs of the liquidation.[21]

Second cause of action: Directions pursuant to s 284 – value of claims by shareholders

[57] The liquidators also sought directions as to matters relating to any claim by the shareholders in the liquidation.[22] Again, as no claim has been made at present, I advised counsel that I would reserve leave to the liquidators to apply for directions if a claim were made. I reserve leave accordingly.

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20 *Mason v Lewis*, above n 6, at [110]; FXHT *Fund Managers Ltd (in liq)*, above n 5, at [17] and [28]-[31].

21 Plaintiffs' Synopsis of Submissions dated 2 March 2017 at [8.20].

22 Companies Act 1993, s 284.

Result

[58] I enter judgment in favour of Ms Madsen-Ries and Mr Levin, in their capacity as liquidators of Ulsterman Holdings Limited, against Mr Walls in the sum of $489,810.06, plus interest from the date of liquidation to the date of judgment in accordance with s 87 Judicature Act 1908.

[59] I reserve leave to the liquidators to apply for relief in respect of the matters referred to in [55] and [57] above.

[60] The liquidators are entitled to costs on a 2B basis, together with reasonable disbursements. Costs and disbursements shall be fixed by the Registrar.

Peters J