IN THE HIGH COURT OF NEW ZEALAND
HAMILTON REGISTRY

CIV-2011-419-001233
[2012] NZHC 3458

UNDER	Part 18 of the High Court Rules and the Companies Act 1993
IN THE MATTER OF	the Independent Livestock Agents Limited (In Liquidation) and Independent Livestock 2010 Limited
BETWEEN	DAMIEN GRANT AND STEVEN KHOV Plaintiffs
AND	INDEPENDENT LIVESTOCK 2010 LIMITED First Defendant
AND	IAN CHARLES SCHULER Second Defendant

Hearing: 26, 27 and 28 November 2012

Appearances: C W Grenfell and B J Norling for Plaintiffs
G D Hayes for Defendants

Judgment: 17 December 2012

JUDGMENT OF POTTER J

This judgment was delivered by Justice Potter on
17 December 2012 at 4.30 p.m., pursuant to
r 11.5 of the High Court Rules

Registrar/Deputy Registrar
Date:

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Introduction

[1] The plaintiffs are the liquidators of Independent Livestock Agents Ltd ("IL Agents"). The second defendant, Mr Schuler, was the sole director and a shareholder of both IL Agents and the first defendant, Independent Livestock 2010 Ltd ("IL 2010"). In this proceeding the liquidators seek to hold Mr Schuler personally liable for the debts incurred by IL Agents.

Summary of factual background

[2] Mr Schuler, as a director of IL Agents, sold stock for Mr and Mrs Mudge on three occasions in April 2007, June 2008 and July 2008. The sale proceeds totalling approximately $90,000 were received by IL Agents, but not paid out to Mr and Mrs Mudge.

[3] In May 2008 Mr Schuler introduced to Mr and Mrs Mudge, who were wanting to sell their farm, a Mr Dodunski, who purchased the Mudges' farm on 4 July 2008.

[4] Mr and Mrs Mudge say that between May 2007 and June 2009 when they requested payment of the sale proceeds, Mr Schuler gave them a number of excuses for non-payment but promised that they would be paid. Mr Schuler disputes that Mr and Mrs Mudge made repeated requests for payment.

[5] In June 2009 Mr Mudge issued an ultimatum to IL Agents that unless the sale proceeds were paid he would refer the matter to his solicitor. Mr and Mrs Mudge say that within a few days of this ultimatum being given they received an invoice from IL Agents claiming "Commission for facilitating sale and purchase of dairy farm at Whatauri Road, Wharepapa South to JKD Farms". The commission claimed was 2 per cent on a purchase price of $4,500,000, amounting to $90,000 plus GST of $11,250, a total of $101,250. The invoice was issued by IL Agents and dated 25 May 2008.

[6] Mr and Mrs Mudge say there was never any agreement to pay Mr Schuler or IL Agents commission in relation to the sale of their farm to Mr Dodunski.

[7] On 10 March 2010, Mr and Mrs Mudge issued a statutory demand to IL Agents for the proceeds of the stock sold in April/May 2007, June 2008 and July 2008.

[8] On 30 March 2010 IL 2010 was incorporated. Mr Schuler was the sole director. IL 2010 took over the business of IL Agents and continued to operate it.

[9] The plaintiffs say that customers of IL Agents were unaware for some time of any change in the ownership of the business of IL Agents; that invoices issued by IL Agents were reissued by IL 2010 and funds received by IL Agents were transferred to IL 2010. The defendants say that invoices were reissued simply to correct errors when customers paid to the incorrect bank account after IL 2010 took over the business of IL Agents.

[10] On 21 June 2010 an order was made for the liquidation of IL Agents. Mr and Mrs Mudge were the only substantial creditors. There were only two other creditors whose debts totalled less than $3,000.

[11] In August 2011 these proceedings were issued.

[12] On 27 September 2011 IL 2010 was liquidated.

Pleadings

[13] In their first cause of action the plaintiffs seek an order pursuant to s 271(1)(b) of the Companies Act 1993 ("the Act") to pool the assets and liabilities of IL Agents and IL 2010.[1]

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[1] A pleading seeking an order under s 271(1)(a) of the Act that IL 2010 pay to the liquidators the whole of the claims made in the liquidation of IL Agents was not pursued because both companies, IL Agents and IL 2010, are in liquidation.

[14] In their second cause of action the plaintiffs plead that IL Agents is a failed company as defined in s 386B of the Act; that Mr Schuler was a director of IL Agents in the 12 months before the commencement of the liquidation of IL Agents; that IL 2010 has, and had prior to the liquidation of IL Agents; a name so similar to IL Agents as to suggest an association with IL Agents, that IL 2010 is a phoenix company as defined by s 386B of the Act; and that the second defendant contravened s 386A of the Act in being a director of IL 2010, a phoenix company, within five years of the liquidation of IL Agents. The relief sought is an order pursuant to s 386C that Mr Schuler pay the relevant debts of IL 2010, being the whole of the claims made in the liquidation of IL Agents.

[15] As an alternative cause of action, the plaintiffs seek relief under s 301 of the Act. They plead misapplication or retention of company funds equivalent in value to the Mudge debt; negligence; and default or breach of duty or trust by Mr Schuler in relation to IL Agents. The relief sought is an order that Mr Schuler repay the debt of Mr and Mrs Mudge claimed in the liquidation of IL Agents together with interest.

[16] The defendants deny the plaintiffs' claims and plead by way of affirmative defences that:

(a) The plaintiffs are estopped from pursuing their claim against IL 2010 because they have not challenged under s 284(1)(b) of the Act the decision of the liquidator of IL 2010 to reject the proof of debt of IL Agents relating to the debt of Mr and Mrs Mudge. They plead that it is an abuse of process to use these proceedings to circumvent the statutory process for disputing a liquidator's decision.

(b) Mr Schuler, if a director of a phoenix company, was not involved in the management of IL 2010 when the debt under the first cause of action arose.

Relevant provisions of the Companies Act 1993

[17] Section 271 of the Act relates to the pooling of assets of related companies. It relevantly provides:

> **271 Pooling of assets of related companies**
>
> (1) On the application of the liquidator, or a creditor or shareholder, the Court, if satisfied that it is just and equitable to do so, may order that—
>
> (a) ...
>
> (b) Where 2 or more related companies are in liquidation, the liquidations in respect of each company must proceed together as if they were one company to the extent that the Court so orders and subject to such terms and conditions as the Court may impose.
>
> (2) The Court may make such other order or give such directions to facilitate giving effect to an order under subsection (1) of this section as it thinks fit.

[18] Section 271A requires that an applicant for an order under s 271(1)(b) must give notice that the application has been filed to the liquidator (excluding the applicant) and the creditor(s) of each related company in liquidation. The purpose of the notice is to provide any of the companies the subject of the proposed pooling order with the opportunity to object to the application.

[19] Section 272 provides guidelines for orders under s 271. In relation to orders under s 271(1)(b), in deciding whether it is just and equitable to make an order the Court must have regard to the following matters:

> **272 Guidelines for orders**
>
> …
>
> (2) In deciding whether it is just and equitable to make an order under section 271(1)(b) of this Act, the Court must have regard to the following matters:
>
> (a) The extent to which any of the companies took part in the management of any of the other companies:
>
> (b) The conduct of any of the companies towards the creditors of any of the other companies:

(c) The extent to which the circumstances that gave rise to the liquidation of any of the companies are attributable to the actions of any of the other companies:

(d) The extent to which the businesses of the companies have been combined:

(e) Such other matters as the Court thinks fit.

[20] Section 2(3) defines when a company is related to another company. Relevant to this case, s 2(3)(d) provides that a company is related to another company if —

(d) The businesses of the companies have been so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable ...

[21] Sections 386A, 386B and 386C relate to phoenix companies. Section 386A provides:

386A Director of failed company must not be director, etc, of phoenix company with same or substantially similar name

(1) Except with the permission of the Court, or unless 1 of the exceptions in sections 386D to 386F[2] applies, a director of a failed company must not, for a period of 5 years after the date of commencement of the liquidation of the failed company,—

(a) be a director of a phoenix company; or

(b) directly or indirectly be concerned in or take part in the promotion, formation, or management of a phoenix company; or

(c) directly or indirectly be concerned in or take part in the carrying on of a business that has the same name as the failed company's pre-liquidation name or a similar name.

(2) A person who contravenes subsection (1) commits an offence and is liable on conviction on indictment to the penalty set out in section 373(4).

[22] Section 386B provides definitions for the purpose of the phoenix company provisions:

386B Definitions for purpose of phoenix company provisions

(1) In sections 386A to 386F,—

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2 These exceptions do not apply in this case.

director of a failed company means a person who was a director of a failed company at any time in the period of 12 months before the commencement of its liquidation, and director of the failed company has a corresponding meaning

failed company means a company that was placed in liquidation at a time when it was unable to pay its due debts

phoenix company means, in relation to a failed company, a company that, at any time before, or within 5 years after, the commencement of the liquidation of the failed company, is known by a name that is also—

(a) a pre-liquidation name of the failed company; or

(b) a similar name

pre-liquidation name means any name (including any trading name) of a failed company in the 12 months before the commencement of that company's liquidation

similar name means a name that is so similar to a preliquidation name of a failed company as to suggest an association with that company.

[23] Section 386C provides for personal liability for debts of a phoenix company in specified circumstances:

386C Liability for debts of phoenix company

(1) A person who contravenes section 386A(1)(a) or (b) is personally liable for all of the relevant debts of the phoenix company.

(2) ...

(3) In this section, **relevant debts**—

(a) in subsection (1), means the debts and liabilities incurred by the phoenix company during the period when the person liable was involved in the management of the company and the phoenix company was known by a pre-liquidation name of the failed company or a similar name:

…

[24] Section 301, on which the plaintiffs' third cause of action relies, relevantly provides:

301 Power of Court to require persons to repay money or return property

(1) If, in the course of the liquidation of a company, it appears to the Court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager,

[administrator,] liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the Court may, on the application of the liquidator or a creditor or shareholder,—

(a) Inquire into the conduct of the promoter, director, manager, [administrator,] liquidator, or receiver; and

(b) Order that person—

(i) To repay or restore the money or property or any part of it with interest at a rate the Court thinks just; or

(ii) To contribute such sum to the assets of the company by way of compensation as the Court thinks just; or

(c) Where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the Court thinks just to the creditor.

(2) This section has effect even though the conduct may constitute an offence.

(3) An order for payment of money under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.

…

[25] Section 131 relates to the duty of directors to act in good faith and in the best interests of the company. It relevantly 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.

...

[26] Section 135 relates to reckless trading. It 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.

[27] Section 137 provides:

137 Director's duty of care

A director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,—

(a) The nature of the company; and

(b) The nature of the decision; and

(c) The position of the director and the nature of the responsibilities undertaken by him or her.

[28] Section 194(1) provides:

194 Accounting records to be kept

(1) The board of a company must cause accounting records to be kept that—

(a) Correctly record and explain the transactions of the company; and

(b) Will at any time enable the financial position of the company to be determined with reasonable accuracy; and

(c) Will enable the directors to ensure that the financial statements of the company comply with section 10 of the Financial Reporting Act 1993 and any group financial statements comply with section 13 of that Act; and

(d) Will enable the financial statements of the company to be readily and properly audited.

Agreed facts

[29] A number of facts are not in dispute. These may be summarised as follows.

(a) IL Agents through Mr Schuler acted as agent for Mr and Mrs Mudge in the sale of —

(i) 29 head of stock for Mr and Mrs Mudge to Fairfax & Associates Ltd ("Fairfax") in April or May 2007. There was some difference between Mr Willoughby, a director of Fairfax, and Mr Schuler as to the nature of the stock sold, whether the animals were steers or heifers, and as to the unit price, but those differences are not of any significance. The invoice from IL Agents to Fairfax is dated 7 May 2007 and the due date for payment is specified as 21 May 2007. Payment for the stock was made in two instalments of $6,525 on 20 June 2007 and $2,193.75 on 20 July 2007. These deposits appear in the bank statement of IL Agents on those dates.

(ii) 99 head of stock to Kahuwera Farms in June 2008 and July 2008. The purchasers paid for this stock.

(b) The amounts paid by the purchasers, Fairfax and Kahuwera Farms, were never disbursed to Mr and Mrs Mudge. The funds, having been credited to the bank account of IL Agents, were applied in the general expenditure of the company. There was no transaction recorded for the commission of 6 or 7 per cent to which IL Agents would have been entitled in terms of the conditions of sale.

(c) Mr Schuler introduced Mr Dodunski to Mr and Mrs Mudge as a potential purchaser of their farm. An entity associated with Mr Dodunski completed the purchase of the farm on 22 July 2008.

(d) The debts of IL Agents proved in its liquidation were:

(i) $94,306.52 for the sale of stock owed to Mr and Mrs Mudge.

(ii) $2,746 being the cost of Mr and Mrs Mudge in the liquidation.

(iii) $2,604.42 due to the Inland Revenue Department.

(iv) $239.06 due to Beban and Associates (recent advice is that this debt has been paid).

(e) Transfers of funds were made from the bank account of IL Agents to the bank account of IL 2010 as follows:

a	19 April 2010	$5,000.00
b	23 April 2010	$1,100.00
c	23 April 2010	$10,000.00
d	23 April 2010	$10,000.00
e	23 April 2010	$10,000.00
f	26 April 2010	$30,000.00
g	27 April 2010	$1,000.00
h	27 April 2010	$5,000.00
i	27 April 2010	$10,000.00
j	27 April 2010	$10,000.00
k	27 April 2010	$10,000.00
l	25 May 2010	$5,000.00

(f) Transfers of funds were made from the bank account of IL 2010 to the bank account of IL Agents as follows:

a	28 April 2010	$3,973.44
b	7 May 2010	$10,000.00

(g) In all, a total of $107,100 was transferred from IL Agents to IL 2010 in the period 19 April to 25 May 2010, all of it except $5,000 in an eight day pereid between 19 April and 27 April 2010. A total of $13,973.44 was transferred from the account of IL 2010 to the account of IL Agents in approximately the same period. [3]

(h) The GST number of IL Agents was 91-473-216.

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[3] These transfers are pleaded in the second amended statement of claim and were the subject of uncontested evidence by the plaintiff, Mr Damien Grant.

(i) The IRD number of IL 2010 was 104-419-062.

(j) Mr Schuler was a director of IL Agents within 12 months prior to the liquidation of that company.

(k) The dates of the following events:

9 August 2005 — IL Agents was incorporated

4 July 2008 — Mr and Mrs Mudge entered into an agreement for the sale of their farm to Mr Dodunski or an associated entity. The sale settled on 22 July 2008. The sale price was $4.5 million.

25 May 2008 — The date of the invoice issued by IL Agents to Mr and Mrs Mudge for commission on the farm sale (the actual date of issue is in dispute).

10 March 2010 — Mr and Mrs Mudge served a statutory demand on IL Agents for proceeds of the stock sold in April/May 2007, 10 June 2008 and 17 July 2008.

30 March 2010 — IL 2010 was incorporated.

21 June 2010 — IL Agents was liquidated.

27 September 2011 — IL 2010 was liquidated.

Factual issues in dispute

[30] There are a number of factual issues in dispute, the determination of which is relevant to the issues before the Court. These are addressed below.

When did Fairfax make payment for the stock it purchased through IL Agents from Mr and Mrs Mudge, and when did Mr Schuler become aware, or ought reasonably to have become aware, that payment was made?

[31] Mr Schuler initially contended that payment had not been made by Fairfax. He said at paragraph 10 of a brief of evidence dated 16 October 2012, "To this day no money has come in for the 29 heifers". However, in an amended brief of evidence dated 21 November 2012 which he read in Court, he said, "With the benefit of discovery I now know the money for those animals was paid".

[32] Between Mr Schuler's brief of evidence dated 16 October and that dated 21 November 2012, Mr Willoughby's brief of evidence was provided to Mr Schuler's counsel.

[33] Mr Willoughby's evidence was that at the relevant time he was a director of Fairfax. In 2007, through his company, he purchased 29 calves through Mr Schuler which were invoiced to him on 7 May 2007. He paid for these animals on 20 June 2007 and 20 July 2007 by direct credit to Mr Schuler's company's account. He believed the 29 animals he purchased from Mr Schuler were those referred to by Mr Schuler in his brief of evidence as "29 one-year-old heifers at $230 each", sold on behalf of Mr and Mrs Mudge, although the details of the stock and the unit price varied slightly in the invoice. Mr Willoughby was not aware at the time that Mr and Mrs Mudge were the vendors.

[34] In answer to questions from the Court, Mr Willoughby confirmed that it was his handwriting on the invoice dated 7 May 2007 to Fairfax from IL Agents. He confirmed that he paid the account in two instalments of $6,525 on 20 June 2007 and $2,193.75 on 20 July 2007,[4] a total of $8,719.75. He said that although the amount was slightly less than the invoiced amount, it was the amount he paid and which IL Agents accepted.

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[4] Mr Willoughby's evidence about payment is confirmed by deposits in the bank account of IL Agents, of $6,525 on 20 June 2007 and $2,193.75 on 20 July 2007.

[35] Mr Willoughby also confirmed that the purchase of the 29 stock units in May 2007 was the only transaction he had through Mr Schuler or IL Agents at that time. There was the following exchange in Court:

> Q. Apart from the transaction in May 2007 when you bought the 29 calves did you have any transactions through Mr Schuler or Independent Livestock Agents Limited between 2007 and 2010?
>
> A. No, I cannot recall. No, I don't think I did.
>
> Q. Can you recall whether you had any other transactions with Mr Schuler or Independent Livestock Agents Limited around the time you bought these 29 calves?
>
> A. No, I didn't.
>
> Q. You didn't?
>
> A. No.
>
> Q. Do I understand from that answer that you can recall and your recollection is that you did not?
>
> A. That's correct, Ma'am.

[36] Mr Willoughby could not recall whether either Mr Schuler or Mr Leatham (who undertook bookkeeping and invoicing for IL Agents) had contacted him regarding payment of the invoice.

[37] Given Mr Willoughby's uncontradicted evidence that the purchase of the stock the subject of the invoice from IL Agents on 7 May 2007, was the only transaction he had with the company or Mr Schuler between 2007 and 2010,[5] I am satisfied that the stock units Fairfax purchased at that time were the 29 units sold by Mr and Mrs Mudge through Mr Schuler. I find that these are the stock referred to in a note for the attention of "Ken" (Mr Leatham), written by Mrs Mudge dated 19 December 2008, seeking payment of the sale proceeds; and in statements from Mr and Mrs Mudge detailing payments due for stock sold through IL Agents in April 2007.

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[5] Mr Willoughby referred to recent transactions through the agency of Mr Schuler involving a sale of stock in Wellsford in June 2010 and a purchase of cattle in March 2011.

[38] I further find that Mr Willoughby (Fairfax) paid for the 29 stock units as detailed in Mr Willoughby's handwriting on the invoice from IL Agents and recorded in the bank statements of the company on 20 June 2007 and 20 July 2007.

[39] I further find that these payments, though received by IL Agents, were not disbursed to Mr and Mrs Mudge. Hence, Mrs Mudge's request to Mr Leatham on 19 December 2008 for payment of this and other outstanding amounts.

[40] There is no evidence that Mr Schuler or Mr Leatham pursued payment of this account from Fairfax. Mr Willoughby could not recall any approaches. Mr Leatham said that he would usually contact Mr Schuler about accounts that had not been paid, but he could not recall doing so on this occasion. He agreed he had changed his brief of evidence dated 16 October 2012 in which he said in relation to this transaction "the company was never paid", because he discovered by his 21 November brief of evidence that IL Agents had been paid.

[41] Mr Schuler said in answer to questions in cross-examination that it was primarily Mr Leatham's role to chase up slow payers, but he agreed that when this did not produce results, Mr Leatham would contact him to pursue the client or the customer. He said he did not recall Mr Leatham telling him that the Willoughby/Fairfax money had not been paid, but he did remember conversations with Mr Mudge asking for his money. He claimed he asked Mr Leatham about that and Mr Leatham said Mr Willoughby had not paid. He then told Mr Mudge "that the guy [Mr Willoughby] was sick".

[42] There is no evidence of any communications, written or oral, to suggest that Mr Willoughby was pursued by Mr Leatham or Mr Schuler in respect of an unpaid debt to IL Agents. It is highly probable that had the amount of the invoice dated 7 May 2007 not been paid, there would have been some communication about it. It is a reasonable inference that no steps were taken to pursue the debt because it had been paid, as evidenced by Mr Willoughby's notations on the invoice and the corresponding deposits in the bank account of IL Agents.

[43] paying, the absence of any evidence of pursuit of this debt infers that IL Agents was aware it had been paid. If there had been any doubt, an inquiry to Mr Willoughby would have immediately revealed evidence of the two payments he made in June and July 2007 on the invoice dated 7 May 2007, which the inquirer could have immediately confirmed by reference to the deposits made in the company's bank account.

[44] I find that Mr Schuler knew, or at the very least ought to have known, that Fairfax had paid for the stock purchased from Mr and Mrs Mudge through the agency of Mr Schuler.

[45] This matter is important because, as I shall shortly address, Mr Schuler's explanation for not paying the proceeds of stock sales to Mr and Mrs Mudge, was that they owed IL Agents commission on the sale of their farm, of $90,000 plus GST. But the transaction with Fairfax took place well before the sale of the farm so the set-off claimed by Mr Schuler in relation to commission provides no explanation for the failure to pay to Mr and Mrs Mudge the money for their stock received from Fairfax.

[46] In relation to the Fairfax transaction I summarise my findings as follows:

(a) 29 stock units, the property of Mr and Mrs Mudge, were sold by IL Agents to Fairfax, as invoiced to Fairfax on 7 May 2007.

(b) Fairfax paid a total of $8,719.25 for the stock on 20 June 2007 and 20 July 2007.

(c) Mr Schuler knew or ought to have known that payment for the stock had been made by Fairfax.

(d) The sale proceeds were not paid to Mr and Mrs Mudge.

Were Mr Schuler's representations to Mr Mudge about Mr Willoughby fair and honest representations?

[47] In his brief of evidence Mr Mudge said that following the sale of the 29 heifers in April 2007, he understood he would receive payment from Mr Schuler within two weeks. When payment was not made he asked Mr Schuler when he would receive the sale proceeds. Mr Schuler told him that the person who had bought the stock had not paid because he had a stroke, so Mr Schuler would not pay Mr Mudge.

[48] Mr Mudge said that from May 2007 he would contact Mr Schuler approximately monthly seeking payment. He said he would have contacted Mr Schuler at least three times over the next three to five months. He was reassured by Mr Schuler that he would be paid and the delay was because the buyer was ill and in hospital after a stroke. After some months, possibly in October or November 2007, when he again asked Mr Schuler when payment would be made, Mr Schuler told him that the person who had purchased the stock had died and that Mr and Mrs Mudge would need to wait for payment to be made from his estate. He said he was certain that payment would be made by Christmas.

[49] Payment was not received by Christmas and inquiries by Mr Mudge of Mr Schuler about the sale proceeds continued through 2008, but by then were focused on the stock sold through Mr Schuler in 2008.

[50] In his brief of evidence dated 16 October 2010, Mr Schuler said:

> I recall some inquiries about him [Mr Mudge] not being paid for the first lot of animals. At no time did I tell him someone had had a stroke. Mr Willoughby had a heart attack and was hospitalised. He subsequently passed away. As a result I would have told him that the estate would have to pay him. This is because clause 5(a) on the Stock Note specifically says we are not liable if not paid. To this day no money has come in for the 29 heifers.

[51] Mr Schuler read his brief of evidence, dated 21 November 2012 in Court. In this brief, Mr Schuler changed his evidence. He said:

> I recall some inquiries about him [Mr Mudge] not being paid for the first lot of animals. At no time did I tell him that someone had had a stroke. Mr Willoughby had a heart attack and was hospitalised. *At the time I understood* he had subsequently passed away. As a result I would have told him that the estate would have to pay him. This is because clause 5(a) on the Stock Note specifically says we are not liable if not paid. *With the benefit of discovery I now know the money for those animals was paid*.
>
> (Emphasis added)

[52] The evidence of Mr Mudge and Mr Schuler is consistent that in response to inquiries from Mr Mudge about when he would be paid for the 29 stock units, Mr Schuler told Mr Mudge that the reason for non-payment was the ill-health (stroke or heart attack), and subsequent death of the purchaser. This was untrue. Mr Willoughby perhaps expressed his reaction quite mildly when he said in his brief of evidence:

> I am obviously very surprised at Mr Schuler's comments that he did not pay Mr and Mrs Mudge for the stock that I purchased due to my ill-health and death. All stock I have ever purchased from Mr Schuler has been paid for by me.

[53] Mr Willoughby explained that he was hospitalised following a heart by-pass at the end of November 2007, until February 2008, but his illness had never resulted in delayed payments to Mr Schuler.

[54] The best Mr Schuler could manage in answer to questions in cross-examination was that his explanation to Mr Mudge as related in his 16 October 2012 brief, was a mistake. He denied he was being untruthful when he said that Mr Willoughby was dead.

[55] This explanation is simply not credible. The more likely explanation is that he changed his evidence after receiving Mr Willoughby's brief of evidence (Mr Willoughby having been located by the plaintiffs when they became aware he was the purchaser of the Mudges' 29 stock units in May 2007) served on the defendants on 1 November 2012. This brief established not only that Mr Willoughby was alive and well, but that he would give evidence that contradicted the assertions concerning his ill-health and untimely death made by Mr Schuler to Mr Mudge.

[56] Further, Mr Willoughby had subsequent transactions with Mr Schuler in 2010 and 2011, as Mr Schuler accepted. Even if Mr Schuler had been mistaken about Mr Willoughby's condition in October/November 2007, it is inconceivable that he honestly believed as at 16 October 2012, that "he subsequently passed away", given his more recent knowledge. This statement was simply untrue.

[57] At the time Mr Schuler made the assertions concerning Mr Willoughby to Mr Mudge, some six months had passed since the sale to Fairfax. IL Agents had received payment from Fairfax/Mr Willoughby but had not paid Mr and Mrs Mudge. I find that Mr Schuler deliberately misrepresented to Mr Mudge the reason for non-payment, telling him untruthfully that Mr Willoughby had died and that his estate would be liable for the payment.

Was there an agreement for payment of commission to IL Agents on the sale of the Mudges' farm?

[58] Mr Mudge's evidence was that in about the middle or end of May 2008, when discussing payment for stock sold, Mr Schuler said he knew a person who was looking to buy a farm and that if he was interested Mr and Mrs Mudge would be able to enter into a private agreement which would not involve the payment of commission. Shortly afterwards Mr Mudge had a telephone conversation with Mr Dodunski, who was introduced by Mr Schuler, and met him on the farm within a few days. Mr Mudge said that all negotiations were conducted directly between him and Mr Dodunski or through their respective solicitors as settlement date became closer. Mr Schuler was not involved in the negotiations at all. Mr Mudge said the only communication he had with Mr Schuler about the sale of the farm during his negotiations with Mr Dodunski, was an inquiry from Mr Schuler about whether the farm had been sold to Mr Dodunski, to which Mr Mudge replied that there was no concluded agreement as Mr Dodunski was still trying to get the price down. Mr Mudge believed this was in about mid-June 2008.

[59] Mr Mudge said that the farm was sold at a lower price than he and his wife would have otherwise accepted and the fact that no commission was payable was one of the negotiating points in reducing the price.

[60] Mr Mudge said that on 7 June 2009 following unsuccessful attempts to obtain payment for the three lots of stock sold on their behalf through Mr Schuler, he telephoned Mr Schuler and advised him that unless the proceeds of the sales were paid into the bank account of Mr and Mrs Mudge by the close of the following day he would put the matter in the hands of their solicitor. He said Mr Schuler responded "no problem" and then hung up. In response to questions in cross-examination Mr Mudge agreed that the call to Mr Schuler could have been around 7 June 2009, rather than on that actual day.

[61] Mr Mudge said that on 10 June 2009 he received an invoice from IL Agents for $101,250 for "Commission for facilitating sale and purchase of the dairy farm at Whatauri Road, Wharepapa South to JKD Farms". The invoice claimed "Commission" at 2 per cent on a purchase price of $4,500,000, plus GST. The invoice was dated 25 May 2008. He said he was "shocked and disgusted" to receive this invoice. At no stage had there been any discussion with Mr Schuler about paying commission for introducing Mr Dodunski. He received this invoice over one year after the introduction and shortly after Mr Mudge's advice to Mr Schuler that, failing payment for the stock sold, he would be placing the matter in the hands of his solicitor. It was the first time he had any idea that Mr Schuler was claiming, or intending to claim, commission or any other kind of fee for introducing Mr Dodunski. He said that upon receipt of the invoice he spoke to his solicitor, Mr Bruce Page, and then faxed the invoice to Mr Page for his information on 10 June 2009. (This date is not in dispute.)

[62] Mr Mudge said that given the history of the matter, he viewed the invoice as another delaying tactic by Mr Schuler. He instructed Mr Page to seek payment of the sale proceeds of the stock from Mr Schuler.

[63] Accordingly, Mr Page wrote to Mr Schuler care of Independent Livestock Agents Ltd on 26 August 2009:

> We have been instructed by MG and JA Mudge to recover the sum of $94,051.58 pursuant to your purchase of livestock from them between April 07 and July 08 as set out in the attached copy invoices.

> If payment is received within seven days of the date hereof the interest contents set out in the invoice will be waived. If payment is not received within that period recovery/liquidation proceedings will be issued without further notice.

[64] Attached to the letter were copies of invoices prepared by Mr and Mrs Mudge dated 19 December 2008 detailing the amounts due for the three stock sales in April/May 2007, June 2008 and July 2008, totalling $89,711.66, and accounts rendered on 12 February 2009, 31 March 2009, 30 April 2009 and 30 May 2009 for that amount together with interest at 11 per cent. The final account rendered dated 30 May 2009 was endorsed:

> Overdue
>
> Please pay immediately as discussed by phone.

[65] Mr Schuler on behalf of IL Agents, in a letter dated 12 October 2009, signed on his behalf by Mr Leatham, replied:

> These proceeds have been withheld by us in lieu of unpaid commission by the Mudges, as per our invoice number 200695, dated 25/05/2009 for the amount of $101,205.[6] This account has been accruing interest at the rate of 21 per cent per annum.

[66] The letter then set out figures which showed a deficit due by the Mudges of $6,171.98 plus GST and stated that interest would be waived if payment was made by the Mudges within seven days. The calculation included a sum for "We [IL Agents] Owe (before interest) $83,828.02 plus GST".[7]

[67] On 15 October 2009, Mr Page replied to Mr Schuler's letter advising that there was no entitlement to commission on the sale of the farm and that the claim for commission "totally lacks any foundation". He advised that steps to liquidate the company would occur unless payment of the moneys due for the livestock was made forthwith. Mr Schuler and IL Agents did not reply to that letter.

[68] Mr Mudge explained that, frustrated in trying to obtain payment for the proceeds of the stock sales and satisfied that there was no commission owing, they

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6 Invoice No. 200695 is in fact dated 25 May 2008.

7 This figure clearly acknowledges that payments from Fairfax in respect of the April 2007 sale had been received by IL Agents.

issued a statutory demand on IL Agents on 10 March 2010. The demand was for the amount admitted by Mr Schuler in the letter of IL Agents of 12 October 2009 as owing by IL Agents, namely $94,306.52 ($83,828.02 plus GST).

[69] On 24 March 2010 Mr Page wrote to Mr Schuler advising that the company would be liquidated unless payment was made.

[70] On 29 March 2010 Mr Schuler's solicitor wrote to Mr and Mrs Mudges' solicitors claiming an "offset" for the amount claimed by the Mudges by the account issued by IL Agents on 25 May 2008. The letter stated that his clients did not intend to take any action with regard to the statutory demand:

> They advise that Independent Livestock Agents Limited is a company without assets and with no current trading with the only receivable being the moneys claimed by that company from the Mudges.

[71] Mr and Mrs Mudge filed a proof of debt in the liquidation of IL Agents for the amount of the sale proceeds and the costs incurred in the liquidation, being $2,746, none of which has been paid.

[72] Mrs Mudge confirmed that while most of the dealings with Mr Schuler were by her husband, she was present when Mr Schuler said there would be no commission on the sale of their farm, it being a private deal between Mr Mudge and Mr Dodunski. This was in mid-2008. The first Mrs Mudge knew about any suggestion that they owed money to Mr Schuler was when he sent the account for commission about a year later in June 2009. She had never been involved in any discussion with Mr Schuler or her husband about commission being payable or any sort of fee being paid to Mr Schuler or his company, quite the opposite.

[73] In answer to questions in cross-examination by Mr Hayes, Mr Mudge said that if he had promised to pay commission he would have paid it, but there had been no agreement to pay a fee and "I didn't back down from anything". He stated that in the only discussion with Mr Schuler involving commission, it was agreed that there would be no commission on the sale to Mr Dodunski. In answer to questions from Mr Hayes suggesting that Mr Schuler could have been referring to real estate agent's commission being saved, Mr Mudge was definite that there would be no commission

and that Mr Schuler had pointed out this would enable Mr and Mrs Mudge to sell the farm more cheaply.

[74] Mr Schuler's evidence was that in May 2008 when he learned that Mr and Mrs Mudge's farm had not sold at auction, he told Mr Mudge that he knew somebody who was looking to buy a farm in the area and that he could put him in contact with that person so as to avoid land agent's commission. He said:

> However, I did tell Mr Mudge that I would take a fee for introducing the buyer if the sale went through. I am a sales person and it just comes naturally to me to expect to be paid out of the deal.

[75] He said that when he learned the farm had been sold to Mr Dodunski's JKD Farms Ltd, he believed "… there was an offset between the parties in relation to the money owed to each other." He said:

> When it became obvious (lawyers letter) that Mr Mudge was backing down on his agreement with me the company then invoiced him for providing the introduction that led to the sale. I dated the invoice 25 May 2008 as that was about the date of the introduction.

[76] However, in response to questions by Mr Grenfell in cross-examination, Mr Schuler ultimately agreed that he could not have sent the invoice for the commission in response to the lawyer's letter because the invoice was received by Mr and Mrs Mudge on 10 June 2009, whereas the first letter from Mr Page was sent on 29 August 2009.

[77] Mr Schuler said it was no secret that IL Agents was liquidated because of the statutory demand issued by Mr and Mrs Mudge:

> I firmly believed Mr and Mrs Mudge agreed I would be paid. I sat at their kitchen table and had lunch with them. They offered several prayers over lunch and I took them to be devout Christians who would honour their word even if their lawyer had said the payment may have been unlawful.

[78] In answer to questions in cross-examination, Mr Schuler preferred to describe the payment he claimed from the Mudges as "… not commission, an introductional facility fee".

[79] In giving evidence, and particularly in answering questions in cross-examination and by the Court, Mr Schuler was reluctant, evasive and often inconsistent.

[80] The following exchange with the Court on the subject of the commission or facilitation fee charged to Mr and Mrs Mudge in the invoice dated 25 May 2008, is revealing:

> Q. How many more meetings did you have with the Mudges about the sale of the farm?
>
> A. We had two, just the two.
>
> Q. The 10th of May –
>
> A. Yes.
>
> Q. - and two weeks later?
>
> A. Later, yes.
>
> Q. No further meetings?
>
> A. Not with the sale with the farm, no.
>
> Q. And on whose behalf did you consider you were acting in relation to the sale of the farm?
>
> A. On the vendors' behalf.
>
> Q. The Mudges?
>
> A. Yes.
>
> Q. And what do you say were the arrangements that you reached with the Mudges about your, what you are now calling a facilitation fee?
>
> A. That, that was the fee to be charged if the sale went through.
>
> Q. What was the percentage discussed?
>
> A. Well our percentage that we discussed was 2%.
>
> Q. Who did you discuss that with?
>
> A. Mr Mudge.
>
> Q. When did you discuss that?
>
> A. At the first meeting on the 10th of May when we introduced the buyer.

Q. You say on the 10th of May you discussed with Mr Mudge that you would get, what did you call it at that meeting, a commission or a facilitation fee?

A. I don't recall Ma'am.

Q. When you prepared this invoice some two weeks later you called it a commission didn't you?

A. I, yes, Ken prepared that document.

Q. But he did it on your instructions didn't he?

A. Yes he did, yeah. So, it's, it's got commission –

Q. He wouldn't have known what to put in it would he?

A. Probably not, no.

Q. So if you look at page 73 –

A. I think it's got both on here hasn't it. He sort of covered himself on that one.

Q. Sorry I didn't hear those two sentences?

A. Yeah, it's got both facilit- commission for facilitating.

Q. Well it's got commission twice hasn't it?

A. Mmm, yes.

…

Q. - and it's got commission at 2%?

A. Yes.

Q. So when you had this discussion about the rate of commission on the 10th of May with Mr Mudge you would have called it a commission wouldn't you?

A. Probably would have, yes.

Q. And who suggested 2%?

A. It's just a going rate.

Q. Well Mr Mudge wouldn't have known that?

A. Yes he was, he'd just sold his other farm for I presume more than 2% at the auction –

Q. Oh are you saying that's a real estate agent's going rate?

A. There is a lot higher.

Q. Pardon?

A. Theirs is higher.

Q. Well whose going rate is it?

A. The going rate is just the, just the industry going rate I presume.

Q. Whose going rate is it?

A. Well it's my going rate.

Q. Well your going rate for the business that you say you were in which was a stock agent was a 6 or 7% wasn't it?

A. On cattle, yes.

Q. And you say that the rate that a real estate agent would have been entitled to charge is more than 2%?

A. Yes.

Q. So whose was the 2% rate?

A. It was my rate.

Q. So it wasn't a going rate?

A. Well it's, it's a common rate.

Q. Common rate for what?

A. I'm sorry, um, it's, was my rate sorry yes.

Q. Your rate?

A. Yes.

Q. So did you propose that rate to Mr Mudge?

A. We, we charged 2%.

Q. How many property sales had you facilitated over the 20 years during which you say you were a stock broker?

A. Stock agent.

Q. Stock agent sorry.

A. I've been involved with other agents and, in providing that service, probably –

Q. How many sales did you facilitate?

A. Not – I haven't actually finali – I've helped but not facilitated the final deal.

Q. The Mudges' sale was the only one which you claim to have facilitated?

A. Yes.

Q. The sale which you consider entitled you to a fee?

A. Yes.

Q. So you wouldn't have had a going rate would you?

A. That, the 2% is a fair going, a fair rate.

Q. It was your rate?

A. Yes.

Q. And what do you say the arrangements that you agreed with the Mudges were for payment of this facilitation fee, when were they going to pay it?

A. We contrad – the, the cattle as that rate.

Q. I know what's what you did, what I'm asking is what you agreed with Mr Mudge on the 10th of May?

A. I didn't – we didn't discuss that far.

Q. So there was never any agreement for contras?

A. Yes, because the farm wasn't sold that day.

Q. No but that's the only day on which you discussed this so called arrangement for your fee?

A. No but later two, two weeks later to.

Q. Oh you had another discussion?

A. We had another meeting.

Q. Yes you said you had another meeting. But I thought you told me that the time when you discussed this facilitation fee was –

A. Was at that first meeting sorry –

Q. - at the 10th of May –

A. - yes was at that first meeting, yes.

Q. Did you discuss it again on at a later meeting?

A. It would have been discussed, yes.

Q. Was it discussed?

A. Yes.

Q. What was the arrangement under which the Mudges would agree to under which they would pay this fee? How were they going to pay it?

A. I don't know that Ma'am.

Q. So there was never any agreement for a contra was there?

A. To sell the farm?

Q. No, for your facilitation fee that –

A. Yes there was –

Q. - it would be set off –

A. - be set off with the cattle.

Q. Who agreed to that?

A. We didn't discuss that.

Q. It was never agreed?

A. No.

Q. You just did it?

A. Yes.

[81] It is abundantly clear from this exchange that there was never any agreement between Mr Schuler and Mr and Mrs Mudge that Mr Schuler (or IL Agents) was entitled to charge commission or a fee for introducing Mr Dodunski as a purchaser of their farm. There was no agreement about the rate of any commission or fee; the rate invoiced was selected by Mr Schuler. There was no agreement about how or when any commission or fee was to be paid; Mr Schuler simply instructed Mr Leatham to issue an invoice for the commission.

[82] It is also relevant that in his letter of 12 October 2009 in response to the letter from Mr Page dated 26 August 2009, Mr Schuler made no reference to the terms of any agreement relating to commission. Nor did Mr Schuler respond to Mr Page's second letter on 15 October 2009, which stated that the claim for commission "totally lacks any foundation".

[83] The exchange set out above at [80], typifies the reluctance, evasiveness and inconsistencies in Mr Schuler's answers to questions. This permeated Mr Schuler's evidence, particularly in reply to questions in cross-examination and from the Court. I found Mr Schuler to be untruthful and unreliable in many aspects of his evidence.

[84] By contrast, Mr Mudge was forthright and consistent in his evidence and to the extent that she was able to give evidence on relevant matters, Mrs Mudge was also. I am satisfied that on the essential issues in this case they were telling the truth. To the extent there is a conflict between their evidence and the evidence of Mr Schuler and Mr Leatham, I prefer the evidence of Mr and Mrs Mudge.

[85] I find as a fact that there was no agreement between the Mudges and Mr Schuler or IL Agents for the payment of commission or a fee on the sale of their farm to Mr Dodunski.

[86] I note that any agreement for the payment of commission or a fee to Mr Schuler or IL Agents on the sale of the farm would have been unlawful and therefore unenforceable. The Real Estate Agents Act 2008 in s 4 defines real estate agency work as including "Any work done or services provided … on behalf of another person for the purpose of bringing about a transaction". By s 6(1)(a) a person cannot carry out real estate agency work unless they are licensed under the Act (or fall within certain exceptions which do not apply here). The transaction for the sale of the Mudges' farm and Mr Schuler's claimed part in it are prima facie covered by these provisions. As Mr Schuler was not licensed under the Real Estate Agents Act (although apparently his wife was), he could not lawfully charge a fee for the services he claimed to provide to Mr and Mrs Mudge.

When was the invoice dated 25 May 2008 created?

[87] Mr Leatham's evidence was that he prepared the invoice in or about July 2008 after he found out that the Mudges' farm sale had proceeded. He said an instruction from Mr Schuler triggered him to issue the invoice but he could not remember when it was issued. He posted the invoice to Mr Mudge but he could not remember when:

> It probably would have been delivered in 2009, but I dunno. I issued that invoice and Ian told me to hold onto it until such time as he said we've got everything else resolved…"

[88] This evidence is inconsistent with Mr Schuler's evidence that the invoice was raised when he received the lawyer's letter that indicated that Mr Mudge was "backing down on his agreement" with him and the company, and that he dated the invoice 25 May 2008 because that was the date of the introduction.

[89] Mr Grant, one of the liquidators, gave evidence of their conclusion that the invoice was likely to have been created in or around June 2009. He said:

> … the invoice appears to have been created in June 2009 yet dated 25 May 2008. We were able to determine the creation date due to the sequential nature of the IL Agents invoicing system and referring to the 00 account. The bank statement references which show that a deposit for invoice 200681 was made on 5 June 2009. Therefore invoice 200695 as issued to the Mudges must have been created after invoice 200681 placing the invoice creation date at some point after 5 June 2009. As IL Agents did not retain copies of invoices issued to customers it is not possible to establish the date of creation of the Mudge commission invoice with any greater accuracy.
>
> Accordingly, we were satisfied that the invoice was not valid and took no steps to seek payment of the balance of that invoice as previously claimed by the company.

[90] I accept the evidence of Mr Mudge that the invoice was received on 10 June 2009, which is the date he faxed it to Mr Page. I find that it is more probable than not that the invoice was created at about the time, soon after Mr Mudge issued an ultimatum concerning the unpaid stock sale proceeds, when Mr Schuler realised that delaying tactics would no longer be effective to forestall action by Mr and Mrs Mudge.

Did Mr and Mrs Mudge make requests for payment?

[91] Mr Mudge said that following the sale of the 29 heifers in April 2007 (having expected payment within two weeks) from May 2007 he made many requests of Mr Schuler for payment. He said he usually called Mr Schuler at home on his landline, but if unable to reach him he would call him on his cell phone. He could not provide records of 21 calls on his landline as they paid a flat rate which covered all calls made to landlines in New Zealand. But from Telecom Mr Mudge was able

to obtain details of calls to Mr Schuler's cell phone 0274-736598 from their landline 07-8718455, in the period between 1 August 2007 and 7 May 2009. Some were recorded as only of one minute duration when it appears contact was not made, but others were of longer duration. Mr Mudge emphasised that he would only resort to calling Mr Schuler's cell phone when he could not make contact on his landline, because the call to the cell phone involved a payment.

[92] He said he also had a telephone conversation with Mr Leatham in December 2008 when he could not contact Mr Schuler and understood that he was in the United States.

[93] On 19 December 2008 Mr Mudge wrote to Mr Leatham, as the accounts person at IL Agents, having received an assurance from Mr Schuler that payment for the first lot of animals would be made by Christmas and that payment of the other amounts had been made by Mr Leatham and banked by Mr and Mrs Mudge.

[94] Mr Mudge's letter of 19 December 2008 marked "Attention Ken" said that no moneys had been credited to their account and referred to Mr Schuler's undertaking that payment for the cattle sold in April 2007 would be made by Christmas. A statement of the amount owing in respect of all three sales of stock was enclosed with the letter.

[95] Mr Schuler denied that Mr Mudge made many requests for payment, although he said he recalled "some inquiries about him not being paid for the first lot of animals". Mr Schuler denied conversations with Mr Mudge in March and April 2009 in which Mr Mudge made it clear that he required payment for the stock.

[96] Both Mr Schuler and Mr Leatham denied receiving Mr Mudge's letter of 19 December 2008. Mr Leatham said he first saw it on 11 October 2012.

[97] Again, I prefer the evidence of Mr and Mrs Mudge on these matters. Mr Mudge acknowledged he had only one conversation with Mr Leatham, but I accept that he made many approaches to Mr Schuler regarding payment, and on

numerous further occasions attempted to contact him concerning the unpaid moneys, but without success.

What happened to Mr and Mrs Mudge's money

[98] On the basis of the evidence, money actually received by IL Agents on account of sales of stock for Mr and Mrs Mudge in 2007 and 2008 were as follows:

(a)	Received from Fairfax on 20 June 2007	$6,525.00
(b)	Received from Fairfax on 20 July 2007	$2,193.75
(c)	Received from Kahuwera Farms on 27 June 2008	$70,537.50
(d)	Received from Kahuwera Farms in July 2008	$7,503.75
		$86,760.00

[99] The GST component of those receipts at 12.5 per cent which, it was accepted, was the applicable rate at the time, is $10,845. The net proceeds of sale after GST are therefore $75,915.

[100] IL Agents would be entitled to commission on stock sales. This was variously stated at six per cent and seven per cent in the relevant documentation, though regularly stated and calculated at six per cent in the statements forwarded by Mr and Mrs Mudge as they repeatedly sought payment for the stock sold on their behalf. This commission rate does not appear at any point to have been contested by IL Agents in response to the accounts rendered by Mr and Mrs Mudge, but in a contract note dated 10 June 2008 issued by IL Agents to Mr Mudge in relation to a sale to Kahuwera Farms the rate is stated to be seven per cent, plus GST. Thus the agreed commission rate, if there was one, is unclear, but on the basis of the available information and taking into account the submission at paragraph 2.2 of the plaintiffs' closing submissions, I will allow for commission at seven per cent. This amounts to $5,314, leaving a balance of $70,601.

[101] Mr and Mrs Mudge also claimed interest at 11 per cent on the amount outstanding in the accounts they rendered to IL Agents. I shall return to this issue under the heading of Compensation.

[102] Mr Leatham, who was responsible for invoicing and accounting for IL Agents, gave evidence that when money came in he would arrange for it to be distributed. There was no separate account for funds received and held on account of clients. He said the money received was usually paid out within a day or two of the funds being cleared, unless it was retained as part of a set off.

[103] In answer to a question in cross-examination about what methodology was used to distinguish between money that belonged to other people, such as clients, and money that belonged to the company, Mr Leatham replied:

> Just going by what, gut feeling basically. Well just knowing people, if there was a bill to be paid then the money was there to pay it.

[104] He said there was a very good cash flow so it was not really an issue. However, he agreed that he did not know when payments were made whether funds belonging to clients were being used, or funds that were surplus to clients' funds and therefore available to the company. He said "That could be, yeah, fair comment".

[105] In the course of questions by the liquidators in an interview with Mr Schuler on 8 August 2010, Mr Schuler confirmed that money received "was dispersed into the company".

[106] The liquidators were not able to trace in the accounts of IL Agents the funds received on behalf of Mr and Mrs Mudge. There is evidence that the level of drawings for Mr Schuler and Mr Leatham increased significantly in 2008 and 2009 from a very low level. Mr Schuler drew $59,309 in 2008 and $83,489 in 2009. In those two years he was paid a salary of $23,500 and $85,300, respectively. In 2008 Mr Leatham's drawings were $2,812 and in 2009 $18,012. His salary was $20,500 in 2008 and $20,700 in 2009. However, operating profit, as analysed by the plaintiffs' investigators, increased significantly from about $9,600 in 2007 to $49,400 in 2008 and to $113,700 in 2009.

[107] It is difficult, therefore, to draw any firm conclusions as to the destination of the money received by IL Agents on behalf of Mr and Mrs Mudge, though clearly the money was not paid out to them as and when it was received and was instead absorbed in the operation of the company, possibly at times being applied to payment of other clients, to overheads, drawings and/or salaries.

[108] However, the liquidators' fifth report, filed pursuant to s 255(2)(d) of the Act for the period December 2011 to June 2012 shows clearly that at the date of liquidation, 21 June 2010 the company was insolvent, with creditors' claims itemised as $2,746 (preferential) and $97,150 (three unsecured creditor claims). The report states that no assets have been realised and that total receipts were $438.16, being essentially a GST refund received.

[109] Thus, for whatever purpose(s) the sale proceeds due to Mr and Mrs Mudge were applied, they have been consumed and absorbed into the ongoing business of IL Agents and at the date of liquidation were no longer available for the persons entitled, namely Mr and Mrs Mudge, who are unsecured creditors of the company.

First cause of action: Section 271 of the Companies Act 1993

[110] The plaintiffs seek in respect of the first defendant an order pursuant to s 271(1)(b)[8] of the Act that the liquidations in respect of IL Agents and IL 2010 must proceed together as if they were one company.

[111] There are two prerequisites to be met before the Court may make such a pooling order:

(a) That the two companies in liquidation, here IL Agents and IL 2010, were related companies; and

(b) That it is just and equitable to make such an order having regard to the guidelines set out in s 272(2).[9]

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8 See at [17] above.
9 See at [19] above.

Were IL Agents and IL 2010 related companies?

[112] Section 15 of the Act provides that a company is a legal entity in its own right separate from its shareholders. However, under s 271, in a liquidation, assets of related companies may be pooled if the Court so orders.

[113] Section 2(3)(d) provides that a company is related to another company if the businesses of the company have been so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable.[10]

Submissions

[114] The plaintiffs acknowledge that this is not the "usual" s 271 situation in which there are two separate businesses with overlapping activities. Rather, there was only one business, the transfer of which was intended to be seamless. The plaintiffs submit that the Court should nevertheless give weight to the significant intermingling of records, movement of funds between the companies, and the fact that third parties dealing with the companies were unaware that there had been any change in the entity they were dealing with.[11]

[115] The defendants oppose the pooling order. They note that the factors under s 272(2) do not apply, as there was no overlap between the management or the creditors of the companies, it was generally clear which company was invoicing for what (though errors were made), and the director Mr Schuler deliberately avoided combining the businesses of the companies. Further, the clients that did not know which entity they were trading with did not suffer loss.

Case law

[116] In *Jordan v First City Trust (No.2) Ltd (in liq)*,[12] Peters J set out the approach to determining whether companies are related as follows:

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10 See at [20] above.
11 Relying on *Re McCullagh* HC Auckland CIV-2008-404-3417, 14 July 2008.
12 *Jordan v First City Trust (No.2) Ltd (in liq)* HC Auckland CIV-2008-404-176, 11 April 2011.

> [57] To determine whether two or more companies are related within the meaning of s 2(3)(d) requires the Court first to determine what was the business of each company in liquidation. "The business" of a company is the totality of its activities.[13] The next step is to determine whether the two or more businesses have been so carried on that the separate business of each company, or a substantial part of it, is not readily identifiable.

[117] Examples of the "usual" s 2(3)(d) situation are provided in *Re McCullagh, Jenkins v Surecall Ltd (in liq),*[14] *Shephard v Carm Holdings Ltd (in liq)* [15] and *Naylor v Demic Construction Ltd (in liq).*[16]

[118] In *Re McCullagh*, the liquidators of a group of companies and its subsidiaries sought a pooling order. By consent, Keane J granted the order, as the companies were essentially run as if they were a single entity. Their records were "intermingled" and "chaotic", there were fund transfers that could be characterised as inter-company borrowings, and those dealing with the companies assumed that they were dealing with a single entity. The fairness and equity of the case required the making of a pooling order, as without one the inter-company fund transfers would result in arbitrarily unequal distributions of dividends.

[119] This outcome may be contrasted with that in *Jenkins*. The businesses in that case were largely combined for more than six months before the appointment of the liquidators. The companies carried on the same line of business for the same client, shared the same management and governance, the revenue was paid into a single bank account from which wages and creditors were paid, and staff provided administrative and support services for both companies. The fact that the pooling order would arbitrarily prejudice the employees of one of the companies was considered in terms of the fairness and equity of the order. However, Associate Judge Christiansen considered that this prejudice was outweighed by the arguments in favour of a pooling order.

[120] The companies in *Shephard* and *Naylor* were defined as "related companies", and pooling orders were allowed, for similar reasons as in *Re McCullagh* and

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13 *Keegan and Anor v Page Vivian Motors Ltd*, 18 June 1986, CA 196/83, Somers J at page 8.
14 *Jenkins v Surecall Ltd (in liq)* HC Dunedin CIV-2006-412-939, 28 March 2007.
15 *Shephard v Carm Holdings Ltd (in liq)* HC Wellington CIV-2009-485-1332, 16 September 2009.
16 *Naylor v Demic Construction Ltd (in liq)* HC Palmerston North CIV-2006-454-949, 29 January 2007.

Jenkins: an overlap between the activities and finances of the companies and their directors and shareholders, with the result that the creditors dealt with both companies at the same time or interchangeably. In both cases, it would have been almost impossible to conduct the liquidations of each entity separately. In *Shephard*, the companies did not generate enough cash flow to be viable independent entities. In both cases, Associate Judge Gendall was satisfied that as the companies effectively operated as one company they were related.

[121] In each of these cases, the businesses of the "related companies" had been operating simultaneously. *Jordan v First City Trust* provides a factually contrasting example. In *Jordan*, the plaintiffs (the liquidators of the second defendant) sought a pooling order for the liquidation of the first and second defendants, who were successive trustees of the same trust. It was submitted that both companies worked towards the same principal business, the first defendant transferred the assets and assigned the agreements to the second defendant for no consideration, the sole director of both companies executed the documents necessary to achieve this transfer or assignment (the purpose of which was to defeat creditors), and neither defendant kept proper financial records or accounts. However, Peters J was satisfied that as a matter of fact the business of each defendant was readily identifiable, as the primary objectives of the businesses were related but different, there was no intermingling of funds, the creditors knew which company was indebted to them, and there was a temporal separation between the businesses, which her Honour considered was contemplated by s 2(3)(d).[17]

[122] Peters J contrasted this situation with the position in *Naylor*, *Jenkins* and *Shephard*:[18]

> [65] To take some examples, in each of *Naylor v Demic Construction Ltd (In Liquidation) & Anor*, *Jenkins v Surecall Ltd (In Liquidation)* and *Shephard & Ors v Carm Holdings Ltd (In Liquidation)*, there was evidence of consistent intermingling of the relevant companies' funds. In Shephard the evidence was that employees worked for various companies but were paid from whatever source had funds. There was inter-company borrowing, and intermingling of funds prior to liquidation. On a day-to-day basis income was banked into a central bank account and paid out "wherever the need appeared greatest".

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17 At [61].

18 Original citations removed.

> [66] In *Naylor* and *Shephard* there was evidence that creditors were confused, quite understandably on the facts, as to the company with which they had contracted and which company was indebted to them. ...
>
> [67] In *Naylor*, *Goodson v Wingate Two Ltd* and *Re McCullagh* there appears to have been a wholesale failure to differentiate in any way between separate corporate entities.
>
> [68] In my view, the facts in those cases are substantially different to those of the present. To conclude, I do not consider on the facts of this case that First City and Gore Street are related companies within the meaning of s 2(3)(d). I consider that the business of each of them, or a substantial part of it, is readily identifiable. ...

Intermingling of records

[123] Mr Schuler made no secret of the fact that IL 2010 was formed as a result of the statutory demand issued by Mr and Mrs Mudge. IL 2010 was incorporated on 30 March 2010. According to Mr Leatham it operated the business previously carried out by IL Agents from 1 April 2010, and the same computer system was used.

[124] The business operation of IL Agents was simply carried on by IL 2010 from 1 April 2010. The liquidator, Mr Grant, gave this explanation in evidence:

> This was one business that continued to trade and it simply moved its base of legal operations from one limited liability company to the next. We were not able to do a clear tracing exercise about which transactions related to which companies so we were unable to determine which particular transaction related to which entity. The customers who were dealing with the, with the business were unable or unaware about which entity they were, they were trading with.

[125] At some point in April 2010 the invoices issued by IL Agents were changed (but not consistently) by deleting the name Independent Livestock Agents Ltd and also substituting for the words "thank you for your business" at the foot of the invoice, the name Independent Livestock Agents (2010) Ltd. This seems to be a hybrid of the names of the two companies under which the business operated, though not the name of an actual company. However the practice was irregular. An invoice issued to Ranginui Station Ltd Partnership dated 2 April 2010 under IL Agents' tax registration number 91-473-216 is in the name of Independent Livestock Agents (2010) Ltd, while an invoice issued to EP and AL Gregory on 3 April 2010 under the same tax registration number but with a GST number 104-419-062 (IL 2010's IRD

number), is in the name of Independent Livestock Agents Ltd. On 9 April 2010 a further invoice to Ranginui Station Ltd Partnership was issued under the name of Independent Livestock Agents (2010) Ltd, and the tax registration number 91-473-216.

[126] Invoices issued to Mr Gregory on 5 April and 16 April 2010 were both in the name of IL Agents, but include the GST number for IL 2010 and the tax registration number for IL Agents. Both, despite being headed "ILA" Independent Livestock Agents Ltd, have entered at the foot of the invoice "Independent Livestock Agents (2010) Ltd".

[127] Mr Schuler was vague about the documentation he used after 1 April 2010. He acknowledged a contract signed by him on 13 May 2010, issued in the name of IL Agents with Mr Willoughby as vendor and JKD Farms Ltd as purchaser.

Movement of funds

[128] Mr Leatham confirmed that in accordance with the intention that IL 2010 should operate from 1 April 2010, the bank account for IL 2010 started with an opening nil balance on 11 April. Very soon after there were the series of transfers between 19 and 27 April referred to at paragraph [29](e) above, followed by the further transfer of $5,000 on 25 May 2010 to the account of IL Agents.

[129] Mr Leatham said these transfers were to correct errors where clients had paid funds due to IL 2010, to IL Agents. He said he thought the transfers were regularly in multiples of $10,000 and $5,000 because there was a daily limit on internet banking transfers of $10,000. He could not explain why, when the transfer of $30,000 was made on 23 April, it was not made for a total amount required to correct the so-called mistakes. He could not explain why the transfers did not reflect the actual amounts said to have been incorrectly deposited by customers to the account of IL Agents.

[130] There were transfers back from IL 2010 to IL Agents, of $3,973.44 on 28 April and $10,000 on 7 May,[19] which Mr Leatham said were transferred to clear the overdraft of IL Agents. The result was a net transfer of $93,126.56 from the bank account of IL Agents to IL 2010's account.

[131] Mr Grant conjectured that the transfers from the account of IL 2010 to the account of IL Agents were likely to have been made to reduce indebtedness in the account of IL Agents because there was a personal guarantee by Mr Schuler to the bank. In the absence of evidence of such a guarantee, I do not consider that such an inference can be drawn. However, on the basis of Mr Leatham's evidence the $10,000 transfer on 7 May 2010 was to clear the overdraft of IL Agents.

Understanding of those dealing with the companies

[132] Two customers of Mr Schuler gave evidence: Mr Willoughby and Mr Gregory. Mr Gregory said that through the years he and Mr Schuler had numerous mutual clients, Mr Gregory also being a stock agent. He said that during his transactions with Mr Schuler in 2010 he was unaware, until he received invoice 430 on 24 July 2010, that either the company name had changed or that he was dealing with a new entity. He noted on invoice 430 that a different bank account was advised for payment. He said he used internet banking and having not been advised of any change in the billing company or its bank account he had continued to make payments to the account of IL Agents as he had it electronically stored. He was not alerted to the change of name or bank account until October 2010, when asked by the liquidators to clarify a number of payments made by him to IL Agents.

[133] Through his company, Fairfax Consultancy Ltd, Mr Willoughby in March, April and May 2011 issued invoices to IL 2010 recording the GST number of IL Agents. There is no evidence of any advice having been given to Mr Willoughby of the appropriate tax number for IL 2010.

[134] Mr Leatham claimed that he handwrote on invoices the change of name and the change of bank account after the bank account for IL 2010 was opened and

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[19] See at [29](f) above.

activated. He said in response to Mr Grant's evidence that no advice was given to clients of a change of entity:

> That is incorrect. I handwrote on their invoices to note change of name and change of bank account which occurred after the bank account was opened. Most clients commenced payments into the correct bank account except for a few.

[135] He acknowledged that he made errors in the documentation, but said he made every effort to keep the two companies' transactions apart, and that in any event, everybody had been paid out.

Analysis

[136] *Re McCullagh*, *Jenkins*, *Shephard* and *Naylor* provide examples of the "usual" situation in which companies will be deemed to be "related". In each of those cases, the business had been carried on in a manner that renders the separate business of each company not readily identifiable. The companies in question were effectively operating as a single entity. A combination of the following overlapping features established the necessary relationship under s 2(3)(d) in those cases:

(a) The companies' businesses involved the same subject matter and possibly the same client(s).

(b) Close structural relationships between the companies (e.g. holding/subsidiary).

(c) External persons (such as creditors) were unsure of which entity they were dealing with, or dealt with both entities interchangeably.

(d) An overlap in finances, such as inter-company borrowing, operating the same bank account, one company paying the creditors of the other company, etc.

(e) Intermingled and/or poorly maintained records.

(f) An overlap between directors, shareholders and/or support staff.

[137] It is implicit in these features that the companies were carrying on business at the same time. The issue in this case is whether companies can have a sufficiently strong relationship that they may be said to be related, despite not having operated contemporaneously.

Is there a sufficiently strong relationship in the absence of temporal overlap?

[138] Most of the cases briefly note at the outset that the jurisdiction to grant pooling orders is an exception to the principle of the separate legal personalities of the companies involved.[20] However, in the absence of an explicit indication that the jurisdiction should be cautiously exercised in light of this principle, the fact that this is an exception to a general (and fundamental) rule does not require any different or heightened standard to be adopted. I apprehend no strong theoretical bar to extending the scope of s 271 beyond the "usual" situation.

[139] However, such an interpretation may not accord with the plain meaning of s 2(3), which contemplates two or more companies with "separate" businesses. I further note that, should a pooling order be made, none of the guidelines under s 272(2)[21] would be readily applied to such a situation (with the exception of the open-ended option in subs (2)(e)).

[140] Further, it is difficult to posit a situation in which companies that were not operating at the same time were nevertheless indistinguishable from each other. Here, there was a degree of overlap and confusion while the business was passing between the companies, which was relatively short-lived. This occurred during the transition of the business, i.e. the companies were not "carrying on" the same business; the business was passing between them. The respective roles of the companies were conceptually distinct, as one was leaving the business while the other was entering. There was no intention that the companies would carry on the business together. Thus, the features in this case that overlap with the characteristics

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20 Companies Act 1993, s 15. See especially *Mountfort v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104 at [80].

21 See at [19] above.

of related companies (the same subject matter of the business, intermingling of records and movement of funds, and the fact that third parties were unaware of the transfer) indicate that the "seamless" transfer of the business was successful (if somewhat clumsy). It does not indicate that the companies were essentially run as one entity.

[141] I consider that the relationship between these companies is very similar to that between the parties in *Jordan* and, for the reasons given above, I agree with Peters J's observation that the temporal separation between the companies' conduct of the business (which overlapped in time, only while the business was passed between the companies) is an important distinguishing feature from the situation in *Re McCullagh*, *Jenkins*, *Shephard* and *Naylor*.

[142] I do not consider that the companies are related under s 2(3). Accordingly, there is no jurisdiction to make a pooling order under s 271(1) and it is unnecessary to consider whether it is just and equitable to do so.

[143] The first cause of action fails.

Second cause of action: Phoenix company provisions

[144] This cause of action is dependent upon relief having been granted in the first cause of action by an order under s 271(1)(b) of the Act that the liquidations of IL Agents and IL 2010 proceed together as if they were one company.

[145] The plaintiffs then contend that:

(a) IL Agents is a "failed company"; and

(b) IL 2010 is a "phoenix company" within the meaning of s 386B[22] of the Act having "a similar name" to IL Agents; and

[22] See at [22] above.

(c) Mr Schuler is in breach of s 386A of the Act having been a director of a failed company (IL Agents) and a director of a phoenix company (IL 2010) within a period of five years after the date of commencement of the liquidation of IL Agents; and

(d) Pursuant to s 386C[23] Mr Schuler is liable for the relevant debts of the phoenix company (IL 2010) which in the plaintiffs' submission should include the debts of the pooled companies and hence the debts of IL Agents, including the debt of Mr and Mrs Mudge.

[146] As the plaintiffs properly acknowledged in submissions, but for a pooling order under s 271, no liability for debts of the failed company can arise because s 386C defines "relevant debts" for which a person who contravenes s 386A is personally liable, to be the debts of the phoenix company.

[147] The plaintiffs advanced an argument that in cases where a pooling order has been made, s 386C should be applied to the liabilities of the companies whose assets and liabilities are merged by the pooling order, such that the pooled companies are treated as a "phoenix company" pursuant to s 386C.

[148] It is unnecessary that I determine whether that submission has merit, given my determination that on the facts of this case, there is no jurisdiction for a pooling order to be made under s 271(1)(b).

[149] Even if IL Agents is a "failed company" (which is not in dispute) and even if IL 2010 is a "phoenix company" (which would require determination of whether it was known by a "similar name" to IL Agents), the second cause of action cannot succeed because s 386C denies the relief sought.

[150] The second cause of action accordingly fails.

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[23] See at [23] above.

Third cause of action: Section 301 of the Companies Act 1993

[151] Section 301 is framed very broadly[24] to allow a breach of essentially any of the rules of company law that causes loss to be actionable against the defaulting party, including a director. Section 301 does not itself create liability; it provides a procedural mechanism through which claims may be determined.[25]

[152] A two-stage approach has been taken to the application of s 301:[26]

> [48] ... claims brought pursuant to s 301 are to be approached in two stages. First, the Court should consider whether there has been breach of duty (or duties). Secondly, the Court should, in its discretion, determine whether and to what extent a director should be required to contribute to the assets of the company. This approach was approved by this Court in *Mason v Lewis* [2006] 3 NZLR 225...

Stage one: breach of duty

[153] The plaintiffs allege that Mr Schuler has misapplied or retained company funds equivalent to the value of the Mudges' debt, has been negligent and is in breach of his duties as a director of IL Agents. The plaintiffs primarily relied on ss 131 and 135 in submissions.

[154] A breach of either of these provisions will satisfy the first stage of this enquiry. A breach of director's duties under s 131 is included in s 301(1). Section 135 was considered in *Mason v Lewis*[27] to "work in tandem" with s 301, such that a finding of liability under s 135 allows the Court to make a consequential order under s 301.[28]

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24 See at [24] above.
25 *Benton v Priore* [2003] 1 NZLR 564 at [46]-[47].
26 *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396; [2010] 2 NZLR 57.
27 *Mason v Lewis* [2006] 3 NZLR 225.
28 At [37].

Section 131: breach of director's duties

[155] The plaintiffs allege that Mr Schuler, as director of IL Agents, failed to act in good faith, in the best interests of IL Agents, and with due care by –

(a) Failing to consider the positions of the Mudges as creditors, or intentionally seeking to defeat their claim on the company.

(b) Failing to retain or make provision for the Mudge debt, or to enter into an arrangement for payment of the debt.

(c) Allocating the available profit as salaries (by the company accountants with Mr Schuler having little or no input into this process).

(d) Either dishonestly or negligently seeking to rely on a fictitious and/or unenforceable invoice for commission.

[156] Under s 131 of the Act,[29] a director must act in good faith in what he or she believes to be the best interests of the company. In relation to this section, in *Sojourner v Robb*[30] Fogarty J said as follows:

> [102] In this context the standard in s 131 is an amalgam of objective standards as to how people of business might be expected to act, coupled with a subjective criteria as to whether the directors have done what they honestly believe to be right. The standard does not allow a director to discharge the duty by acting with a belief that what he is doing in the best interest of the company, if that belief rests on a wholly inappropriate appreciation as to the interests of the company. If a director believes that the duty to act in the best interests of the company is a duty always to act in the best interests of the shareholders, and never in the interests of the creditors, in a situation of doubt as to the solvency of the company, the director cannot be said to be acting in good faith. Creditors are persons to whom the company has ongoing obligations. The best interests of the company include the obligation to discharge those obligations before rewarding the shareholders.

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29 See at [25] above.

30 *Sojourner v Robb* [2006] 3 NZLR 808.

[157] The plaintiffs submit that the facts of this case are very similar to those in *McCullagh v Gellert*,[31] in which two companies worked in a partnership that was dissolved in acrimonious circumstances. One of the companies successfully sued for its share in the profits of the other, which had made provision in its accounts, but this provision was reversed and the entire net property was disbursed to the owners. The company was liquidated, leaving only the debt. The plaintiffs sought compensation against the director, for the misapplication of the company's property and breaches of fiduciary duties, reckless trading, and negligence. The Court found that the breaches of the director's duty to the company were grounds to order compensation in the amount for which a prudent director would make provision. (The Court did not consider the remaining grounds.) In considering the duties owed by directors to consider the interests of creditors, the Court referred to *Nicholson v Permacraft (NZ) Ltd*:

> [66] As Cooke J said in *Nicholson v Permacraft (NZ) Limited* [1985] 1 NZLR 242 (CA) at p.249 —
>
> > The duties of directors are owed to the company. On the facts of particular cases this may require the directors to consider inter alia the interests of creditors.
>
> He continued at p.250 —
>
> > The recognition of duties to creditors ... is justified by the concept that limited liability is a privilege. It is a privilege healthy as tending to the expansion of opportunities in commerce; but it is open to abuse ... Irresponsible structural engineering — involving the creating, dissolving or transforming of incorporated companies to the prejudice of creditors — is a mischief to which the Court should be alive. But a balance has to be struck. There is no good reason for cultivating a paternal concern to protect business people perfectly able to look after themselves.
>
> His Honour continued that the test to be applied was an objective one —
>
> > Whether at the time of the payment in question the directors 'should have appreciated' or 'ought to have known' that it was likely to cause loss to creditors or threatened the continuing existence of the company. ...

[158] The following factual findings in this case are relevant to this assessment: Mr and Mrs Mudge had made several inquiries as to payment,[32] Mr Schuler had

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31 *McCullagh v Gellert* (2002) 9 NZCLC 262,942.

32 See at [97] above.

deliberately misrepresented the reasons for non-payment,[33] the invoice for commission was created when it became clear that such tactics would no longer forestall action by Mr and Mrs Mudge;[34] there was no agreement that Mr Schuler was entitled to charge commission or a fee (and any such agreement would have been unenforceable);[35] and funds available to satisfy the debt due to Mr and Mrs Mudge had been applied to the ongoing business of the company and were no longer available to the Mudges at the date of liquidation.[36]

[159] Each of these findings may establish a breach of director's duties. Together, they demonstrate deliberate and ongoing conduct that was designed to mislead and forestall the creditors in pursuing the recovery of their debt. The deliberate nature of this conduct evidences a lack of good faith; no issues arise as to honest belief or constructive knowledge. Such actions were also clearly detrimental to the company, which remains indebted to the creditors.

Section 135: reckless trading

[160] The plaintiffs rely on essentially the same facts to allege that Mr Schuler traded recklessly under s 135[37] of the Act. Under s 135, a director is prohibited from causing the business of a company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[161] The plaintiffs rely on the approach set out in *Mason v Lewis*,[38] which has subsequently been applied in the context of a single transaction:[39]

> [51] The essential pillars of the present section [135] are as follows:
>
> - 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;

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33 See at [57] above.
34 See at [90] above.
35 See at [81] and [86], respectively above.
36 See at [109] above.
37 See at [26] above.
38 *Mason v Lewis* [2006] 3 NZLR 225.
39 See *Goatlands Ltd (in liq) v Borrell* (2007) 23 NZTC 21,107.

- 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;

- what is required when the company enters troubled financial waters is what Ross (above at para [48]) 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.

[162] The fourth point refers to the definition of "substantial" in the provision. The approach that is referred to is as follows:[40]

> [48] As to what is meant by "substantial risk" and "serious loss" Ross, *Corporate Reconstructions: Strategies for Directors* (1999) suggests:
>
> > The first phrase, "substantial risk" requires a sober assessment by directors as to the company's likely future income stream. Given current economic conditions, are there reasonable assumptions underpinning the director's forecast of future trading revenue? If future liquidity is dependent upon one large construction contract or a large forward order for the supply of goods or services, how reasonable are the director's assumptions regarding the likelihood of the company winning the contract? Even if the company wins the contract, how reasonable are the prospects of performing the contract at a profit? ...

[163] *Goatlands Ltd (in liq) v Borrell* is one of the few cases which concerned behaviour arising from a single transaction.[41] In *Goatlands*, the company entered into an agreement to purchase land and claimed a substantial GST refund after the agreement became unconditional. However, the agreement did not settle, and the company was unable to repay this refund. The Court found that the directors' decision to use the deposit, in anticipation of sales of other property which did not eventuate, carried a substantial risk that it would be unable to sell the properties to allow it to complete its purchase and extinguish the debt. It also found that the spending of the GST refund and failing to arrange bridging finance, amounted to carrying on of the company's business in a way that placed the creditor at substantial and illegitimate risk of serious loss.

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40 *Mason v Lewis* at [48].

41 See the comment in *Great Northern Land Co Ltd v Richardson* [2012] NZHC 2342 at [29]: "Counsel refer to two previous authorities where the Court had considered claims in respect of a single transaction: *Re [Wait] Investments Ltd (In Liquidation)* and *Goatlands Limited (In Liquidation) v Parsons*. *Re Wait* concerned a claim against directors for entry into an unconditional agreement, without having arranged finance and having no other funds available to complete the purchase."

[164] The plaintiffs frame the issue as whether, objectively, Mr Schuler's actions in withholding and then dispersing the Mudge sale proceeds were justified in the circumstances and therefore legitimate.[42] The plaintiffs say that if the Court accepts that no agreement (enforceable or otherwise) for a commission or fee payable by Mr and Mrs Mudge on the sale of their farm, was entered into, then Mr Schuler's actions were unjustifiable. However, even if the Court considered that an agreement had been reached but that Mr and Mrs Mudge subsequently disputed the enforceability of the agreement, it would be unjustifiable to make use of the funds held for Mr and Mrs Mudge, until the enforceability of the contract had been established.

[165] The defendants submit that the manner in which the company's business was carried on did not create a substantial risk of loss to the creditors, and when the matter crystallised, Mr Schuler ceased the trading.

[166] For the reasons stated above, it is clear that in dishonestly taking steps to prevent Mr and Mrs Mudge from recovering their debt, Mr Schuler caused the business to be carried on in a manner likely to cause loss to the company's creditors (including Mr and Mrs Mudge) to the detriment of the company.

[167] However, I do not consider that this behaviour naturally or easily fits within the ambit of reckless trading. First, this concept implies that the behaviour constitutes a risk. It is implicit in the concept of "risk" that the director sought to gain a commercial advantage by embarking on a business venture that was unlikely to succeed. The deliberate evasion of creditors and claim for a fictitious commission does not naturally fit within this concept, as any "benefit" would have been unlawful and unsustainable. This may be contrasted with the situation in *Goatlands*, in which the actions in claiming the GST refund while failing to allow for bridging finance, was a risk taken which, had settlement occurred, would have been justifiable.

[168] Secondly, such a risk must be illegitimate in the circumstances. Commercial endeavours are inherently risky, and Courts will not lightly assume a protective role. As such, s 135 aims to preserve the interests of creditors against the taking of illegitimate risks only when the company is in "troubled financial waters". Mr

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42 Ibid at [47].

Schuler's evasive behaviour culminated in 2010 when, at the time of liquidation, the company was insolvent. However, the bulk of his actions were committed when IL Agents was financially sound. Mr Leatham's evidence was that there was no issue with the mixing of the funds belonging to creditors, clients and the company because there was sufficient cash flow at the relevant times and from time to time IL Agents did not appear to have difficulties in making its other payments, and later transferred funds to IL 2010. This is materially different to a situation where a company is in financial jeopardy and a director seeks to remedy this situation by taking unacceptable commercial risks.[43] It is distinguishable from the situation in *Goatlands* where the running of the risk itself established financial difficulty. Here, Mr Schuler simply sought to avoid repayment and to obtain additional windfall benefits, with the financial difficulties coming later.

[169] Mr Schuler's actions are better characterised as an ongoing and serious breach of director's duties than an instance of reckless trading. The purpose of s 135 is to prevent the taking of illegitimate commercial risks (which may be taken in times of solvency) to preserve the interests of the creditors when the company is in financial jeopardy. There is no evidence that Mr Schuler was seeking to "trade his way out" of financial jeopardy.

Other alleged breaches

[170] The plaintiffs also allege against Mr Schuler negligence,[44] breach of trust by IL Agents to Mr and Mrs Mudge caused by the actions of Mr Schuler in misapplying the sale proceeds, and failure as a director to cause proper accounting records to be kept.[45] It is unnecessary that I consider separately each of these allegations, given my clear finding that Mr Schuler has breached his duties as a director in a serious, ongoing and deliberate way.[46]

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43 Cf. *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 at [123]-[124].
44 See s 137 at [27] above.
45 See s 194 at [28] above.
46 See at [159] above.

Stage two: contribution/compensation

[171] Having established a breach of duty to IL Agents by Mr Schuler, I turn to consider the appropriate measure of contribution under s 301.

[172] Section 301(1)(b) empowers the Court to order a defaulting director to pay or restore the money or property, or any part of it with interest at a rate the Court thinks just. Alternatively, the Court may order under s 301(1)(b)(ii) that the defaulting director contribute to the assets of the company, such sum by way of compensation as the Court thinks just.

[173] Pursuant to these provisions the plaintiffs seek an order under s 301(1)(b)(i) or in the alternative under s 301(1)(b)(ii).

[174] Section 301(1)(c) (which empowers the Court to order payment of money or property with interest at a rate the Court thinks just to the creditor), does not apply in this case because the application for relief is not made by a creditor, but by the liquidators.

[175] In *Goatlands Ltd (in liq) v Borrell*[47] Lang J summarised the principles relating to the assessment of compensation under the predecessor of s 301 of the Act, s 320 of the Companies Act 1955. He said:

> [121] In considering the issue of compensation under s 320 of the 1955 Act, the courts have traditionally focussed upon three factors. These are the duration of the conduct that has given rise to the breach of duty, the extent to which that conduct has caused loss to the company and the overall culpability of the conduct: *Re Bennett, Keane & White Ltd (In Liquidation) (No 2)*(1988) 4 NZCLC 64,317.
>
> [122] In *Fatupaito v Bates* O'Regan J adopted a similar approach in applying s 301 of the 1993 Act. He referred (at [111]) to the earlier decision of Tompkins J in *Maloc Construction Ltd v Chadwick Lovegrove and Burr* (1986) 2 BCR 217, which was decided under the 1955 Act. In that case Tompkins J had suggested that the three factors relevant to the exercise of the discretion under the 1955 Act were causation, culpability and duration. O'Regan J accepted that those factors remained relevant in applying s 301 of the 1993 Act.

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[47] *Goatlands Ltd (in liq) v Borrell* (2007) 23 NZTC 21, 107.

> [123] In *Mason v Lewis* the manner in which s 301 should be applied was, strictly speaking, not relevant because the Court of Appeal ultimately decided to remit the case to this Court for final determination. Nevertheless, it is clear from the observations made by the Court (at [109] to [111]) that it considered that the factors of causation, culpability and duration should govern the exercise of the discretion under the 1993 Act.

[176] I turn to consider the factors of causation, culpability and duration. IL Agents failed to pay the sale proceeds due to Mr and Mrs Mudge because Mr Schuler directed that they not be paid. Ultimately when pressed for payment he claimed a set-off on the basis of commission on the sale of the farm to Mr Dodunski, which I have held was a claim without foundation or merit. Further, Mr Schuler's claim to a set-off bore no relevance to the failure of IL Agents to account for the proceeds of the sale of stock to Fairfax/Mr Willoughby. That transaction preceded the agreement by Mr and Mrs Mudge to sell their farm to Mr Dodunski.

[177] IL Agents held the proceeds of the sale of the Mudges' stock on trust for Mr and Mrs Mudge. They were under a fiduciary duty to account to Mr and Mrs Mudge for those proceeds. Mr Schuler's direction that payment not be made caused the company to act in breach of its fiduciary obligations to Mr and Mrs Mudge. The actions of Mr Schuler were the sole and direct cause of Mr and Mrs Mudge's loss. The culpability for their loss rests solely with him. Any actions by Mr Leatham in relation to this matter were, I am satisfied, taken at the direction of Mr Schuler.

[178] I have held that Mr Schuler dishonestly misrepresented to Mr and Mrs Mudge the reasons for delay in payment of the moneys due to them and did so intentionally. Further, in the face of continuing and frequent requests for payment by Mr and Mrs Mudge from 2007, in relation to the Fairfax sale proceeds, and from 2008 in respect of the Kahuwera Farms sale proceeds, Mr Schuler either ignored or met their requests with false and dishonest excuses and explanations. Ultimately IL Agents reached a point where it was insolvent and unable to meet the debt due to Mr and Mrs Mudge.

[179] I accordingly conclude that under each of the headings of causation, culpability and duration, an order should be made that Mr Schuler repay and restore

to IL Agents the whole of the money owing to Mr and Mrs Mudge. As set out at paragraph [100], I calculate that sum to be $70,601.

Interest

[180] I consider Mr and Mrs Mudge are entitled to interest on the amount outstanding from time to time at a rate the Court thinks just: s 301(1)(b).

[181] In the statements sent by Mr and Mrs Mudge to IL Agents interest was claimed on the unpaid sale proceeds at 11 per cent. This was never disputed by Mr Schuler. Indeed, on the evidence of Mr and Mrs Mudge, which I have accepted, Mr Schuler made various promises to pay the amount owing. Although Mr Leatham said he had not received Mrs Mudge's letter of 19 December 2008 noted for attention "Ken", she referred in that letter to a promise to pay made by Mr Leatham on behalf of IL Agents in the following terms:

> Further to my telephone conversation with you regarding payment for cattle sold to Ian Schuler in April 2007 when Ian was in the States for a couple of months. You said it would be paid with interest added. This has not yet been paid and Ian said about two weeks ago it would be paid by Christmas.

[182] She asked for payment to be made by Christmas, "… as Ian has told me". She enclosed a copy of a statement of the amount owing, at that point $89,711.66 including interest calculated on a daily basis at 11 per cent.

[183] A subsequent statement on 12 February 2009 recorded the balance owing as $91,496.06, which included interest for a further 66 days from 19 December 2008 at 11 per cent.

[184] When Mr Schuler wrote to Edmonds Judd, solicitors for Mr and Mrs Mudge, on 12 October 2009, he stated that the sale proceeds had been withheld "in lieu of unpaid commission … as per our invoice number 200695 dated 25/05/209[sic] for the amount of $101,205", and said, "This account has been accruing interest at the rate of 21 per cent per annum".

[185] On the above basis it is reasonable to conclude that both parties contemplated that amounts unpaid and outstanding from time to time would bear interest. I conclude that interest at a rate that is "just" should be included in the amount payable by Mr Schuler under s 301(1)(b).

What rate of interest is just in terms of s 301(1)(b)?

[186] Section 87(1) of the Judicature Act 1908 empowers the Court to award interest on debts in any proceedings for the recovery of any debt or damages —

> … at such rate, not exceeding the prescribed rate, as it thinks fit on the whole or any part of the debt or damages for the whole or any part of the period between the date when the cause of action arose and the date of the judgment …

[187] The prescribed rate for most of the period in issue in this case was 8.4 per cent being the prescribed rate that applied between 1 July 2008 and 30 June 2011. Thereafter, the rate has been 5 per cent.

[188] Assessing as best I can, a rate that is just and fair in all the circumstances of this case, I consider that interest should be assessed and payable on the amounts owing to Mr and Mrs Mudge from time to time at the rate of 8.4 per cent from the date which is 14 days after the date of each of the three transactions which gave rise to the sale proceeds due to Mr and Mrs Mudge. Fourteen days is the period which appears to have been usually specified by IL Agents for payment on its stock note, and is the period which Mr Mudge said was advised to him by Mr Schuler as the period within which he could expect payment.

[189] I leave the parties to calculate interest due on the above basis. I reserve leave for either party to apply for further directions if required on this or any other of the financial aspects of the compensation awarded in this judgment.

Other matters

[190] For the sake of completeness I refer to the following matters addressed in submissions.

Section 217A

[191] This section requires an applicant for a pooling order to give notice of the application to the liquidator and each creditor of each related company in liquidation.[48] The provision predicates that there are in liquidation "related companies". In accordance with my previous determination, IL Agents and IL 2010 are not "related companies".

[192] The plaintiffs took steps to comply with s 217A, albeit only during the hearing. Notification must be a prudent step for an applicant for a pooling order where the success of the application depends on the companies in liquidation being "related companies".

[193] The principal creditors of IL Agents, Mr and Mrs Mudge, were well aware of the application. The other creditors[49] were Beban and Associates (who advised that their debt has been paid) and the Inland Revenue Department

[194] Because of my decision to decline a pooling order, compliance or otherwise with s 271A is not a matter of any moment. However, given the discretion for the Court to "order otherwise" under s 271A(1), I would not have been concerned that the Inland Revenue Department had not been earlier notified.

[195] Notice to the plaintiffs was not required and clearly Mr Nicholas Hayes, as liquidator of IL 2010 and a prospective witness in the proceedings, was aware of the application.

Funding of litigation

[196] Mr Grenfell acknowledged that the litigation was funded on a contingency basis by his firm, Edmonds Judd, and by Waterstone Insolvency for the liquidators. Mr Hayes in submissions sought to make something of this fact, though I remain unclear as to the basis for his objection.

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48 See at [18] above.
49 See at [29](d) above.

[197] I mention this aspect for the sake of completeness only.

Pleaded defence

[198] The defendants plead by way of affirmative defence that the plaintiffs are estopped from pursuing their claim against IL 2010 because they did not challenge under s 284(1)(b) the decision of the liquidator of IL 2010 to reject the proof of debt of IL Agents relating to the debt to Mr and Mrs Mudge.[50]

[199] This defence, if it has any merit, can only apply in respect of the first and second causes of action which I have determined against the plaintiffs. However, I would not have considered the process adopted by the plaintiffs to pursue recovery of the Mudges' debt to raise an estoppel, particularly in a situation where the plaintiffs have concerns about the independence of the liquidator of IL 2010. Nor do I consider that an allegation of abuse of process could succeed in the circumstances.[51]

Result

[200] I order that the second defendant, Mr Schuler, pay to the plaintiffs as liquidators of IL Agents, the sum of $70,601 pursuant to s 301(1)(b)(i) of the Act together with interest calculated as set out at [185] and [188] above.

Costs

[201] The plaintiffs have been successful and are entitled to costs in accordance with the previous direction of Associate Judge Faire, costs are awarded on a category 2 basis. The appropriate band is band B. The plaintiffs are also entitled to proper and reasonable disbursements.

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50 See at paragraph [16](a) above.

51 Refer *Re QBE Insurance (International) Ltd* HC Auckland CIV-2009-404-3637, 23 March 2011.

Leave reserved

[202] Leave is reserved for either party to apply should further directions or clarification be required in respect of any of the financial aspects of the compensation awarded by this judgment.