IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV-2017-404-3000
[2020] NZHC 451

BETWEEN	COMMISSIONER OF INLAND REVENUE Plaintiff
AND	CLOONEY RESTAURANT LIMITED First Defendant
	ANTONY STEWART Second Defendant

Hearing: 2 March 2020

Appearances: N H Malarao and H Salisbury for the plaintiff
No appearance for the defendants

Date of judgment: 10 March 2020

JUDGMENT OF JAGOSE J

This judgment was delivered by me on 10 March 2020 at 11.00am.
Pursuant to Rule 11.5 of the High Court Rules

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Registrar/Deputy Registrar

Solicitors/Counsel:
Meredith Connell, Auckland
Inland Revenue Department, Wellington

[1] In this proceeding, the Commissioner of Inland Revenue seeks declaratory and compensatory relief against the defendants, in connection with the Clooney restaurant business' tax liabilities. The defendants have not continued their defence of the proceeding. By reason of procedural directions of this Court,[1] it now comes before me for formal proof.[2]

Background

[2] Clooney was a restaurant of some repute, operating from premises in Auckland's Freemans Bay since the mid-2000s. It initially operated through a partnership formed between four separately-owned companies. The second defendant, Antony Stewart, was sole director and (by 2010) shareholder of one of those companies. He became sole director of each of the other three companies in August 2012, all of which he acquired on 6 November 2013, thus becoming also each company's sole shareholder. The companies' only material asset was the Clooney restaurant business. They ceased trading from 1 April 2014.

[3] Mr Stewart then operated the Clooney business through Clooney Restaurant Limited, the first defendant, of which he also was sole director and shareholder. The formal transfer of the business from the vendor companies to the first defendant on 25 September 2014 expressly excluded the vendor companies' liabilities to the Commissioner of Inland Revenue for tax periods in the twelve months ending 31 March 2014, amounting to $383,958.40 (and to specified creditors in the sum of some $3,000). Consideration for the transfer was $3,301.20, calculated by netting the value of transferred assets ($411,546.00) against liabilities to be assumed by the first defendant ($408,244.80) in respect of assigned creditors.

[4] Also on 25 September 2014, Mr Stewart placed the vendor companies into liquidation. According to the liquidator, Henry David Levin, their combined financial statements at 30 September 2014, after transfer of the business (and its assets and

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1 *Commissioner of Inland Revenue v Clooney Restaurant Ltd,* CIV-2017-404-3000, minute, 12 December 2019.

2 High Court Rules 2016, r 15.9, and the principles referred to in *Chen v Zhong* HC Auckland CIV-2010-404-1995, 14 November 2011; *Neumayer v Kapiti Coast District Council* [2013] NZHC 1106; *Ferreira v Stockinger* [2015] NZHC 2916**;** *Kim v Cho* [2016] NZHC 1771, [2016] NZAR 1134; and *Superior Blocklayers Ltd (in liq) v Bacon* [2016] NZHC 2601, (2016) 14 TCLR 425.

assigned liabilities), "left a shell with virtually no assets (only $3,713) and liabilities of $927,691". The Commissioner previously had issued statutory demands for payment of their tax liabilities, and then served liquidation proceedings on the companies on 15 September 2014.

[5] Clooney ceased operations in October 2019, the first defendant then liable to the Commissioner for tax debts in the amount of $152,741.94. That sum since has grown with associated penalties and interest to $201,256.53 as at 27 February 2020.

Commissioner's claims

[6] The Commissioner alleges:

(a) transfer of the Clooney business to the first defendant was a disposition of property intended to prejudice creditors, liable to be set aside under s 348 of the Property Law Act 2007, and seeks the first defendant pay $383,958.40 as compensation to the vendor companies and associated relief;

(b) transfer of the Clooney business to the first defendant was in breach of Mr Stewart's director duties to the vendor companies under ss 131(1), 133, 135, 136, and 137 of the Companies Act 1993, and seeks he pay compensation to the vendor companies or to the Commissioner and associated relief; and

(c) as director of the failed vendor companies, Mr Stewart's directorship of the first defendant and involvement through it in the continuing Clooney business was in breach of s 386A of the 1993 Act, rendering him personally liable to the Commissioner for the first defendant's debts under s 386C, and seeks judgment and associated relief accordingly.

Discussion

—first cause of action: disposition prejudicing creditors

[7] Section 348 of the Property Law Act 2007 enables prejudicial dispositions to be set aside, so (the value of) the prejudicially-disposed property is "restored for the benefit of creditors".[3]

[8] I am satisfied the Commissioner is prejudiced by the transfer from the vendor companies to the first defendant.

[9] The Commissioner is a creditor of the vendor companies at least in the amount of their tax liabilities. The transfer alienates the vendor companies' property, rendering it a qualifying "disposition".[4] As illustrated by the partnership's financial accounts for 30 September 2014, it was a disposition made at a time the vendor companies were insolvent, as "unable to pay all [their] debts, as they fall due, from assets other than the property disposed of".[5]

[10] It is prejudicial, because it defeats the Commissioner's exercise of any right to recourse in respect of the property.[6] That clearly was the transfer's objective,[7] coming immediately after the Commissioner's service of liquidation proceedings, and expressly to exclude "[a]ll Taxation duties and excise of the Vendor (as those terms are defined in the Tax Administration Act)", leaving only the vendor companies' heavily-indebted 'shell'. In those circumstances, the first defendant "must be taken to have intended this consequence".[8]

[11] There is no proof of the available defences (and no prospect either may be established).[9] As an alternative to vesting the Clooney business in the vendor companies, I therefore may require the first defendant to pay "reasonable compensation" to the vendor companies.[10]

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3 Property Law Act 2007, s 344.
4 Section 345(2).
5 Section 345(1)(d).
6 Section 345(1)(a).
7 Section 346(1)(b).
8 *McIntosh v Fisk* [2017] NZSC 78, [2017] 1 NZLR 863, at [35]–[36].
9 Property Law Act 2007, s 349(1).
10 Section 348(2)(b).

[12] The 'alternative' illustrates the restitutionary nature of the relief: "to correct normatively defective transfers of value, usually by restoring the parties to their pre-transfer positions".[11] The vendor companies thus otherwise would have restored their assets, which the transfer valued at $411,546, as well as the balance of their liabilities.

[13] The Commissioner's counsel, Nick Malarao, proposes the transfer's asset value could be identified as 'reasonable compensation' (although he only seeks payment of the lesser tax liability). Without netting off the assumed liabilities, such does not appear restitutionary, but a windfall to the vendor companies' remaining creditors, who would have access to a larger sum than if the assigned creditors also were competing for the funds.

[14] Mr Levin identifies the vendor companies' 30 September 2014 liabilities, other than those owed predominantly to the Commissioner, to be "the partnership loan accounts of $583,750" owed to shareholders (being Mr Stewart, deemed to have surrendered any charge for the general benefit of creditors)[12]. There is no evidence as to the position of the assigned creditors, for trade and operational debts. Presumably the first defendant met those liabilities in the course of the continuing Clooney business, or otherwise is accepted to be responsible for them.

[15] But the Commissioner is a preferential creditor in the amount of $235,862.81, to which other creditors' interests are in any event deferred.[13] 'Reasonable compensation' must be at least that sum. Given the Commissioner is the only creditor to claim in the vendor companies' liquidation, reasonable compensation in the circumstances should be the whole of its claim.

—second cause of action: breach of director duties

[16] It is trite law directors have duties to the company to act in good faith and in its best interests. These duties are recited, and with greater specificity, in the Companies Act 1993.[14] In particular, a director "must exercise a power for a proper

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11 *Investment Trust Companies v Revenue and Customs Commissioners* [2017] UKSC 29, [2017] 2 WLR 1200 at [42].
12 Companies Act 1993, s 302; Insolvency Act 2006, s 7.
13 Companies Act 1993, Sch 7.
14 Sections 131–138.

purpose",[15] and not agree to, cause or allow "the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors".[16] The "best interests of the company" include taking account of its obligations to creditors, which have greater weight in circumstances of at least pending insolvency.[17] Directors "must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances".[18]

[17] I have no difficulty in concluding Mr Stewart's transfer of the Clooney business from the vendor companies to the first defendant was in multiple breach of his duties to the former companies. Relieving the companies of their only significant asset, while leaving them without means to meet substantial liabilities, is not in their best interests. No proper purpose of the vendor companies was met by exercise of his powers to transact the transfer; it was exercised instead to enable the Clooney business to continue to trade for the benefit of the first defendant. Thus it was a transfer in the conduct of the vendor companies' business, creating significant risk of substantial loss to creditors. Inferentially, the transfer and vendor companies' liquidation precisely was motivated by the Commissioner's service of liquidation proceedings on the vendor companies. A reasonable director in circumstances of the Clooney business' insolvency would 'soberly' have assessed the companies' – not the business' – future prospects,[19] which assessment on any objective view could not have resulted in alienation of the vendor companies' only asset while retaining their material liabilities.

[18] On liquidation, as is the present case, a director may be required to compensate the company for such breach, or pay such sum to an applicant creditor.[20] The amount of that contribution is to be determined by reference to the cause of, culpability for,

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15 Section 133.
16 Section 135. There is uncertainty if the s 136 prohibition on a director agreeing to the company incurring particular obligations extends to tax debts: compare *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396, [2010] 2 NZLR 57 and *Cooper v Debut Homes Limited (in liq)* [2019] NZCA 39, [2019] 3 NZLR 57; the Supreme Court has reserved its decision on appeal from the latter. In the circumstances, the Commissioner seeks to adjourn its s 136 claim, with leave to revisit it in wake of the Supreme Court's decision. That aspect of the Commissioner's claim will be adjourned accordingly.
17 *Nicholson v Permakraft (New Zealand) Ltd (in liq)* [1985] 1 NZLR 242 (CA) at 250.
18 Companies Act 1993, s 137.
19 *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [48]–[51].
20 Companies Act 1993, s 301.

and duration of trading under "inadequate corporate governance" leading to deterioration of the company's financial position.[21]

[19] Again, I have no hesitation in concluding the vendor companies' unmet liabilities to the Commissioner exclusively is caused by Mr Stewart failing to ensure the companies remit tax payments to the Commissioner. The Commissioner only evidences the partnership's prior overdue PAYE payments for the period to 30 November 2008, which appear to have been resolved in 2009. But GST ceased to be remitted in March 2013. By July 2013, employee deductions also ceased to be remitted. No further payments were made before the companies ceased to trade from 1 April 2014.

[20] For the entirety of that time, Mr Stewart was the companies' sole director. Although he spent extended periods away from New Zealand pursuing business opportunities in San Francisco, that is not exculpatory; he remained the companies' sole director with all the obligations for the companies' governance that entailed. The companies' business pattern of conduct continued under the first defendant; Mr Stewart explained the sums intended for remittance to the Commissioner were used by the business "to pay [other] creditors".

[21] For all those reasons, I think it just Mr Stewart should be liable to contribute the whole sum of the vendor companies' liability to the Commissioner, for payment to the Commissioner on her application.

—third cause of action: 'phoenix' company director liability

[22] Except with presently irrelevant exceptions,[22] s 386A of the 1993 Act prohibits a director of a failed company, for a period of five years after commencement of its

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21 *Mason v Lewis*, above n 19, at [108]–[110].

22 Companies Act 1993, ss 386D–386F. The last section allows an exception for a company known by the same or a similar name as of a failed company's pre-liquidation name(s), if known by that name for at least twelve months before the liquidation commenced and was not dormant during that period. A company is not dormant if its transactions "have occurred throughout that period": s 386F(2). 'Throughout' means "during the whole of (a period of time, event, situation, etc.)": *Oxford English Dictionary* (online 3rd ed, Oxford University Press, Oxford, 2017). Clooney Restaurant Limited, while incorporated under that name on 18 June 2012, filed GST and employer deduction nil returns for the six months prior to 1 April 2014. The exception does not apply to

liquidation, from being a director of a "phoenix company", or being involved in its promotion, formation, management, or in the carrying on of a business in the same or a similar name. A 'phoenix company' is one known by a name that is, or is similar to, a failed company's pre-liquidation name. By 'similar name' is meant a name that is so similar to a name (including a trading name) of a failed company in the twelve months prior to its liquidation "as to suggest an association with that company".[23]

[23] Prior to name changes on 19 September 2014, less than a week prior to Mr Stewart placing them in liquidation on 25 September 2014, the vendor companies were named respectively Clooney Limited, Clooney No 1 Limited, Clooney No 2 Limited, and Clooney No 3 Limited. Clooney Restaurant Limited self-evidently is those companies' 'phoenix'. Indeed, the vendor companies' partnership expressly was given the name "Clooney Restaurant Partnership". Miranda Jane Law, giving evidence for the Commissioner, produces an undated extract from the Clooney business website, referring to "the arrival of Clooney in 2006", which Mr Stewart continues "[t]welve years later", inferentially in 2018.[24]

[24] As director of Clooney Restaurant Limited, Mr Stewart's contravention of s 386A(1)(a) accordingly renders him personally liable for its relevant debts, being those incurred during Mr Stewart's management of the company.[25]

Result

[25] Under s 348 of the Property Law Act 2007, I **order** Clooney Restaurant Limited to pay compensation to the vendor companies in the amount of $383,958.40

Clooney Restaurant Limited, which was dormant during the twelve months before the vendor companies' liquidations commenced on 25 September 2014.

23 Companies Act 1993, s 386B(1) (definitions of 'phoenix company' and 'similar name').

24 Ms Law additionally explained she could "see from the documents" Mr Stewart communicated with the *National Business Review* at the time of the vendor companies' liquidation to assure it the Clooney business had been purchased by Clooney Restaurant Limited and continued to trade. The documents to which she refers do not appear to be in evidence; I am provided with no basis on which to assess its reliability; and Mr Stewart (who sat in the public gallery throughout the hearing plainly was available to give evidence. All that renders Ms Law's assertion inadmissible hearsay and I therefore disregard it. She does produce the *NBR*'s subsequent correspondence with Mr Stewart (who identifies himself as "Owner | Clooney"), advising him "there's no story here, you can rest easy". Nonetheless, I am not prepared to infer the non-'story' is that outlined by Ms Law. Evidence Act 2006, ss 17 and 18.

25 Companies Act 1993, s 386C.

(plus interest for the period commencing 25 September 2014, calculated in accordance with the Interest on Money Claims Act 2016).

[26] I reserve the Commissioner leave to seek additional compensation if Mr Stewart, or any party related to him, makes any claim to the compensation ordered in the preceding paragraph, whether as secured or unsecured creditor of the vendor companies.

[27] Under s 301(1) of the Companies Act 1993, I:

(a) **declare** Mr Stewart breached his duties to the vendor companies under ss 131(1), 133, 135, and 137 of the Act;

(b) adjourn the Commissioner's claim Mr Stewart breached his duty to the vendor companies under s 136 of the Act, and reserve leave to the Commissioner to reactivate that claim;

(c) **order** Mr Stewart to pay the Commissioner $383,958.40 (plus interest for the period commencing 25 September 2014, calculated in accordance with the Interest on Money Claims Act 2016).

[28] Subject to any additional compensation ordered to be paid, I direct the total recovery by the vendor companies and the Commissioner under [25] and [27](c) above is not to exceed $383,958.40 (plus interest for the period commencing 25 September 2014, calculated in accordance with the Interest on Money Claims Act 2016).

[29] Under s 386C of the Companies Act 1993, I adjudge Mr Stewart liable to the Commissioner for $201,256.53, plus any further tax debts accrued after 27 February 2020 to the date of this judgment.

Costs

[30] In my preliminary view, the Commissioner is entitled to category 2B costs for all steps taken in the proceeding, and disbursements. That is because, from what I presently know of it, nothing in the steps the Commissioner took in this averagely complex proceeding required other than a normal amount of time. If that is not

accepted by the Commissioner, costs are reserved for determination on a short memorandum of no more than five pages – annexing a single-page table setting out any contended allowable steps, time allocation, and daily recovery rate – to be filed and served by the Commissioner within ten working days of the date of this judgment.

—Jagose J