IN THE COURT OF APPEAL OF NEW ZEALAND

CA608/2012
[2014] NZCA 578

BETWEEN		GRANT BRUCE REYNOLDS AS THE LIQUIDATOR OF JAMES DEVELOPMENTS LTD (IN LIQUIDATION) Appellant
AND		CHRIS JAMES Respondent

Hearing:	21 October 2014
Court:	Miller, Heath and Dobson JJ
Counsel:	A C Sorrell for Appellant M R Sherwood King for Respondent
Judgment:	28 November 2014 at 3.30 pm

JUDGMENT OF THE COURT

A The application to strike out the appeal is dismissed.

B The appeal is dismissed.

C The appellant is to pay the respondent costs in this Court on his application for extension of time and on the appeal, as for a standard appeal on a band A basis, plus usual disbursements.

REASONS OF THE COURT

(Given by Dobson J)

The context of the appeal

[1] This is an appeal from a decision of Associate Judge Bell delivered in the High Court at Auckland in August 2012.[1] The judgment declared payments to the respondent (Mr James) of $60,904 to be a voidable preference under s 292 of the Companies Act 1993 (the Act), but dismissed a liquidator's claim for orders for payment of that amount plus interest. The payments had been made to Mr James in the period shortly before the relevant company, James Developments Ltd (JDL), passed into voluntary liquidation. Mr James was the sole director, and linked to those who held the beneficial interest in the shares in JDL.

[2] The decision also determined the enforceability of a general security agreement (GSA), which Mr James had procured JDL to execute, again in the period shortly before JDL passed into voluntary liquidation. The finding that the security intended to be provided by the GSA was not relevantly enforceable is not challenged by way of cross-appeal, and does not need to be reviewed.

[3] The appeal is brought by the current liquidator of JDL, Mr Reynolds, who is the second to occupy that position.[2] The liquidator's stance reflects the interests of the major unsecured creditor of JDL, Mana Property Trustee Ltd (Mana), which has funded the present liquidator's initiatives in this litigation.

[4] Although the present appeal was filed in a timely way, thereafter no steps were taken to obtain a hearing date or file the case on appeal for more than six months. That delay required an application for an extension of time in which to take further steps in the appeal, given the effect of r 43 of the Court of Appeal (Civil) Rules 2005 (the Civil Rules), which deemed the appeal to be abandoned when the appellant had not taken those steps within the six month period. The application was opposed, and the Court granted the required r 29A extension of time in a judgment on 2 September 2013.[3]

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1 *Reynolds v James* [2012] NZHC 2132.
2 The circumstances of appointment of successive liquidators is addressed in [9] to [12] below.
3 *Reynolds v James* [2013] NZCA 413.

[5] Once the present hearing date was allocated, the appellant was required to file and serve submissions in support of the appeal by 23 September 2014. That did not occur, and on 25 September 2014 Mr James applied for the appeal to be struck out for failure to comply with r 41(3) of the Civil Rules. That application was opposed on grounds including that the appellant's submissions were filed shortly after the time expired on 26 September 2014.

[6] The Court heard briefly from counsel at the outset of the hearing on the strike-out application. A decision on it was reserved pending hearing the substantive argument. In the result, the Court is satisfied that the extent of non-compliance by the appellant did not warrant striking out the appeal, and the preferable course was to deal with the substantive merits of the appeal. Accordingly, the application to strike out the appeal is dismissed.

Factual circumstances

[7] In October 2007, Mana contracted to sell a block of land near Cromwell to JDL. The purchase price was $4.5 million plus GST and JDL paid a deposit of $450,000. The contract provided that the land to be sold to JDL would not be less than 4.715 hectares. When title to the property issued, the area was marginally less than that minimum stipulated in the contract, and JDL relied on that discrepancy to cancel the contract in November 2008. Mana sued JDL for specific performance, and on 8 April 2009 Associate Judge Osborne was granted orders for specific performance and costs.[4] The liability created by that judgment meant that JDL could not meet its liabilities as they fell due.

[8] JDL pursued an appeal from the order for specific performance. It obtained a stay of the order for specific performance on terms requiring it to lodge some $820,000 in the trust account of solicitors for Mana.[5]

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4 *Mana Property Trustee Ltd v James Developments Ltd* (2009) 10 NZCPR 295 (HC).

5 *Mana Property Trustee Ltd v James Developments Ltd* HC Dunedin CIV-2008-412-1027, 28 May 2009.

[9] In early July 2009, JDL was put into voluntary liquidation by a shareholders' special resolution. Messrs Paul Jenkins and Iain Nellies of Dunedin were appointed the liquidators.

[10] The first set of liquidators continued with the appeal against the order for specific performance that JDL had commenced before their appointment. JDL succeeded in a decision given by this Court in October 2009, with the result that JDL was freed of the obligation to complete the purchase, and was entitled to return of the deposit it had paid of $450,000.[6]

[11] However, Mana pursued a further appeal, the Supreme Court gave leave and ultimately Mana succeeded.[7] The Supreme Court decided that JDL's purported cancellation of the contract was of no effect, with the consequence that JDL was not entitled to recover the original deposit of $450,000.

[12] In November 2010 the first liquidators resigned and Mr Reynolds was appointed as the second liquidator.

[13] The transactions relevant to the liquidator's present claims occurred in the period between Mana obtaining orders for specific performance and JDL going into liquidation. First, on 22 May 2009, JDL signed the GSA in favour of Mr James. It was challenged in the proceedings to prevent Mr James relying on it to justify the preference he otherwise obtained for payments to him in the relevant period. The Associate Judge held that the GSA was ineffective to grant security in relation to past advances.[8] He also found that the GSA was voidable under s 292 of the Act to the extent it purported to give a charge for Mr James' claims for reimbursement of expenses he had paid on behalf of JDL after the GSA was executed.[9]

[14] Secondly, during June 2009, JDL made three payments totalling $60,904 to Mr James in reduction of amounts JDL owed to him. In the present litigation,

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6 *James Developments Ltd v Mana Property Trustee Ltd* [2009] NZCA 483.
7 *Mana Property Trustee Ltd v James Developments Ltd* [2010] NZSC 90, [2010] 3 NZLR 805.
8 *Reynolds v James*, above n 1, at [19].
9 At [58].

Mr James has accepted that those payments represented preferential payments.[10] However, Mr James denied liability to repay those amounts to the liquidator on the ground that he subsequently met expenses for JDL in liquidation that are more than sufficient to offset his liability to repay the sums received in June 2009.

The Associate Judge's decision

[15] The Associate Judge found that Mr James had either paid or procured the payment of various amounts on behalf of JDL. His judgment divided these sums into the following four groups:

Costs of litigation incurred before liquidation	$13,738.31
Costs of litigation after liquidation	70,760.31
Non-litigation legal expenses	6,908.93
Remuneration of original liquidators	39,250.00
Total	**$130,657.55**

[16] The pre-liquidation litigation expenses were not a liability which the liquidators had to accept. In addition, the non-litigation legal expenses were found by the Associate Judge to be for services provided for Mr James as a director and creditor of JDL and were not for a company purpose. It followed that they are not claimable against JDL.[11]

[17] Accordingly, excluding the first and third categories of expenses, the second and fourth categories comprise $110,010.31. The Associate Judge's analysis proceeded on the basis that if those payments were to meet properly incurred expenses of the liquidator, and if the payments were made by or on behalf of Mr James in circumstances that he could claim credit for them, then they exceeded the preferential payments of $60,904 he had received, and would expunge or remedy the preference he had otherwise obtained.

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10 In the High Court, Mr James denied that one of the three payments (for $13,738.31) had been received by him, or paid for his benefit. The Associate Judge rejected that claim, and his finding is not challenged: *Reynolds v James*, above n 1, at [20]–[24].

11 *Reynolds v James*, above n 1, at [37].

[18] The Associate Judge found that Mr James had met the costs of the litigation whilst JDL was in liquidation, as well as the first liquidators' remuneration. He reasoned as follows:[12]

> [25] Most of the invoices from the original liquidators and the lawyers are made out to Otago Real Estate Ltd. Mr Reynolds relies on these invoices to say that Mr James cannot take the credit for paying these expenses.
>
> [26] Otago Real Estate Ltd runs a real estate agency business. It was not part of its business to fund the litigation of [JDL]. It would not be able to claim the costs of funding that litigation as a deductible expense in carrying on its business. Despite the invoices, the payments could only have been made on behalf of Mr James. Otago Real Estate Ltd was not paying its own debts, but was advancing funds to Mr James. I find that although he obtained funds for payment from Otago Real Estate Ltd, it was Mr James, rather than Otago Real Estate Ltd, who met the costs of the litigation and the liquidators' remuneration.

[19] A Companies Office record in evidence showed that Mr James was the sole director and the only shareholder in Otago Real Estate Ltd (OREL).

[20] The Associate Judge then reasoned that the amounts paid were for a company purpose of JDL, and that they were of a type that gave Mr James as a creditor a claim in the liquidation that he was entitled to offset against the preference he had obtained by JDL paying him the $60,904 in June 2009.

The statutory provisions on insolvent transactions

[21] The provisions in ss 292 to 296 of the Act rendering insolvent transactions voidable at the instance of a liquidator constitute a relatively strict regime for liquidators to claw back amounts paid by companies when insolvent. The provisions apply in the same way in relation to charges created against a company's assets whilst it is insolvent. Once a liquidator serves notice of the liquidator's wish to set aside a transaction under s 294, it will automatically be set aside if the person given notice does not object.[13]

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12 Footnotes omitted.

13 The range of options open to a liquidator, and the scope of the Court's powers in responding to such initiatives, were considered in this Court's recent decision in *Grant v Lotus Gardens Ltd* [2014] NZCA 127, [2014] 2 NZLR 726.

[22] The jurisdiction under s 295 is triggered by a court order setting a transaction aside. The section provides for a range of remedies that the Court may choose as appropriate in particular cases. Those include the following:[14]

> **295 Other orders**
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> If a transaction or charge is set aside under section 294, the Court may make 1 or more of the following orders:
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> (a) an order that a person pay to the company an amount equal to some or all of the money that the company has paid under the transaction:
>
> …
>
> (c) an order that a person pay to the company an amount that, in the Court's opinion, fairly represents some or all of the benefits that the person has received because of the transaction:
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> …

[23] There is no provision in the Act specifically authorising liquidators or the Court to recognise the offsetting effect of other transactions where a company in liquidation has been advantaged by payments to it, or on its behalf, by a party that would otherwise be vulnerable to repay preferential amounts that party had received. The analysis undertaken by the Associate Judge is consistent with the approach mandated by s 295 of the Act. In a case such as the present, it would be unfair to require repayment of the extent of Mr James' preferred receipts from JDL, once it is established that he thereafter made payments for a greater amount to or on behalf of JDL in respect of which there is a relevant preference. In those circumstances, on the approach contemplated by s 295(c) if the company has received benefits that outweigh those received by Mr James, the amount he should be ordered to pay is reduced to zero.

[24] In its recent decision in *Grant v Lotus Gardens Ltd*, this Court confirmed the on-going availability of common law remedies in relation to the resolution of claims over insolvent transactions.[15] In that case, such remedies were relevant because the recipient of the liquidator's notice to set aside a transaction under s 294 had not

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[14] These discretionary powers exist alongside the mandatory prohibition on making an order for recovery of property where a third party has acquired property from the company for value in good faith and being unaware of the prospect of the company being or becoming insolvent: s 296(3).

[15] *Grant v Lotus Gardens Ltd*, above n 13, at [37].

taken any steps to challenge that process. In contrast, here, Mr James did engage in the statutory process, and in those circumstances the issue must be resolved pursuant to the statutory provisions as to remedy.

Grounds for the appeal

[25] The essence of the arguments advanced on the appeal was as follows:

(a) that the Associate Judge erred in finding that the relevant payments were made by or on behalf of Mr James;

(b) that the payments should not have been recognised as made for the company purposes of JDL; and

(c) that if Mr James was responsible for payments so as to give him a claim against JDL in liquidation, then such claim ranked after preferential creditors.

Insufficient evidence that the payments were made by or on behalf of Mr James

[26] This was the major point in Mr Sorrell's oral argument. He argued that the Associate Judge could not have been satisfied, to the extent that payments were made by OREL, such payments were made for Mr James. He argued that OREL was a separate legal entity, and that there was no evidence that OREL did not assume responsibility for its own purposes for payments to the liquidators for their remuneration, and to fund steps in the litigation against Mana. There was no evidence that, for example, the payments either reduced an indebtedness owed to Mr James by that company, or increased his indebtedness to that company.

[27] Once Mana succeeded in the Supreme Court, it became the major unsecured creditor of JDL. When Messrs Jenkins and Nellies resigned as liquidators, Mana was in a position to appoint a replacement liquidator, and did so in appointing Mr Reynolds. Fulfilling his role as an independent liquidator, he was obliged to have regard to the circumstances in which payments were made to the first liquidators or on behalf of JDL in liquidation while the litigation was before the

Supreme Court. The stance that Mr Reynolds has taken is at odds with evidence he gathered in the course of his administration,[16] the affidavit of Mr James on the application before the Associate Judge (on which he was not cross-examined)[17] and the common position taken in the Supreme Court when Mana sought costs personally against the first liquidators.[18]

[28] In an affidavit opposing the liquidator's claim to recover the $60,904, Mr James acknowledged in respect of two of the three payments making up that sum:[19]

> These sums were the proceeds of the sale of shares held by JDL. The proceeds were transferred to me for the purpose of allowing me to pay JDL's legal fees in relation to the on-going litigation with Mana.
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> …
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> Invoices in relation to the liquidation and the Mana litigation were addressed to me at [OREL] with one exception being the Van Art Sycamore invoice dated 31 March 2011, which is addressed directly to JDL. The invoices specifically refer to the Mana litigation.
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> The transactions between the company and me were made pursuant to the agreement with the sole purpose of allowing me, acting as agent for the company, to meet the company's obligations to pay its on-going legal expenses and the expenses of the liquidation.

[29] On 30 May 2012, Mr Reynolds conducted an interview with Mr James in relation to the affairs of JDL. Ms McCartney SC, who had acted for Mana in its litigation against JDL, and in the High Court stage of the present litigation, asked questions on behalf of the liquidator. The extract from the transcript of that interview, appended to an affidavit from Mr Reynolds in the present litigation, includes a question as to whether Mr James had agreed to take responsibility for the relevant costs. Answers to questions on this topic included observations by Mr James that he probably should not have paid them but that he did, and that he was "paying them all the way through".

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16 See [29] below.
17 See [28] below.
18 See [32] below.
19 Mr James characterised the third payment differently (See above n 10).

[30] It was no part of OREL's business to involve itself in litigation between JDL in liquidation and Mana. Conversely, it was a matter in which Mr James had a direct on-going interest. Mr James was in a position to procure payments out of OREL on his behalf, and the absence of evidence as to how the payments were accounted for within OREL is not sufficient to rebut the inference.

[31] Quite apart from that shared history, we are satisfied that the Associate Judge was justified in drawing the inference that Mr James had procured OREL to make the payments that it did on his behalf, from all the circumstances that were in evidence.

Payments not for the company's purposes

[32] Mr Sorrell's written submissions criticised the Associate Judge for finding that it was appropriate for the first liquidators to authorise the commitment of resources to continuing the litigation against Mana. That criticism is not tenable in view of the observations of the Supreme Court in its separate judgment dealing with Mana's application for costs, which included seeking an order against the liquidators personally.[20] Blanchard J observed for the Court:

> [12] The present case is not one in which the liquidators should be required to pay a costs award personally. There was no impropriety on their part in electing to continue with the extant appeal by James to the Court of Appeal. Indeed, it is only with hindsight that it can clearly be seen that the argument being pursued by James (concerning the essential term) could not carry the day even if, as happened, James was right on that issue. The crucial issue, on which James ultimately lost, was not then fully developed by Mana and did not plainly emerge until after James had won in the Court of Appeal and Mana applied for leave to this Court.
>
> [13] The liquidators, who obviously were not themselves responsible for the company going into liquidation (that was the act of Mr James), were at all times acting on behalf of the company and its creditors. They have been criticised in submissions of counsel for Mana for having pursued an appeal which was contrary to its interests as the major creditor (the others were Mr James and entities associated with him) but they could rightly see it as their duty to the company to establish whether Mana in fact had any claim at all as creditor against James provable in the liquidation and whether an asset of $450,000 (the deposit) was recoverable by James.

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[20] *Mana Property Trustee Ltd v James Developments Ltd (No 2)* [2010] NZSC 124, [2011] 2 NZLR 25.

[33] There can be no issue that the commitment of resources by the first liquidators to continuation of the litigation with Mana was an appropriate company purpose for JDL in liquidation. Payments by or on behalf of Mr James to pay the liquidators' remuneration also should be recognised as appropriate. If not met by Mr James, those expenses would otherwise have been a first charge on JDL's assets.

Payments did not qualify for a preference

[34] We are satisfied that the Associate Judge was correct in treating both the litigation expenses and liquidators' remuneration as being within cl 1(a) of sch 7 to the Act, which sets out the priority of payments to preferential creditors. That provides:

> **1 Priority of payments to preferential creditors**
>
> (1) The liquidator must first pay, in the order of priority in which they are listed,—
>
> (a) the fees and expenses properly incurred by the liquidator in carrying out the duties and exercising the powers of the liquidator, and the remuneration of the liquidator; and
>
> …

[35] Mr Sorrell argued that the costs of the litigation incurred by JDL in liquidation should not have been treated as coming within this first order of priority. This was, in essence, a further attempt to challenge the legitimacy of the first liquidators continuing with the litigation. Given that the powers appropriately open to the liquidators included pursuit of the litigation, there can be no argument that the expenses incurred in doing so fall outside this first priority for payments.

[36] In his oral submissions, Mr Sorrell fairly acknowledged the effect of cl 4 of sch 7 to the Act which recognises the prospect of subrogation. That provision entitles the payer of an amount for which sch 7 recognises a preference to be subrogated for the entity whose obligation the payment was meeting or reducing. Clause 4 confirms that a person who has taken responsibility for the payment of an amount that would otherwise be a preferential claim in the liquidation is entitled to be subrogated to the rights of the original obligor, and in the same priority. Because Mr James put the first liquidators in funds to enable them to discharge their

obligations, he became entitled to recover those amounts as if he had held the priority from the outset.

[37] A subset of Mr Sorrell's argument that the payments were not for a company purpose of JDL in liquidation was that there was no evidence of an acceptance of liability by the first liquidators to reimburse Mr James for the payments being made. This raises the spectre that the payments were made or procured by Mr James as a volunteer. The point was not pressed in oral argument.

[38] We are satisfied that the first liquidators made a proper commercial judgement to continue JDL's litigation with Mana. If JDL had had the resources from which to pay the first liquidators' costs and expenses, they would have been entitled to take their remuneration and expenses from that fund. There is no reason why the fact Mr James provided those funds should mean that he is to be left in a worse position than the liquidators. Similarly, when Mr James paid those liquidators' remuneration, he did so relieving the company of what would otherwise be a first claim against its assets. The clear inference is that he did so expecting to claim credit for the liability he had discharged.

Conclusion

[39] We are accordingly satisfied that the Associate Judge was correct in recognising that the preferred payments Mr James received in June 2009 were more than offset by the sums he paid or procured to be paid in the course of the liquidation. They were payments coming within cl 1(a) of sch 7, and accordingly ranked as a first priority, thereby justifying Mr James offsetting them against his liability to reimburse the preferential payment of $60,904 received.

[40] In summary, we are satisfied that the nature of the specific arrangements entered into by the first liquidators with Mr James means it would be inequitable for Mr James to be required to repay into the liquidation fund the amount represented by the transactions that were set aside. In our view, this is one of those rare cases in which it is proper to exercise the residual discretion under s 295 to deny a remedy to the liquidators.

Costs

[41] Costs on the appellant's application for an extension of time were reserved, to be determined when the substantive appeal was resolved.[21] We order costs in favour of the respondent on that application on a band A basis, plus usual disbursements.

[42] The appellant must also pay the respondent costs in this Court on the same basis as for the extension of time.

Solicitors:
Whitlock & Co, Auckland for Appellant
Mackay & Gilkison, Wellington for Respondent

[21] *Reynolds v James*, above n 3, at [22].