IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2013-419-760
[2014] NZHC 688

BETWEEN	HENRY DAVID LEVIN and VIVIEN JUDITH MADSEN-RIES Applicants
AND	Z ENERGY LIMITED Defendant

Hearing: 21 March 2014

Appearances: Ms C Murphy for Applicants
Mr R Gordon for Respondent

Judgment: 7 April 2014

JUDGMENT OF ASSOCIATE JUDGE J P DOOGUE

This judgment was delivered by me on
***07.04.14 at 4 pm**, pursuant to*
Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date……

[1] This is an application by liquidators of a company, Tarsealing 2000 Limited ("the Company") for orders under ss 292, 294 and 295 of the Companies Act 1993. The company was liquidated by order of the Court on 4 May 2012. The applicant for liquidation order was the Commissioner of Inland Revenue. However the Commissioner was not the original creditor who took proceedings for liquidation and the initial application was made 21 November 2011 by another party. The Commissioner was substituted as creditor when the original creditor did not wish to proceed.

[2] The liquidators claim from the respondent the sum of $293,555.86 plus costs and interest. The background to the claim is that the company began trading with the respondent from approximately February 2010. The last transaction which occurred took place in October 2011 when there was a refund made to the company of $5,107.73 which it had paid in the previous month. The continuing business relationship between the parties, which both sides accepted had been in existence, ended in substance on 21 July 2011 with a payment from the company of $78,601.93.

[3] The liquidator claims that there has been a voidable transaction within the meaning of s 292 of the Companies Act 2003 which provides as follows:

> **292 Insolvent transaction voidable**
>
> (1) A transaction by a company is voidable by the liquidator if it—
>
> (a) is an insolvent transaction; and
>
> (b) is entered into within the specified period.
>
> (2) An *insolvent transaction* is a transaction by a company that—
>
> (a) is entered into at a time when the company is unable to pay its due debts; and
>
> (b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.

(3) In this section, *transaction* means any of the following steps by the company:

(a) conveying or transferring the company's property:

(b) creating a charge over the company's property:

(c) incurring an obligation:

(d) undergoing an execution process:

(e) paying money (including paying money in accordance with a judgment or an order of a court):

(f) anything done or omitted to be done for the purpose of entering into the transaction or giving effect to it.

…

(4A) A transaction that is entered into within the restricted period is presumed, unless the contrary is proved, to be entered into at a time when the company is unable to pay its due debts.

(4B) Where—

(a) a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the company (including a relationship to which other persons are parties); and

(b) in the course of the relationship, the level of the company's net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship;

then—

(c) subsection (1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction; and

(d) the transaction referred to in paragraph (a) may only be taken to be an insolvent transaction voidable by the liquidator if the effect of applying subsection (1) in accordance with paragraph (c) is that the single transaction referred to in paragraph (c) is taken to be an insolvent transaction voidable by the liquidator.

(5) For the purposes of subsections (1) and (4B), *specified period* means—

(a) the period of 2 years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

(6) For the purposes of subsection (4A), *restricted period* means—

(a) the period of 6 months before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order of the court was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

[4] It is of significance in this case to determine when the "specified period" and the "restricted period" as those terms are used in the section commenced and concluded. As I have noted, the Commissioner was a substituted creditor. The original creditor in this proceeding, Success Personnel Ltd ("Success"), served a statutory demand on the company 19 October 2011 and then issued proceedings against it 21 November 2011. When the proceeding was first called, the Judge noted that Success presented no evidence and at that point the Commissioner of Inland Revenue was substituted. It was to be another six months until the Court ordered appointment of liquidators. The Commissioner of Inland Revenue was the plaintiff who successfully obtained an order for appointment of liquidators. She acceded to that application when she was substituted as a plaintiff.

[5] The issues between the parties that require determination in this case are the following:

a) When did the specified period begin?

b) Did a voidable transaction occur within the specified period and in relation to that question, is the so-called "peak indebtedness" test applicable?

When did the specified period begin?

[6] The process of substitution results in the substituted creditor becoming a plaintiff in the proceeding.[1] The specified period in a case where the liquidation results from a Court order commences:[2]

> … 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on a date on which and at the time at which the order was made.

[7] This section does not expressly deal with the issue of the substitution of plaintiffs. It is concerned with fixing a date from which the practical effects of the insolvency would extend back in order to capture transactions that occurred in the

[1] High Court Rules, r 31.24(2).
[2] Companies Act 1993, s 292(5)(b).

period leading up to the formal recognition that the company is insolvent which occurs when the Court makes an order.

[8] There is no reason to suppose that the legislature would have intended that enquiries would be necessary to determine when a creditor was substituted as a party in the liquidation proceedings in order to thereby establish when "the application" was made to the Court.

[9] It is difficult to see why a change in identity of the plaintiff should be a relevant issue that impacts the start of the specified period. The only reason why the process of substitution could conceivably be of significance is that by its nature a substitution could have the effect of delaying completion of the proceedings and therefore cause the date of the making of the order to be delayed. It would only be one of a number of occurrences that might occur in the course of the liquidation proceedings that could potentially have the same effect.[3] That in turn would have the effect of extending out the endpoint of the specified period because it would enlarge the time from the application to the Court to the making of the Court order.

[10] I do not consider that the substitution of a new plaintiff/s in the proceeding pursuant to the High Court Rules results in a new application being made to the Court for the purposes of the section. It follows from the matters just discussed that the date of the commencement of the specified period was two years prior to 21 November 2011, that is the period commenced 21 November 2009.

Voidable transaction and the "peak indebtedness" principle

The "peak indebtedness" principle

[11] The case for the applicant was that in accordance with settled authority it could establish that there had been a preference which represented the difference between the peak indebtedness of the company to the respondent when compared with the closing figure at the end of their trading relationship. The amount of any reduction of debt so measured would equate with the preference that the respondent

[3] For example, delays while dealing with applications to restrain advertising: High Court Rules, r 31.11.

had received. Accordingly, the indebtedness of the company to the respondent peaked on or about 30 April 2010 at which point the sum owing for goods supplied was $293,555.86. Because the amount owing to the respondent at the date of the application was zero dollars that was the closing balance, according to the applicant, for the purposes of determining net effect and therefore the claim is for $293,555.86. This represents the reduction of indebtedness which the respondent received during the specified period as defined by s 292.

[12] The position which the respondent takes is that the peak indebtedness rule is no longer recognised in New Zealand following the judgment of *Shephard v Steel Building Products (Central) Limited.*[4]

Relevant authorities

[13] In his judgment in *Shephard*, Abbott AJ considered the form of the section and surveyed relevant authorities, the principal one of which was *Airservices Australia v Ferrier*[5] where in a well known passage the High Court of Australia described the Australian equivalent of s 292 in the following words:

> If at the end of a series of dealings, the creditor has supplied goods to a greater value than the payments made to it during that period, the general body of creditors are not disadvantaged by the transaction – they may even be better off. The supplying creditor, therefore, has received no preference. Consequently, a debtor does not prefer a creditor merely because it makes irregular payments under an express or tacit arrangement with a creditor that, while the debtor makes payments, the creditor will continue to supply goods. In such a situation, the Court does not regard the individual payments as preferences even though they were unrelated to any specific delivery of goods or services and may ultimately have had the effect of reducing the amount of indebtedness of a debtor at the beginning of the six month period. If the effect of the payments is to reduce the initial indebtedness, only the amount of the reduction will be regarded as a preferential payment.

[14] In *Shephard*, Judge Abbott went on to consider what was the correct approach to fixing the starting point of the trading period which was to be compared with the position at the termination of the continuing business relationship. It was submitted for the liquidators in that case, as it was in the case now before the Court,

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[4] *Shephard v Steel Building Products (Central) Limited* [2013] NZHC 189.
[5] *Airservices Australia v Ferrier* (1996) 185 CLR 483(HCA) at 503

that in reliance upon a decision of the High Court of Australia in *Rees v Bank of New South Wales*,[6] the liquidators were entitled to determine the starting point for the transaction and that they were entitled to nominate the date of the company's peak indebtedness for that purpose.

[15] Abbott AJ noted that the so called "peak indebtedness" rule has not been applied consistently in Australia and, as already mentioned, he made reference to *Airservices Australia v Ferrier*,[7] where the majority suggested that the starting point of the running account is not a matter to be decided by the liquidator.[8]

[16] For the reasons which the Judge set out subsequently in his judgment,[9] he viewed the *Airservices Australia* approach as persuasive. As he said, allowing the liquidator to pick a point at peak indebtedness is inconsistent with the basic principle of the continuing business relationship test enshrined in s 292(4B) which is to place the transaction in the wider context of "all the transactions forming part of the relationship". After reviewing the evidence, the Judge concluded that in the course of the continuing business relationship in that case, analysis showed that the respondent provided more to the company in goods than the company provided to the respondent. There was therefore no preference.

[17] I respectfully agree with Associate Judge Abbott's approach in *Shephard* for the reasons that he set out and for the reasons set out in the discussion that follows. I reject the contentions by the liquidators in this case that they are entitled to nominate the starting point of the continuing business relationship from which the question of whether there has been a preference is to be calculated.

Policy behind running account approach

[18] The rejection of the peak indebtedness approach is further bolstered by an analysis of the policy behind the running account approach and the adoption of a purposive interpretation with reference to s 5 of the Interpretation Act 1999. Such an

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[6] *Rees v Bank of New South Wales* (1964) 111 CLR 210.
[7] *Airservices Australia v Ferrier*, above n 7.
[8] *Shephard v Steel Building Products (Central) Limited*, above n 6, at [33].
[9] At [34] and following.

analysis assists in establishing the appropriate approach to adopt in the New Zealand setting.

[19] In *Airservices Australia*, the High Court of Australia first directed its attention to what the significant elements of a running account were.[10] Having first noted that the term "running account" had "achieved almost talismanic significance in determining when the ultimate, rather than the immediate and isolated, effect of a payment is to be examined for the purposes of a determination under..." the Australian legislation,[11] the Court went on to observe:[12]

> However, the significance of a running account lies in the inferences that can be drawn from the facts that answer the description of a "running account" rather than the label itself. A running account between traders is merely another name for an active account running from day to day as opposed to an account where further debits are not contemplated. The essential feature of a running account is that it predicates a continuing relationship of debtor and creditor with an expectation that further debits and credits will be recorded. Ordinarily, a payment, although often matching an earlier debt, is credited against the balance owing on the account. Thus, a running account is contrasted with an account where the expectation is that the next entry will be a credit entry that will close the account by recording the payment of the debt or by transferring the debt to the Bad or Doubtful Debt A/c.

[20] It described the arrangement between the parties in that case as follows:[13]

> The facts recorded in the "running account" indicate that Compass and Airservices had a continuing relationship which contemplated further debits and credits and that the individual payments were intended to continue and not determine that relationship. The various payments must therefore be regarded as so connected with the continuing provision of services, that it is the ultimate and not the immediate effect of each payment on the relationship of Compass and Airservices that is relevant.

[21] The policy was further explained in the *Airservices* decision[14] by the majority of the High Court in the following way:

> 27. To ignore the practical relationship between the payments and the subsequent supplier of services and the ultimate effect of the dealings between the parties would not advance the purpose for which section 122 was enacted. That purpose is to strike down those payments by the debtor during the six months period prior to

[10] *Airservices Australia*, above n 7.
[11] At 504.
[12] At 504 – 505.
[13] At 507 – 508.
[14] At paragraph 27

> bankruptcy that have the effect of depleting the assets available to the general body of creditors. But it is no purpose of section 122 to prevent a debtor from making payments-even payments to existing creditors-if the purpose of the payments is to acquire goods or services equal to or of greater value than the payment. That is what happened here, except for the last payment…

[22] As was noted in the Queensland Court of Appeal judgment in *CSR v Starkey*, the running account principle is based upon:

> The premise that, where an insolvent company and one of its creditors continue with both supply and payments and supply and payments are inter-dependent, or, as it is sometimes put, 'integral parts of an entire transaction' (or an overall arrangement), both, and not merely the payments, are to be taken into account in determining the extent if any, of the creditor's 'preference, priority or advantage over other creditors'. The principle is a recognition that, just as the other creditors are disadvantaged by the company's payments to the particular creditor, they are advantaged by that creditor's continuing supply to the company during the material period. And just as the creditor is advantaged by the payments, it is disadvantaged by its continuing to supply the company. The extent of any benefit is the net result of setting the advantage (payments) against disadvantage (supply)

[23] As the Court of Appeal noted in its judgment in *Farrell v Fences & Kerbs Ltd*:[15]

> [76] In some important respects, the Australian approach has been adopted in our s 296. In particular, the abandonment of the "ordinary course of business" test and the adoption of the "continuing business relationship" provision in our s 292(4B). These changes indicate an intention to avoid the often difficult assessment of whether a transaction is in the ordinary course of business while still recognising an ongoing business relationship. Under s 292(4B) debits and credits can be "netted off". This may occur, for example, in a running account by treating the debits and credits as a single transaction during the two year period prior to commencement of the liquidation. In this respect, the ordinary course of business test has been given at least a partial recognition to assist creditors who engage in ongoing business relationships with a company that ultimately becomes insolvent. This is likely to be a significant benefit to creditors who continue to trade in good faith. It recognises the commercial realities for many involved in business.

[24] In an earlier passage, the Court of Appeal referred to the explanatory note to the legislation which was in the following terms:[16]

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[15] *Farrell v Fences & Kerbs Ltd* [2013] NZCA 91, [2013] 3 NZLR 82 at [76].
[16] At [47].

> The following measures are proposed to remove the uncertainties and the inconsistencies that currently exist in the voidable transaction regime: replacing the "ordinary course of business" exception for setting aside a transaction with a test along the lines of the Australian "continuing business relationship". The new test will focus on the business relationship between the parties over a certain period of time. If, in the course of such a relationship, the level of the debtor's indebtedness to that creditor increases and decreases from time to time, then the relationship is to be viewed as one transaction and the net effect of those transactions together is considered in determining whether there is a preference

[25] I consider that would be inconsistent with the policy identified as underlying the running account type cases to allow enquiry about whether there had been a voidable transaction to focus upon the state of the account at one particular point during the duration of the continuing business relationship and to nominate the indebtedness at that point as significant in measuring whether or not there had been a voidable transaction. To do so would be to ignore the importance of assessing the overall effect of all of the transactions making up the running account which the parties maintained pursuant to their continuing business relationship.

Was there a continuing business relationship such as a running account in this case?

[26] The next question is whether in fact the parties in this case were engaged in a relationship that fell within s 292(4B).

[27] A "running account" is defined in Black's Law Dictionary as an "open, unsettled account that exhibits the reciprocal demands between the parties"[17] "Open account" is defined as:[18]

> An account that is left open for ongoing debit and credit entries by two parties and that has a fluctuating balance until either party finds it convenient to settle and close, at which time there is a single liability

[28] There is no other material that assists with the meaning of the statutory words. They are not defined in the statute. My conclusion is that the definitions referred to reflect the meaning of the words that Parliament used when enacting s 292 with the amendment to include running accounts.

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[17] Bryan A Garner (ed) *Black's Law Dictionary* (9th ed, Thomson Reuters, United States of America, 2009) at 21.

[18] At 21.

The arrangements between the parties in this case

[29] Although the High Court in *Airservices* made reference to inferences that can be drawn, the test for whether the type of underlying relationship was or was not in existence in the particular case can also be tested by looking at the way in which the parties documented their agreement. The present is such a case.

[30] The company opened a credit account in December 2009 and began operating the account from February 2010. Invoices were issued that required payment typically on 20th or 21st of the following month. The company ceased trading with the respondent in June 2011. The credit manager of the respondent in his affidavit states that the payments would have been intended to ensure that the respondent continued to supply bitumen to the company on credit, which the company did.

[31] The documents governing the supply arrangements did not contemplate any close off point by which they would end. Provision was made for direct debits to be taken from the account of the company. That information coupled with the deposition that the invoices specified the time of payment as being the 20th or 21st of the months following suggest that the debit balance in the account was to be cleared monthly. There was no agreement about appropriations of payments to any particular invoice. The course of trading suggests that while there could be several debits to the account over a payment period one payment only was received which was not specified to be in regard to any particular supply of goods.

[32] My conclusion is that the business arrangements between the parties in this case amounted to a continuing business relationship in the form of a running account and that therefore the case is to be dealt with according to s 292(4)(B) of the Act.

[33] Pursuant to subsection "(c)" subsection 292(1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction.

[34] Section 292 will only apply if the net or overall effect of the continuing business relationship was to result in the respondent being unable to receive more

towards satisfaction of a debt owed by the company than the respondent would receive or be likely to receive in the company's liquidation. The transactions in the sequence making up the running account were of neutral effect and therefore there was no possibility of the company receiving more than it was entitled to in the liquidation.

Conclusion

[35] As already concluded above, I consider that in the present case there was a continuing business relationship between the parties which covered the entire course of trading between them. The enactment of provisions relating to a running account during the course of a continuing business relationship has the practical effect in a case of this kind that if the result of trading was to return the parties' accounts to a neutral position where neither party owes the other, then there cannot be any voidable transaction. If on the other hand, there had been an antecedent debt that came into existence independently of the dealings that comprise the continuing business relationship and if a payment was made in the course of the relationship which exceeded the liabilities of the company arising from the relationship, then an insolvent transaction would be a possibility. Such a transaction would have occurred if the excess payments made by the company to the creditor were retained by the creditor and applied in reduction of the antecedent debt. That, however, did not occur in this case. At the commencement of the trading relationship, the indebtedness of the company to the respondent was nil. The various transactions making up the running account all set each other off so that even had there been antecedent debt, the running balance would have been neutral in its effect.

[36] In my view there has been no insolvent transaction. That being so, there is no requirement to go on and consider whether the company was able to pay its debts when due under s 292(2)(a) or whether it has a defence under s 296 to the application which the liquidator has brought.

[37] The application is dismissed. The parties should confer on the issue of costs and if they are unable to agree they are to file submissions not exceeding five pages in length within 10 working days of the date of this judgment.

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J.P. Doogue
Associate Judge