

IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

**CA598/2018
[2021] NZCA 461**

BETWEEN	JOHN LAWSON LITTLE Appellant
AND	NZ NATURAL THERAPY LIMITED (IN LIQUIDATION) First Respondent
	VIVIEN JUDITH MADSEN-RIES AND HENRY DAVID LEVIN Second Respondents

Hearing: 24 March 2021

Court: Clifford, Ellis and Muir JJ

Counsel: P J Dale QC for Appellant
K H Morrison and H Hui for Respondents

Judgment: 10 September 2021 at 3.00 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant must pay one set of costs to the respondents for a standard appeal on a band A basis and usual disbursements.

REASONS OF THE COURT

(Given by Clifford J)

Introduction

[1] The appellant, John Little, was the sole director of the first respondent, NZ Natural Therapy Ltd (the Company) which was put into liquidation in 2012. The Company was the corporate trustee of one of Mr Little's family trusts, a trading trust called the NZ Natural Therapy Trust (the Trust). The second respondents, Vivien Madsen-Ries and Henry Levin, are the liquidators of the Company appointed by the High Court. Three creditors subsequently filed claims in the liquidation, totalling approximately \$207,000.

[2] Proceedings commenced by the liquidators in 2012 had, by June 2020,¹ resulted in Mr Little having been found by the High Court to owe:

- (a) the Company in its capacity as trustee \$323,148, being the debt represented by the overdrawn balance of Mr Little's drawings account as shown in the Trust's accounts for the financial year ending 31 March 2012;² and
- (b) the liquidators' scale 2B costs of \$151,245.50 and disbursements of \$65,124.82.³

[3] Mr Little now accepts his liability to the Company for his current account debt. He continues to argue, however, that he should not have to pay any or, if some, then only greatly reduced costs to the liquidators. In this appeal he challenges the High Court's costs decision.

Background

[4] To explain this question of costs it is unfortunately necessary to go into considerable detail.

¹ In May 2019 this Court had observed of those proceedings: "the case has been procedurally tortuous and the delays regrettable": *Little v NZ Natural Therapy Ltd (in liq)* CA598/2018, 23 May 2019 at [1].

² *NZ Natural Therapy Ltd (in liq) v Little* [2018] NZHC 2164.

³ *NZ Natural Therapy Ltd (in liq) v Little* [2020] NZHC 1506 [Judgment under appeal].

[5] When the liquidators first commenced proceedings against Mr Little in 2012 they said:

- (a) As a first cause of action, he owed the Company \$1,059,590.49; money he had unlawfully caused the Company to pay him. They claimed, in the alternative and in amounts to be determined after inquiry, for monies Mr Little caused the Company to pay when it was insolvent, or to the prejudice of its creditors, or for compensation for breaches by Mr Little of his director's duties.
- (b) As a second cause of action they said Mr Little owed the Company as trustee of the Trust part of the sum of \$323,148, which was owing to the Trust on the beneficiaries' current account as at 31 March 2012. Mr Little pleaded a simple denial to that claim.

First cause of action

[6] The High Court heard and determined the first cause of action separately.⁴

[7] At the hearing of that claim it was accepted by both parties that if, as Mr Little claimed, the Company was in debt to its creditors as trustee of the Trust, then that amount would not be owing.⁵ Reflecting the very disorganised and undocumented state of affairs the liquidators had faced from their appointment, Mr Little was unable to provide direct evidence of the Company's status as trustee and of many other facts he purported to rely on. The Court's task was, accordingly, more difficult and more complex than would normally be the case.

[8] At the end of that hearing Brewer J gave a results judgment finding that the Company was indeed acting as trustee as Mr Little had claimed, and so dismissing the liquidators' first cause of action.⁶ Costs were reserved.⁷

⁴ *NZ Natural Therapy Ltd (in liq) v Little* [2016] NZHC 2585.

⁵ At [4]–[6].

⁶ At [34].

⁷ At [35].

[9] At that point the hearing was adjourned part heard, and orders were made for further disclosure in response to matters that had become apparent during the trial thus far.⁸ Shortly after that judgment was released the relevant trust documentation was found amongst papers held by Mr Little's lawyers. It was acknowledged that the disorganised state of the Company's records and those of related entities had largely contributed to that unfortunate oversight.

Second cause of action

[10] The liquidators subsequently filed amended pleadings. In those pleadings (and as a first cause of action), they claimed Mr Little owed the Company the full amount of the \$323,148 shown as owing on the beneficiaries' current account. The pleading of that claim was, however, considerably more detailed than it had previously been, including references to the Trust's financial statements for the years 2006 to 2012. In addition the liquidators:

- (a) added, as second defendants, Mr Little and his (former) wife in their capacity as trustees of another family trust;
- (b) claimed that same amount from the second defendants as monies paid to them by the Company to the prejudice of its creditors and the liquidators; and
- (c) claimed in the alternative against Mr Little himself for breach of various duties he owed to the Company and the liquidators as sole director of the Company.

[11] Mr Little disputed that liability, including by reference to what he said was the significance of transfers between the Trust and Mr Little's other family trust, Woodside. If those transactions were correctly accounted for the Trust, and hence the Company as trustee, would owe Woodside \$93,852.

⁸ *NZ Natural Therapy Ltd (in liq) v Little* HC Auckland CIV-2013-404-4866, 1 September 2016.

[12] The High Court heard those claims over four days in May 2018, and released its decision in August of that year.⁹ Preferring the expert accounting evidence called by the liquidators over that called by Mr Little, the High Court found Mr Little liable to the Company as trustee for the amounts showing in the Trust's 2012 financial statements as the overdrawn beneficiaries' current accounts of \$323,148.¹⁰ In doing so, the Court rejected Mr Little's argument that those amounts constituted distributions from the Trust to its beneficiaries, and hence not a debt.¹¹

[13] The Judge also found for the liquidators on their alternative causes of action albeit, as regards some, to the extent of liability only.¹² The Judge reserved questions of:

- (a) compensation to the Company for Mr Little's breaches of directors' duties and his failure to keep adequate accounting records;¹³ and
- (b) the determination of Mr Little's affirmative defence: that the liquidators were not entitled to recover the costs of the liquidation because they had not acted in the best interests of the Company and had acted inconsistently with their obligations as liquidators.¹⁴

Mr Little's substantive appeal

[14] At that point, and before those reserved questions and the related question of costs in the proceedings could be determined, Mr Little appealed all aspects of the High Court's decision to this Court.

[15] At the commencement of that appeal, Mr Little advised this Court through his counsel Mr Dale QC that he no longer challenged the High Court's finding he owed the personal debt of \$323,148. Rather, and as this Court put it:¹⁵

⁹ *NZ Natural Therapy Ltd (in liq) v Little* [2018] NZHC 2164.

¹⁰ At [37] and [144](a).

¹¹ At [28].

¹² At [61] (dispositions made to the prejudice of creditors), [115] (breaches of directors' duties) and [126] (failure to keep adequate accounting records).

¹³ At [113]–[115] and [126].

¹⁴ At [143].

¹⁵ *Little v NZ Natural Therapy Ltd (in liq)*, above n 1, at [2].

Instead, he wished to argue that he should not be required to pay the full amount of that debt where it exceeded the extent of creditors' claims against the company, and a lack of proportionality in the liquidators' conduct ought to disentitle them to recovery of substantially more than is required to satisfy creditors' claims.

[16] In light of that concession, this Court adjourned the hearing and referred the matter back to the High Court for it to decide the reserved questions.¹⁶

The High Court addresses the reserved questions

[17] The reserved questions were addressed by the High Court in a judgment of 29 November 2019.¹⁷ First, as regards the question of compensation, the Court noted the position remained reserved, and it would be open to the liquidators to apply for specific compensation in the event the liquidation is concluded and there were outstanding liquidators' costs.¹⁸ Secondly, the High Court determined that even were it to find for Mr Little on his allegations against the liquidators, that would not reduce his personal liability to pay the \$323,148 the Court had earlier found he owed the Company.¹⁹ The Court then found against Mr Little as regards his claim the liquidators had breached their duties and had acted unlawfully.²⁰

[18] Thus, the liquidators were entitled to be paid their reasonable costs; the quantum of which would be determined in due course. The question of costs in the proceedings were "fully at large", with memoranda to be filed.²¹

Judgment under appeal

[19] In his final foray on to these troubled waters Brewer J determined the question of costs in the proceedings. At that point Mr Little argued that the liquidators' conduct over the course of the litigation disqualified them from obtaining any costs, and indeed they should pay costs to him. As a fall-back submission, Mr Little argued that if the liquidators were entitled to some costs then a global figure of no more than \$50,000 should be payable.

¹⁶ At [8].

¹⁷ *NZ Natural Therapy Ltd (in liq) v Little* [2019] NZHC 3132.

¹⁸ At [40] and [45].

¹⁹ At [11]–[12].

²⁰ At [39].

²¹ At [47]–[48].

[20] Largely for the same reasons as he had earlier rejected Mr Little's affirmative defence, the Judge determined that the question of costs in the proceedings would be assessed on the usual basis: namely, costs would be payable to the successful party, the liquidators.²²

[21] The liquidators claimed costs totalling \$252,811.32 comprising:

- (a) scale 2B costs of \$151,245.50;
- (b) disbursements of \$65,124.82; and
- (c) increased costs of \$36,441.

[22] Whilst the liquidators had failed in their first cause of action, if Mr Little had complied with his discovery obligations and discovered the Trust documents that subsequently became available, the Judge determined the liquidators would not have proceeded with that claim.²³ The Judge also weighed Mr Little's formal success on that first cause of action and his subsequent unsuccessful defence against the claim based on the beneficiaries' overdrawn current account.²⁴ Accepting the liquidators' claims for disbursements but not their claim for increased costs,²⁵ the Judge awarded costs of \$150,245.50 on a 2B basis, and disbursements of \$65,124.82.²⁶

This appeal

[23] Mr Little now appeals. As he did in the High Court, he contends the liquidators' costs are disproportionate to the task that was properly theirs as liquidators. In particular, he points to a settlement offer the liquidators' made before the first hearing, which was for an amount considerably in excess of that claimed in the liquidators' first cause of action and even more again than the amount of the judgment they finally obtained. That was, he says, the only settlement offer made by the liquidators capable of acceptance. It was accordingly evident of their

²² Judgment under appeal, above n 3, at [20].

²³ At [21]–[22].

²⁴ At [23].

²⁵ At [24].

²⁶ At [31]–[32].

disproportionate approach. What was involved here was a comparatively simple liquidation, in which three creditors had proved for debts and which could have been wound up by the liquidators with considerably less costs and expenses than they in fact incurred.

Analysis

[24] For Mr Little, Mr Dale placed considerable emphasis on the differences between the amounts for which the liquidators:

- (a) offered to settle the proceedings in 2016, that is \$1,633,794.38;
- (b) claimed under their first cause of action against Mr Little, that is \$1,059,590; and
- (c) claimed, and were awarded, by reference to the outstanding balance of the beneficiaries' drawings account in the books of the Trust as at 31 March 2012, namely \$323,148.

[25] In hindsight, and once the High Court had determined that the Company was the trustee of the Trust, the initial amounts claimed do appear unusually high. They invite the criticism that, in general terms, it cannot be proper for liquidators to pursue claims against officers of a company where by far the largest part of the amount claimed is not needed to satisfy the creditors' claims, and will only be returned to the shareholders, less the liquidators' costs, at the end of the day. At the hearing of this appeal, we were mindful of that concern.

[26] We were also concerned by some aspects of the liquidators' pleadings, which asserted that the Company had a "beneficial interest" in the Trust's assets to the extent of its indemnity, and that the pleadings did not appear to reflect an awareness of the distinction between the Company trading on its own account and trading as trustee of the Trust. On reflection, and given that the Company's only activities were carrying out the day-to-day business of the Trust as its trustee, those concerns, whilst justified in general terms, may not have been of great practical significance in this case.

[27] We note that, reflecting our discussion with counsel at the hearing, we asked for and received further submissions from both Mr Little and the liquidators on the role of liquidators of a company which is a sole trustee and which is placed in liquidation. We were referred to the decision of *Levin v Ikiua*,²⁷ and the statutory provisions as to the removal of insolvent corporate trustees.²⁸ As those materials reflect, the fundamental position is that the liquidator of a corporate trustee is primarily interested in the assets of the trust only to the extent of the trustee's right to be indemnified. That right does not constitute a beneficial interest in the trust's assets, but rather an equitable lien over both the capital and income of the trust.²⁹ Further, the power provided under statute to replace an insolvent trustee can helpfully crystallise the relationship between an insolvent trustee and a trust. The replacement of an insolvent trustee separates the affairs of the trust from those of the insolvent trustee subject, of course, to the trustee's right of indemnification.

[28] Be that as it may, as the Judge found:

- (a) The hearing on the first cause of action was a direct consequence of Mr Little's failure as shareholder and director of the Company, and as appointer of the Trust, to ensure that records were kept of the business and affairs of those entities³⁰ — even if not to the absolute letter of the law — then at least to the extent where the liquidation could be conducted reasonably efficiently.
- (b) The High Court having found that the Company was indeed acting as trustee, it was then Mr Little's denial of any liability on the amounts stated by the Trust's accounts to be owing by beneficiaries that gave rise to the necessity for the second hearing. The time and effect, particularly that of expert accounting witnesses and of counsel involved in the second hearing, was the direct result of that denial. It was in that context that the liquidators incurred a large portion of their costs.³¹

²⁷ *Levin v Ikiua* [2010] 1 NZLR 400.

²⁸ Trustee Act 1956, s 43 (and the equivalent provisions in Trusts Act 2019, ss 92 and 105).

²⁹ See *Levin v Ikiua*, above n 27, at [117]–[119].

³⁰ Judgment under appeal, above n 3, at [22].

³¹ At [23], citing *NZ Natural Therapy Ltd (in liq) v Little*, above n 17, at [38].

Given the significance of Mr Little's denial, his criticism of the liquidators' approach does not have any great force.

- (c) Finally, it was not until the opening of his substantive appeal in this Court that Mr Little accepted his personal liability. The significance of that, relative to his position theretofore, was reflected in this Court remitting the outstanding matters to the High Court for determination.³²

[29] Against that background, we endorse the Judge's comments at [28] to [38] of his substantive judgment of 29 November 2019 and in particular the following:³³

[35] I do not accept Mr Little's criticisms. Mr Little had breached his duty to maintain proper records. He did not give the liquidators the deed appointing the Company corporate trustee. He did not accept liability to pay the current account debt.

[36] The liquidators were entitled to sue Mr Little. They did not have to confine their suit to the current account debt. They could not be sure it would succeed, or, if it did, what the quantum might be. Further, it was always possible that more creditors might be identified.

[37] In one sense, the amounts the liquidators sued Mr Little for did not matter. He could not be liable for a sum greater than the admitted debts and the liquidators' reasonable costs. Any surplus would be returned to him as sole shareholder.

[38] I also find that Mr Little unduly contributed to the expenses of the liquidation by the way he defended the current account claim. It was only at the 2016 trial that he unexpectedly raised the defence that the records showing the current account amount were wrong. He wished to call expert evidence to establish that point. The liquidators had no choice but to go to the considerable trouble of examining Mr Little's experts' opinions and to counter them. In the end they were successful.

[30] In our view, accordingly, Brewer J was well placed to make the costs decision Mr Little now challenges. We see no error of principle or otherwise in that discretionary decision.

Result

[31] The appeal is dismissed.

³² At [13].

³³ *NZ Natural Therapy Ltd (in liq) v Little*, above n 17.

[32] The appellant must pay one set of costs to the respondents for a standard appeal on a band A basis and usual disbursements.

Solicitors:

Neilsons Lawyers, Auckland for Appellant

Meredith Connell, Auckland for Respondents