IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2015-404-001830
[2016] NZHC 3188

UNDER	Part 18 of the High Court Rules and the Companies Act 1993
IN THE MATTER	of the liquidation of Marathon Imaging Limited
BETWEEN	VIVIEN JUDITH MADSEN-RIES AND HENRY DAVID LEVIN Plaintiffs
AND	CHRISTOPHER JOHN GREENHILL First Defendant
	CHRISTOPHER JOHN GREENHILL and HEATHER ANDREA GREENHILL as trustees of the Greenhill Family Trust Second Defendants
	GREAND PROPERTIES LIMITED Third Defendant

Hearing:	21 - 23 November 2016
Counsel:	N H Malarao and S W C Shin for Plaintiffs T J L Werry for Defendants
Judgment:	21 December 2016

JUDGMENT OF DOWNS J

This judgment was delivered by me on Wednesday, 21 December 2016 at 4 pm pursuant to r 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Solicitors/Counsel:
Meredith Connell, Auckland.
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The issues

[1] Marathon Imaging Ltd, or Marathon, was placed in liquidation on 1 November 2012. The liquidators contend on the eve of the company's liquidation, Mr Greenhill, Marathon's owner and director, engineered a transaction by which he was no longer indebted to the company in relation to his current account—to the prejudice of its unsecured creditors. The liquidators also contend Mr Greenhill breached his duties to the company by trading recklessly, incurring obligations without reasonable grounds, using company funds as his own, and engaging in related party lending. They seek compensation under the Property Law Act 2007 and Companies Act 1993. Mr Greenhill disputes the allegations. He contends he managed Marathon well, particularly during difficult times. And, he argues the transaction was merely a belated tidying up of affairs in relation to his current account, and one approved long before any suggestion of liquidation.

[2] This modest set of facts gives rise to no fewer than seven causes of action, two counterclaims and a host of particulars. However, many of the prolix pleadings

overlap or are advanced as alternatives. The real issues are more confined, and largely, those above.

Key facts

[3] Marathon was founded on 7 October 2004 to purchase and operate a business which recycled printer cartridges and sold them, wholesale.[1] The cartridges cost less than new ones, hence its market. Mr Greenhill has been Marathon's director and shareholder since its inception.[2]

[4] Doubt attaches to whether the company was ever profitable. In 2008 its fortunes worsened. Sales dropped, perhaps in consequence of the global financial crisis. From the end of that year, Marathon was late in remitting PAYE tax on behalf of its employees. In relation to these payments it was frequently late thereafter: from 31 December 2008 until 31 August 2012, Marathon incurred late payment penalties of $12,470.77 and non-payment penalties of $24,671.23. Marathon was similarly late in meeting its GST and KiwiSaver commitments; the former from 30 September 2009 and the latter from 31 March 2010. In relation to GST, Marathon incurred $21,775.62 in late payment penalties. And in relation to KiwiSaver, Marathon incurred non-payment and late payment penalties of $2,313.74.

[5] The company's own books revealed its trouble. In the financial year ending 31 March 2009, Marathon made a loss of $72,726. And, its liabilities exceeded its assets by $392,210. There was little improvement the next year. By 31 March 2010 Marathon had made a surplus—just—of $3,009. But its liabilities still exceeded its assets by $389,203. The true position was actually worse. Marathon's accountant had included goodwill of $378,000 as an asset, the figure Marathon had paid for goodwill in acquiring the business. However, by 2009 the inclusion of goodwill was unrealistic as no reasonable purchaser would have paid any. So, in 2009 and 2010 Marathon's liabilities exceeded its assets by approximately $770,000. These are large sums for a small company of approximately 10 employees.

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[1] The company was originally called D & H Imaging Ltd. It changed its name on 26 November 2004.

[2] Mr Stuart Anderson was also a director between 10 March 2005 and 5 August 2010.

[6] Mr Greenhill withdrew money from Marathon through a current account. By 31 March 2009, he owed the company $169,847. By the end of the 2010 financial year, the figure had grown to $223,097.11.

[7] In May 2010 Marathon's only other director, Mr Stuart Anderson, left the company. He and Mr Greenhill had been business partners for many years. An agreement was prepared and signed to deal with Mr Anderson's departure, which was acrimonious.

[8] Marathon's financial health deteriorated further. In the year ending 31 March 2011, it made a loss of $19,846. Marathon's books for the same year recorded liabilities as exceeding assets by $409,050. However, because of the artificiality of the inclusion of goodwill and an unreported tax debt of $30,537, its true position was even worse. Marathon's liabilities actually exceeded assets by $817,587.

[9] Mr Greenhill believed Marathon's salvation lay in the purchase of a competitor, RTS Imaging NZ Limited, or RTS. Mr Greenhill retained a firm of accountants to conduct a feasibility study. The firm recommended a purchase price of $74,000. In February 2011, Mr Greenhill had D & H Properties Ltd buy RTS at almost twice that price.[3] Mr and Mrs Greenhill are the directors and shareholders of D & H Properties Ltd, more easily D & H. The thinking behind the purchase appears to have been Marathon's sales would increase in two different but complementary ways: through an expansion of its customer base vis-à-vis RTS's customers, who Marathon had not been able to secure as its own, and through remanufacture of that company's used cartridges.

[10] In November 2011 Marathon refinanced its business with a significant loan from Kiwibank. Mr Greenhill and his wife, Heather Greenhill, provided guarantees. So too the Greenhill Family Trust, or the Trust, of which Mr and Mrs Greenhill and Mr Brian Everett, a solicitor, were trustees. Two related companies also provided guarantees: D & H and Greand Properties Ltd, or Greand. Mr Greenhill is the sole director and shareholder of Greand.

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3 $143,000.

[11] Marathon's related party borrowings were very large. For example, the Trust had periodically injected large amounts of capital to Marathon, and Marathon had given the Trust a general security over its property in 2006. By 31 March 2010, Marathon owed the Trust $915,905.66.

[12] 2012 offered no reprieve. Cheaper Chinese cartridges entered the market. And, in July that year two of Marathon's large customers went out of business without paying their debts to Marathon. On 18 July 2012, Mr Greenhill sent an email to the Inland Revenue Department asking for Marathon's penalties and interest to be remitted. As observed above, Marathon had begun defaulting on its taxation obligations at the end of 2008. Mr Greenhill said Marathon would pay $60,000 on 20 August 2012 and $1,000 each month for 17 months. The proposed total payment was $77,298.66. The Commissioner rejected Marathon's proposal. It then owed the Commissioner $147,019.37.

[13] On 24 July 2012, the Commissioner applied to liquidate Marathon.

[14] On 17 October 2012 at 5.39 pm, RTS's primary client, Office Products Depot, sent Mr Greenhill an email saying it was withdrawing all of its business and somewhat euphemistically, "hand over" planning should immediately commence. What happened in the following 24 hours is central to the case. The parties referred to it as "the transaction". I do the same.

[15] On 18 October 2012—and acting on Mr Greenhill's instructions—Marathon's accountant created a journal entry in which the Trust apparently forgave Marathon $340,000 of its debt to the Trust, in return for the company crediting Mr Greenhill's current account in the same sum. So, according to Marathon's books:

(a) Mr Greenhill no longer owed Marathon almost $264,000. Instead, it now *owed* Mr Greenhill $64,737.89.

(b) And, Marathon's indebtedness to the Trust was now $575,905.66, not $915,905.66.

[16] No funds were injected to Marathon, or the Trust for that matter, in connection with the transaction. This was a journal entry only. The entry purported to be retrospective, as if the transaction had occurred before 31 March 2011 and therefore in the 2011 financial year. Unsurprisingly, the parties have very different interpretations of the transaction. More about this later.

[17] On 29 October 2012, the Trust appointed receivers to Marathon. It will be recalled the Trust had three trustees: Mr and Mrs Greenhill and Mr Everett. He resigned as a trustee that day. Mr Everett later gave two reasons for his decision: a breakdown in his professional relationship with the Greenhills, and their “lack of communication” as trustees.

[18] It is common ground Mr Everett was unaware of the transaction.

[19] On 1 November 2012, and so three days after the Trust’s appointment of receivers, Marathon was placed in liquidation on application by the Commissioner. The liquidators immediately wrote to the company’s secured creditors inquiring, in accordance with s 305 of the Companies Act 1993, whether they wished to enforce or surrender their security interests. The Trust and Greand never responded. Much later, Kiwibank informed the liquidators Greand had repaid it as guarantor.

[20] The liquidators and receivers conferred on 2 November 2012.[4] The receivers said they had “closed the door of the business” and disposed of stock for $6,500. They noted Marathon had very few assets. The receivers said they wanted do what was necessary “and resign by Xmas”. It is not clear when the receivers sold Marathon’s stock, but that could only have happened between 29 October and 2 November 2012.

[21] On 6 November 2012, the liquidators interviewed Mr Greenhill. He said the global financial crisis had hurt the company, and he had injected capital to it. Mr Greenhill acknowledged responsibility for Marathon’s day-to-day accounts. Mr Greenhill completed two documents for the liquidators in relation to Marathon the same day: a statement of financial position and a “Business Profile”. In the

[4] Having exchanged telephone messages and perfunctory email the day before.

former, Mr Greenhill essentially said what the receivers had already told the liquidators. But he added Marathon owed him $64,737 by virtue of its current account. In the latter, Mr Greenhill referred to an undated "set off" between the Trust and the current account.

[22] The receivers issued their first report on 21 January 2013. It said they were "working in co-operation with the liquidators to progress the [company's] winding up". The report noted Marathon was unable to repay the amounts due to the secured creditors. It concluded:

> The receivers attend [sic] to take control of the assets of the company and realise such assets for the benefit of the creditors. The proceeds will be applied to repaying the secured parties. Any surplus funds will be remitted to the liquidators to distribute in terms of Schedule 7 of the Companies Act.

[23] Claims of unsecured creditors total $281,491.04. The largest claim is that of the Commissioner of Inland Revenue for $164,358.82 in unpaid taxes, penalties and interest.

[24] There were only two witnesses. Mr David Levin, an experienced liquidator, receiver and former banker. And, Mr Greenhill for himself and the second and third defendants.

The first cause of action: a prejudicial disposition of property to Mr Greenhill or the Trust?

[25] The liquidators contend the transaction constituted a disposition of property by Marathon with intent to prejudice a creditor, or absent reasonably equivalent value in exchange, in contravention of subpart 6 of Part 6 of the Property Law Act 2007. That subpart empowers a Court to restore, for the benefit of creditors, the property of a debtor disposed of in a manner that prejudices creditors. Section 346 of the Act captures the essential requirements:

> **346 Dispositions to which this subpart applies**
>
> (1) This subpart applies only to dispositions of property made after 31 December 2007—
>
> (a) by a debtor to whom subsection (2) applies; and

(b) with intent to prejudice a creditor, or by way of gift, or without receiving reasonably equivalent value in exchange.

(2) This subsection applies only to a debtor who—

(a) was insolvent at the time, or became insolvent as a result, of making the disposition; or

(b) was engaged, or was about to engage, in a business or transaction for which the remaining assets of the debtor were, given the nature of the business or transaction, unreasonably small; or

(c) intended to incur, or believed, or reasonably should have believed, that the debtor would incur, debts beyond the debtor's ability to pay.

[26] The liquidators must establish Marathon:

(a) Disposed of property after 31 December 2007.

(b) When insolvent (or that Marathon became insolvent as a result of the disposition).

(c) With intent to prejudice a creditor … *or* without receiving reasonably equivalent value in exchange.

[27] The defendants accept ingredients (a) and (b) are established. That is responsible. All relevant events occurred after 31 December 2007. Consistently with the statutory objective, the term "disposition" is defined extremely broadly.[5] So too the term "property".[6] The transaction occurred on 18 October 2012. And by

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5 Pursuant to s 345(2) of the Act, disposition means—
(a) a conveyance, transfer, assignment, settlement, delivery, payment, or other alienation of property, whether at law or in equity:
(b) the creation of a trust:
(c) the grant or creation, at law or in equity, of a lease, mortgage, charge, servitude, licence, power, or other right, estate, or interest in or over property:
(d) the release, discharge, surrender, forfeiture, or abandonment, at law or in equity, of a debt, contract, or thing in action, or of a right, power, estate, or interest in or over any property (and for this purpose a debt, or any other right, estate, or interest, must be treated as having been released or surrendered when it has become irrecoverable or unenforceable by action through the lapse of time):
(e) the exercise of a general power of appointment in favour of a person other than the donee of the power:
(f) a transaction entered into by a person with intent by entering into the transaction to diminish, directly or indirectly, the value of the person's own estate and to increase the value of the estate of another person.

6 See Property Law Act 2007, ss 4 and 345(2).

then, even Mr Greenhill accepts the company was insolvent. (In Marathon's statement of financial position dated 6 November 2012, Mr Greenhill said he believed the company became insolvent in "August/September 2012").

[28] The battle was over the third ingredient. That battle was part fact, part law.

Part fact

[29] Mr Greenhill gave evidence when Mr Anderson left Marathon in 2010, it was agreed Mr Anderson's initial contribution to Marathon and his current account would be combined, leaving a net debt due to Mr Anderson by Marathon. Mr Greenhill said the company's accountant made the suggestion, which was adopted. Corroborative evidence supports this aspect of Mr Greenhill's evidence. An audit trail report printed on 9 September 2011 shows entries for the financial year ending 31 March 2011, and these include the apparent introduction of $340,000 to offset Marathon's corresponding indebtedness to Mr Anderson. The entries are consistent with Mr Anderson's departure in May 2010, and in turn, events forming part of the 2011 financial year. The liquidators did not challenge this aspect of Mr Greenhill's testimony, which I accept as true.

[30] Mr Greenhill said it was agreed at the same time—May 2010—this approach would also be adopted in relation to his current account with Marathon. Mr Greenhill said no urgency attached to this, however, and the transaction on 18 October 2012 was merely a belated tidying up of affairs in advance of Marathon's likely liquidation. Mr Greenhill said the agreement in relation to his current account and the Trust was oral only, but nonetheless real. I do not accept Mr Greenhill's evidence here.

[31] First, Mr Greenhill's account is unsupported by any evidence. Most significantly agreements in life—even oral ones—leave *some* trace of evidence: a hurried scribble on a piece of paper; a more formal file-note; a resolution in a set of Minutes; an email, letter or facsimile; or say, a message to return a telephone call. And in a digital age, the possibilities are broader still. Nothing emerged.

[32] Mr Greenhill was required to keep records in relation to the transaction, both as director of Marathon,[7] and as a trustee of the Trust.[8] The absence of any record is significant.

[33] Second, there are discrepancies in Mr Greenhill's account. On 20 March 2015, Mr Greenhill's lawyers wrote to the liquidators in relation to the transaction. The letter referred to the May 2010 agreement as one in which the Trust was to make:

> … a distribution to Mr Greenhill, which was reflected by a reduction on what Mr Greenhill owed the company via his overdrawn current account. The GFT [the Trust] distribution to Mr Greenhill was applied against what the company owed GFT. This is not a transaction entered into by the company, but rather records the distribution by GFT to Mr Greenhill.

[34] Under cross-examination, Mr Greenhill said he did not accept the terminology used by his lawyers, and he had referred the transaction to the liquidator as a "set off". Mr Greenhill is a lay person. Care must therefore be taken to avoid misapplication of unduly strict standards of forensic accuracy. However, the statement of defence made no reference to an agreement of May 2010. That omission is telling.

[35] Third, under cross-examination, Mr Greenhill said his wife, Marathon's Hamilton-based accountant and Mr Everett all knew of the transaction. Because I had understood it was an admitted fact Mr Everett did not know about the transaction,[9] I invited counsel to confer. When the hearing resumed, Mr Werry confirmed it was an admitted fact Mr Everett was ignorant of the transaction. Mr Greenhill did not call his wife or Marathon's accountant to testify. Mr Greenhill did not suggest either person was unavailable as a witness, and neither did Mr Werry.

[36] In *Perry Corporation v Ithaca (Custodians) Ltd*, a Full Court of the Court of Appeal considered the circumstances in which an adverse inference may be drawn in a civil case from a party's failure to call a witness.[10] The Court concluded:[11]

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7 Companies Act 1993, ss 189(1) and 194.
8 Given the Trust deed's rules about decisions of the trustees.
9 Evidence Act 2006, s 9.
10 *Perry Corporation v Ithaca (Custodians) Ltd* [2004] 1 NZLR 731 (CA).
11 At [153]–[154].

> The absence of evidence, including the failure of a party to call a witness, in some circumstances may allow an inference that the missing evidence would not have helped a party's case. In the case of a missing witness such an inference may arise only when:
>
> (a) the party would be expected to call the witness (and this can be so only when it is within the power of that party to produce the witness);
>
> (b) the evidence of that witness would explain or elucidate a particular matter that is required to be explained or elucidated (including where a defendant has a tactical burden to produce evidence to counter that adduced by the other party); and
>
> (c) the absence of the witness is unexplained.
>
> Where an explanation or elucidation is required to be given, an inference that the evidence would not have helped a party's case is inevitably an inference that the evidence would have harmed it. The result of such an inference, however, is not to prove the opposite party's case but to strengthen the weight of evidence of the opposite party or reduce the weight of evidence of the party who failed to call the witness.

[37] To return to the facts, Mr Greenhill said: "everybody who was involved, and obviously the bank as well, knew about all this".[12] Given the significance of this point to the case, Mr Greenhill's connection to the potential witnesses (his wife, Marathon's accountant, and its banker), and the absence of any evidence as to their unavailability, I infer the potential witnesses' testimony would not have assisted Mr Greenhill's evidence.[13]

[38] Fourth, Mr Greenhill's evidence is inconsistent with the evidence more generally:

(a) Mr Anderson's departure was the subject of a written agreement. Given the significance of the transaction between Mr Greenhill, the Trust, and Marathon, it is odd a written agreement was seen as unnecessary.

(b) The timing of the journal entry is significant. It was made after the Commissioner of Inland Revenue had applied to liquidate Marathon,

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12 Notes of evidence, p 94.

13 Mr Greenhill's evidence on this point was also hearsay, as he was essentially asserting others could say they knew about the transaction. Mr Malarao did not object to the admissibility of the evidence, but submitted its hearsay nature diminished its weight. I accept that submission.

and the day after Mr Greenhill learned RTS's primary client was withdrawing its business.

[39] Under cross-examination, Mr Greenhill said the timing was merely a coincidence, and the email from Office Products Depot on 17 October did no more than reduce to writing what he had already learnt days earlier. This aspect of Mr Greenhill's account is also problematical. I note the email thanked Mr Greenhill for his "time today" and then observed: "As discussed, we have come to the unfortunate decision that the officeware toner business will shift to another supplier … effective 1 February 2013". The email implies the decision was communicated to Mr Greenhill that day.

[40] Fifth, Mr Greenhill was less than forthright the journal entry was retrospective:

(a) The business profile he completed for the liquidators on 6 November 2012 left undated what he said was a set-off between the Trust and Marathon's current account.

(b) The statement of defence made no mention of an agreement in May 2010.

(c) And, the retrospective nature of the entry was detected largely by chance: the key journal entries were printed on the other side of a document in relation to an unrelated client for the period ending 31 October 2012.

[41] Sixth, by 18 October 2012, Mr Greenhill must have known Marathon would be liquidated; the Trust would get very little, if any, of its money back, and he was exposed to risk by virtue of his indebtedness to Marathon vis-à-vis its current account.

[42] Consequently, I am satisfied the transaction of 18 October 2012 did not reflect an earlier oral agreement between the Trust, Marathon and Mr Greenhill (or any other permutation for that matter).

Part law

[43] The defendants contend the disposition was not with an associated intent to prejudice a creditor because, unlike the Trust, the injured creditors were unsecured, and hence had no right to property of the company. They submit, as a matter of law, there could be no intent to prejudice a creditor.

[44] I disagree. Subpart 6 of Part 6 of the Property Law Act is designed to protect the rights of unsecured creditors. This is clear from the definition of creditor in s 4 of that Act, which adopts the meaning of that term from s 240 of the Companies Act 1993, in turn meaning only an unsecured creditor absent prescribed statutory exceptions. It is also clear from s 344 of the Property Law Act, which refers to the purpose of the subpart as protecting creditors from certain prejudicial dispositions "but without … effect so as to increase the value of securities held by creditors over the debtor's property". The learned authors of Heath and Whale *Insolvency Law in New Zealand* observe the subpart "is intended to benefit creditors only to the extent that they are unsecured".[14] Taken to its logical extreme, Mr Werry's argument is that so long as a debtor intends to prejudice only unsecured creditors, the section affords no assistance. That is to traduce the statute.

[45] Two other matters buttress the conclusion the subpart is concerned to protect unsecured creditors. First, s 345(1)(a) provides a disposition of property prejudices a creditor "if it hinders, delays, or defeats the creditor in the exercise of any right of recourse of the creditor in respect of the property". The provision does not require the creditor to have a right against the property, but rather refers to "any right of recourse in respect of the property", a broader concept. And, a liquidator may apply for an order under the statute, obviously with a view to obtaining relief for unsecured

[14] Paul Heath and Michael Whale (eds) *Insolvency Law in New Zealand* (2nd ed, LexisNexis, Wellington, 2014) at [24.95].

creditors.[15] Second, in *Re Hale*, Richmond J observed in relation to the antecedent provisions of the Property Law Act:[16]

> If there is an intention to prejudice creditors by putting an asset wholly or partly beyond their reach, then that will be an intent to defraud creditors provided that in the circumstances the debtor is acting in a fashion which is not honest in the context of the relationship of debtor and creditor.

[46] A similar view was reached by Tipping J in *Regal Castings Ltd v Lightbody*.[17] His Honour considered the concept of intent to prejudice a creditor extended to "creating or increasing a risk that they will not be paid or will be hindered or delayed in receiving payment".[18]

[47] Mr Werry relied on *TSB v Dollimore*[19] in which Palmer J concluded a disposition had not been with intent to prejudice creditors because the debtor merely preferred one creditor over another. The case is distinguishable because it was concerned with s 345(1)(b) of the Act, which specifically excluded the situation before His Honour. I acknowledge a secured creditor was preferred over an unsecured one. But the case is not authority for Mr Werry's much broader proposition that feature is necessarily decisive beyond the circumstances set out in s 345(1)(b). If it were, the statute would be spent. I accept, as Mr Werry pointed out, the Trust was a secured creditor, and so it would take priority over unsecured creditors. But the Trust would not, in all probability, pursue Mr Greenhill for his reduction of his current account debt.

[48] To return to this case, the nature of the transaction, its timing, and the circumstances in which it was made admit an obvious conclusion: Mr Greenhill was seeking to hinder, delay or defeat unsecured creditors in the exercise of any right of recourse in respect of Marathon's current account.

[49] The first cause of action is established.

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15 Section 347(1)(b).
16 *Re Hale (a bankrupt)* [1989] 2 NZLR 503 at 508.
17 *Regal Castings Ltd v Lightbody* [2009] NZSC 87, [2008] 2 NZLR 433 at [86].
18 See also *Fisk v McIntosh* [2015] NZHC 1403 at [52]-[53].
19 *TSB v Dollimore* [2015] NZHC 3175.

Without receiving reasonably equivalent value in exchange

[50] This limb was advanced as an alternative in the event the disposition was not made with intent to prejudice a creditor. I address it for completeness.

[51] The transaction reversed Mr Greenhill's indebtedness to Marathon (and made him a creditor). It also diminished Marathon's indebtedness to the Trust by the same amount. Mr Werry submitted Marathon therefore received reasonably equivalent value in exchange for its disposition, particularly as the overall effect was neutral to it.

[52] It is not entirely clear from the provision or related common law whether the statutory concept requires reciprocity between all of the parties to the disposition in order for there to be "reasonably equivalent value in exchange". The point can be illustrated by reference to the facts. Mr Greenhill introduced no money to Marathon to discharge the current account debt. Nor is there any evidence he advanced funds to the Trust as part of the transaction or in consequence of it. So, the Trust seemingly waived its entitlement to $340,000 in return for Marathon waiving Mr Greenhill's indebtedness to the company in the same sum. Of the three parties involved, only Mr Greenhill gained anything.

[53] However, the provision is facially confined to the debtor receiving reasonably equivalent value in exchange for the disposition, presumably because of the statutory focus on the debtor's position and injury to the creditor vis-à-vis the debtor. I approach it in this way. Even then, I am satisfied Marathon did not receive reasonably equivalent value in exchange for its disposition of $340,000 in favour of Mr Greenhill.

[54] In *Regal Castings Ltd v Lightbody*, the Supreme Court concluded the exchange of an interest in a home for an unsecured debt to the debtor's family trust was an undervalue transaction.[20] The case makes clear circumstance is important. Marathon's reduction of its indebtedness to the Trust was of value to Marathon, save there was little prospect it could ever repay the Trust. The company had been

[20] *Regal Castings Ltd v Lightbody*, above n 17, at [60].

insolvent for several years. Its loss of Mr Greenhill as a debtor, however, compounded its financial problems on the very eve of its liquidation. So, while the sums involved were the same, their impact was uneven. In return for being relinquished of $340,000 of debt Marathon could never repay, it lost the same amount from a debtor it could have otherwise called on in a time of financial crisis. In these circumstances, its disposition of property in favour of Mr Greenhill went unsupported by reasonably equivalent value in exchange.

The second cause of action: a breach of Mr Greenhill's duties as a director of Marathon?

[55] The liquidators contend Mr Greenhill breached his duty to act in Marathon's best interests, traded the company recklessly, and incurred obligations without believing on reasonable grounds Marathon would be able to perform them. This cause of action relied on the transaction and much else besides, as revealed by the liquidators' summary of their case:

> Mr Greenhill has breached the duties contained in ss 131(1), 135 and 136 of the Act. The particular actions of Mr Greenhill relied on by the plaintiffs for each breach of duty are detailed at paras 60 to 64 of the plaintiffs' amended statement of claim. In summary, Mr Greenhill:
>
> (a) Caused the company to dispose of a significant asset of the company in the form of the current account debt, which could otherwise have been used to pay its unsecured (and unrelated) creditors.
>
> (b) Preferred his own interest by eliminating a debt he owed the company through the transaction, at a time when the company was insolvent.
>
> (c) Caused the company to make payments to him for his personal benefit, at a time when the company was insolvent.
>
> (d) Caused the company to advance sums to entities related to him, without making provision for security or interest and at a time when the company had insufficient funds to pay its debts when they fell due.
>
> (e) Allowed the company to continue to trade and failed to cause the company to cease trading despite it being insolvent.
>
> (f) Permitted the company not to meet its tax obligations as they arose.
>
> (g) Permitted the company to act in breach of trust by failing to pay PAYE and KSD to Inland Revenue.

(h) Failing to prepare a business plan, budgets, cash flow projections or other similar documentation in relation to the company.

(i) Extracted funds out of the company as drawings while the company was insolvent.

[56] As will be apparent, many of these contentions overlap or are different ways of expressing a similar default. The real issues reduce to four.[21] Did Mr Greenhill breach his duties to Marathon:

(a) Through the transaction?

(b) Through continuing to trade while Marathon was insolvent, in turn creating a substantial risk of serious loss to its creditors (including the Commissioner of Inland Revenue)?[22]

(c) In withdrawing Marathon's funds for personal expenditure?

(d) By advancing funds to related parties without adequate consideration and associated documentation?

[57] The legal principles are not in dispute. Section 131 of the Companies Act 1993 requires a director to act in good faith in what the director believes to be the best interests of the company. Good faith in this context requires honesty and "forbearance from promoting one's own interests where to do so would not be to promote those of the other party to the relationship, the company".[23] These obligations are fiduciary in nature.[24]

[58] Related obligations arise by virtue of ss 135 and 136 of the Act. The former prohibits a director from carrying on the business of a company in a manner likely to create a substantial risk of serious loss to the company's creditors. The latter

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[21] Needless particularisation and alternative pleading should not be encouraged, especially when they introduce complexity in what is otherwise a routine case. Moreover, plaintiffs should select their best causes of action, not every cause of action.

[22] If so, there would also be a breach of s 136 of the Companies Act in relation to Marathon's tax obligations.

[23] Peter Watts, Neil Campbell and Christopher Hare *Company Law in New Zealand* (2nd ed, LexisNexis, Wellington, 2016) at [13.3].

[24] *Morgenstern v Jeffreys* [2014] NZCA 449, 11 NZCLC 98-024 at [99].

precludes a director from permitting a company to incur an obligation unless he or she believes, at that time and on reasonable grounds, the company will be able to perform the obligation when required to do so.

[59] The case law in relation to s 135 draws a distinction between legitimate and illegitimate risk-taking on the basis business involves risk.[25] Unsurprisingly, the test is objective; not what the director considers appropriate.[26]

The transaction in the context of a breach of director's duties

[60] Mr Greenhill's primary defence to this element of the second cause of action is the same in relation to the first: the transaction represented the belated tidying up of a much earlier oral arrangement between Marathon and the Trust. I have already rejected that explanation.

[61] Mr Greenhill also sought to reheat the distinction between Marathon's secured and unsecured creditors, noting the Trust had a security interest over Marathon's property extending to the current account. True, but the point is a *non sequitur*. If Mr Greenhill preferred his own interests at the expense of the company's and its creditors, that would breach s 131. Given my earlier findings, that is my conclusion here too. Mr Greenhill's current account indebtedness was one of Marathon's few assets, particularly as even he accepted goodwill was no longer sustainable as an asset. The transaction had the effect of replacing that asset with a liability in Mr Greenhill's favour.

[62] It is true the company's indebtedness to the Trust was also apparently diminished, but Marathon could never have repaid that debt. And in any event, Mr Greenhill was removing company property for his own benefit. Under cross-examination, Mr Greenhill said he could not afford to pay the current account debt if called upon to do so. That may well explain Mr Greenhill's motive. But it is neither a defence nor mitigatory.

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25 *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [53]–[55].
26 At [49].

[63] In short, Mr Greenhill promoted his own interests at the expense of the company's, including its creditors. This is an obvious breach of s 131(1).

Reckless trading

[64] A company is solvent when able to pay its debts as they fall due in the normal course of business, and the value of its assets is greater than the value of its liabilities.[27] Both limbs must be met.[28] Mr Levin said it was "indisputable" Marathon was insolvent since at least March 2009, and probably well before. As observed earlier, Mr Levin is an experienced liquidator, receiver and former banker.

[65] Mr Werry did not challenge Mr Levin's assessment, at least directly. He instead focused on Mr Greenhill's directorship of Marathon, and submitted Mr Greenhill believed in its solvency until the eleventh hour. He said Mr Greenhill did not take illegitimate risks and had sought professional advice in relation to the purchase of RTS. He said Mr Greenhill navigated Marathon through a particularly difficult period, including the global financial crisis, and invited me to conclude only bad luck ultimately undid the company (when Office Products Depot withdrew its business from RTS).

[66] I have no doubt Mr Greenhill believed Marathon was solvent until August or September 2012. I accept also Mr Greenhill devoted much time, energy and money to Marathon. The Trust made large advances to Marathon. And Mr Greenhill provided personal guarantees, including to Kiwibank. However, sincerity of belief is not synonymous with reasonableness of belief.

[67] I conclude Marathon was insolvent from March 2009. Many of the facts in support of this conclusion are recorded earlier in the judgment. To recapitulate, Marathon's own books demonstrated its insolvency. In 2009, its liabilities exceeded assets by $392,210. And that year, it made a loss of $72,726. In 2010, Marathon made a very modest profit of $3,009, but its liabilities continued to outweigh its assets by $389,203. In 2011, the company reverted to making a loss (of $19,846). Its liabilities then exceeded assets by $409,050. As observed, these were the

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27 Companies Act 1993, s 4(1).
28 Made clear by the use of the word "and" in s 4(1).

company's own figures. However, the true position was much worse because Marathon's accounts included goodwill of $378,000 when no reasonable purchaser would have paid any. Its books also failed to record an unreported tax debt of $30,537. So in 2009 and 2010, Marathon's liabilities actually exceeded its assets by approximately $770,000. In 2011, that figure had swollen to $817,586. The company also had insufficient working capital from which to pay its growing debts. And, it had substantial related party indebtedness. Marathon was a small company of only 10 employees or so.

[68] Evidence of insolvency went beyond balance sheet indebtedness. From the end of 2008, Marathon struggled to pay PAYE tax on behalf of its employees and to meet its GST and KiwiSaver commitments. Penalties grew. Under cross-examination, Mr Greenhill accepted that at least with the benefit of hindsight, he had chosen to pay other creditors with monies that ought to have been paid to the Commissioner. In other words, Marathon was using other people's money to pay its debts. Mr Werry pointed out Marathon was not always in default of its taxation obligations. True. But it frequently defaulted. And as Mr Levin explained, repeat failures to pay tax is a clear sign a corporate is in trouble. After refinancing with Kiwibank, Marathon exceeded its overdraft limit on no fewer than 70 occasions. It was also late in making payments to a finance company (UDC).

[69] As director, Mr Greenhill ought to have known Marathon was insolvent. His approach was more akin to that of a patient who refuses to accept a specialist's advice the patient is terminally ill—notwithstanding ghastly evidence of mortality. To wit, the Trust continued to lend Marathon money. By 31 March 2010, Marathon owed the Trust almost a million dollars ($915,906).

[70] Reckless trading arises when a company's business is conducted in a manner likely to cause a substantial risk of serious loss to its creditors. A company need not cease trading as soon as technically insolvent.[29] Most companies struggle at some point, and many go on to be profitable. Business is inherently risky. To borrow language from another area of law, directors must be entitled to some margin of appreciation in the way a company's affairs are managed. Ex post facto analysis is

29 *Re South Pacific Shipping Ltd* (in liq) (2004) 9 NZCLC 263,570 (HC) at [125].

always easy—making corporate decisions as they arise is not. However, there is risk and *risk*. I am satisfied Mr Greenhill's directorship of Marathon engaged reckless trading from September 2009 (six months after Marathon became insolvent).

[71] The point can be illustrated by reference to Marathon's largest unsecured creditor, the Commissioner of Inland Revenue. Marathon was late in paying PAYE tax in August, September, October and December 2009. Put another way, in the last five months of that year, it paid PAYE tax only once on time. Matters deteriorated in early 2010: Marathon missed or was late in paying PAYE tax in February, March, April and May. It met its June and July commitments, but missed payment or was late with payment every month the rest of that year. By 31 October 2010, Marathon owed the Commissioner more than $12,000 in relation to PAYE tax. Thereafter, its position became only worse. By 31 July 2012, Marathon owed almost $69,000 in relation to PAYE tax and related penalties.

[72] A similar story emerges in relation to GST. Marathon was late in its GST payments for September and November 2009, and for three of the first six months in 2010. By May 2010, Marathon owed the Commissioner more than $10,000 in relation to GST. By 31 July 2012, GST and related penalties had grown to more than $87,000.

[73] Marathon's KiwiSaver defaults are not as significant, presumably because of the company's size. But it frequently missed or was late in making KiwiSaver contributions from 31 March 2010 until its liquidation. By then, Marathon owed the Commissioner more than $3,000 in relation to KiwiSaver contributions and related penalties.

[74] Marathon's total indebtedness to the Commissioner grew to $164,447.80 by the time she applied to liquidate Marathon. Mr Greenhill never made a sober assessment of whether Marathon should cease trading. More importantly, he did not cease trading in late 2009 when Marathon was clearly insolvent. Instead, Mr Greenhill saw RTS as the answer to what he described as Marathon's "struggling". That was understatement. Marathon was insolvent. Even then, Mr Greenhill failed to heed professional advice in paying almost twice RTS's

recommended purchase price. Mr Greenhill further aggravated the position by continuing to draw on Marathon's current account. At the end of the 2009 financial year, Mr Greenhill owed the company $169,847. By the end of the next financial year, the figure was $223,097. And by the end of the 2011 financial year, the figure had risen further to $275,622.

[75] Mr Greenhill created and perpetuated a substantial risk of serious loss to the company's creditors from September 2009. And in doing so, he allowed Marathon to incur taxation obligations without a reasonably grounded belief it could perform them as they fell due.

Personal payments in contravention of s 131(1) of the Act?

[76] The liquidators contend Mr Greenhill also breached his duties to Marathon by using its funds to pay for personal expenditure. Mr Levin analysed the company's bank statements from 1 April 2011 to 29 October 2012. He identified a total of $55,810 which the liquidators contend Mr Greenhill took from the company:

Description	**Amount ($)**
Personal in nature	6,113
ATM and cash withdrawals	3,038
Payments to C J & H A Greenhill	17,582
Payments to BNZ Visa and Visa Gold	3,600
Payments to ASB Visa	3,003
Payments to AMEX	12,700
Payments to Greenhill Family Trust	2,000
Payments to 4550-4700-0152-1286	1,358
Payments to 03-1394-0003603-00 and 91	4,516
Payments to Darren	1,900
Total	$55,810

[77] Mr Greenhill accepts he took $21,054.74 in his favour and a further $6,700 in favour of the Trust. However, Mr Greenhill says the balance of $28,055.26 comprised payments on Marathon's behalf for "matters like tea, coffee, sugar, milk, toilet rolls etc" and was reimbursement of others' corporate expenditure. Mr Greenhill also says he paid $3,992.42 to the Commissioner on behalf of Marathon.

[78] In relation to this limb of the case, the onus is on Mr Greenhill to account for the expenditure.[30] With one exception, I conclude he has not discharged that onus:

(a) Mr Greenhill did not adduce a single record to demonstrate how Marathon's monies had been spent. As a director, he had a duty to maintain records.[31]

(b) Under cross-examination, Mr Greenhill acknowledged intermingling Marathon's funds with his own on the basis there were "times I had to buy food". I infer from this answer Mr Greenhill's personal finances were under pressure and so he resorted to the company's.

(c) Tea, coffee and petrol could never account for much of the disputed expenditure. There is an air of unreality in relation to this explanation given the sums involved.

(d) Other corroborative evidence is absent. Mr Greenhill said some of the expenditure was to reimburse a sales representative, Mr Darren Brewer. Mr Greenhill did not call Mr Brewer as a witness.

(e) Many of the entries identified by Mr Levin plainly relate to personal expenditure. So, one sees references to Muffin Break, Lim Fruit, Countdown and so on. And yet in the wake of the company's collapse, Mr Greenhill was not candid with the liquidators. Only when taxed about the issue in February 2015 did Mr Greenhill acknowledge applying monies for his and the Trust's benefit.

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[30] *Morgenstern v Jeffreys*, above n 24.
[31] Companies Act 1993, s 194.

[79] As to the single exception, Mr Greenhill identified a series of payments totalling $3,992.42 to the Commissioner of Inland Revenue on behalf of Marathon. If untrue, this is an audacious piece of testimony given the Commissioner's ability to disprove it. And, given no evidence has been adduced in reply by the Commissioner, I accept Mr Greenhill's evidence on this issue notwithstanding the absence of related source documentation.

[80] This aspect of the liquidators' case is established to the value of $51,817.58.

Related party lending

[81] In 2007 or earlier, Marathon advanced $26,121 to D & H, a related party. Mr Levin said he could not find any documentation in relation to the loan. It is clear from the loan's treatment in Marathon's books D & H did not pay interest. Nor did it provide security. Mr Greenhill accepted as much in cross-examination. He also accepted D & H had not repaid the loan—as it was no longer trading and had no funds to do so. Mr Greenhill said the loan was made to assist D & H's cash flow.

[82] It was not in Marathon's best interests to lend a related party a not inconsiderable sum, without interest or security, and without associated record-keeping. Moreover, Marathon was desperately in need of funds from at least 2009 on. And yet no demand was ever made for repayment or payment of interest. In the circumstances, the loan constituted a breach of s 131(1).

[83] Mr Levin also gave evidence Marathon made a similar loan to RTS of $5,268.98. This appears to be an error on his part. The entry appears as a liability in Marathon's books, implying it owed RTS the money rather than the other way around.

[84] Related party lending to D & H breached s 131(1) of the Act. But there was no loan to RTS, related or otherwise. I dismiss that element of the claim.

The third to seventh causes of action and two counterclaims

[85] The third to seventh causes of action seek various forms of relief. Their unifying theme is that only unsecured creditors with claims in liquidation should share compensation. Mr Malarao submitted the Trust and Greand had lost their status as secured creditors because:

(a) The Trust surrendered its general security in relation to Marathon's assets by failing to respond to the liquidators in accordance with s 305 of the Companies Act. If not, its security should be set aside pursuant to s 299 of that Act.

(b) Greand surrendered its general security in relation to Marathon's assets because under the doctrine of subrogation, Greand could have no better rights than those of Kiwibank, to whom the security was given. And, because Kiwibank had failed to respond to the liquidators pursuant to s 305, it and hence Greand had surrendered the security.

[86] Mr Malarao further submitted even as unsecured creditors, the Trust and Greand should be precluded from sharing compensation because both are related to Mr Greenhill and Marathon, and neither would have brought proceedings against Mr Greenhill for breach of his duties in relation to Marathon. The Trust, he said, was Mr Greenhill's alter ego.

[87] Mr Werry submitted neither the Trust nor Greand had lost secured creditor status. He contended the Trust was not required to respond to the liquidators pursuant to s 305 because it had appointed receivers on 29 October 2012, three days before Marathon was placed in liquidation. In relation to Greand, Mr Werry submitted it stood in Kiwibank's shoes. In the alternative, he submitted both Greand and Kiwibank should be entitled to withdraw any surrender of security and rely on their charges pursuant to s 305(10) of the Act.

[88] Mr Werry also questioned the jurisdictional basis for a direction precluding the Trust and Greand for advancing claims as unsecured creditors in the liquidation.

[89] The claims and counterclaims reduce to two broad questions:

(a) What compensation should be awarded?

(b) Who is eligible for compensation?

[90] I deal with these in reverse order because the identity and number of claimants could affect the amount of compensation. And because secured creditors have priority over unsecured creditors when a company is liquidated, I first consider whether Greand and the Trust have or should retain secured creditor status.

Who is eligible for compensation?

[91] As will be recalled, Marathon refinanced its business with a loan from Kiwibank. Kiwibank required guarantees from Mr and Mrs Greenhill, the Trust, D & H and Greand. When Marathon was placed in liquidation on 1 November 2012, the liquidators wrote to Kiwibank seeking the bank's election in accordance with s 305 of the Companies Act. Kiwibank replied on 1 April 2015, and so almost two-and-a-half years later. It explained Greand had repaid Marathon's debt on 14 March 2014 pursuant to the guarantee. Because Kiwibank did not respond to the liquidators in accordance with the 20-working day timeframe prescribed by s 305(8) of the Companies Act, it is "taken as having surrendered the charge to the liquidator … for the general benefit of creditors" pursuant to s 305(9) of that Act.

[92] Greand's payment of Marathon's debt pursuant to the guarantee means Kiwibank's general security would normally pass to Greand. The *Laws of New Zealand* observes:[32]

> A surety who pays off the debt owed by a principal debtor to a creditor is subrogated to any securities and other rights given by the debtor to the creditor as security for the debt.

[93] I say normally because by virtue of s 305(9), Kiwibank surrendered its security long before Greand assumed Kiwibank's rights. The subrogation principle

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[32] *Laws of New Zealand* Equity: Subrogation (online ed) at [78]. See also Insolvency Act 2006, s 272 and Companies Act 1993, s 203.

is often described as allowing one person to "stand in the shoes" of another.[33] That person may then exercise rights available to the original right-holder. However, because of the derivative nature of the principle, as a matter of law and logic, Greand could not enjoy any more rights than Kiwibank enjoyed. And Kiwibank surrendered its security rights by failing to comply with s 305.[34]

[94] I also reject Mr Werry's alternative argument Greand should have leave to withdraw the surrender (caused by Kiwibank's inaction) and rely on the general security agreement. Greand is a related party. It has long known of the proceedings—and done nothing. And, it is highly likely to the point of being almost certain, Greand would never have taken action against Mr Greenhill for breaching his duties to Marathon because Mr Greenhill would, in effect, be suing himself. It would be wrong to allow Greand to share, as a restored secured creditor, compensation it would never have sought for itself.[35]

[95] Which brings us to the Trust. It will be recalled the Trust appointed receivers on 29 October 2012. Marathon was placed in liquidation on 1 November 2012. The liquidators immediately issued notices pursuant to s 305, including to the Trust. It never responded. The section provides:

> **305 Rights and duties of secured creditors**
>
> (1) A secured creditor may—
>
> (a) Realise property subject to a charge, if entitled to do so; or
>
> (b) Value the property subject to the charge and claim in the liquidation as an unsecured creditor for the balance due, if any; or
>
> (c) Surrender the charge to the liquidator for the general benefit of creditors and claim in the liquidation as an unsecured creditor for the whole debt.
>
> (2) A secured creditor may exercise the power referred to in paragraph (a) of subsection (1) of this section whether or not the secured creditor has exercised the power referred to in paragraph (b) of that subsection.
>
> (3) A secured creditor who realises property subject to a charge—

[33] *New Zealand Society of Accountants v ANZ Banking Group Ltd* [1996] 1 NZLR 283 (CA) at 287-288.
[34] Mr Werry did not advance an unjust enrichment argument.
[35] I would have reached the same conclusion in relation to the Trust for the same reasons. However, the point does not arise because of my other conclusions, as now outlined.

(a) May, unless the liquidator has accepted a valuation and claim by the secured creditor under subsection (6) of this section, claim as an unsecured creditor for any balance due after deducting the net amount realised:

(b) Must account to the liquidator for any surplus remaining from the net amount realised after satisfaction of the debt, including interest payable in respect of that debt up to the time of its satisfaction, and after making any proper payments to the holder of any other charge over the property subject to the charge.

…

(8) The liquidator may at any time, by notice in writing, require a secured creditor, within 20 working days after receipt of the notice, to—

(a) Elect which of the powers referred to in subsection (1) of this section the creditor wishes to exercise; and

(b) If the creditor elects to exercise the power referred to in paragraph (b) or paragraph (c) of that subsection, exercise the power within that period.

(9) A secured creditor on whom notice has been served under subsection (8) of this section who fails to comply with the notice, is to be taken as having surrendered the charge to the liquidator under subsection (1)(c) of this section for the general benefit of creditors, and may claim in the liquidation as an unsecured creditor for the whole debt.

[96] The issue here is whether the Trust's appointment of receivers meant it did not need to respond to the notice. No authority is directly on point, but case law and principle imply the answer.

[97] In *Grant v Waipareira Investments Ltd*, the Court of Appeal considered a claim by liquidators a secured creditor had vacated its security by voting in an unsecured creditors meeting.[36] The Court observed:[37]

> [29] Under s 305(8) a liquidator may require a secured creditor to elect within 20 days which of the three powers the creditor wishes to exercise.
>
> [30] Third, the election by a secured creditor of which power the creditor wishes to exercise leads to different consequences:
>
> (a) If a secured creditor elects to realise property subject to a charge, the creditor may to do so independently of the liquidation. As this Court has pointed out, the scheme of pt 16 of the Act is to exclude from the ambit of the liquidation property which is subject to a charge. The Act contemplates that secured creditors

[36] *Grant v Waipareira Investments Ltd* [2014] NZCA 607, [2015] 2 NZLR 725.
[37] Footnotes omitted.

will operate independently of the liquidation, unless they decide to surrender their security.

(b) If a secured creditor elects to value the security and claim in the liquidation for the balance due, if any, the creditor must by s 305(4) claim "in the prescribed form". The claim is then governed by the provisions of s 305(5)–(7).

(c) If a secured creditor elects to surrender the charge for the general benefit of creditors and claim in the liquidation as an unsecured creditor for the whole debt, the creditor must by s 304(1) make a claim "in the prescribed form". The claim is then governed by the provisions of s 304(2)–(5).

[98] The Court of Appeal considered the effects of surrender. It said "for present purposes" a secured creditor would remain a secured creditor under the Act unless and until the creditor's charge was surrendered in one of two identified ways (referring to s 305(1)(c) or 305(9)), and that in the absence of surrender, the creditor remained secured. But surrender could arise from failing to comply with a notice under s 305(8)—as the subsection itself makes plain.

[99] *Grant* was focused upon what behaviour constitutes surrender, and not whether a secured creditor must respond to a notice when it has already appointed a receiver. But it is clear from *Grant* if a secured creditor fails to make an election within the prescribed time, the charge is taken as surrendered.[38] The creditor must make an election.

[100] The learned authors of *Insolvency Law in New Zealand* describe the surrender question as one of fact.[39] The authors refer to *Bay Flight 2012 Ltd v Flight Care Ltd*, in which Kos J, as His Honour then was, considered whether submission of a proof of debt was a surrender under s 305(1)(c).[40] The Judge said the scheme of Part 16 of the Companies Act, with its three options for secured creditors, implied submission of a proof of debt constituted an election to abandon the security. However, the Judge did not need to decide the point.

[101] In the Australian case of *Surfers Paradise Investments Pty Ltd (in liq) v Davoren Nominees Pty Ltd*, the liquidator argued the secured creditor had made an

38 See also *Walker v Forbes* [2015] NZHC 1730, [2015] 3 NZLR 831 at [45].
39 Heath and Whale, above n 14, at 508.
40 *Bay Flight 2012 Ltd v Flight Care Ltd* [2012] NZHC 484, (2012) 10 NZBLC 99-705 at [42].

election to surrender its security.[41] The first-instance court found the creditor had not intended to do so. On appeal, it was common ground the decision turned on the question of whether there had been an election to surrender the security, and what type of election was needed. Specifically, the appeal court said there was no doubt the subjective intention of the secured creditor had been to retain the security, but the question was whether there had been:

> … some act which is of such a nature that, irrespective of his actual intention or determination, the law treats him as having exercised his election. This imputation of an election may occur even though the party does not subjectively know that he has the right to elect, or even where he does not intend to elect.

[102] The Queensland Court of Appeal said such an election requires "unequivocal conduct" in the face of a necessary choice. That had not occurred on the facts. Grant Slevin, commenting on the decision in the New Zealand Business Law Quarterly, says the case represents an analysis of the rule in *Moor*:[42]

> … by analysing the circumstances to see whether an unequivocal election has been made. It also gives effect to its underlying policy, which is to prevent a secured creditor from recovering more than it is entitled to in a liquidation by proving in respect of debt for which it continues to hold security.

[103] The reference to *Moor* is to *Moor v Anglo-Italian Bank*, in which Jessel MR observed:[43]

> In bankruptcy, if a secured creditor wants to prove, he must do one of three things: he may give up his security altogether and prove for the full amount, or he may get his security valued and prove for the difference, or he may sell and realize his security and then prove for the difference. If, without doing either of the latter two things, he proves for the full amount, as he cannot prove for the full amount and receive a dividend except on the theory of giving up the security, he shews by that an intention to give up his security; and, if he so proves and receives a dividend or votes, he shews pretty conclusively that he has finally elected to give up his security and take his dividend; in other words, having two funds to resort to, the bankrupt's general estate, so as to get a dividend on the whole amount of his debt, or his security, he elects to take the bankrupt's estate, and in that way gives up his

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41 *Surfers Paradise Investments Pty Ltd (in liq) v Davoren Nominees Pty Ltd* [2003] QCA 458, [2004] 1 Qd R 567 at [103]. In *Grant v Waipareira Investments*, the Court of Appeal said Australian cases decided under a different regime should be distinguished. However, *Surfers Paradise Investments* remains relevant on the factual nature of an election in this context.

42 Grant Slevin "Liquidation and Secured Creditors — The Purpose and Effect of Section 305 of the Companies Act 1993" (2013) 19 NZBLQ 61 at 68.

43 *Moor v Anglo-Italian Bank* (1879) 10 Ch D 681 at 689–690.

> security. It is not forfeiture, it is election; but, the petitioning creditor gets nothing unless he proves.

[104] Sir George Jessel's comments have been seen as the basis for our s 305.[44]

[105] If surrender is a question of fact, the requirement to respond is likely one too. Put another way, if the secured creditor's conduct left no doubt about his, her or its election, the absence of a formal response does not matter: their conduct suffices. Or more accurately, their conduct *constitutes* their election. But unless the case falls in this category, s 305 clearly anticipates a response.

[106] Principle implies the same conclusion. Section 305 permits liquidators to know what property is to be dealt with in the liquidation, so the liquidation can proceed efficiently. As Associate Judge Doogue said in *A J Park v Nepri*:[45]

> Section 305 exists to provide assistance to liquidators to implement the policy which was explained in the *Moor* decision. In order for liquidators to progress the liquidation they need to know whether a secured creditor intends to rely upon his or her security or to prove as an unsecured creditor. Uncertainties as to what the secured creditor's intentions are have the potential to delay progress with the liquidation. The mechanism provided in s 305(8) provides the liquidators with the means of compelling the creditor to make a timely decision and, if he/she does not, makes provision for a default position which will apply in the absence of an election by the creditor. As a result, when the statutory provisions contained in s 305(8) and (9) have run their course, the liquidators will have the necessary certainty as to how to manage the future course of the liquidation. The requirement for certainty means that, in general terms, a creditor will usually have to live with the consequences of an election which he makes under s 305(8) or the default position that applies if no election is made in time. …

[107] And as the authors of *Insolvency Law in New Zealand* observe, liquidators are also a "watchdog" for unsecured creditors,[46] with greater powers to investigate antecedent transactions than a receiver. This too suggests, albeit indirectly, s 305 should be interpreted in a manner consistent with the efficient dispatch of a liquidator's role.

[108] To return to this case, Mr Werry submitted the fact of the receivers' appointment dispensed with the Trust's requirement to answer the liquidators' notice.

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44 Above n 41 at 64.

45 *AJ Park v Nepri Ltd (in liq)* HC Auckland CIV-2009-404-2629, 15 February 2010 at [19].

46 Heath and Whale, above n 14, at [14.18].

Or framed in terms of the case law above, the receivers' appointment constituted the Trust's election to realise its security.

[109] Receivers are generally appointed to realise a creditor's security. However, receivers are sometimes appointed with a view to managing a company's business in the hope of returning it to financial health for the benefit of the secured creditor. Even when the former is the position, it may be unclear whether the secured creditor wishes to join the liquidation as an unsecured creditor for the balance of the outstanding debt after realisation of any security. The policy behind s 305 is inconsistent with the view silence and pre-existing receiver appointment, is, without more, necessarily sufficient to demonstrate an election to realise the security. To this may be added an admittedly obvious point: the requirement to respond to a s 305 notice is not onerous.

[110] I consider the Trust's conduct insufficiently clear to constitute an election under s 305. It never responded to the notice. Its appointment of receivers was in the circumstances, equivocal. True, the receivers quickly ended Marathon's trading and realised its stock. But importantly, it is not clear from their conduct, in the face of the Trust's silence, whether the Trust would claim for the balance of its debt as an unsecured creditor. The receivers' first report at [22] tends to imply the Trust did not intend to claim for the balance of its debt, but that report post-dates the s 305 notice period by more than a month. And the file note of the receivers' conversation with the liquidators on 2 November 2012, the day after the notice was issued, is equivocal on the Trust's election. Critically, no clear picture emerges within the statutory period. In the absence of an explicit response or conduct amounting to a response, I conclude the Trust is deemed to have surrendered its general security by virtue of s 305(9) of the Act.

[111] Had I not reached this conclusion, I would have set aside the Trust's general security. Section 299 of the Companies Act affords jurisdiction to do so when a company is in liquidation, unable to pay all its debts and the security was created in favour of a related person (as described in the provision). The Court must consider the circumstances in which the security was created, the related person's conduct

vis-à-vis the affairs of the company, and any other relevant circumstances. And, it must be just and equitable to make the order.

[112] Mr Werry did not contest jurisdiction. Instead, he submitted an order should not be made because the security was made in 2006 when the company was solvent, and the Trust had lent Marathon a great deal of money since then. These submissions have force. However, Mr Greenhill prosecuted the transaction as a director of Marathon and trustee of the Trust. In doing so, he diminished the Trust's indebtedness to offset his own. It is likely Mr Greenhill is the Trust's alter ego. The transaction implies that. So too the Trust's considerable loans to Marathon (notwithstanding its insolvency), Mrs Greenhill's absence from the witness box, and Mr Everett's resignation as a trustee. As with Greand, the Trust has known of the proceedings and done nothing. And as Mr Greenhill's alter ego, the Trust would not authorise a suit against Mr Greenhill for breaching his duties to Marathon. An order would have been just and equitable had the issue arisen.[47]

[113] This brings us to whether the Trust and Greand should be excluded from sharing any compensation as unsecured creditors through an order that, first, would expressly confine relief to existing creditors in the liquidation and second, "value at zero" any belated claims by the Trust and Greand. The scene needs to be set. Neither has proved in the liquidation as an unsecured creditor. The application presupposes both parties may attempt to do so, and seeks to stymie that. The liquidators concern is that compensation would otherwise be diluted among deserving unsecured creditors, and Mr Greenhill would, in effect, compensate himself. These concerns are not unreasonable.

[114] Mr Werry resists. He submits the alleged jurisdictional basis for the order, s 284 of the Companies Act, is directed at procedural matters only.

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[47] The liquidators invited me to do likewise in relation to Greand if, for whatever reason, I concluded Greand was a secured creditor. However, s 299's jurisdiction to set aside a charge is expressly confined to a charge *created* in favour of a related party; s 299 confers no jurisdiction to set aside a charge later acquired or assumed by a related party; see Michael Arthur, "Where do Insolvency Recoveries Go?" (11th Annual Corporate Insolvency Conference, Pullman Hotel, 8 March 2012). I would have declined relief on that ground.

[115] Section 284 is a broad provision, at least facially. It affords the High Court supervisory jurisdiction over liquidators and power to make a variety of orders in connection with liquidations. In *Re Kiwi International Airlines Ltd (in liq)*, Associate Judge Abbott considered the provision empowered the Court with a "wide discretion" to make directions, and one suitably broad to permit direction as to whether or not the liquidators were required to pay out the surplus to unsecured creditors: [48]

> It is axiomatic that most liquidations and applications for directions affect creditors' rights in some way. There have been many cases where liquidators have sought directions as to distribution: see, for example, *Re International Investment Unit Trust* [2005] 1 NZLR 270.

[116] The case provides support for the liquidators' contention. But two cases do not.

[117] In *Re HIH Casualty and General Insurance (NZ) Ltd*, Paterson J considered an application that would have deprived holders of insurance policies from claiming against a company who had assumed their policies from the company in liquidation. The Judge declined to do so because the policy holders were not represented in the proceeding.[49] And, the Judge considered s 284 of the Act did not afford jurisdiction to do so:[50]

> The particular provision of s 284 is subsection (1)(a) which empowers the Court to "give directions in relation to any matter arising in connection with the liquidation." An order effectively taking away policy holders' rights is, in my view, more than a direction to a liquidator. It is an alteration of contractual rights of a third party.

[118] In *McGreal Floor Coverings Ltd (in liq) v McGreal*, the liquidators sought a direction to value at zero any claims by Mr McGreal, a director found to have breached his duties to the company in liquidation.[51] It owed Mr McGreal $114,177 but he had not proved as an unsecured creditor. The order was sought under the

48 *Re Waller* HC Auckland CIV-2005-404-7051, 26 July 2006 at [20].

49 *Re HIH Casualty & General Insurance (NZ) Limited* HC Auckland CIV 2003-404-2838, 17 December 2003.

50 At [17].

51 *McGreal Floor Coverings Ltd (in liq) v McGreal* [2014] NZHC 2884.

Court's inherent jurisdiction or s 284. Citing Paterson J's *obiter dictum* above, Venning J declined to make the order:[52]

> I am not prepared to make the declaration sought at present either under s 284 or in the Court's inherent jurisdiction. There is no separate cause of action pleaded in relation to the declaration sought. The declarations simply appear in the prayer for relief. I do not consider it appropriate to make a declaration effectively altering any contractual entitlement Mr McGreal may have in relation to a claim against the company.
>
> However, as noted the current claim has proceeded on the basis that the quantum of creditors' claims totals the $260,906.35. That is because Mr McGreal has not lodged a proof of debt. If he had then the claim made by the plaintiffs, assuming that proof of debt was accepted by the liquidators, would have been substantially higher.
>
> For that reason this is an interim judgment fixing quantum against Mr McGreal in the figure of $240,330.04. I reserve leave to the liquidators to file an amended claim to address the issue of any claim Mr McGreal may make in the future in relation to the current account debt. That is, of course, assuming the liquidators accept the validity of such debt and accept that it is properly able to be proved in the liquidation.

[119] It is not entirely clear whether Venning J considered s 284 could authorise the order, but His Honour's—and Paterson J's—concern about the potential curtailment of contractual rights strikes me as important. The Companies Act does provide for the curtailment of contractual rights and property rights, but when it does, it is explicit. An example is s 299 of that Act, discussed earlier. Another is s 293, by which voidable charges may be set aside. Yet another is s 296, by which undervalue transactions may too. In each instance, the Court is afforded clear jurisdiction to interfere with a right of property for reasons of commercial policy.

[120] It is unlikely Parliament intended to clothe a power of this nature in less than explicit language, particularly in a statute ultimately concerned with preservation of corporate property rights through provision for separate legal personality. But even if s 284 does afford jurisdiction, I would not exercise it. The Trust and Greand should not forfeit their rights because of Mr Greenhill's misadventures, even though it is likely the Trust is Mr Greenhill's alter ego. The better approach, as Venning J did in *McGreal*, is to approach compensation by way of interim judgment with a view to increasing it if the related parties belatedly seek to join the liquidation. A

52 At [23]–[25].

similar course was contemplated by Fogarty J in *Sojourner v Robb*,[53] and Anderson J in *Nippon Express (New Zealand) Limited v Woodward*.[54]

[121] So, the Trust and Greand are no longer secured creditors. But there is no jurisdictional basis by which either may be denied their status as unsecured creditors, albeit neither has sought to prove in the liquidation.

What compensation should be awarded?

[122] The logical starting point is the relief claimed. The liquidators seek an order requiring Mr Greenhill to pay $331,072 to Marathon, and hence the liquidators, pursuant to s 348(2)(b) of the Property Law Act in relation to the transaction. The sum represents Mr Greenhill's indebtedness to Marathon under the current account but for the transaction. The liquidators also seek relief against Mr Greenhill pursuant to s 301 of the Companies Act for the various breaches of his director's duties, including the transaction. Here, $331,072 is sought as an alternative to Property Law Act relief. The liquidators then seek an additional $281,494.04, the full extent of unsecured creditors' claims, on the basis Mr Greenhill should repay the current account and meet the creditors' claims. Mr Malarao submits a global figure of $612,566.04 is consistent with authority.

[123] Clearly, Mr Greenhill should pay $331,072 to Marathon as "reasonable compensation" under s 348 of the Property Law Act, and as "just" compensation under s 301 of the Companies Act. The approach is restitutionary under each statute. The underlying conduct is the same. And an order does no more than restore Marathon to the position it would have been in but for Mr Greenhill's prejudicial disposition and duty-breach. To avoid doubt, the sum is payable only once.

[124] The more difficult question is whether additional compensation should be ordered against Mr Greenfield for the balance of his breaches vis-à-vis Marathon. To recapitulate, Mr Greenfield engaged in reckless trading, incurred obligations without reasonable grounds, removed $51,817.58 of company funds, and engaged in

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53 *Sojourner v Robb* [2006] 3 NZLR 808, (2006) 9 NZCLC 264,108.
54 *Nippon Express (New Zealand) Ltd v Woodward* (1988) 8 NZCLC 261,765.

related party lending in contravention of s 151(1). There are powerful arguments each way. First, those favouring additional compensation:

(a) When considering quantum, orthodox assessment looks to "causation, culpability and the duration of the trading".[55] Here, Mr Greenfield caused the unsecured creditors' losses because he allowed Marathon to continue to trade when it should not have been (from September 2009). And he allowed it do so for three years. Mr Greenfield ought to have known the company was insolvent because of his role. Moreover, as day-to-day bookkeeper, Mr Greenfield had all of the information he needed to make an informed decision. He persisted unreasonably. The ss 135–136 breaches are serious examples of their kind having regard to the period of trading and extent of loss.

(b) Mr Greenfield's removal of $51,817.58 is also serious, particularly as Marathon was insolvent. I have already noted Mr Greenfield's lack of candour here. And a discrete award for this amount would do no more than restore Marathon to its correct position, in turn consistent with the restitutionary nature of relief under s 301.

(c) All of these breaches existed in their own right.

(d) Finally, as Mr Malarao observes, 100 percent recovery is not unusual. In *Morgenstern v Jeffreys*, the Court of Appeal upheld compensation of $3.5 million, even though that amount exceeded creditor loss.[56] In doing so, the Court of Appeal rejected an argument the maximum amount payable under s 301 should be the loss suffered by creditors. The Court considered that would not leave any funds to pay the liquidators and noted if there was a surplus in the liquidation, the money would be returned to the appellant in any event as the sole

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[55] *Mason v Lewis*, above n 25, at [110].
[56] *Morgenstern v Jeffreys*, above n 24.

shareholder of the company. This approach has been adopted recently by the High Court.[57]

[125] Now, the factors against an additional award:

(a) The figure to restore Marathon's current account is more than the amount lost by unsecured creditors.[58]

(b) The transaction was central to the case against Mr Greenhill. In bringing this aspect of the case, the liquidators noted if Mr Greenhill had repaid the current account rather than engaging in the transaction, all of the unsecured creditors could have been paid.

(c) The case is unusual in that whereas some debtors lose only other people's money, Mr Greenhill lost much of his own too. Marathon's biggest creditor was the Trust. And through Mr Greenhill, the Trust continued to fund Marathon. Had it not, Marathon might well have collapsed earlier.

(d) Relief in this area is not intended to be punitive. An award of $612,566.04 could be seen as that. In any event, relief at this level may well be disproportionate to the gravity of Mr Greenhill's misconduct and creditor loss. It bears repeating the latter is not more than $281,494.04.

[126] I am satisfied additional compensation is necessary in two areas. First, $51,817.58, being the amount Mr Greenhill took from Marathon for his own use and that of the Trust. This merely restores Marathon to the position it should have been in. Second, in recognition of Mr Greenhill's other breaches of his duties to Marathon, meaning those not captured by compensation in relation to the transaction, his personal drawings from Marathon or those in relation to the Trust.

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57 *Alpha box Property Holdings Ltd v Wiekart* [2015] NZHC 1257.

58 The liquidators do not seek their fees or expenses as part of the action. I gather these reach almost $300,000. These will need to be approved in the usual way. I offer no view on their reasonableness.

As observed, orthodox assessment looks to causation, culpability and duration of the trading.[59] Factors at [124](a) support a significant award; those at [125] tend to cut the other way.

[127] An appropriate figure is $186,000, which represents 66 percent of the total of unsecured creditor loss (as claimed in the liquidation).[60] Full recovery sits awkwardly with the considerations identified at [125]. And, Mr Greenhill's reckless trading commenced in September 2009, whereas the Marathon was insolvent at least six months earlier. This reflects several things. Clear evidence of insolvency came later in 2009, risk is inherent to business, and some loss was inevitable.

[128] No separate award is required for related party lending. It exacerbated an already poor situation but did not cause loss, at least other than very indirectly. And while the sum involved was not insignificant, it was not large either ($26,121).

Result

[129] Mr Greenhill must pay the liquidators:

(a) $568,889.58 compensation:

(i) $331,072 pursuant to s 348 of the Property Law Act, and s 301 of the Companies Act. This sum is payable only once.

(ii) $51,817.58 pursuant to s 301 of the Companies Act.

(iii) $186,000 pursuant to s 301 of the Companies Act.

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59 Above n 54.

60 In cross-examination of Mr Levin, Mr Werry highlighted two unsecured creditors (BMW Financial Services New Zealand Limited and Imaging Solutions NZ Limited) had lodged claims in the liquidation even though Mr Greenhill had repaid, as guarantor, the first in full ($7,242.38) and the second to the value of $70,000 (in relation to a debt of $87,617.50). He submitted this should affect the level of compensation. Mr Malarao disagreed on the basis Mr Greenhill could step into their shoes vis-à-vis s 272 of the Insolvency Act 2006 and s 203 of the Companies Act 1993, and with reference to the principle against double recovery. I disregarded this issue in setting compensation (at $186,000) as I considered it introduced undesirable complexity in an area intended to be broad in its sweep.

(b) Interest at the prescribed rate under the Judicature Act 1908 on all three sums from the date of the proceedings' commencement until judgment.

(c) Costs on a 2B basis.

Addendum

[130] The Trust and Greand have not sought to be admitted to the liquidation as unsecured creditors. Should that change, the liquidators have leave to apply for amended relief to ameliorate dilution of compensation.

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Downs J