

IN THE COURT OF APPEAL OF NEW ZEALAND

**CA354/2016
[2017] NZCA 315**

BETWEEN

ANGELA CLAIRE SHAW AND IAN
ALEXANDER SHAW
Appellants

AND

COLIN DAVID OWENS AND DAVID
STUART VANCE AS THE
LIQUIDATORS OF ALUMINIUM PLUS
WELLINGTON LIMITED
Respondents

Hearing: 6 June 2017

Court: Harrison, Miller and Clifford JJ

Counsel: C J Tennet and C G Beaumont for Appellants
J R Sumner and J G Cole for Respondents

Judgment: 25 July 2017 at 2 pm

JUDGMENT OF THE COURT

A The appeal is allowed to the extent of quashing the amount of the High Court judgment of \$125,884.59 and substituting the amount of \$106,505.03.

B In all other respects the High Court judgment remains in force.

C There is no order for costs in this Court.

REASONS OF THE COURT

(Given by Harrison J)

Introduction

[1] Angela and Ian Shaw appeal against a judgment of Brown J in the High Court at Wellington ordering them to pay compensation of \$125,884.59 to Colin Owens and David Vance as liquidators of Aluminium Plus Wellington Ltd (Aluminium Plus).¹

Background

[2] The relevant facts fall within a brief and undisputed compass. The Shaws are trustees of what is known as the I & A Shaw Family Trust (the Trust). In 1995 the Trust commenced trading as a farming enterprise and later started operating as a glazier and manufacturer of aluminium joinery. One of its suppliers, CSR Viridian (NZ) Ltd, was only prepared to supply materials to a corporate entity, not to a trading trust. So in 2007 the Shaws incorporated Aluminium Plus for the purpose of contracting with Viridian. The Shaws were its sole directors.

[3] Aluminium Plus effectively served as a conduit for the Trust — it operated without a bank account and simply passed supplies from Viridian on to the Trust for distribution to its clients. In consideration the Trust paid Viridian's invoices directly, thereby extinguishing the company's debt.²

[4] This method of operation worked without apparent incident for some years. However, between 7 October 2013 and 20 December 2013 Aluminium Plus did not pay for materials ordered from and provided by Viridian to a value of \$61,043.05 because it considered them defective. As Mr Shaw explained at trial, sometime in December 2013 the Shaws, acting in their dual capacities as directors and trustees, then decided that:

55. ... a fair arrangement between the two entities would be that [Aluminium Plus] would not require the Trust to pay for the invoices

¹ *Owens v Shaw* [2016] NZHC 1400.

² At [4]–[10].

issued by Viridian that were outstanding at that time [for \$61,043.05]. It was understood that if Viridian brought court proceedings against the Company, then the Company would counterclaim for the credits owed and receive whatever amount was awarded under the counterclaim, whether that amount was greater or less than \$61,043.05.

56. The agreement that the Trust would not have to pay \$61,043.05 was intended to be a settlement of all claims the Trust may have against the Company in respect of the faulty glass. The figure seemed fair. ...
57. This settlement between the Company and Trust was not put in writing as it seemed [to the Shaws] that writing a contract between ourselves would be artificial and contrived. ...

[5] Viridian subsequently obtained a default judgment against Aluminium Plus in the District Court for \$87,648.00 including interest and credit consultant's costs of \$14,108.00, together with other costs and disbursements. Aluminium Plus failed to pursue a notice of defence and counterclaim, which it had originally filed to Viridian's claim. Nor did it take any steps to apply to set aside the default judgment.³

[6] Aluminium Plus was wound up by an order of the High Court for its failure to comply with Viridian's statutory demand for \$88,814.54. On 18 October 2014 Messrs Owens and Vance were appointed as Aluminium Plus' joint and several liquidators. The company's only creditors other than Viridian were two companies owed just over \$10,000.

High Court

[7] The liquidators issued a proceeding in the High Court. Brown J dismissed the liquidators' first claim against the Shaws for breach of contract and their separate claim against the Shaws in their capacities as directors of Aluminium Plus for breaching the duty imposed by s 136 of the Companies Act 1993 not to agree to incur further obligations.⁴ The liquidators have not cross-appealed against these findings and we do not need to address them further.

³ At [11]–[16].

⁴ At [18]–[31].

[8] However, Brown J upheld the liquidators' claims that the Shaws were guilty of reckless trading and negligence in breach of the duties imposed by ss 135 and 137 respectively.⁵ The Shaws' recklessness arose from their election to release the Trust from its obligation to pay Viridian on Aluminium Plus' behalf for supplies of materials. This decision exposed Viridian to the risk of loss because Aluminium Plus had no income or assets to pay the invoices then outstanding. The Shaws' negligence lay in releasing the Trust from its agreed role as funder of Aluminium Plus' purchases in circumstances where there was no other source of funding and the prospect of an offsetting counterclaim was speculative.

[9] Brown J ordered the Shaws to pay compensation under s 301 of \$125,884.59, comprising Aluminium Plus' debts of \$99,005.03 plus the costs and disbursements of the liquidation of \$26,879.56.⁶

Decision

Liability

[10] The Shaws' original ground of appeal against the liability finding was that Brown J erred by failing to take into account Aluminium Plus' counterclaim against Viridian. However, Mr Tennet, who did not appear in the High Court, accepted that the counterclaim defence was not raised or pleaded by the Shaws, and that we would not grant leave to raise a new ground on appeal. Mr Tennet submitted nevertheless that Brown J erred in finding that the Shaws were guilty of reckless trading or negligence and was unduly influenced by the large loss to a single creditor without considering the counterclaim. He also submitted that the Judge erred in ordering the Shaws to pay compensation in an amount including the liquidators' costs of \$26,879.56; and that liability should have been limited to the company's loss of \$99,005.03.

[11] The Shaws' appeal will fail if one of Brown J's two alternative findings is sustained. We will focus for these purposes on the negligence finding. When exercising his or her powers or performing his or her duties as a director, a person

⁵ At [38]–[44] and [45]–[53].

⁶ At [54]–[65].

must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances.⁷ The reasonable director is bound to take into account the nature of the company and of the decision and any other relevant factors including the interests of creditors especially if their decision exposed the company to the risk of insolvency.⁸

[12] Brown J rejected the liquidators' primary claim that the directors were negligent throughout Aluminium Plus' operations by virtue of its alleged insolvency from its incorporation.⁹ He was satisfied that, provided the agreement with the Trust remained in place, the directors were not in breach of their duty to the company. But the Shaws' decision in December 2013 to release the Trust from its obligation to fund Viridian's purchases was negligent because there was no other source of funding.¹⁰ The decision was not saved simply because of a prospective or contingent right of counterclaim.

[13] We agree with Brown J. The nature of Aluminium Plus was that it had no assets or income to meet its liabilities other than from recourse to matching payments made by the Trust. Its solvency was entirely dependent upon the Trust's financial support. The nature of the directors' decision was to release the Trust from its contractual obligation to indemnify Aluminium Plus against all liabilities. Insolvency was its inevitable and immediate consequence, leaving the creditors' interests without protection.

[14] Mr Shaw rationalised Aluminium Plus' decision as settling all claims which the Trust may have against Aluminium Plus for faulty glass originally supplied by Viridian; and, if Viridian sued for its debt, Aluminium Plus could counterclaim for a greater or lesser amount. However, a release from its contingent liability to the Trust was of no tangible benefit to Aluminium Plus unless the directors (a) formed an opinion independently of the Trust that the company was liable to the Trust; (b) resolved affirmatively to contest Viridian's claim; and (c) secured an unconditional right to indemnity from the Trust if its defence and counterclaim

⁷ Companies Act 1993, s 137.

⁸ *Sojourner v Robb* [2007] NZCA 493, [2008] 1 NZLR 751 at [25].

⁹ *Owens v Shaw*, above n 1, at [51].

¹⁰ At [52].

failed. In any event, as Brown J pointed out, there was no certainty that the counterclaim would equal Viridian's claim.

[15] We are satisfied that the Shaws' decision to release the Trust in December 2013, at a time when it was otherwise indebted to Viridian and other creditors, was in breach of their duty to exercise the care, diligence and skill expected of a reasonable director in those circumstances given that its inevitable and immediate consequence was to render Aluminium Plus insolvent.

Compensation

[16] However, we agree with Mr Tennet that Brown J erred in allowing all the liquidators' costs of \$26,879.56 within the compensation award.

[17] Section 301 provides, among other things, that if a director has been guilty of negligence the court may order the director to contribute such sum to the assets of the company by way of compensation as the court thinks just in the light of the director's conduct. As the Judge correctly observed,¹¹ the s 301 power is guided by the standard approach outlined by this Court in *Mason v Lewis*: by looking first to the deterioration in the company's financial position between the date the inadequate corporate governance became evident and the date of liquidation, and then exercising judicial discretion by reference to the three factors of causation, culpability and the duration of the trading.¹²

[18] The s 301 compensation award reflects the financial measure of the director's contribution to the loss suffered by a company as a result of the acts or omissions underpinning his or her relevant breach of duty.¹³ However, the question of whether compensation should include the liquidators' costs in undertaking the liquidation is less straightforward.¹⁴ The costs of administering a liquidation will generally be incurred regardless of whether the company's directors are liable.¹⁵

¹¹ At [55].

¹² *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [109]–[110].

¹³ *Madsen-Ries v Petera* [2015] NZHC 538 at [94].

¹⁴ *Madsen-Ries v Twine* [2015] NZHC 227 at [10].

¹⁵ *Madsen-Ries v Petera*, above n 13, at [112].

[19] This was not an orthodox company liquidation or liquidator's claim. Viridian was Aluminium Plus' only significant creditor when it was wound up. The other two creditors were for relatively minor amounts. It would have been immediately plain to the liquidators that the company's indebtedness was very modest; and that it had no assets available to meet creditors' claims except for a contingent right of action against the Shaws. Nevertheless, Ms Louise Craig, an employee of the liquidators, deposed at trial that to 18 March 2016 the liquidators' costs amounted to \$38,404. The liquidators sought to recover costs of \$43,187. Later at Brown J's direction they amended their claim to \$26,879 for costs which were not attributable to the litigation against the Shaws.

[20] Ms Craig deposed to leading the liquidators' investigations into Aluminium Plus' financial affairs. Among other things she spent time obtaining advice from the Inland Revenue Department, Viridian and Viridian's debt collectors. She made inquiries of all major banks, spoke to Aluminium Plus' distributors, and met with various entities and the Shaws. By 17 March 2016 the liquidators' staff had worked 131.6 hours on this liquidation. It is not easy to follow how non-litigation costs of \$26,879 could justifiably be incurred in a liquidation relating to a very modest level of indebtedness.

[21] As Ms Craig herself deposed, the liquidators' focus was on establishing that the Shaws set up the company from the outset in a way designed to defeat creditors. Brown J dismissed that claim. We are satisfied that proving this unsuccessful thesis was the primary focus of the liquidators' work; that the liquidation was pursued as a debt-collection exercise for one entity's benefit; and that the liquidation costs were primarily incurred for and incidental to that overriding purpose, rather than being attributable to the general costs of liquidating a company (such as maintaining records of the liquidation, preparing accounts and filing GST returns).

[22] Liquidators are entitled to follow the course pursued here. But they cannot necessarily expect to recover more than the usual award of legal costs and disbursements if successful. The purpose of an award of compensation under s 301 is to recoup or indemnify the company for its losses attributable to a director's breaches. While it may be appropriate to incorporate an allowance for the

liquidator's costs where they are necessarily incurred as a consequence of the relevant breach, care is required to ensure that the award is truly proportionate to the company's actual loss. It is telling that the final award in the High Court — inflated by credit consultant's and liquidation costs — more than doubled Viridian's actual debt. On any cost-benefit analysis, pursuit of this litigation was not a commercially rational exercise.

[23] We agree with Brown J that in the normal course the creditors' recovery should not be unduly diluted by the liquidators' costs.¹⁶ However, for the reasons just given, we do not regard the Shaws as primarily responsible for that part of the dilution attributable to the liquidators' pursuit of this litigation. In our judgment the Shaws should be required to contribute only a proportion of the liquidators' costs. We assess that figure on a broad-brush approach at \$7,500. When that sum is added to the award for Aluminium Plus' core loss of \$99,005.03, the Shaws' liability for compensation is \$106,505.03.

Result

[24] The appeal is allowed to the extent of quashing the amount of the High Court judgment of \$125,884.59 and substituting the amount of \$106,505.03.

[25] In all other respects the High Court judgment remains in force.

[26] Each party has enjoyed a measure of success. There is no order for costs in this Court.

Solicitors:
Te Haa Legal Ltd, Otaki for Appellants
Ford Sumner, Wellington for Respondents

¹⁶ *Owens v Shaw*, above n 1, at [64]–[65].