IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA175/2018
[2019] NZCA 39

BETWEEN	LEONARD WAYNE COOPER Appellant
AND	DEBUT HOMES LIMITED (IN LIQUIDATION) First Respondent
	VIVIEN JUDITH MADSEN-RIES AND HENRY DAVID LEVIN AS LIQUIDATORS OF DEBUT HOMES LIMITED (IN LIQUIDATION) Second Respondents
	LEONARD WAYNE COOPER AND TRACEY COOPER AS TRUSTEES OF THE L & T COOPER FAMILY TRUST Third Respondents

Hearing:	21 November 2018
Court:	Miller, Asher and Gilbert JJ
Counsel:	R B Hucker and R F Selby for Appellant P V Shackleton for First and Second Respondents
Judgment:	8 March 2019 at 10 am
Reissued:	17 May 2019
Effective date of Judgment:	8 March 2019

JUDGMENT OF THE COURT

A The appeal is allowed in part.

B The High Court order for Mr Cooper to pay compensation under the Companies Act 1993, s 301(1)(b)(ii) is quashed.

C The High Court order setting aside the General Security Agreement in part under the Companies Act 1993, s 299 is quashed.

D The High Court order granting leave to the liquidators to re-apply to the court for an increase in compensation if the trustees of the L & T Cooper Family Trust succeed in proving in the liquidation is quashed.

E The High Court order setting aside payments as voidable transactions remains in force.

F The first and second respondents must pay the appellant costs for a complex appeal on a band A basis and usual disbursements. We certify for two counsel.

REASONS OF THE COURT

(Given by Asher J)

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Introduction

[1] This case concerns the liability of the appellant Leonard Cooper for alleged breaches of his duties as a director under the Companies Act 1993 to the first respondent Debut Homes Ltd (in liquidation) (Debut Homes). The claim has been brought by the second respondents as the liquidators of Debut Homes.

[2] The case revolves around Mr Cooper's decision at the start of November 2012 when Debut Homes was in financial difficulties, to complete and sell houses that Debut Homes had been building. The primary creditor who will benefit from the litigation is the Inland Revenue Department (the IRD). It seeks to prove for GST on a number of sales of properties that was not paid from the proceeds of sale at the time they were settled. GST was outstanding and continues to be outstanding. Unsecured creditor claims in the liquidation totalled $499,507, and of that sum $366,011 is GST and $84,088 is interest and penalties.

[3] Debut Homes was a residential property developer, incorporated on 1 August 2005. For the purposes of profit it purchased vacant sections, constructed homes on them, and sold them on completion. Its shareholders were Mr and Mrs Cooper, and Mr Cooper was its sole director. The Coopers provided the initial working capital for the company of $210,000. In the last 18 months of the company's trading life, Mr Cooper worked for the company without remuneration. There were, however, payments of $34,129.54, made by the company to him that could not be identified as for company purposes.

[4] The L & T Cooper Family Trust (the Trust) is the third respondent in this case. Mr and Mrs Cooper are the settlors, trustees and beneficiaries of the Trust. The Trust advanced $376,816.56 to Debut Homes throughout 2013 and early 2014. A General Security Agreement (GSA) was entered into on 22 March 2013 documenting that advance. The GSA gave the Trust general security over the assets of the company. The funds were used to pay accounts for the building completion work so that it did not come to a standstill. This loan by the Trust was only partially repaid, leaving the Trust with a deficit of more than $200,000. The Trust has not made any claim in the liquidation.

[5] In a High Court judgment issued on 15 March 2018[1] Hinton J found that Mr Cooper had breached his duties under ss 131(1), 135(b) and 136 of the Companies Act. She made the following orders:[2]

(a) Under s 301(1)(b)(ii) of the Act, Mr Cooper was required to make a contribution in the sum of $280,000 towards the assets of Debut Homes.

(b) Under ss 292 and 294(5) of the Act, the payments made by Debut Homes to Mr Cooper totalling $34,129.54, were set aside as voidable transactions. Mr Cooper is also required to repay that amount to the liquidators.

(c) Under s 299(1) of the Act, the GSA entered into between Debut Homes and the Trust, dated 22 March 2013, was set aside as against the second defendants, only to the extent of the awards made against Mr Cooper in the judgment.

(d) Leave was granted to the liquidators to re-apply to the court for an increase in compensation if the trustees of the L & T Cooper Family Trust succeed in proving in the liquidation as unsecured creditors.

Background

[6] Debut Homes was incorporated in 2005. Mr Cooper was the sole director and worked full time in the business. He and his wife Tracey Cooper owned all the shares. From 2005 onwards Debut Homes completed a number of developments. By October 2012 it still had some to complete. The High Court Judge found, as at 31 October 2012, Debut Homes had paid all debts as they fell due including GST.[3] There had been notional balance sheet insolvency of Debut Homes in the years prior to this, but the company had been supported by shareholder loans from the Coopers, and had traded without default until this time.

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1 *Debut Homes Ltd (in liq) v Cooper* [2018] NZHC 453.
2 At [143].
3 At [6].

[7] By the end of October 2012 the company was plainly in financial difficulties. These are detailed in the High Court judgment.[4] As at early November 2012 it had four remaining properties to complete. A house at 4 Karika Place was very close to completion. A house at 28 Coby Sydney Drive (divided into two titles: 28B and 28C Coby Sydney Drive) and a house at 78 Pemberton Avenue were at early stages of construction. Two other houses were already completed and were rented out, but had not been sold.

[8] After a meeting on 6 November 2012 between Mr Cooper and his accountant Mr Steve Furlong, Mr Cooper decided to limit the company's trading for the time being to the completion and sale of the remaining partially developed remaining properties, with all properties being sold as soon as possible. The GST position was discussed and Mr Cooper was told by Mr Furlong that there would be a GST deficit of at least to $300,000.[5] The figures however showed a surplus of $170,000 that could be available for GST.[6]

[9] Through its trading years, Debut Homes had two financiers, the BNZ and a second-tier lender JT Jamieson & Co Ltd (JTJ). In order to finance the completion of the houses on 7 November 2012 Debut Homes obtained further borrowing from JTJ on the basis that Mrs Cooper gave security over a $200,000 deposit that she had with JTJ.

[10] More funds were required to complete the remaining houses. On 20 February 2013 Mr and Mrs Cooper as trustees of the Trust agreed to lend up to $380,000 to Debut Homes as further working capital. The funds were derived from the estate of Mrs Cooper's parents. There was a general security agreement signed by Debut Homes with the Trust in March 2013, and advances of $376,816.56 were made by it between March 2013 and February 2014. Mrs Cooper's $200,000 deposit to JTJ was returned to her and the security released. With the assistance of these funds the four properties at 4 Karika Place, 28B and 28C Coby Sydney Drive, and 78 Pemberton Avenue were completed and sold.

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4 At [8]–[14] and [47].
5 At [13]. This was disputed by Mr Cooper, but Mr Furlong's evidence was accepted in the High Court.
6 At [11].

[11] From November 2012 and through to early 2014 those properties and other properties that had already been completed prior to October 2012 were sold and the sales settled. Cash flow and the extra Trust funding were used to pay the costs of completion (although there was a modest trade shortfall at the end). On all the sales after 9 November 2012, no GST was paid.[7] Ultimately 28B and 28C Coby Sydney Drive, 4 Karika Place and 78 Pemberton Road were sold. Most of the money was paid towards the secured creditors BNZ and JTJ, although $170,103 was paid to the Trust leaving over $200,000 of the Trust loan outstanding.

[12] On 7 March 2014 Debut Homes went into liquidation on the IRD's application. In addition to the $499,507 of unsecured creditor claims, Mr and Mrs Cooper were still owed a current account debt of approximately $210,000 and over $200,000 of the Trust loan. There were few other unsecured creditors, and some of them were contested.

The High Court decision

[13] The proceedings have been brought by the liquidators, seeking a number of orders against Mr Cooper in his capacity as a director. Mr Hucker, for Mr Cooper, submitted that the decisions made by Mr Cooper in early November 2012 to complete the building of the houses and the sale of them, were sensible commercial decisions made in good faith and in the company's interests. Mr Cooper's actions were entirely in the company's interests and there was no breach by Mr Cooper of his duties. The effect of his actions was to minimise the losses to the creditors as a whole. The IRD was not a preferential creditor at the time.

[14] We have already referred to the key orders that were made in the High Court. The Judge noted that the liquidators placed most emphasis on a breach of s 136 of the Companies Act (set out later in this judgment). She found that Mr Cooper agreed to the incurring of a GST obligation when he entered into agreements for sale and purchase after the end of October 2012.[8] She found there was no breach of s 136 in relation to earlier agreements for sale and purchase prior to November 2012, and that

7 There had also been non-payment on some earlier sales.
8 At [37].

decision by her has not been challenged.[9] She found that Mr Cooper could not reasonably have believed when signing sale and purchase agreements and incurring GST obligations after the meeting with the accountant on 6 November 2012, that Debut Homes would be able to meet the GST debts when they fell due.[10] Her finding extended to any other debts included in the total claim incurred after 31 October 2012. She also found that he was in breach of ss 131(1) and 135(b) of the Companies Act after 31 October 2012. She held:

> [49] Mr Cooper's personal interests and those of his wife and the Trust were in direct conflict with the best interests of Debut and his duty as director to promote those interests. Mr Cooper acted in his own interests when he sought to pay off the secured and guaranteed debts. In doing so he neglected to satisfy the obligation of Debut to account for GST to the Commissioner. The GST collected on the sales was instead used to pay off the guaranteed and secured debts and create cashflow which was applied to the completion of the other properties, the proceeds of which were used in similar fashion. The ultimate result was to reduce the guarantee liability of Mr Cooper and the Trust.

[15] She concluded that Mr Cooper had failed to satisfy the IRD's debt when he applied funds realised from the sale of properties to fund further work and to satisfy the secured debts. He was not considering the obligations Debut Homes owed to all creditors and was acting in his own interests above those of Debut Homes. She held that by failing to provide for the GST payment to the IRD, Mr Cooper was creating a new debt for Debut Homes.

[16] She held that by allowing the business of the company to be carried on after 1 November 2012 Mr Cooper was guilty of reckless trading in carrying on the business of the company in a manner likely to create a substantial risk of serious loss to Debut Homes' creditors, in particular the IRD. She rejected a defence relying on s 138 of reliance on professional advice. She found that the GST deficit was discussed at the meeting of 6 November with Mr Furlong and that Mr Cooper was aware that the agreements for sale and purchase would incur GST liabilities.[11] She held that "Mr Furlong probably did use language such as that Debut should be okay, or should be able to trade out." [12]

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9 At [36].
10 At [38].
11 At [61].
12 At [62].

[17] Nevertheless she held that this was not advice given to Mr Cooper when "performing duties" and was too vague to fall into the category of professional or expert advice. Mr Cooper must have known that Mr Furlong's advice was at best wishful thinking. Mr Cooper must have known there would be a significant shortfall. There was no proper plan to pay the IRD.[13]

[18] She turned to consider compensation under s 301 of the Companies Act for breach of duty. She recognised that Mr Cooper had injected significant new funds in the course of the ongoing work after 1 November 2012 and lost those funds "in material part".[14] She noted that he worked for one and a half years without pay, and had always paid all creditors up to November 2012. She observed:

> [78] While Mr Cooper was clearly in breach and was clearly preferring secured creditors and therefore himself, he mistakenly viewed his actions as being the best likely outcome for all creditors, including the IRD, because he understood that the only parties who would receive funds on a liquidation would be the secured creditors. He did not appreciate that on a liquidation or on a mortgagee sale, the IRD becomes a preferential creditor. He saw himself as, if anything, improving the position of unsecured trade creditors by completing buildings rather than leaving those creditors in the lurch. *My understanding is that the total unsecured creditors other than the IRD would have been materially worse in a 31 October 2012 liquidation, than in the actual liquidation.*
>
> (Emphasis added).

[19] She found that there was $316,000 relevantly owed as GST for the post-1 November 2012 sales. She noted that Mr Cooper had worked for 18 months without salary and that the Trust had lent funds which were new monies to facilitate completion. She noted the Trust had been left with a deficit of $200,000. The total input therefore from Mr Cooper and the Trust would have had a value of at least $320,000.[15] She therefore made an allowance to Mr Cooper of $80,000 to recognise his inputs and those of the Trust. She added half the claimed accrued interest and penalties to reach a rounded compensation figure of $280,000 that Mr Cooper was to pay to the liquidators.

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[13] At [65].
[14] At [77].
[15] At [84].

[20] She also found that payments of $34,129.54 were paid towards Mr Cooper's unsecured debts, and were a voidable transaction and that he was obliged to repay that amount to the liquidators. Under s 299(1) of the Companies Act she set aside the GSA between Debut Homes and the Trust, but only to the extent of the awards made against Mr Cooper.

The Companies Act

[21] The long title of the Companies Act sets out its purposes. It is an Act to reform the law and define the law relating to companies, and amongst other things to define the relationships between companies and their directors, shareholders and creditors:

> (a) to reaffirm the value of the company as a means of achieving economic and social benefits through the aggregation of capital for productive purposes, the spreading of economic risk, and the taking of business risks; and
>
> (b) to provide basic and adaptable requirements for the incorporation, organisation, and operation of companies; and
>
> (c) to define the relationships between companies and their directors, shareholders, and creditors; and
>
> (d) to encourage efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgment while at the same time providing protection for shareholders and creditors against the abuse of management power;
>
> (e) to provide straightforward and fair procedures for realising and distributing the assets of insolvent companies.

[22] The key director's duties are owed to the company both at common law and under the Companies Act.[16] Directors may not put their own interests ahead of the interests of the company they control. In this case it is the specific provisions of the Companies Act that are invoked in the statement of claim. We will go through them and they must all be read in the light of the long title. In particular, we note (d). While the long title does not make direct reference to directors duties, it makes the specific point that directors are allowed a "wide discretion in matters of business judgment" while protecting shareholders and creditors from the "abuse of management power".

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[16] *Sojourner v Robb* [2006] 3 NZLR 808 (HC) at [100].

[23] We begin chronologically with the first sections invoked, and the causes of action that arise. In doing so we differ from the order adopted in the High Court of considering s 136 first, as we do not see s 136 as the critical section.

Sections 131(1)

[24] Mr Cooper was found to have breached the duty in s 131(1) which 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.
>
> …

[25] The duty to act in good faith and in the best interests of the company performs an important function in the statutory regime. The Law Commission's 1989 report proposed that this duty was the fundamental duty of every director.[17] This language was not adopted in the legislation but the courts have treated the duty as such.[18] This duty is derived from the duty to act in the company's best interests, which originated in the Courts of Equity, often described as a fiduciary duty.[19] It stands astride the later more specific duties which evolved in later case law, and often as in this case, the analysis of whether the director acted in good faith will be central, (although not always determinative) of whether there has been breaches of other statutory duties in the context of insolvency.[20]

[26] The conduct at issue is often the same across each of the duties.[21] When a company is nearing insolvency, the interests of the company extends to encompass the

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17 Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) at 241.

18 Susan Watson "Duties of Directors – Good Faith and the Best Interests of the Company" in Susan Watson and Lynne Taylor (eds) *Corporate Law in New Zealand* (2018, Thomson Reuters, Wellington) 515 at 519; *Cool Cars (Wholesale) Ltd (in liq) v Sharma* [2014] NZHC 256 at [19].

19 See *Bristol and West Building Society v Mothew* [1998] Ch 1 at [18] (EWCA). See the discussion in Peter Watts "Duty to act in the best interests of the company" in Peter Watts, Neil Campbell and Christopher Hare (eds) *Company Law in New Zealand* (2nd ed, LexisNexis, Wellington, 2016) at [13.2]–[13.4].

20 *Morgenstern v Jeffreys* [2014] NZCA 449 at [55].

21 For example, see *Madsen-Ries v Petera* [2015] NZHC 538, *Auckland Crash Repairs Ltd (in liq) v van Rooy* [2015] NHZC 2640 and *CGES Ltd (in liq and rec) v Kelly* [2016] NZHC 1465.

interests of the company's creditors.[22] This is stated to be so in s 135, directed as it is to the risk of loss to "the company's creditors". An analysis of what measures, if any, the director took to protect the position of creditors is necessary across each of the duties at issue in this case. This approach to the analysis also reflects (d) in the long title of the Companies Act, namely to provide "protection for shareholders and creditors against the abuse of management power".

[27] The duty in s 131 is to act in "good faith", and in what the director "believes" is the company's best interest. The test is subjective. While the belief cannot be based on a wholly inappropriate appreciation of the interests of the company,[23] these words do not require perfect business judgment. The duty must be assessed recognising the wide discretion given to directors in matters of business judgment. Commercial good practice is relevant in assessing good faith.

Section 135

[28] 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.

[29] The division between ss 135(a) and 135(b) turns on the degree of involvement of the director, direct or indirect. The body of the section makes no reference to reasonableness or indeed recklessness. However, it seems clear that the background intention of the Law Commission in its 1989 Report was that the existing s 320 of the Companies Act 1955 had been undermining the ability of a company to operate as a vehicle for the taking of business risk.[24] Risk, is undoubtedly an intrinsic feature in

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[22] *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) at 249–250; *Sojourner v Robb* [2008] 1 NZLR 751 (CA) at [25].

[23] *Sojourner v Robb*, above n 16, at [102].

[24] Law Commission, above n 17, at [516].

the starting of many businesses operated by companies. On its own without context it cannot be seen as a bad thing for companies.

[30] With this in mind in *Re South Pacific Shipping Ltd (in liq)*, William Young J indicated that the Court should depart from a literal approach to s 135 in favour of a test which examines whether the trading risks that have been taken are "legitimate".[25] This decision was cited by this Court in *Mason v Lewis*, which summarised the "essential pillars" of s 135 as follows:[26]

> - the duty which is imposed by s 135 is one owed by directors to the company (rather than to any particular creditors);
> - the test is an objective one;
> - it focuses not on a director's belief, but rather on the manner in which a company's business is carried on, and whether that modus operandi creates a substantial risk of serious loss; and
> - what is required when the company enters troubled financial waters is what Ross …accurately described as *a "sober assessment" by the directors*, we would add of an ongoing character, *as to the company's likely future income and prospects*.
>
> (Emphasis added).

[31] In s 135 it is a matter of objectively evaluating that risk. Directors do not become liable under the section simply because they continue trading after a company becomes insolvent.[27] If directors are to have a wide discretion in matters of business judgment to encourage efficient and responsible management of companies as the long title envisages, the bar in terms of risk to the company's creditors must not be set too high. A court is not to assess the risk of a particular transaction ignoring up-side to the business. It is a risk and loss to the company as a whole that is referred to and not just in relation to a particular transaction.

[32] We turn to the text of s 135. The risk of loss that is referred to is loss to creditors, not the company.[28] The requirements of being "likely" to cause a "substantial" risk and "serious" loss must be given weight. It seems to us that the

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[25] *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 (HC) at [128].
[26] *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [51], see also *Grant v Johnston* [2016] NZCA 157 at [36]–[38].
[27] *Re South Pacific Shipping Ltd (in liq),* above n 25, at [125].
[28] *Madsen-Ries v Petera* [2016] NZCA 103, [2018] 2 NZLR 500 at [25].

clause "… likely to create a substantial risk of serious loss to the company's creditors…;" the words "substantial risk" and "serious loss" have to be read together, and the heading must also be considered. The word "likely" accompanying as it does the reference to risk and loss requires an assessment not just of the risk of loss from the particular transaction, but the potential loss to "the company's creditors" generally. It is not possible to just look at one particular debt arising from a course of action and determine the application of s 135 on that basis alone. It is the carrying on of the company's business as a whole that is to be examined.[29] The overall position of a company, and whether inthe end it is likely to lose more than it gains from the business being carried on must be assessed.

[33] A substantial risk, in the sense of more likely than not, of a significant loss to creditors is required. Risk must be considered with the potential advantage of the proposed action to the company and an assessment of how likely it is that the advantage will be enjoyed. Potential downside must be considered with potential upside, otherwise the purpose of encouraging efficient and responsible management of companies and leaving directors a wide discretion in matters of business judgment will be defeated. The section must be interpreted in the light of its purpose. Consistent with the long title, caution must be exercised to avoid bringing hindsight judgment to bear in circumstances which do not fully and realistically comprehend the difficult commercial choices facing the directors.[30]

Did Mr Cooper breach ss 131 and 135?

Overview

[34] With this in mind, we turn to an assessment of whether it was established on the evidence that there had been a breach of ss 131 and/or 135. We consider that the two issues are best considered sequentially although there is a degree of overlap in the assessment.

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29 *Mason v Lewis*, above n 26, at [51].

30 *Re South Pacific Shipping Ltd (in liq),* above n 25, at [128].

[35] The respondents' statement of claim alleges that the breach of good faith by Mr Cooper was permitting the company to continue trading, failing to ensure sufficient funds were retained by the company to pay creditors, incurring GST obligations (being the GST on the sale of the development properties) at a time when the company was insolvent, incurring obligations, failing to pay the GST and instead using GST funds collected on sale to reduce other liabilities to whom Mr Cooper had given personal guarantees, and to repay money to the Trust. It is alleged that Mr Cooper applied surplus funds produced by the sales for his own benefit rather than to meet the company's outstanding tax obligations and failed to keep accurate records. The same factual assertions are relied on to assert the claim of a breach of duty under s 135.

[36] The allegations begin by referring to it being wrong for the company to have continued trading, and that can now be put more precisely as wrongly continuing to trade after 1 November 2012 by completing and selling the remaining houses. The allegations then go on to focus on the company's inability to pay GST. In essence it is alleged that Mr Cooper should not have arranged for the company to go on to finish and sell the houses, and that the company should have ceased trading and allowed the properties to be disposed of in one way or another in their partially completed state at the end of October. It is asserted that the proceeds of sale ought to have been applied differently to ensure that the IRD received a preferential payment over the entitlements of secured and other creditors. Before we go any further, it is necessary to place the obligation to pay GST into context.

The GST obligation

[37] We have not had detailed submissions on the circumstances of the original purchase of the properties that were ultimately completed and sold by the company, or on the potential GST liability as at November 2012 prior to the course of action being embarked upon. However certain general observations can be made.

[38] It must be first recorded that in fact the IRD was not a preferred creditor when the decision to complete and sell was made in November 2016. It was not a creditor at all when the course of action was embarked upon and the work began. It only became a preferred creditor on the settlement of sales when GST became payable.

Under s 8(1) of the Goods and Services Tax Act 1985, GST is payable on supply. Debut Homes was registered on a payments basis. Liability to pay accrued when the payment was received. Even then, the IRD's GST debt would not have priority over the secured debts.[31] The secured debts were always going to be paid first.[32]

[39] It is also important to note that the company had a potential liability to pay GST on each property from the time of the original purchase of a property years earlier. Whenever a development company purchases property for development for profit, it is almost inevitable the company will incur obligations to the IRD for GST, although the quantum of that obligation is not yet known, and the obligation to pay is not crystallised.

[40] If at the start of November 2012 Mr Cooper had arranged for the company to sell all the properties as is, without embarking upon the completion and sale programme that the respondents submit was in bad faith and reckless, there would still have been a GST liability on sale of the partially completed properties, and the IRD would have been almost certainly unpaid. There was uncontested evidence that there would be a shortfall on such sales at that time, because of the diminished value of the uncompleted buildings. So good faith and the assessment of risk must be seen in the context that there was already a potential GST liability which could not be met, before the complained of actions.

[41] It must also be recognised that the obligation to pay GST either in November 2012 or ultimately when the properties were sold after that date after they had been completed, was not the result of any specific agreement to pay GST with the IRD. The agreements for sale and purchase that were ultimately entered into by the company to sell the various properties after 1 November 2012, contained just the standard provision for the payment of the purchase price and the fact that the purchase price stated was GST inclusive. The IRD was not a party to the agreements, and there was no bad faith or reckless "transaction" with the IRD. Moreover, the obligation to

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[31] The Commissioner is a preferential creditor under the Companies Act 1993, sch 7.

[32] Section 248(2) of the Companies Act provides that the commencement of liquidation does not effect the right of a secured creditor to take possession of, and realise or otherwise deal with, property of the company over which the creditor has a charge.

pay GST arose incidentally as a consequence of genuine sales at fair market value to genuine purchasers.

[42] The essence of the respondents' position is that the completion and sale programme continued after 1 November 2012 should not have taken place. The properties should have been sold at that point of time, or mortgagee sales should have been allowed to proceed, or the company placed into voluntary liquidation. The point is made by the respondents that if there were mortgagee sales there would be no obligation to pay GST. The obligation to pay the GST liability would have shifted from Debut Homes to the mortgagee at whatever reduced price was obtained for the unfinished houses.[33] However, there could be no certainty as to what the outcome would be for the IRD. Some of the possibilities were referred to in *Peace and Glory Society Ltd (in liq) v Samsa*:[34]

> [61] … Essentially, if a mortgagor completes a sale before liquidation the Commissioner ranks as an unsecured creditor. Alternatively, if a mortgagee sells the property then the Commissioner obtains priority. Finally, if a liquidator sells a property, he or she will be personally liable for the GST on any sale. In those circumstances, a liquidator is likely to insist on the mortgagee selling the property.

[43] A further option was for Mr Cooper to have arranged for the company to sell the unfinished houses at the best possible price. As was noted later in *Peace and Glory Society Ltd (in liq) v Samsa*:

> [74] We do accept that the IRD was in an unenviable position as an involuntary potential creditor of Peace and Glory. An input tax credit had been claimed by the company but the control over the timing of any liability for output tax rested with the taxpayer (in terms of the decision when to sell the property and/or whether there would be a change of use triggering an output tax liability). Further, until the liability to pay output tax actually arose upon sale or change of use, there was no debt and therefore no ability to undertake enforcement steps (such as taking steps to liquidate the company). *It is also true that the IRD is an unsecured creditor if there is a sale by the taxpayer but that it is in a privileged position with regard to GST if there are enforcement steps by a mortgagee. …*
>
> (Emphasis added)

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33 Goods and Services Tax Act 1985, ss 5(2) and 17; *Edgewater Motel Ltd v Commissioner of Inland Revenue* [2004] UKPC 44 at [10]; *Simpson v Commissioner of Inland Revenue* [2012] NZCA 126, [2012] 2 NZLR 131 (CA) at [44]; Property Law Act 2007, s 185(1)

34 *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396, [2010] 2 NZLR 57 (CA) at [61].

[44] Finally, we observe that at the end of October 2012 the loss to the company had it ceased trading and undertaken no further work in the properties and they had been sold would have been $608,693.91.[35] The liquidators have pleaded that the actual loss to the creditors was $499,507 including all penalties and interest charged on the outstanding GST and the preferential court costs ordered in favour of the Commissioner, as well as some disputed debts.

[45] It is not possible for us to be precise on numbers with the information before the Court but for all these reasons, expanded on later, it is by no means clear that in a net cash sense the Commissioner is any worse off now, than if the company had stopped trading in November 2012 which the respondent submits is what Mr Cooper should have done or sold the properties at that point.

Breach of s 131?

[46] The Judge held:

> [50] Mr Cooper has breached his duty under s 131(1) in two regards. Mr Cooper neglected to satisfy the obligations of a creditor, the Commissioner, when he applied the funds realised from the sale of properties to fund further work and to satisfy secured debts for which he was personally liable by virtue of his guarantee. In doing so he was not acting in good faith as he was not considering the obligations that Debut owed to *all* its creditors. Secondly, Mr Cooper was acting in his own interests above those of Debut. By failing to pay GST to the Commissioner, Mr Cooper was creating a new debt for Debut, which would be subject to penalties and interest totalling $84,088.31, while limiting his own liability for debts guaranteed by himself. No director of a company could seriously believe in good faith that accruing a large tax debt, with no way of paying it, could be in a company's best interests.

[47] We are unable to agree that Mr Cooper's actions can be rightly described as "creating a new debt for Debut". As we have set out, there was a potential GST debt existing in any event. Mr Cooper's actions in arranging for more money to be spent on the properties so they could be sold for a higher price, had the effect of increasing the amount that would inevitably be payable, because of the greater sale prices. In carrying out the extra building work and increasing the value of the properties, Mr Cooper's actions were increasing the amount payable to the IRD by way of GST.

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[35] This figure comes from Annexure B to the appellant's submissions, where the calculation of the amount is set out – the figure was not contested by the respondents.

If there had been a liquidation in 2012, and there had been mortgagee sales of partially completed houses, the GST payable would have been of a lesser amount. The effect of continuing after November 2012 to complete the buildings was that while the debt for GST to IRD went up because of the higher sales prices, the effect of the extra work was to increase IRD's entitlement. Ironically, the IRD in this sense may have benefited from the extra work.

[48] The fact that Mr Cooper would obtain a benefit if the company proceeded to develop the properties and sell them for a higher price, because more debt he had guaranteed could be repaid, does not in itself mean that he was acting in bad faith. A director is able to enter into transactions that have as one of their consequences a benefit for the director, providing the director does not do so in bad faith or recklessly. As Lord Selborne LC said in *Hirsche v Sims*:[36]

> If the true effect of the whole evidence is, that the defendants truly and reasonably believed at the time that what they did was for the interest of the company, they are not chargeable with dolus malus or breach of trust merely because in promoting the interest of the Company they were also promoting their own[.]

[49] As part of the redevelopment process, Mr Cooper was putting in considerable further funds from the family trust controlled by him and his wife, and doing more unpaid work. His actions would have the effect of making it more likely that the existing secured creditors would be paid. The costs of the development work were budgeted for, and indeed most were paid. The High Court Judge found:

> [77] … Mr Cooper had always paid all creditors down to November 2012 and he says, even at the end, close to half of the relatively small quantum of unsecured creditors, aside from the IRD, was disputed.
>
> [78] While Mr Cooper was clearly in breach and was clearly preferring secured creditors and therefore himself, he mistakenly viewed his actions as being the best likely outcome for all creditors, including the IRD, because he understood that the only parties who would receive funds on a liquidation would be the secured creditors. [Mr Cooper] did not appreciate that on a liquidation or on a mortgagee sale, the IRD becomes a preferential creditor.

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36 *Hirsche v Sims* [1894] AC 654 (PC) at 660–661.

> *[Mr Cooper] saw himself as, if anything, improving the position of unsecured trade creditors by completing buildings rather than leaving those creditors in the lurch. My understanding is that the total unsecured creditors other than the IRD would have been materially worse in a 31 October 2012 liquidation, than in the actual liquidation*.
>
> (Emphasis added).

[50] It was Mr Cooper's evidence that his sole focus was to get the partially developed houses finished and sold. We agree with the Judge that the alternative was worse. There would be mortgagee sales of unfinished properties. The return to creditors would be much less than if the jobs were completed. This would appear to accord with the usual commercial expectation that a finished building is likely to attract a much higher price than one which is unfinished.

[51] The liquidators did not challenge the valuation evidence adduced by Mr Cooper as to the improved value that would have been obtained for the partially completed houses, in comparison to what would have happened had those houses been sold as is where is in around October 2012. There is no challenge to the figures contained in a table attached to Mr Cooper's evidence which showed a significant surplus after the sales, (not including GST which could only be paid in part).

[52] Mr Cooper said in his evidence that he was reasonably experienced in property development having been doing it since 2005. He did not understand that there was any security to the IRD over the property for GST, and considered that the GST would be paid in due course but not on the individual sales, as more properties were sold and profits made. He thought long term he would be able to resolve GST issues. Mr Furlong does not appear to have disagreed. Mr Cooper had done an analysis of the actual costs for each of the properties against the estimated costs to complete. He was estimating a significant surplus at the end of the sales. It was not shown that Mr Cooper's view was, at the time, unreasonable. The Judge held:

> [62] The view I have formed of the November 2012 meeting is based in particular on the NZICA correspondence, my clear impression of which was not altered by hearing from Mr Furlong and Mr Cooper. It seems that they discussed Debut's likely shortfall and Mr Furlong said that JTJ would pursue Mr Cooper to bankruptcy, whereas he considered the IRD would negotiate and be likely to write off any shortfall. Mr Cooper then decided that the IRD would be the lesser of the two evils. *Coupled with that, I accept that*

> *Mr Furlong probably did use language such as that Debut should be okay, or should be able to trade out.*
>
> (Emphasis added).

[53] What happened was that in implementing the decision to complete, new problems started to emerge in late 2012 and through 2013 in relation to completing the building work. Costs increased and this led ultimately to there being no surplus money in terms of the budget, available to pay the GST. In the end, it turned out that completion cost far more than was anticipated, and there were unexpected delays. However there is nothing to show that Mr Cooper was reckless or indeed negligent in his costings. His good faith is shown by the significant advance made by the Trust to finish the building. He must have been confident that the building could be finished and sales achieved at a profit. It is also shown by the year and a half of unpaid work that he did, including a great deal of the labour for building and landscaping.

[54] On our assessment of the evidence it has not been shown that these cost overruns could have been reasonably foreseen by Mr Cooper. Mr Cooper can be assumed to have expected that his costings to finish the houses were accurate, as he invested Trust money and his own time in the completion work.

[55] As the High Court Judge pointed out, if Debut Homes had ceased trading in October 2012 and not completed the buildings, there would have been greater losses to the company and the creditor body as a whole, and these would have been greater than were in fact suffered ultimately on the liquidation of the company. For instance, if there had not been the cost overruns, the total surplus estimated by Mr Cooper to be available and taking account of the surplus achieved on 4 Karika Place was $200,658.51.

[56] There had also been discussions between Mr Cooper and Mr Furlong about an arrangement being reached with the IRD in relation to the payment of the GST. This was seen as a realistic prospect. The table prepared by Mr Cooper showed a potential surplus on the sale of the five properties of $169,375. This did not include the paying of GST and was less than the GST that would be payable. Such a surplus would have left a deficit of approximately $300,000. Mr Cooper was cross-examined extensively on the reality of his expectation that in due course GST would be paid. He

accepted that the GST owed in each respective sale could not be paid to the IRD at the time of settlement. However he was firm that his intent was to achieve the best outcome for all the creditors by getting the best possible prices for the houses that were to be built and the best possible return to the company. He thought that ultimately IRD could be accommodated by ongoing trading, and on our assessment of the evidence, his accountant thought this also.

[57] Overall Mr Cooper's figures showed that at the point that the losses to the company if work had stopped at the end of October 2012, would have been $608,693.99. Even with the cost overruns, the loss to the creditors pleaded by the liquidators was $499,507, including all penalties and interest charged on the outstanding GST, preferential court costs in favour of the Commissioner as well as debts that had not been accepted in the liquidation and which were disputed. This also includes creditors arising from the unexpected cost overruns that arose after the decision to complete. If penalties, interest and costs are put to one side, the financial advantage to the company in proceeding rather than selling at the end of October 2012 was overwhelming, but that advantage was still significant even with those costs.

[58] During submissions we asked Mr Shackleton for the liquidators what Mr Cooper's options were if he had not gone ahead and completed the partially built houses. He suggested that Mr Cooper could resign as a director. However, as Mr Cooper was the sole director that was not possible.[37] He also suggested that Mr Cooper might invite a creditor to put the company into liquidation. However for the reasons that we have set out this could be seen as contrary to the interests of both the company and the creditors. There was a good chance of a much better return to the creditors as a whole if the building developments were all completed and sold for the best possible price on a non-forced basis. He was supported by Mr Furlong, who told Mr Cooper not to worry about the IRD.

[59] We also put this notional scenario to counsel, which in our view exposes the difficulty in the proposition that Mr Cooper should not have proceeded with sales. If a notional development was complete and an agent presented a commercially attractive

[37] A new director would have had to be appointed before Mr Cooper could have resigned. A company must have one or more directors, Companies Act, s 10(d).

unconditional cash offer for $10 million when the secured and unsecured debt was $9.5 million, the notional company would face incurring a $1.5 million GST obligation upon sale. In our view it cannot be the law that a director must refuse the $10 million offer because he knows that the company will not be able to meet the full obligation to the Inland Revenue Department. The consequence of refusing that offer is likely to be that a lesser price is obtained under a forced sale resulting in lesser recovery for all creditors including the IRD, which would also lose the benefit of the greater sale price. In our view the duty in s 131 would surely require the acceptance of the $10 million offer, and there would be no breach of s 135.

[60] A developer when faced with the option of abandoning a house project or selling for the best price faces a dilemma as was pointed out in *Peace and Glory Society Ltd (in liq) v Samsa*.[38] On our overview of the evidence we have reached the clear view that Mr Cooper was acting in good faith and in what he believed was the best interests of the company when he decided to complete the building work and enter into the further agreements for sale and purchase from 6 November 2012. The prospect of a surplus not including GST, and Mr Furlong telling Mr Cooper not to worry about the IRD, confirms that Mr Cooper was not manipulating events to defeat its interests. In all these circumstances we reach a different conclusion on the facts to the High Court Judge. Completing the buildings was a reasonable commercial course. Mr Cooper would get incidental benefits in that the secured debt would be more reduced, but he put in significant new funds, and provided one and a half years work without pay.[39] But it could be said that everyone, including the IRD, stood to get more money because of his actions.

Breach of s 135?

[61] This analysis in terms of good faith under s 131 provides, as will often be the case, much of the answer to the allegation of a breach of s 135. As we have set out, it seems to us that the decision to complete the houses was a perfectly sensible business decision. Overall it was likely to improve the return rather than cause loss to the company's creditors. It is true that one creditor, the IRD, would be more at risk than

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38 *Peace and Glory Society Ltd (in liq) v Samsa*, above n 34, at [69].
39 *Debut Homes Ltd (in liq) v Cooper,* above n 1, at [77].

the secured creditors in that there was no specific provision for payment of the GST. However, given that there was a sincere belief that significant surpluses excluding GST were expected overall when all the sales had been completed, and that in due course the GST issues would be able to be resolved with the IRD to its satisfaction, we are not satisfied that this was reckless trading. The IRD was at serious risk of getting no GST before the complained of conduct. The risk taken was legitimate.

[62] A developer needs to trade bearing in mind its GST obligations and must act with reasonable belief that the IRD will be paid.[40] If tax debt is in effect being used as the company's bank, that can be reckless trading. Here, as we have said, the IRD was going to be in a bad position if there had been an immediate liquidation before the sales. If there had not been the unexpected cost overruns, Debut Homes would have had a surplus at the end of the sale process, and a greater amount would be owed for GST because of the higher prices.

[63] In the High Court risk was assessed largely from the point of view of the risk of non-payment of the GST.[41] The assessment was not carried out with a sufficient consideration of the certain benefits to other creditors from obtaining higher prices for the properties, and Mr Cooper's personal input of unpaid work and funds all of which were to the great advantage of the company and its creditors.

Our conclusion on ss 131 and 135

[64] Mr Cooper was a reasonably astute and attentive person who had a reasonable understanding of his business, its financial position and the interests of creditors. When things got rough he took stock of the company's position, put the brakes on further projects, and focussed on completion of the developments to best serve the interests of creditors. He incurred further debt in order to complete, but he considered whether those creditors could ultimately be paid, and did his costings with that in mind, and by and large they were paid with the exception of the IRD and the Trust.

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40 *Richard Geewiz Gee Consultants Ltd (in liq) v Gee* [2014] NZHC 1483 at [96]–[103].

41 *Debut Homes Ltd (in liq) v Cooper*, above n 1, at [55].

[65] In relation to that IRD debt, the GST situation was complex and the IRD was not necessarily going to be worse off, and could be better off, after completion and sales. The option which the respondent says should have been taken of some sort of walk away by Mr Cooper in November 2012 leaving the houses unfinished in our assessment was the less sensible commercial option. We conclude that Mr Cooper did not act in bad faith and was not reckless.

Section 136

[66] The Judge's central initial finding was a breach of s 136.[42] 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.

[67] Section 136, unlike s 135, involves focusing on the incurring of a particular obligation, rather than the carrying on of the business as a whole.[43] It must be asked first, what is the agreement "incurring an obligation" that is the subject of this claim? It can only be the individual sale agreements, entered into after the houses had been completed. No other agreements are identified in the relevant part of the amended Statement of Claim. However those sale agreements were inevitable, once the key decision had been made to complete in early November 2012. It would have been foolish not to have sold the houses in an orderly way. The respondents' real complaint is about that overall course of action, properly considered under ss 131 and 135, but not under s 136 which is aimed at specific agreements.

[68] The fact that there was an incidental GST liability that would arise on particular sales that would not be paid immediately, does not make the agreements the sort of transactions that are the object of s 136. 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

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42 At [33] and [37].
43 See *Peace and Glory Society Ltd (in liq) v Samsa*, above n 34, at [44].

years earlier, when there is no question about the company's solvency. 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". He entered into no agreement on behalf of the company with the IRD.[44] GST was an obligation that occurred automatically. His action in signing the agreement for sale and purchase can be seen as a trigger, rather than the incurring of an obligation. In these circumstances we do not consider that a particular sale transaction in these circumstances was the sort of mischief which s 136 is aimed to prevent. There was no breach of s 136.

[69] In the High Court, the decision of *Peace and Glory Society Ltd (in liq) v Samsa* was relied on by the IRD.[45] It was suggested that it is authority for the proposition that GST output tax is "incurred" in terms of s 136 on the signing of a sale agreement, and is payable on whatever date the GST return is due. However, the judgment does not go this far. The case concerned the application of s 301 of the Companies Act, and did no more than express its approval of the concession that was made by counsel and that the three elements of s 136 of the Companies Act were met.[46] Moreover, the facts of that case were different. In *Peace and Glory Society Ltd,* the property in question was unfinished and unlikely to fetch a satisfactory purchase price. The director bought the unfinished house himself at a price above market value in order to pay secured creditors and avoid significant loss to the company, despite the GST shortfall. On the facts here, the sale was an arms-length genuine sale and part of a course of action that gave the creditors as a whole a better return. What is significant is that in *Peace and Glory Society Ltd (in liq) v Samsa* the Court upheld the decision of the High Court Judge under s 301 that for the director to do more work on the house and then purchase it, with a resulting non-payment of GST, was not a failure to exercise the care, diligence and skill expected of a reasonable director.[47] The Court stated:

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[44] We do not have sufficient factual detail and submissions concerning the original purchasers or detail on the sale options in 2012, to comment further.

[45] *Debut Homes (in liq) v Cooper,* above n 1, at [80] citing *Peace and Glory Society Ltd (in liq) v Samsa*, above n 34, at [74].

[46] At [64].

[47] At [35].

> [69] We do not consider Hugh Williams J was wrong to take into account, when considering the proper contribution under s 301, *what he called Mr Samsa's dilemma: to allow the insolvent Peace and Glory to continue to accrue the holding costs of the property (that is, incur more debt) or to bring the matter to a head by purchasing the property*. It seems clear that the property was unsaleable on the open market, at least for a price that would have cleared the company's debts. Indeed, Mr Dickey accepts that Mr Samsa's dilemma was a relevant consideration in considering the extent of any contribution under s 301, as noted above at [49].
>
> (Emphasis added).

[70] The High Court decision to refuse to order the director to make any payment to the liquidators was upheld by this Court. The incurring of the GST obligation did not therefore lead to any relief for the liquidator and the IRD.

Section 138

[71] This section provides:

> **138 Use of information and advice**
>
> (1) Subject to subsection (2), a director of a company, when exercising powers or performing duties as a director, may rely on reports, statements, and financial data and other information prepared or supplied, and on professional or expert advice given, by any of the following persons:
>
> (a) an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned:
>
> (b) a professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence:
>
> (c) any other director or committee of directors upon which the director did not serve in relation to matters within the director's or committee's designated authority.
>
> (2) Subsection (1) applies to a director only if the director—
>
> (a) acts in good faith; and
>
> (b) makes proper inquiry where the need for inquiry is indicated by the circumstances; and
>
> (c) has no knowledge that such reliance is unwarranted.

[72] In *Morgenstern v Jeffries* it was recognised that it is an affirmative defence to a breach of duty claim, where a director relies on the advice given by a professional advisor, who acts in good faith, makes proper inquiry and has no knowledge that such reliance is unwarranted.[48] The onus is on the director.

[73] It is not strictly necessary to deal with the s 138 defence, given our findings of no breach, but we consider it briefly, and strengthen our earlier conclusions as to the reasonableness of Mr Cooper choosing to complete the houses.

[74] It was held in the High Court that Mr Furlong in the meeting of 6 November 2012 did use language to the effect that if it completed the building Debut Homes "should be okay, or should be able to trade out". Mr Furlong played a role in arranging additional finance from the mortgagee JTJ in early November. Mr Furlong had an interest in that company. Given Mr Furlong's interest in improving the position of JTJ, it can be observed that it was in his interests for Mr Cooper to carry on and get the best return for the encumbered properties. Mr Cooper did not know of his interest in JTJ until August 2013.

[75] In our view when Mr Cooper was speaking to Mr Furlong he was seeking advice and guidance as to the way forward. It was reasonable for him to rely on Mr Furlong who was qualified to provide such advice. Mr Furlong had been the company accountant from its inception and had completed the accounts. He was responsible for filing GST returns on behalf of Debut Homes and income tax returns. We can see why Mr Cooper accepted Mr Furlong's assurances and acted on them.

[76] It was held in the High Court that Mr Cooper had knowledge that there would be a shortfall (not accepting Mr Cooper's evidence at trial and preferring Mr Furlong's evidence).[49] Mr Furlong's evidence was to the effect that he had worked through the options with Mr Cooper but gave no advice that there would be no shortfall. Mr Cooper's evidence had been that Mr Furlong gave his opinion on the situation (which appears to have been reasonably positive) but left the final decision to Mr Cooper. However the Judge found that there had been a decision made by

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48 *Morgenstern v Jeffries*, above n 20, at [75].
49 At [62].

Mr Cooper and Mr Furlong to embark on the process of selling down assets of the company as they were completed.[50] Mr Furlong appears to have been part of this decision. All this must be seen in the context that Mr Cooper's expertise was in construction and he was reliant on his accountant's advice on GST and taxation matters.

[77] In the end we agree with the High Court Judge that s 138 is not available as a defence. There was nothing in the category of "reports, statements, and financial data and other information prepared or supplied" from Mr Furlong that clearly fell within s 138. However, Mr Furlong's general support expressed to Mr Cooper in favour of completing the buildings and selling them, is a significant factor in the general assessment of the reasonableness of Mr Cooper's actions, and whether there was any element of recklessness. On our analysis Mr Furlong was a credible accountant who Mr Cooper was entitled to rely on, and he generally encouraged Mr Cooper to embark on the course that he did.

[78] However s 138 does not assist him.

The trust advance and the repayment

[79] In the High Court the GSA was set aside as to the amount ordered in the judgment, under s 299 of the Companies Act. Section 299(1) provides:

> **299 Court may set aside certain securities and charges**
>
> (1) Subject to subsection (2), if a company that is in liquidation is unable to meet all its debts, the court, on the application of the liquidator, may order that a security or charge, or part of it, created by the company over any of its property or undertaking in favour of—
>
> (a) a person who was, at the time the security or charge was created, a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or
>
> (b) a person, or a relative of a person, who, at the time when the security or charge was created, had control of the company; or

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[50] At [65].

(c) another company that was, when the security or charge was created, controlled by a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(d) another company, that at the time when the security or charge was created, was a related company,—

shall, so far as any security on the property or undertaking is conferred, be set aside as against the liquidator of the company, if the court considers that, having regard to the circumstances in which the security or charge was created, the conduct of the person, relative, company, or related company, as the case may be, in relation to the affairs of the company, and any other relevant circumstances, it is just and equitable to make the order.

(2) Subsection (1) does not apply to a security or charge that has been transferred by the person in whose favour it was originally created and has been purchased by another person (whether or not from the first-mentioned person) if,—

(a) at the time of the purchase, the purchaser was not a person specified in any of paragraphs (a) to (d) of that subsection; and

(b) the purchase was made in good faith and for valuable consideration.

(3) The court may make such other orders as it thinks proper for the purpose of giving effect to an order under this section.

(4) Nothing in the Land Transfer Act 2017 restricts the operation of this section.

(5) The provisions of section 7 apply with such modifications as may be necessary to determine control of a company.

[80] This GSA was created in favour of the Trust, of which Mr Cooper was a settlor trustee and beneficiary, as was Mrs Cooper. The security was therefore in part in their favour, and comes within s 299(1) of the Companies Act. However, unlike most cases where the section is invoked, the security did not secure past advances. As was recognised in the High Court, it secured new advances made over the period 4 March 2013 to 11 February 2014.[51] As the Judge noted, it can be presumed that the advances would not have been made without the security being granted.

[81] Under s 299 the court will only set aside a security or charge if it is "just and equitable" to do so. In deciding this, it must consider the circumstances in which the

51 At [125].

security was created, the related person's conduct in relation to the affairs of the company, and any other relevant circumstances.

[82] We have traversed the relevant circumstances. We have found that Mr Cooper had made the decision to complete the houses so they could be sold for the best price on the market in good faith, and that the decision was not reckless. To do this fresh funds were required and only the Coopers could provide them. We do not consider that there was any bad faith or conduct to the detriment of other creditors in securing those funds as best as possible. Clearly, given the ultimate shortfall, the advance ranked below the existing secured creditors, and payment for these new funds would depend on the success of the completion of the building work and the sales process. Mr Cooper and his family were increasing their exposure to unsecured loss by advancing the new money, and there was nothing reprehensible in seeking to secure it as best as possible.

[83] The High Court judge correctly noted that other cases where s 299 had been invoked were not analogous to the present.[52] The GSA was not to protect the director's past advances in the event of a liquidation. It was intended to avoid liquidation by injecting new money to complete the enterprise of the company for a profit. The Judge, given her findings of breach of duty (that we have not accepted), considered that if the GSA was not in part set aside Mr and Mrs Cooper would be able to claim the benefit of the judgment through the GSA and indirectly return it to Mr Cooper.[53] We differ from her assessment of what is just and equitable, because in essence we differ in our assessment of whether Mr Cooper committed any breaches of duty. The case can be contrasted with the position in *Petterson v Browne,* where an order was made.[54] The advance there was for an ulterior motive, granting security over previously unsecured lending to insulate the related third party from the consequences of liquidation.

[84] Not only was there no securing of past advances here, but we see no ulterior motive on the part of Mr and Mrs Cooper; the motive was the obvious one of wishing

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52 *Debut Homes Ltd (in liq) v Cooper*, above n 1, at [121]–[124], citing *Petterson v Browne* [2016] NZCA 189 and *Harris v Bank of New Zealand* [2017] NZHC 2374.

53 *Debut Homes Ltd (in liq) v Cooper*, above n 1, at [132].

54 *Petterson v Browne,* above n 52, at [98].

to make a significant new advance to a company to enable it to trade its way out of an insolvent situation. It is a signal that this was a bona fide advance not warranting intervention under s 299 that the Trust was only partly repaid, leaving a deficit of more than $200,000. This indicates that it was a sincere and proper investment made for the benefit of the company and creditors.

[85] Therefore, we do not consider it just and equitable in those circumstances to set aside the GSA in whole or in part. The partial repayment cannot be criticised given that the money advanced significantly improved the return to the creditors even with the repayment. This conclusion can be tested by considering whether any commercial person would have advanced such a sum, so slenderly secured, to an insolvent company. No such person would so invest, and Mr Cooper should not now be penalised for making a risky advance through the Trust to the overall advantage of the company, and securing it as well as possible.

[86] Therefore, in considering the relevant circumstances surrounding the GSA and whether an order is just and equitable, no order to set aside the security over company property under s 299 should have been made. We make no comment on any ability on the part of liquidators to challenge any proof of debt by the Trustees, should they do so out of time, on other grounds.

The voidable transactions

[87] From 31 October 2012 until the date of liquidation, Mr Cooper took payments from the company totalling $35,918. These were cash withdrawals through ATMs and transfers of funds to Mr Cooper's personal account, all from Debut Homes' account. They had the effect of reducing the liability of Debut Homes to Mr Cooper on liquidation. Of these some were reimbursement to Mr Cooper for sums spent by him for company purposes, so the liquidators claimed the net amount of $34,129.54 as a voidable transaction under s 292(1) of the Companies Act.

[88] The payments qualified as an insolvent transaction under s 292(2), as the Judge found that that they were payments which enabled Mr Cooper to receive more towards the satisfaction of his debt from the company that he would have received or been

likely to have received, in the company's liquidation.[55] Indeed he would not have received any of this money on liquidation.

[89] The Judge was satisfied that the requirements of s 292 were met. On appeal Mr Hucker for Mr Cooper argued that she erred in her assessment of whether there was a running account under s 292(4B). He argued that the current account was for the commercial purposes of funding the operations of the company, and could be seen as having a legitimate basis, and reimbursing him for his work as an unpaid project manager.

[90] Sub-section provides 292(4B) provides:

> (4B) Where—
>
> (a) a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the company (including a relationship to which other persons are parties); and
>
> (b) in the course of the relationship, the level of the company's net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship;
>
> then—
>
> (c) subsection (1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction; and
>
> (d) the transaction referred to in paragraph (a) may only be taken to be an insolvent transaction voidable by the liquidator if the effect of applying subsection (1) in accordance with paragraph (c) is that the single transaction referred to in paragraph (c) is taken to be an insolvent transaction voidable by the liquidator.

[91] The difficulty with Mr Hucker's argument is that the payments are shown as drawings in the company records. On our reading of the evidence, we are unable to accept that this classification was incorrect. The Judge so found. Mr Cooper has not shown that the payments were mis-characterised. There was no continuous business

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55 At [91]–[96].

relationship or running account in relation to these payments. There was no integral connection between outgoings from the company and further supplies by Mr Cooper.

[92] Therefore we can see no basis for rejecting the Judge's finding that no running account existed. There is nothing to suggest payments for the purposes of inducing further supply. As we have set out, Mr Cooper had good reason to support the company in completing the building and selling the properties irrespective, of whether he got some payments along the way.

[93] While this outcome may seem harsh to Mr Cooper given the extensive nature of his unpaid work, he did not persuade the Judge that the payments that otherwise fell under s 292 should not be re-paid, and he has not persuaded us. Therefore we will not uphold this aspect of the appeal.

Compensation under s 301 for breach of duty

[94] It would be artificial for us to assess compensation, given our findings of no liability. It follows from our conclusions that Mr Cooper should not pay any compensation. For the reasons we have set out, we are not satisfied his actions caused any loss.

[95] We do observe that even if a breach of duty was found to exist, the Judge's finding that compensation of $280,000 should be paid by Mr Cooper is clearly in error. That figure approaches the whole amount of the unpaid GST ($366,011 not including accrued interest and penalties). The Judge failed to consider that much of the GST debt was likely pre-existing and Mr Cooper increased the amount of the debt by completing the properties.

Conclusion

[96] We propose allowing the appeal against the findings of breach by Mr Cooper of ss 131, 135 and 136 of the Companies Act. It follows that the Judge's finding that Mr Cooper breached those duties, and the orders made requiring him to make a contribution of $280,000 towards the assets of Debut Homes and setting aside the GSA entered into between Debut and the Trust will be quashed, as will the order granting

leave for the liquidators to re-apply to the Court for an increase in compensation if the trustees of the L & T Cooper Family Trust succeed in proving in the liquidation as unsecured creditors.

[97] We will dismiss the appeal against the finding that the affirmative defence in s 138 was not made out. We also do not uphold the appeal against the order that Mr Cooper repay the $34,129.54, and setting aside the payments to him as voidable transactions.

Result

[98] The appeal is allowed in part.

[99] The finding at [142] of the High Court judgment is set aside, and the orders made at [143] (a) (c) and (d) are quashed. The order made in paragraph [143](b) is not quashed and remain in force.

[100] In our view the appellant has been largely successful. The part of the appeal relating to the voidable payments was very limited. He should receive costs in accordance with the usual principle of costs following the event. The first and second respondents must pay the appellant costs for a complex appeal on a band A basis and usual disbursements. We certify for two counsel.

Solicitors:
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