IN THE HIGH COURT OF NEW ZEALAND
DUNEDIN REGISTRY

CIV-2011-412-663
[2013] NZHC 2435

UNDER	the Companies Act 1993
IN THE MATTER OF	the Liquidation of Rowmata Holdings Limited
BETWEEN	ROWMATA HOLDINGS LIMITED (IN LIQUIDATION) First Plaintiff
	H D LEVIN and V J MADSEN-RIES Second Plaintiffs
AND	N M HILDRED First Defendant
	S D HILDRED Second Defendant
	G S COLE Third Defendant

Hearing: 15-18 April 2013

Counsel: M Davies and P Murray for First and Second Plaintiffs
L A Andersen for First and Second Defendants
R J M Sim for Third Defendant

Judgment: 18 September 2013

JUDGMENT OF WILLIAMS J

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Introduction

[1] The Hildreds, whether by themselves personally or as trustees of two mirror trusts, purchased a dairy farm. It was intended the title would ultimately be taken by a new company to be formed – Rowmata Holdings Limited (RHL). The Hildreds were to be directors of the new company. Under the agreement for sale and purchase the Hildreds had 10 working days to obtain finance and their solicitor's approval. If the contract was declared unconditional, there was then a reasonable delay before a deposit was payable and 10 months before final settlement.

[2] The deal was structured this way so as to allow the purchasers time to obtain and use the GST refund on the purchase price to pay the deposit and then to maximise the time post deposit to secure funding before being required to settle. RHL applied for, and received a refund of the GST component of the purchase price and effectively used that to pay the deposit (it is slightly more complicated than that as I explain below but that is the substance of what happened).

[3] The Hildreds made the contract unconditional 10 working days later. At that point they had neither finance nor investors in place to enable them to settle on the due date. Over the 10 months that followed, the Hildreds attempted first to convince the ASB to bank the transaction and when that prospect faded, to draw in further equity investors to make up the shortfall. Their attempts failed, and they proved unable to settle the purchase.

[4] The IRD at that point became a creditor to RHL for the GST refund earlier paid out on the uncompleted contract. RHL had insufficient cash and no realisable assets from which it could pay the IRD back. The IRD then obtained an order liquidating RHL. The liquidators now ask the court to reach through the company to its directors, the Hildreds, to make them account for the GST refund originally paid to RHL. The liquidators say this is appropriate because the Hildreds breached their duties as directors under ss 131(1), 135, 136 and 137 of the Companies Act 1993. They also make a separate claim against the Hildreds and their friend George Cole as trustees of the two mirror trusts under ss 292, 297 and 298 of the Companies Act 1993, s 348 of the Property Law Act 2007 and equitable doctrines of restitution. The liquidators say the trusts were the true purchasers, not the Hildreds personally.

The facts

Agreement to purchase Marshall Road

[5] Shane and Noelene Hildred are very successful (and hard working) Southland dairy farmers. They are the trustees, together with George Cole, of two trusts: the Rowmata No. 1 Trust and the Rowmata No. 2 Trust. In this judgment I will call them the Rowmata 1 and 2 Trusts. Mr Cole is a Taranaki farmer and family friend. It is common ground that he had little hands-on involvement in the business of the

trusts. These trusts were settled by Shane and Noelene Hildred respectively. They are otherwise identical in all material respects.

[6] Shane and Noelene Hildred ran their farming businesses through the Rowmata 1 and 2 trusts. The trusts operated as a single informal partnership. The trusts ran a successful dairying operation at Henley-Berwick Road in Outram on the Taieri plains.

[7] Through a separate joint venture company that brought in passive investors, the Hildreds also part own and share milk on a 50/50 basis, a second farm in the district. The joint venture company is called Waipori Holdings Ltd.

[8] On 15 August 2008 the Hildreds signed an agreement for sale and purchase of a third farm at Marshall Road Outram, close by their Henley-Berwick Road property. This farm is the subject of these proceedings. The purchase price was $6.4 million plus GST – making a total of $7.2 million. The agreement was signed by the Hildreds not expressly in their own names but "on behalf of Rowmata Trust". (There is, of course, no such entity as Rowmata Trust. There is only Rowmata No. 1 Trust and Rowmata No. 2 Trust.) The settlement date for the purchase would be 10 months later, on 1 June 2009. The agreement was conditional on solicitor approval and finance, each within 10 working days of 15 August 2008. The unconditional date was later extended by agreement to 5 September 2008. A 10 per cent deposit ($720,000) was to be payable when the agreement became unconditional. This was later amended so that the deposit could be paid in two instalments of five per cent or $360,000, payable on 5 September and 10 November 2008.

Initial discussions on financing the purchase

[9] The "Hildred Group" had an existing relationship with the ASB bank – that bank had financed all of the Hildreds' acquisitions to that point. The bank officer with whom they worked most closely was Darren Homer whose designation was "Rural Manager". ASB had no difficulty with financing the deposit on the Marshall Road farm but advised the Hildreds that it could not promise to finance the total purchase price because the Henley-Berwick Road and Marshall Road properties

when consolidated, had insufficient clear equity to meet – or indeed even get close to – the bank's lending ceiling of 60 per cent of value on the Hildreds' trust and other assets. On a purchase price of $6.4 million, the so-called scaled security deficit exceeded $2 million. Mr Homer's evidence was that the bank could have accepted a deficit of $1 million pre Global financial Crisis (GFC), in light of the Hildreds' strong cash flow, but $2 million was too much.

[10] In an internal memorandum from Mr Homer to Simon Parks, the bank's South Island credit manager, Mr Homer noted that even the proposal to borrow the deposit of $720,000 still had a scaled security deficit of $440,000 against the existing farm at Henley-Berwick Road. This took the loan to valuation ratio to 67 per cent, 7 per cent above the bank's official ceiling. The bank was prepared to exceed that limit slightly. The memorandum noted:

> Clients have been made aware The ASB makes no commitment to fund the settlement of the property on 1st June 2009. …
>
> Hildreds are aware of the settlement risks involved here, but they are excellent operators and should have little trouble in attracting an equity investor.

[11] As a potential plan 'C', Mr Homer noted: "If an equity partner is not found the farm will be remarketed in the autumn [i.e. in March-April 2009]."

[12] Kelvin Freeland, service manager in the bank's approvals and risk team, advised Mr Parks that the loan was approved "on the basis that this does clear from GST." In other words that the loan would be promptly repaid on receipt of the GST refund from the IRD.

[13] The Hildreds say that although that was the formal position recorded in writing by the bank, Mr Homer was nonetheless supportive of the proposal and loyal to them. It was understood that if the Hildreds could produce more equity whether through demonstrating an increase in the value of the land or by attracting investors so as to meet the bank's requirements, then the whole purchase would be supported by the bank.

[14] Mr Homer's perspective was slightly different. In his evidence he said:

> The Hildreds were focused on an increase in land values before settlement to get more equity. This was a possibility but it was by no means a certainty. If land values did not increase outside equity investors would be required. From my point of view, the emphasis needed to be on additional equity from outside investors. As a rule of thumb in banking, you hope for increased land values but you never rely on it.
>
> At [my meeting with the Hildreds on 5 August 2008] we spoke about the risks involved in the purchase because the ASB would not approve finance for the total purchase price. The Hildreds accepted that there was a risk involved and it was their risk. However, at that stage they were willing to enter into the agreement and wait to see if land values would increase.
>
> As I recorded in my briefing memorandum dated 26 August 2008 … no commitment had been made by the ASB to fund the full purchase price. In fact we discussed that if equity investors could not be found the farm would be remarketed and the Hildreds were aware of the risks.
>
> At that point in time, I did not perceive the settlement risk to be great. While it was not risk free I considered that the purchase would probably complete. Because of this, I indicated to the Hildreds that if they found adequate equity, ASB would finance the purchase. At no time did I tell the Hildreds that ASB would fund the farm purchase without adequate equity. I also made it clear that a formal funding application would be needed and that the final decision would not be up to me.

[15] Both the bank and the Hildreds had some confidence around this because the Hildreds had in fact purchased the second farm a year earlier by means of buying in their own right and then drawing in an equity partner before settlement. The company they used was Waipori Holdings Ltd in which they still retain a 26 per cent share alongside other more passive investors. In the case of Waipori, the Hildreds purchased the farm "as agent" – that description being written by Mrs Hildred on the sale and purchase agreement. The ASB funded the entire transaction. In that purchase the initial deposit of $750,000 was also ultimately financed out of the GST refund on the purchase price. Mrs Hildred said this technique was in fact suggested to them by the ASB at the time.

[16] Mr Homer said in his evidence that when he drafted his briefing memorandum on 26 August 2008:

> ... I did not perceive the settlement risk to be great. While it was not risk free, I considered the purchase would probably complete.

RHL incorporated and deposits paid

[17] In any event, the Marshall Rd agreement was declared unconditional on 5 September 2008 without guaranteed bank funding to complete the purchase. The Hildreds then decided to incorporate RHL with the intention that it would take title on settlement. RHL was duly incorporated on 11 September 2008.

[18] Two parcels of one share each were issued. One is held by the trustees of Rowmata No. 1 Trust and the other is held by the same individuals as trustees of the Rowmata No. 2 Trust. The Hildreds were the directors. The company, it appears, would provide a convenient vehicle into which capital from equity investors could be placed should that ultimately become the means by which the Hildreds funded the purchase. In evidence the Hildreds made it clear however that their first preference was to buy alone by means of valuation uplifts in the intervening period prior to settlement date.

[19] On 3 September 2008, a week prior to RHL's incorporation, the Hildreds had opened a bank account in the name of RHL. The first tranche of the deposit ($360,000) was credited by the Bank to the Rowmata Trusts Partnership account and was then transferred to the new company account. The deposit was then paid (via solicitors) to the vendor from the RHL account on 5 September 2008.

[20] So there was an initial bank advance to the Rowmata 1 and 2 trusts which then on lent that advance to RHL. This chain of transactions was necessary because RHL did not exist on 5 September 2008 to take the funding directly from the Bank, even though, as indicated, an account in its name had been created. The GST refund would not be paid by the IRD until six weeks later so it was necessary for the Rowmata Trusts Partnership account to advance that amount to RHL until then.

[21] On 23 September 2008, the vendor issued a GST tax invoice to RHL thereby treating that company as if it were the purchaser. And on 6 October 2008, RHL submitted its GST return claiming a refund of $737,500. The refund was paid on 17 October; the IRD presumably accepting that RHL was to take title and so would be the recipient of the taxable supply in terms of s 20(3) of the Goods and Services Tax Act 1985 (GST Act).

[22] On 20 October 2008, RHL repaid the $360,000 loan to the Rowmata 1 and 2 trusts by transferring that amount to the Rowmata Trusts Partnership Account. And on 10 December 2008 (a month late), the company paid to the vendor from its own funds the second tranche of $360,000. This left $17,500 in RHL's account.

[23] The original technique proposed by the Hildred Group's legal adviser to insert RHL into the transaction was to substitute RHL as purchaser in the sale and purchase agreement for the 'Rowmata Trust' by executing a deed of novation. This would simply replace the 'trust' with RHL as the new contracting party. A deed was drafted and executed by the Hildreds and George Cole as trustees. But it was never executed by the vendors. I come back to this below.

Changes in financial markets

[24] Meanwhile between September and December 2008 world financial markets went into cardiac arrest in what has since been labelled the GFC or global financial crisis. Farm land prices tanked and stock values fell in response to both the crisis itself and collapsing commodity prices. The ASB responded by tightening its requirements and the Hildreds, already facing an uphill battle to make the sale work, were in real difficulty.

[25] Mr Homer spoke with the Hildreds on 31 October 2008 about economic conditions. Mr Homer said that the GFC was affecting investor confidence. He said he was concerned that the Hildreds may at that point need more equity than originally thought, and that they could find it harder to attract investors. Mrs Hildred agreed there was a discussion about "global economic conditions" at the 31 October meeting but her view was that nothing was said to cause her any concern that the bank would not fund the venture if the set criteria were met. She said that Mr Homer phoned and left a message later on that day indicating ongoing support. She said Mr Homer advised they should go to Open Country rather than Fonterra with their milk supply to avoid having to fund the purchase of Fonterra shares. Mr Homer does not recall this conversation, but does acknowledge that Open Country had been discussed on other occasions.

[26] By early November the Hildreds must have been aware that all was not well with the transaction because Mrs Hildred suggested that their solicitor, Stephen Rogers, should advise the Lords (the vendors) that the Bank had refused to finance the purchase. He responded that it would be unwise to spook the vendors and risk an over-reaction and the idea went no further.

[27] Mr Ray Kean, an experienced and successful local rural real estate agent – and the agent who handled this transaction – said that during this period dairy farm sales went very quiet nationally. He said no dairy farm on the Taieri plains came onto the market after probably December 2008. He could not be sure about the situation earlier. He also said that the Taieri market is small and a quiet period in the last quarter of 2008 may not have had any particular significance anyway.

[28] That said, the Bank was not unsupportive. Mr Homer was of the view that the Hildreds were hard working, innovative and successful dairy farmers and that they should be supported if at all possible through this difficult time.

Deed of novation

[29] It was in September 2008 that the Hildreds' solicitor, Mr Rogers, prepared the deed of novation that I have already mentioned. The intituling page recorded that the deed was between Shane Hildred, Noelene Hildred and George Cole as trustees of the Rowmata 1 and 2 trusts as retiring purchasers; RHL as the new purchaser; and Michael Lord, Philippa Lord and Carrie Weaver as vendors. In the deed recital, the retiring purchaser was described as "Rowmata Trust" while the other two sets of parties remained the same.

[30] The vendors' solicitors requested that the description of the retiring purchaser in the recital should be amended so as to include the full names of all three trustees recording as well that they are trustees of the Rowmata 1 and 2 trusts. Mr Rogers duly made the amendment. On 12 December 2008, Mr Rogers wrote to the Hildreds and Mr Cole enclosing a copy of the amended deed of novation and asking them to initial at the bottom of page 1 before returning it. Mr Rogers advised:

> We have had to replace this [page][1] to incorporate the full names of the trustees for your trusts.

[31] Shane and Noelene Hildred, together with George Cole executed and initialled the deed expressly as trustees of the Rowmata 1 and 2 trusts. And Shane and Noelene Hildred signed in their second role as directors of RHL. As I have said, the vendors did not sign the deed as requested. The novation therefore failed.

[32] The plaintiffs say the document is nonetheless important in the context of this litigation because it shows that the "Rowmata Trust" on whose behalf the Hildreds purportedly executed the original sale and purchase agreement, was, from the outset, in fact the Rowmata 1 and 2 trusts. The plaintiffs acknowledge that the third trustee, George Cole, did not execute the original agreement for sale and purchase and that, in the absence of provision to the contrary, trustee decisions of this nature must be unanimous. But the plaintiffs say it is significant that George Cole executed the deed of novation as trustee. This amounts, they say, to a retrospective ratification by the missing third trustee, of the actions of Shane and Noelene Hildred as trustees in entering into the sale and purchase agreement in August 2008.

Settlement fails

[33] Mrs Hildred then records in her evidence that by January 2009 the Fonterra pay-out forecast had fallen from $7.00 to $5.10 per kilo and that this took $1.5 million off the value of the Marshall Road property. A meeting with Mr Homer on 3 February 2009 confirmed a gravely worsening outlook and reiterated the need for equity partners as the only way forward now. The Hildreds set about finding investors. They also lodged an application on 13 February 2009 to allow the Rowmata 1 and 2 trusts to contribute $1.68 million to a joint venture but this was later withdrawn. A further application was lodged on 13 May seeking a term loan of $2.95 million and an overdraft of $200,000 but this too was withdrawn. The Bank was obviously not supportive and the Hildreds were advised, it appears, that these would not be granted.

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[1] In the original letter the word used was "place", but this was clearly a mistake – page was the word intended – and Mr Rogers accepted as much in cross-examination: Notes of Evidence 423, line 9.

[34] By 22 May 2009, two sets of equity partners were found, together prepared to put in a total of $1.75 million in return for a 25 per cent share each in RHL – one of them, it seems rather reluctantly, and only because of a family connection. The Lords had indicated, at the same time, a willingness to leave in $950,000 in vendor finance. The Hildreds sought bank support of $1.2 million for themselves to purchase a 50 per cent share in RHL with a further $2.95 million to be borrowed by RHL. The rest was to be provided by the partners. The proposal was subsequently amended with the Hildreds putting in a reduced share. The local ASB branch was supportive but Head Office turned the proposal down. It seems that, while Head Office had in the past been flexible with the 60 per cent lending ceiling, the new economic climate meant that was no longer the case, and the package put up was rejected as both over-stretching the Hildreds in light of their existing commitments, and still outside the ASB's stricter underwriting standards.

[35] As Mr Homer accepted in evidence, the new strict compliance approach meant an extra $2.8 million in asset or equity value had to be found instead of $1.4 million (the figure required in August the previous year). And that was assuming the land had held its value in the meantime. Of course, it had not.

[36] The settlement date of 1 June 2009 came and went. The Hildreds moved to plan C – a buy/lease proposal in which they (with the proposed equity partners) would buy half of the farm and lease half from the Lords. The Bank "reluctantly" agreed to finance the buy/lease proposal to a level of $540,000. But in the end, the vendors refused any option other than full purchase.

[37] At that point, it became clear that the Hildreds would not be able to settle.

[38] On 8 June 2009, the vendors' solicitors served a settlement notice on the purchasers' solicitors naming RHL as the purchaser, and giving the company 12 working days to settle the balance. On 3 July 2009, a second notice was sent, this time naming the purchasers as 'the Trustees of the Rowmata Trust'.

[39] On 10 September 2009, the vendors gave notice of cancellation, addressing the notice simply to 'Rowmata', but making reference in the notice to the failed novation in favour of RHL.

[40] The Hildreds' solicitor set about negotiating a settlement of the outstanding obligations under the agreement. A settlement was reached between him on behalf of the Hildreds and the Lords where (following a $75,000 payment from the Rowmata Trusts Partnership account[2]) all parties would walk away. The payment was duly made although the final deed of settlement was never signed by the Hildreds and Mrs Hildred in particular says she never agreed to it.

[41] Mr Homer's evidence was that there was reluctant agreement, but agreement nonetheless. The impression I gained from his evidence was that as the Hildreds' banker, his discussions were primarily with Stephen Rogers and from that source he learned that Mr Hildred had accepted the deal. Mr Homer accepted that Mrs Hildred had never verbally consented and was unhappy about the payment at the time. Mr Homer also accepted that there was no contemporaneous record of who authorised the Bank to make the transfer, in fact no record at all except for the transfer entry itself.

Liquidation

[42] Mr Eden, RHL's accountant, then attempted to settle with the IRD, the question of the $737,500 GST refund. RHL offered to repay $17,500 – the amount of the original refund remaining in RHL's account. The IRD rejected the offer and applied to this court to liquidate the company. It had a preferential debt of $740,446.84. Total creditors' claims in the liquidation were $924,023.56. All but $1,712.04 was IRD preferential and unsecured claims or court costs. On 29 July 2010, the IRD applied to this court to liquidate the company. An order placing RHL in liquidation was made on 14 September and the plaintiffs were appointed liquidators.

[43] I turn now to summarise the arguments for each side and the evidence called.

[2] The amount was paid from the Trust Partnership Account to Stephen Rogers' Trust Account who on-paid it to the Lords.

The liquidators' claim

[44] The essential case for the liquidators of RHL is straightforward. They say that through their trust partnership, the Hildreds entered into a highly speculative purchase and then used RHL as a shield to protect them from the financial consequences of that transaction failing.

[45] It was, the liquidators say, the means by which the Hildreds shifted responsibility for their own risk taking to RHL's creditors. They say further that in order to do that, the Hildreds breached their responsibilities as directors, and gave priority to their personal interests over those of the company. The liquidators say that by bringing RHL into the purchase of the Marshall Road farm when the company had no capital or cash with which to settle that purchase, the directors breached their duties under the Companies Act. In particular, they failed to act in good faith and in the best interests of RHL as required by s 131(1) of the Companies Act; they allowed RHL to trade recklessly in breach of s 135; they allowed RHL to enter into an obligation it could not perform in breach of s 136; and they failed to exercise the diligence, skill and care required of directors in breach of s 137.

[46] Section 301 of the Companies Act entitles the court, if it finds such breaches, to hold directors personally responsible in whole or in part for the losses occasioned by those breaches. The liquidators say that the Hildreds should be made to repay the entire debt of RHL under s 301. That is because, they say, the breaches in this case were particularly egregious.

[47] The liquidators also rely on ss 292, 297 and 298 of the Companies Act and s 348 of the Property Law Act. They say that the first deposit of $360,000, the subsequent reimbursement of the advance of that amount from the Rowmata Trust Partnership Account, and/or the payment by RHL of the second deposit were:

(a) transactions at an undervalue in breach of s 297 because RHL paid the deposits despite having no legal obligation to do so yet received nothing in return when the purchasers proved unable to settle the purchase;

(b) transactions for inadequate consideration in breach of s 298 for the same reasons;

(c) insofar as the company repaid to the Rowmata Partnership Trust Account on 20 October 2008, the amount of the Rowmata 1 and 2 trusts' original advance to the company of $360,000, that repayment was made when the company was insolvent. It was therefore a voidable transaction pursuant to s 292 of the Companies Act; and

(d) transactions designed to prejudice creditors in breach of s 348 of the Property Law Act for all of the reasons already traversed.

[48] The liquidators also argue that they are entitled to restitution of the $720,000 on ordinary equitable principles.

[49] In support of its case, the liquidators called the following witnesses:

(a) Vivienne Madsen-Ries:

Ms Madsen-Ries is an experienced liquidator and was appointed co-liquidator in this case. She set out the facts from the plaintiffs' perspective in relation to the purchase of the Marshall Road property, RHL's GST claim, and the use of those funds to repay the advance from the Rowmata Trust Partnership Account and to pay the second deposit directly. She then concluded that RHL was insolvent at the time of its incorporation on 11 September 2008 (at that stage it already owed the Rowmata Trust Partnership Account $360,000 but had no funds of its own); when that advance was repaid on 20 October 2008; and when it paid the second deposit to the vendors on 10 December 2008. This was either because RHL was never the appropriate entity to claim the GST refund making it liable immediately to repay the entire amount, or, if it was the appropriate entity, then it was still immediately liable to repay because from the outset there was no reasonable prospect that RHL would actually settle the transaction. RHL, she said, did not at any stage have the funds to meet these obligations when they arose.

In her reply evidence, Ms Madsen-Ries noted that even if, contrary to her view, RHL's liability to repay the IRD did not crystallise until June 2009 – the settlement date on the agreement – then it still carried a contingent liability as at 17 October 2008 and that in itself was sufficient to make RHL insolvent from that date forward.

(b) *William Bayliss*:

Mr Bayliss is a professional director and chartered accountant with extensive governance experience including in agribusiness. He evaluated the performance of the directors of RHL in terms of the Companies Act standards already referred to. He concluded that it was unreasonable and reckless for directors to commit a company to paying a substantial deposit for the purchase of land when the company had no funds or other assets, and no commitment from a lending institution to bank the transaction.

In his reply evidence, Mr Bayliss agreed with Ms Madsen-Ries that RHL was required to make provision to repay the IRD from 17 October 2008 at the latest.

(c) *Timothy Jones:*

Mr Jones, a solicitor, also gave evidence. He is an experienced property lawyer and partner in an Auckland law firm. He concluded that the uncompleted novation document could not be treated as a nomination of RHL and that RHL could not therefore have claimed a GST refund on the purchase. He said, in response to questions from Mr Anderson for the first and second defendants, that the point at which the rightful claimant of a GST refund is identified, is the time of supply. In his view, the time of supply was the date on which the sale and purchase contract became unconditional. He did accept however, that the purchasers had options in terms of the identity of the ultimate recipient of title, and they could at any time have directed the vendors to transfer title to RHL even without a novation or nomination.

(d) Darren Homer:

Mr Homer of the ASB was the Hildreds' banker at all relevant times. The plaintiffs called Mr Homer to give evidence only because the defendants did not. He appeared under subpoena. His evidence was that the Bank had throughout made it clear that it could not finance the purchase unless the scaled security deficit on the Hildred Group's assets could be reduced to well below the $2 million level, at which it sat when the agreement was entered into in August 2008. Prior to the GFC, a scaled security deficit of $1 million would have been acceptable, but by 2009 he said, the ASB began to adhere more strictly to its longstanding 60 per cent requirement. Any shortfall would have to have been met through a rise in land values, or by bringing in equity investors. Mr Homer said that the Bank's attitude was that equity investors were the preferable option as increased land values could never be relied upon.

Insofar as the Hildreds' final walk away payment to the vendors was concerned, Mr Homer, as I have said, confirmed that the Hildreds were not happy with having to make a payment, Mrs Hildred particularly so, but the advice to him from Mr Rogers was that they agreed to settle at the agreed sum.

The Hildreds' defence

[50] The Hildreds' case in response can also be simply put:

(a) the purchase of the Marshall Road property was not highly speculative at all whether viewed from the date it was entered into in August or at the dates RHL was incorporated or committed funds to the purchase. Rather, it was not until 2009 that unpredicted economic conditions in the dairy sector became so constrained so as to make settling the transaction impossible;

(b) RHL received value in the transaction as a credit against the price it would eventually have paid if the purchase had settled;

(c) the deposits paid by RHL to the vendors (the first pre-incorporation but on a RHL cheque) were not lost to the company. They could be recovered in accordance with the principles in *Falls Road Properties v Fletcher*;[3] and

(d) RHL was entitled to claim the GST refund from the IRD because all parties agreed it was the intended receiver of the taxable supply in terms of s 20(3) of the GST Act.

[51] The following witnesses gave evidence in support of the Hildreds' defence:

(a) *Noelene Hildred*:

Mrs Hildred gave the primary factual account from the defendants' perspective. She traversed the purchase of the O'Neil property through Waipori Holdings Ltd. She emphasised with respect to the purchase of the Marshall Road property that Mr Homer was supportive of their proposal throughout because of their good record and strong cash flows on their existing operations. She noted that when she applied for a GST refund on behalf of RHL, the IRD questioned the return but was satisfied on receipt of a tax invoice from the vendors made out to RHL, together with a copy of the agreement for sale and purchase. She confirmed that she signed the Deed of Novation to insert RHL into the transaction but she said it was a mistake for Rowmata 1 and 2 trusts to have been treated as the retiring purchasers because they were not the purchasers in that transaction.

Mrs Hildred said that she relied on legal and accounting advice for paper work around the purchases and paid little attention to it.

3 *Falls Road Properties v Fletcher* (2011) 25 NZTC 20-093 (HC).

At the outset, she said the Hildreds' strong preference was to go it alone by relying on pre-settlement land value increases. That was their focus until December 2008. She said that by February 2009, all efforts had turned to finding equity partners since land values had not increased, and there was no prospect of reselling the Marshall Road property prior to settlement because the rural property market had simply stopped in its tracks. Mrs Hildred confirmed that equity partners were found but by that stage the bank was no longer prepared to accept a scaled security deficit of any kind. She also confirmed that the limited support offered "reluctantly" by the bank was not sufficient for the vendors and they eventually cancelled. She confirmed that the negotiation over the settlement was between their lawyer, Mr Rogers, and the vendors. She said neither she nor Shane Hildred signed any settlement nor were aware that there was a written agreement.

Mrs Hildred accepted that the Waipori transaction had been carried out by experienced directors and the paper record of decisions in that case was very good. She said when signing the Marshall Road agreement for sale and purchase, she just put Rowmata Trust in for lack of anything else to fill the gap. She said she was not aware that it was not appropriate to use an entity as purchasers that did not exist. She could not explain why they did not use their own personal names in the transaction, but she did confirm that the intention was always to create a separate entity to carry the transaction through.

She confirmed that throughout 2008 and the first part of 2009, there was never any doubt in their minds that the purchase would settle. Nor was Mr Homer at the bank particularly negative about prospects in that respect. On the contrary, she said, Mr Homer also expressed confidence in the deal. That confidence, she said, remained on 5 September and 10 December when RHL paid the two deposits. There was, she said, no need to step back and reassess matters. The sense of concern did not arise until the following year.

In respect of the settlement, Mrs Hildred said she had been very angry to discover that $75,000 was missing from the Rowmata Trusts Partnership account as Mr Homer and Mr Rogers had paid the money over to the vendors. She said she initially told Mr Homer to get it back but eventually took the matter no further.

She also confirmed that she did not see any distinction between the interests of the company, the trusts or their own personal interests. As far as she was concerned "they're all the same".[4]

(b) *Shane Hildred*:

Mr Hildred gave brief evidence in support of Mrs Hildred's evidence. He suggested that the use of the term Rowmata Trust on the agreement for sale and purchase was merely a clerical error although he did accept that the term was used regularly to describe the Hildreds' business operations. He confirmed that at the time of the agreement the intention was to commit the "trusts". He considered however that it was himself and Mrs Hildred personally who had entered into the purchase. He also confirmed that their faith in the agreement concluding successfully was based on the successful history of the Waipori investment and the steady rise over the years prior to 2008 in the value of dairy land.

(c) *John Faulks*:

Mr Faulks was formerly an ASB rural bank manager. He is currently managing director of SRM Realty. His evidence was that farm values in the district did not fall until early 2009 and that the Hildreds could not have reasonably foreseen the impact of the GFC in 2008.

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[4] Notes of Evidence 237, line 10.

(d) *Raymond Kean*:

Mr Kean was the real estate agent who handled the Marshall Road purchase. His evidence was that although it was relatively rare for purchasers to enter into unconditional contracts without finance arranged, it does happen in a rising market particularly where there is a long lag to settlement date. He confirmed that it was likely he was instructed to write "Rowmata Trust" on the agreement for sale and purchase (the appellation was recorded on the document in his handwriting). His evidence was that at purchase date, the market for dairy farms was buoyant and that it did not fall significantly until 2009.

(e) *James Eden*:

Mr Eden was the Hildreds' accountant at the relevant time. He confirmed in his evidence-in-chief that the use of GST refunds to pay deposits was common practice in 2008. In fact it had been used for the purchase of the Waipori Holdings Ltd farms.

(f) *Stephen Rogers*:

Stephen Rogers was the Hildreds' solicitor at the time. He advised on both the transaction and the settlement after the transaction collapsed. He confirmed that he drafted the uncompleted novation agreement. He said he took the view that there was no need for a nomination in favour of RHL given that the respective interests of RHL and the Hildreds were identical insofar as they related to the transfer.

Mr Rogers also confirmed that he negotiated the settlement with the vendors involving a payment of $75,000 and that the Hildreds had agreed to this although they did not sign the agreement. He confirmed that in his mind the correct purchaser was to be Rowmata 1 and 2 trusts. The amendment to the Deed of Novation in which the specific names of the trustees of the two Rowmata trusts were inserted, reflected this understanding. He said that he explained to the Hildreds that if the transfer did not settle, they would lose their deposit. During the course of that warning, he said that Mrs Hildred in particular was very “upbeat” about the Hildreds being able to settle.

Mr Rogers was clear that the Hildreds instructed him to advise the vendors that the transaction was unconditional despite there being no finance in place. He confirmed that at the beginning of November 2008, Mrs Hildred suggested that the vendors be told that the bank would not lend them sufficient to cover the second tranche of the deposit and he said this occurred around the time when the banks were becoming very nervous about lending generally. He said that the events of late 2008 would have caused people to pause to reflect and reassess previous assumptions.

He accepted that by 2009, the value of the Marshall Road property could have fallen by $1 million or more, exposing the Hildreds to potentially extensive legal liability on failure of the transaction. He considered that the settlement with the vendors at the value of the deposit of $720,000 plus a further $75,000 was “a very good settlement” for the Hildreds. He accepted that the settlement was intended to be full and final in respect of all matters between the various parties. He confirmed the terms of an 11 September 2009 discussion with Mike Turner of Poulson Higgs that the $75,000 payment should be made by the trustees in order to remove trustees’ liability on the contract, and any risk of RHL being liquidated and the payment being clawed back from the vendors. He said that, contrary to the Hildreds’ evidence, the Hildreds were in fact aware of the written agreement and that they specifically approved the extra $75,000 payment.

Mr Rogers confirmed that he sought a second opinion from a Queenstown barrister to ensure that his advice was sound and that, although the Hildreds were not happy about it, they accepted the inevitable. He said that he then contacted Mr Homer at ASB to advise that he had instructions to settle at $75,000 and the payment was duly made. Mr Rogers could not comment on whether Mr Homer subsequently spoke to and confirmed that instruction from the Hildreds before making the transfer.

(g) *Stephen Higgs*:

Mr Higgs is an experienced accountant and principal of a Dunedin accounting firm. He gave evidence in relation to when RHL failed the insolvency test in s 4 of the Companies Act. His view was that actual liability did not crystallise until the IRD formally reassessed RHL. This occurred he said, on 28 October 2009 – the due date following the GST return period ending 30 September 2009. He accepted that a contingent liability arose at the latest on 1 June 2009, the contractual settlement date, but he accepted such contingent liability could have arisen earlier if it became clear that the transaction could not settle. His view was that no such contingent liability arose on the transaction date of 5 September 2008 when the first payment was made; the date of RHL's incorporation on 11 September 2008; when the Rowmata 1 and 2 trusts were repaid on 20 October 2008; or when RHL paid the second tranche on 10 December 2008.

His view was that it was not clear on any of these dates that the transaction was likely to fail. It followed, he said, that the assets and liabilities of RHL during 2008 were in equilibrium and the company was not insolvent at any stage during that year.

The case for George Cole

[52] Mr Cole's case was also straightforward. He argued that the purchaser could not have been the Rowmata 1 and 2 trusts. He argued that the Hildreds could not bind the trusts, as both trust deeds required unanimity. He argued further that the failed novation document could not be recast as ratification by him of the

commitment by the Hildreds on behalf of the trust. That meant, he argued, that the Hildreds must have purchased in their own personal names and not as trustees.

[53] Mr Cole gave evidence. He said that he did not have any involvement in the Marshall Road purchase decision, nor was he consulted. He accepted that he did sign a consent to act as shareholder of RHL but had no recollection of the details. He also accepted that he signed the deed of novation. He confirmed that he has now resigned as trustee. He confirmed that he had no day-to-day involvement in running the Rowmata 1 and 2 trusts' farming business (he lived in New Plymouth and was an old family friend), nor with respect to any of the trusts' large purchases of machinery and so forth. He said he first became aware of the transaction when the lawyers sent him a shareholder consent for RHL. He said he then rang Mr Hildred who explained what was going on.

[54] I turn now to address the issues in the case. Before turning to the specific statutory provisions under which the plaintiffs level their claims, I will address two preliminary questions that affect all issues. They are:

(a) did the Rowmata 1 and 2 trusts purchase Marshall Road?; and

(b) can RHL claim return of its deposits from the vendors?

Preliminary issues

Did the Rowmata 1 and 2 trusts purchase Marshall Road?

[55] It is common ground that RHL was not the purchaser. The liquidators' argument is the Rowmata 1 and 2 trusts were the purchasers. This delivers to them the advantage that the trusts hold most of the assets under the Hildreds' control. The defendants say that the purchasers were the Hildreds personally because there is no such thing as the "Rowmata Trust", the appellation written on the agreement for sale and purchase by Ray Kean. Two questions arise. What did the Hildreds intend in this respect at the time of the agreement? And, if the intention was to purchase in the name of the two trusts, did the third trustee, Mr Cole, ratify that intention? I turn now to address these questions.

[56] It is common ground that there was no such thing as the "Rowmata Trust". The only trusts associated with the Hildreds are the Rowmata 1 and 2 trusts. These trusts own all of the Hildreds' significant farming interests. Their shares in Waipori Holdings Ltd were added to the trusts in 2009. They operate as an informal partnership run generally as a single business with combined bank accounts. They are usually referred to as the Rowmata Trusts in bank correspondence and memoranda, although in their "Profile" of February 2009, the Hildreds had the singular Rowmata Trust.

[57] It is clear that the Hildreds did not intend to purchase Marshall Road in their personal names. If they had, they would have instructed Ray Kean to record that.[5] The Hildreds clearly understood the distinction between entering into personal commitments and making commitments on behalf of another, because Mrs Hildred wrote on the Waipori agreement for sale and purchase that she and Mr Hildred entered into the transaction "as agent".

[58] In her evidence Mrs Hildred's position was that she and Mr Hildred simply made a bad mistake by having Ray Kean record on the Marshall Road agreement as purchaser, an entity that did not exist. That meant, she said, that by default, the Hildreds should be treated as purchasing in their own names.

[59] I accept that the description the Hildreds used on the agreement was loose. They did not instruct Ray Kean to write Rowmata 1 and 2 trusts in the appropriate space. This probably reflected their expectation that, as with Waipori, the end recipient of the asset would be a different entity. Great particularity was probably felt to be unnecessary. But it is clear in my mind that on 15 August 2008 when they signed the agreement for sale and purchase the Hildreds intended the formal purchaser to be their overall business operation. Rowmata Trust was used as a short hand for the partnership owned by the Rowmata 1 and. 2 trusts. This was how the Hildreds perceived their business group and it was perfectly natural for them to use this description when referring to it. They did so consistently in their day-to-day management of the business. It follows that the Hildreds intended the purchaser to

[5] The inscription "Rowmata Trust" on the agreement for sale and purchase is written in Mr Kean's handwriting and he recorded in evidence that he would have been instructed to do so.

be the Rowmata 1 and 2 trusts purchasing as a partnership. Indeed Mrs Hildred said as much in cross-examination.[6]

[60] It does not matter that RHL was intended at some point and in some way to take over the transaction. What matters is the Hildreds' intention on the date of purchase. At that point, the intended entity is quite plain. The use of the singular simply reflects the fact that in the context of everyday operations, the two trusts operated as a single entity. All of this is confirmed by the later attempt by the Hildreds to novate the agreement. There they agree that the retiring purchasers are the two trusts, saying so expressly when invited to do so by the vendors' solicitors.

Did George Cole then retrospectively ratify that purchase as the third trustee?

[61] It is common ground that a decision to bind the Rowmata 1 and 2 trusts to such a transaction could only be made unanimously (see cl 12.1 of the Trust Deeds). It is also common ground that Mr Cole had not delegated any such authority to the other trustees. In any event the deed gave him no such power to do so. Nor does s 29(1) of the Trustee Act 1952 relating to delegation of the day-to-day operations of a trust's business. This transaction is hardly a day-to-day operation for a farming trust.

[62] This aspect of the case then boils down to whether the uncompleted deed of novation signed by Mr Cole explicitly as a trustee of the Rowmata 1 and 2 trusts in December 2008 was a sufficient ratification.

[63] The plaintiffs rely on the Court of Appeal's decision in *Visini v Cadman* in which Harrison J writing for the court said as follows:[7]

> The judgment of Romilly MR in *Messeena v Carr* is settled authority for the proposition that one trustee can subsequently approve another trustee's exercise of a discretion.

[64] In that case a defendant sought to strikeout proceedings by two of three trustees in a leaky home case on the basis that the third trustee had not joined in the

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6 Notes of Evidence 189, line 18.
7 *Visini v Cadman* [2012] NZCA 122, (2012) 21 PRNZ 70 at [17] (footnotes omitted).

proceeding. The third trustee subsequently confirmed in an affidavit that he consented to the proceeding. The Court of Appeal found that amounted to a subsequent ratification. Mr Cole says the principle in *Visini* does not apply on these facts because the uncompleted novation document cannot be said to be a "clear adoptive act" accompanied by "full knowledge of the essential facts". The defence argued that the purpose of the Deed of Novation was to remove the trusts as purchasers, so it cannot be considered an acceptance of the opposite proposition – that is that the trusts *were* the purchasers. Rather, the deed proceeded on the basis that the two trusts were already bound by the agreement for sale and purchase and needed to be taken out.

[65] I agree that the ratifying trustee must know he or she is adopting the transaction and must have some knowledge of the facts of the transaction. But it is not necessary that the ratifying party must understand the legal consequences of ratification.[8]

[66] The authorities are clear that a party can impliedly ratify or adopt a contract by (for example) behaving in a manner inconsistent with its rejection. For example, in *Clark v Libra Developments Limited*,[9] a majority in the Court of Appeal (Hugh Williams and Warwick Gendall JJ) held that Libra had adopted a contract with its employee Hyslop when Libra invoiced the appellant for Hyslop's services.

[67] The English Chancery decision in *Thompson v Hickman* has a number of similarities to the present case.[10] At issue in that case was whether the Midland Railway Company was bound by a contract executed on its behalf by its solicitors, Beale & Co. The court found that the company was so bound because Midland had subsequently assigned the contract under its own seal to the defendant Hickman. That assignment was an adoptive act because it was inconsistent with the contention that Midland had rejected Beale & Co's original authority to complete the first contract on Midland's behalf. It did not matter that the purpose of the assignment was obviously to sell the company's interest under the contract in an act superficially inconsistent with the company buying it.

8 See for example *McEwan v Johnstone* [1918] NZLR 49 (SC) at [50].
9 *Clark v Libra Developments Limited* [2007] 2 NZLR 709 (CA).
10 *Thompson v Hickman* [1907] 1 Ch 550.

[68] In the present case, Mr Cole's execution of the novation deed is inconsistent with his rejection of the trusts' purchase of the Marshall Road property. The deed of novation only makes sense if Mr Cole is first accepting, and therefore adopting, the purchase in his role as a Rowmata Trusts trustee. I do not accept Mr Sim's submission that Mr Cole did not have full knowledge of the essential facts as required by the authorities because, it was argued, he must have mistakenly thought he was bound by the Hildreds' execution of the agreement.[11]

[69] Mr Cole knew he had not signed the agreement for sale and purchase and, as a trustee, he should have known that cl 12.1 of both trust deeds provided that his signature was necessary to create a binding contract in the names of the two trusts. It was Mr Cole's responsibility to know that. And he cannot claim ignorance of such an essential element of his role as a trustee in order to exclude his own responsibility.

[70] Thus, when Mr Cole executed the deed of novation, he adopted the purchase that made novation necessary and upon which it was based, just as Midland Railway Company, by assigning its right under a contract executed by its solicitors, adopted that contract. It makes no difference in my view, that the deed of novation was never completed by the vendors. What is important in analysing whether George Cole adopted the purchase, are his actions, not those of the vendors. I conclude therefore that the purchase is ratified by Mr Cole and was completed by the Rowmata 1 and 2 trusts.

[71] That said, Mr Cole is of course entitled to indemnification from trust assets in accordance with s 38(2) of the Trustee Act 1956, unless, entering into the contract, was itself a breach of trust. This matter was not raised before me.

Can RHL claim its deposits back?

[72] Central to the plaintiffs' case was the idea that RHL lost $720,000 in a loan repayment to cover the first deposit and in paying the second deposit directly to the vendors. The plaintiffs' argument was that since RHL had no contractual obligation to make these payments and since they could not now be recovered, relevant

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[11] See for example *Frank Harris & Co Limited v Hakaria* (1914) 33 NZLR 1074 (CA).

breaches of the Companies Act and the Property Law Act ought properly to be found.

[73] For the Hildreds, Mr Anderson argued that this assumption was incorrect in law. He relied upon the decision of Venning J in *Falls Road Properties Ltd v Fletcher*.[12] Mr Anderson says that case stands for the proposition that when a third party makes a payment to a vendor on behalf of the purchaser, that payer is entitled to restitution if the transaction subsequently fails. In that case, the Hulls agreed to purchase a property for $5 million with a deposit of $500,000 payable in three tranches. They paid the deposits as required. The vendor was the Fletcher Trust. The trust subsequently found that it was liable to pay GST on the purchase prior to the settlement date some months later. The trust agreed with the Hulls that it would issue a GST invoice for the purchase price to a nominated recipient of the taxable supply – the plaintiff, Falls Road Properties Ltd – and that company would claim the GST back. It was agreed that this would then be on-paid to the Fletcher Trust and further credited against the purchase price. The whole point of this money-go-round was to ensure that the vendors were not put out of pocket as a result of their surprise discovery that they carried immediate liability to pay GST on the purchase.

[74] As I have said, Mr Anderson's argument was that this case stands for the general proposition that a payment by a third party – in that case Falls Road Properties – is recoverable on failure of the agreement.

[75] I agree with the plaintiffs that this case does not stand for so general a proposition. Crucially the payment made by Falls Road Properties on behalf of its owners (the Hulls) was made without any legal obligation. It was a favour to the Fletcher Trust in light of the predicament in which the trust found itself. It is to be contrasted with the $500,000 deposit paid in three tranches by the Hulls personally. That was clearly not recoverable and no argument was made in that respect. Venning J therefore had no difficulty in applying principles of restitution and allowing Falls Road Properties to claw back the amount it paid over and above the deposit.

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12 *Falls Road Properties Limited v Fletcher*, above n 3.

[76] This case is quite different. In this case, RHL met a legal obligation owed (as I have now found) by the Rowmata 1 and 2 trusts. The payment was accepted by the payee. It discharged the trusts' obligation under the agreement. It was clearly not an additional gratuitous payment by the payer as was the case in the *Falls Road* decision. In those circumstances, the payment must bind RHL as much as it bound the Rowmata 1 and 2 trusts. The consideration was both that it discharged the trusts' obligation to pay the deposit and that in doing so, it further secured the transaction that would (it was hoped at the time) ultimately lead to the property coming into RHL's ownership. Applying the principles in *Simpson v Eggington*,[13] the payment by RHL discharged the Rowmata 1 and 2 trusts' obligation under the agreement to pay the deposits. It therefore binds all parties including RHL. There is no basis upon which the principles of restitution applied in the *Falls Road* case have any application to this case.

[77] It follows that RHL cannot recover the deposits.

[78] With these preliminary conclusions in mind, I turn now to address each of the plaintiffs' nine causes of action.

Reckless trading

[79] Section 135 of the Companies Act provides as follows:

> A director of a company must not–
>
> (a) Agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) Cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[80] The plaintiffs must establish that by having RHL pay the deposits on their behalf, the Hildreds, as directors of RHL knew that this was likely to create a substantial risk of serious loss to the IRD.

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13 *Simpson v Eggington* (1855) 10 Ex 845.

The authorities

[81] The leading case is *Mason v Lewis*.[14] That case involved innocent directors who had received assurances from a fraudulent manager that all was well with the company when it was not. The Court of Appeal comprising Hammond, Chambers and Robertson JJ found that the test for recklessness was objective. The subjective state of mind of the innocent directors was irrelevant. Rather, they carried a positive obligation to engage in the company's affairs. Directors, the court said, must take reasonable steps to put themselves in a position not only to guide but to monitor the management of a company. Sleeping directors will nonetheless be liable. The court found specifically that:[15]

> … the limitation of liability given by incorporation is conditional on proper compliance with the statute.

[82] In that case, the court had no difficulty in finding that the extent of neglect by the Lewises of their duties as directors could properly be described as reckless.

[83] One of the essential "pillars" of s 135 is that when the going begins to get tough for a company – in the words of that court "when the company enters troubled financial waters" – directors must be able to demonstrate that they have stepped back and undertaken a "sober assessment" of the company's likely future income and prospects.[16]

[84] The court, interestingly, had this to say about the disciplines adopted by the innocent directors in that case:[17]

> The Lewises seem to have had little or no appreciation of the duties of directors of a company. As with trustees, one of the first duties of a director of a company is to actually come to grips with those duties. Practically nothing about the internal workings of this company was ever regularised or recorded. That pattern continued throughout the life of the company. The financial structure was never properly settled, board meetings were (at best) ad hoc, and minutes of meetings (even when a meeting was held) were not taken and distributed. The Lewises simply allowed the affairs of the company to repose in the hands of Mr Grant, a manager, who subsequently turned out to be a crook.

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14 *Mason v Lewis* [2006] 3 NZLR 225 (CA).
15 At [83].
16 At [51].
17 At [58].

[85] At the point it was put into liquidation, RHL was a one transaction company. The focus then is on whether the manner in which the Hildreds brought the company into the transaction ought properly to be described as likely to create a substantial risk of serious loss to the IRD.

[86] In a very useful synthesis of the effect of s 135, O'Regan J in *Fatupaito v Bates* set out the following basic principles:[18]

> - Section 135 imposes a duty which is owed by a director to the company rather than to any particular creditor;
>
> - The test is an objective one;
>
> - Although the law reform process makes it difficult to elicit any legislative intent in relation to the wording of s 135, it appears to impose a stringent duty on directors to avoid substantial risks of serious loss to creditors and does not appear to allow for such risks to be incurred, even in circumstances where the potential for great rewards exists;
>
> - In situations where a company has little or no equity (as is the case here), directors will need to consider very carefully whether continuing to trade has realistic prospects of generating cash which will allow for the servicing of pre-existing debt and the meeting of commitments which such trading will inevitably attract. As Anderson J said, the reference to "substantial risk" and "serious loss" does appear to set a higher standard than simply any risk at all to creditors which must be inevitable where a company is operating at a loss and has few, if any, realisable assets;
>
> - Where a breach of the duty is found, the assessment of the amount to be paid by a director under s 301 should be "neither more nor less than that [director's] just desserts" [sic].

[87] The plaintiffs say the s 135 standard was breached. They focused particularly on the decision of Lang J in *Goatlands Ltd (In Liquidation) v Borrell*,[19] a case that they say is on all fours with the present facts. The Borrells entered into an agreement to purchase a farm property. They had a year to settle. They incorporated Goatlands Ltd and formally nominated it as purchaser. Goatlands obtained a GST refund on the purchase price as nominee. They used part to pay the deposit and part for other purposes. Although the agreement became unconditional, successful completion of the transaction depended on the Borrells selling their existing farm.

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[18] *Fatupaito v Bates* [2001] 3 NZLR 386 (HC) at [67].

[19] *Goatlands Ltd (in liquidation) v Borrell* (2007) 23 NZTC 21,107 (HC).

As matters transpired, they were unable to sell. The transaction failed. Goatlands was unable to repay the GST refund. The IRD obtained a liquidation order and invoked s 135.

[88] As in this case, Lang J was anxious to point out that it was not the Borrells' decision to enter into the agreement that creates any potential liability under s 135. Goatlands was merely a nominee. Rather, the focus is on what was done with the GST refund. In that case, it was spent on the deposit and other farm related expenditure. (In RHL's case the refund was expended entirely on deposits). Having reviewed the authorities, and considered in particular what risks will be legitimate in terms of s 135 and what risks will not, Lang J offered the following test:[20]

> If, as in the present case, the directors are considering whether the company should enter into a single transaction that has the potential to cause its complete demise, they must reach their decision after a "sober assessment" of the level of risk that the transaction entailed for the company and its creditors. They should only proceed to commit the company to the transaction if, objectively viewed, the risk of failure is sufficiently small to warrant the company taking it. If the risk of failure is substantial, in the sense of real and significant, it should not be taken.

[89] Lang J accepted that the one year delay to settlement provided some protection, but in his view, the risk was still too great. The Borrells should not have dissipated Goatlands' GST refund without having either bridging finance to settle the transaction in the event that their farm did not sell, or independent funding to provide Goatlands with the means to repay the GST refund if the transaction did not settle.

Arguments

[90] The plaintiffs say that the *Goatlands* analysis applies in the case of the Rowmata 1 and 2 trusts.

[91] The Hildreds argue first that the GST refund had not been dissipated but in fact could be claimed back. I have rejected that argument. The Hildreds also argued that they did not expose the IRD to a significant risk of serious loss by committing RHL to a transaction without first having finance in place. The Hildreds focused on the fact that Mr Homer at the ASB remained positive all the way through to 2009

[20] At [46].

about their ability to complete the transaction using equity investors. They point out that investors were actually found in early 2009 whose contributions would have satisfied the Bank's 2008 requirements. The problem, the Hildreds said, was that the Bank's requirements tightened up and the Hildreds could not have foreseen that, or the impact of GFC on commodity and therefore farm prices.

Assessment

[92] I do not agree with that analysis. The Hildreds chose to make this contract unconditional on 5 September 2008. At that point, relying primarily on their far more positive experience with Waipori Holdings Ltd, they felt that a long delay to settlement provided sufficient protection. Through the Rowmata 1 and 2 trusts they loaned RHL sufficient money to pay the first deposit. The international banking system had by that time already begun to unwind as a result of the problems associated with US merchant bankers carrying subprime mortgage assets. RHL's interests were not exposed however except to the Rowmata 1 and 2 trusts as its lenders. The GST refund was received from the IRD on 17 October and RHL repaid the Rowmata 1 and 2 trusts' loan three days later. By then, the global financial system had begun to stall.

[93] The GFC was, of course, all over the media reports at the time. But there is some direct evidence of what the Hildreds knew of these matters in October and November. Eleven days after RHL repaid the Rowmata 1 and 2 trusts, Mr Homer spoke to the Hildreds about his concerns over the GFC's impact on investor confidence. His concern was specifically that settlement would now be harder to achieve and more equity would be needed. In early November, Mrs Hildred suggested to her solicitor that the vendors be told the bank had refused to finance the purchase. I do not accept for a moment that the Hildreds were unaware of the sharp correction in economic conditions going on around them, or the possible impact that it might have had on their transaction.

[94] So it was in October and November that the Hildreds were required to stand back and make a sober assessment of the situation in accordance with the authorities. They clearly did not. Mrs Hildred was very clear that the possibility of failure did

not enter her head at any stage, let alone at this point. She struck me as a formidable and highly focused business woman. Once she was set on a path, I expect it would be nigh on impossible to divert her from it. Her faith in their ability to complete the deal was unshakeable and she made a point of minimising any signs that her faith was misplaced. Mr Hildred did not differ in his view.

[95] Mr Ray Kean and Mr Faulkes, both experienced rural real estate agents, confirmed that by 10 December 2008, the market for dairy farms had essentially frozen. Land values may or may not have fallen at that point (I very much suspect they had) but the market for dairy farms had stalled. Once again, there was no evidence of the Hildreds making a sober assessment of the situation in which the company found itself before committing it to a further payment of $360,000. There is some evidence of hesitation. As I have said, Mrs Hildred suggested to Mr Rogers that they advise the vendors that they could not get finance to cover the second payment. And of course the payment itself was delayed by a month. But there is no indication of any proper assessment of the risks to RHL's creditors in continuing down this track when RHL was not actually the purchaser.

[96] As with the Borrells in *Goatlands*, and the Lewises in *Mason v Lewis*, the Hildreds appeared not to contemplate the possibility of the purchase collapsing and the GST refund paid to RHL having to be repaid to the IRD. But in this, they actively blinded themselves to an obvious and growing risk throughout the third and fourth quarters of 2008. In my view, that amounted to causing the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the IRD.

Performance of obligations

[97] Section 136 of the Companies Act provides as follows:

> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

[98] It is to be remembered that RHL was never liable to settle the agreement in its own name, the Rowmata 1 and 2 trusts having failed to complete either a

novation or a nomination in favour of RHL. The relevant obligation for the purposes of s 136 is to repay the GST refund to the IRD.

Arguments

[99] The plaintiffs' primary position is that RHL incurred *immediate* liability to repay the GST refund when it was received on 17 October 2008 because the company, since it was not the purchaser, had no right to it. The plaintiffs' alternative position is that, even if RHL did have a right to the refund, then it incurred an immediate contingent liability on the same basis as that found by Lang J in the *Goatlands* decision.

[100] The plaintiffs argue further the Hildreds could not have had a rational belief in RHL's ability to repay the refund and even if there was such a belief, it was not reasonable.

[101] The Hildreds argue that there was no immediate liability because RHL was entitled to claim the GST refund. Once the vendors issued their invoice to RHL. following discussions with the Hildreds, this was a signal that all parties (including the IRD) accepted that RHL was the legitimate recipient of the taxable supply. Mr Anderson submitted that it did not matter how RHL would ultimately receive title because in the end the Hildreds were entitled to require the vendors to convey the Marshall Road title to RHL and they had made clear to the vendors, that was what would happen.

[102] The Hildreds also argued that on 17 October 2008, they believed that RHL would settle (and that therefore no repayment obligation would arise), and they had reasonable grounds upon which to form such a belief.

Assessment

[103] On my view of the application of s 136 to this case, it is unnecessary to resolve whether RHL was entitled to receive the GST refund. I will however return to this matter in relation to the claim under s 297 of the Companies Act. For now however, I pass over that question.

[104] As Lang J set out in *Goatlands*, the test in s 136 is both subjective and objective. There must be actual belief in the ability of RHL to meet its obligations when they fall due, and there must be reasonable grounds upon which to base that belief.

[105] The third element in s 136 arises from the use of the imperative "will". The belief on reasonable grounds must be that RHL *will* be able to perform its obligation when required. A belief that it could probably do so, or even that it was likely that it could do so, is insufficient. Rather, the belief must be that it can certainly perform its obligations.

[106] The Hildreds' belief that they could meet any GST liability that would arise is necessarily tied up in their belief that the purchase would settle, obviating the obligation to repay the IRD.

[107] I have no doubt that the Hildreds did believe that the purchase would settle, and that RHL would take title. Indeed Mrs Hildred believed that with a religious fervour. It is difficult (and in my view unnecessary) to attempt to separate the psychology of belief from hope in that context. It is sufficient to conclude that there is no credible suggestion that the belief they professed was other than genuine.

[108] What then was the objective evidence upon which this belief could be said to be reasonable? At various points the Hildreds pointed to:

(a) supportive noises from Mr Homer at the bank;

(b) their long term experience of a rising market;

(c) the eight month delay in settlement giving them plenty of time to bring in equity investors if need be; and

(d) the structure and success of the Waipori transaction.

[109] It is of course important to avoid the wisdom of 20/20 hindsight in analysing these bases. We now know that farm values went through the floor as world

commodity markets convulsed in the second half of 2008. But the fact that things did not work out for the transaction is irrelevant in determining whether, at the time, there was a reasonable basis looking forward, for concluding that the transaction would be completed.

[110] Having reviewed the written communications from Mr Homer and having heard his evidence, I am satisfied that there was no objective basis for the Hildreds to conclude that Mr Homer's personal support for them and sympathy for their predicament, could form the basis of any reasonable belief that the bank was committed to supporting this purchase. On the contrary, Mr Homer was at all key points anxious to remind the Hildreds that there were no guarantees that the bank would support this transaction beyond funding the deposit on a short term basis. Nor do I think it matters that in 2009, the Hildreds found investors whose contributions could meet the bank's original 2008 flexible requirements. The fact is that, by 2009, the world had changed dramatically. The bank was now no longer willing to be flexible, land and stock values had fallen, and the Rowmata 1 and 2 trusts scaled security deficit had probably increased. This was the risk of requiring a lengthy delay to settlement without sufficient available funds. The economic outlook can change in the intervening period. Bank support then can be put to one side as a basis for reasonable belief.

[111] As to a prospective belief in a rising market, I agree with the evidence of Mr Bayliss that rising markets cannot be relied on. It may be possible to say that a market will *probably* continue to rise, even that it is *likely* that a market will continue to rise. But it cannot be said that it is reasonable to believe that a market *will*, with certainty, rise. The test in s 136 is, as I have said, a *will* test. I conclude therefore that the prospect of a rising market does not provide a reasonable basis for belief in RHL's ability to settle.

[112] The question is whether the company will repay the IRD if it was required to. That belief was based on either a rising market or equity investors, ensuring the purchase would settle.

[113] The carefully negotiated eight months delay to settlement was obviously designed to give the Hildreds plenty of time to satisfy the bank that the transaction was supportable without equity investors, or failing that, to find equity investors to fill the gap. Delay to settlement was the strategy utilised by the Borrells in the *Goatlands* case to give them time to sell their existing property. The danger is of course that, the longer the delay to settlement, the greater the likelihood of a change in market conditions. Extra time comes at a price. This is ultimately what caught the Hildreds out in this case. I would conclude therefore that long delay to settlement on its own does not provide a reasonable basis upon which to conclude with the level of certainty required by s 136, that RHL would meet its obligations as they fell due. Though delay to settlement maximised flexibility for the Hildreds, it produced a correlated increase in risk of change in market conditions.

[114] In the end, the Hildreds' success with the Waipori transaction was the only possible basis upon which they could have concluded that success in that context established reasonable certainty that success would also accompany this transaction. While there is superficial attraction in this approach, a careful comparison between the two transactions demonstrates that they were materially different.

[115] In the Waipori transaction, equity investors had been identified and negotiations with them commenced before the contract was declared unconditional. In this case, the Hildreds much preferred not to share this opportunity with other investors. They spent the last two quarters of 2008 hoping (in vain as it turned out) that land values would increase so as to remove their scaled security deficit. It was not until the new year that they turned to find equity investors in earnest. By then market conditions had very clearly taken a turn for the worse and the Hildreds had insufficient time to meet the bank's requirements. To their credit they did find investors but by that stage the bank's flexible attitude from the past had been replaced by a requirement of strict compliance with the 60 per cent value cap. And of course, both the land and stock had fallen in value as a result of the fall in commodity prices anyway.

[116] A second key distinction is that prior to the Waipori transaction, the Rowmata 1 and 2 trusts were not labouring under a scaled security deficit. On the contrary, they had a scaled security surplus of $1.29 million.

[117] At 17 October when the GST refund was paid, the situation was therefore that the Hildreds had no bank support, RHL had no money, the Rowmata 1 and 2 trusts had no money either, the GFC had begun, the Hildreds had not even started to look for equity investors with whom to share the risks of this transaction, and RHL as a single purpose company, did not trade and had no income.

[118] Considering all these elements together, it cannot be said that there was a reasonable basis upon which to believe that either the contract would be completed and RHL take title or, on failure of the contract, RHL would be in a position to repay the GST refund.

[119] I conclude therefore that the standard in s 136 was breached.

Care, diligence and skill

[120] Section 137 of the Companies Act provides as follows:

> A director of a company when exercising powers or performing duties as a director, must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation, –
>
> (a) the nature of the company; and
>
> (b) the nature of the decision; and
>
> (c) the position of the director and the nature of the responsibilities undertaken by him or her.

Arguments

[121] The plaintiffs argued that as a result of changing economic conditions no reasonable director would have committed the company to completing the contract. Nor would such a director have dissipated the GST refund in light of the increasing risk around settlement, at 5 September, 20 October, and certainly not at 10 December.

[122] For the Hildreds, Mr Anderson relied on reasonable belief in the ability to complete and his submission that the *Falls Road* decision made the deposits reclaimable by RHL.

Assessment

[123] I have already concluded that the Hildreds' belief in their ability to complete the transaction was not reasonable and that *Falls Road* is distinguishable. It must follow that the Hildreds cannot be considered to have exercised the care, diligence and skill of a reasonable director in these circumstances.

[124] On the contrary, I agree with the plaintiffs' expert Mr Bayliss when he said that the directors were negligent when they expended the $720,000 GST refund repaying the Rowmata 1 and 2 trusts and paying the second deposit in the increasingly problematic economic conditions of the second half of 2008.

[125] Mr Anderson argued that the plaintiffs were wrong to treat RHL as if it carried the obligation to purchase. I agree he is right in that respect, but that does not change the conclusion. Any prospect of the Hildreds failing to complete the transaction created a correlated prospect that RHL would have to repay the $720,000. It follows that diligent directors exercising reasonable skill and care would have chosen to retain the GST refund in order to be sure that it could be repaid on failure of the transaction. Diligent directors would have either found another source of funds from which to pay the deposits or not bought in the first place.

Best interests of the company

[126] Section 131(1) of the Companies Act provides:

> Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.

[127] The plaintiffs in reliance on the evidence of Mr Bayliss argued that the Hildreds never saw the interests of RHL as separate from their own personal

interests. Mrs Hildred, they argued, said in evidence “they’re all the same”.[21] The plaintiffs argued that the Hildreds were prepared to expose the company to a significant risk of liquidation in order to both advance a speculative transaction and protect themselves from personal liability in doing so.

[128] The Hildreds argued that they had throughout acted in good faith and nothing they did was inconsistent with the company’s best interests. In this they relied on the *Falls Road* decision entitling RHL, they said, to reclaim the deposit.

[129] There is no doubt that the Hildreds did not perform their duties as directors in the manner consistent with the best interests of the company. By bringing the company into the transaction by means of having it claim and obtain the GST refund and then repay the Rowmata 1 and 2 trusts and pay the second deposit, the Hildreds exposed RHL to liability it could not meet. This is because the transaction was from the date of payment of the first deposit, at serious risk of failing, which would entitle the IRD to claim repayment of the refund.

[130] This breach is made out accordingly.

Section 301: Reparations, compensation or contribution

[131] Before proceeding to deal with the fifth to ninth causes of action, it is necessary now to turn to s 301 of the Companies Act. This is the provision that gives this court the power to order company directors to personally pay reparations, compensation or contribution where (as here) they have been found to have breached directors’ duties. Section 301(1) provides:

> (1) If, in the course of the liquidation of a company, it appears to the Court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the Court may, on the application of the liquidator or a creditor or shareholder,–
>
> (a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and

[21] Notes of Evidence 237, line 8.

(b) order that person–

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

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

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

[132] It was common ground that the three relevant factors for consideration in exercise of the court's jurisdiction under s 301 are:

(a) causation – that is the extent to which the breaches of duty caused the losses in question;

(b) duration – that is the period of the breaches;

(c) culpability – that is the blameworthiness of the breaching conduct.[22]

[133] Mr Anderson's argument under this section was that the Hildreds did not cause the loss. He relied, as I have said, on the *Falls Road* decision in making that submission. I do not agree that *Falls Road* applies because, as I have said, the facts are distinguishable. There is, in my view, no question that the Hildreds were entirely responsible for RHL's inability to repay the GST refund because they committed the company to paying the deposits when it had no other cash or assets and no prospect of obtaining any. The second factor – duration – is not an issue here because RHL was a one transaction company. Duration can be set to one side.

[134] The real issue here is the culpability of the directors' conduct. A brief review of the reported cases provides useful guidance in that respect.

[135] The Court of Appeal in *Lower v Traveller* applied the old s 320 of the Companies Act 1955 – the equivalent of s 301 in 1993 Act.[23] In that case, the

[22] See for example, *Fatupaito v Bates* [2001] 3 NZLR 386 (HC) at [111].
[23] *Lower v Traveller* [2005] 3 NZLR 479 (CA).

director was found to have been a knowing party to the company carrying on business in a reckless manner. The director facilitated an expansion of the company's business at a time when it was clearly insolvent. The court found that at least part of the incentive for this expansion was the extensive fees and margins that Lower's separate business interests stood to gain from their contracts with the company if it was allowed to continue trading. An additional factor was that the company was allowed to continue trading for some years, and with increasing deficits before it was finally liquidated.

[136] The Court of Appeal upheld the trial Judge's finding of 100 per cent liability for losses during the relevant period. Lower, the Court of Appeal found, was unreasonably optimistic and put his own advantage ahead of other unsecured creditors over an extended period. The court described the spectrum of behaviour going to culpability in these terms:[24]

> The relevance of culpability is linked to the deterrent purpose of the provision. This factor calls for an assessment of the blameworthiness of Mr Lower's conduct, bearing in mind that at one end of the range the nature of a director's involvement will be blind faith or muddleheadedness, while at the other end there will be actions or instances of inaction which are plainly dishonest. The deterrent purpose of the section is served in cases involving a high degree of culpability by orders which are punitive as well as compensatory.

[137] An example of blind faith or muddleheadedness can be found in *Mason v Lewis*, a case to which I have made earlier reference. In that case, the Lewises were naive and simply led by the nose by a "thoroughly devious and dishonest" manager.[25] Nonetheless, the Court of Appeal found the Lewises to have been reckless in discharging their duties as directors and rejected the trial Judge's finding that they lacked any culpability. Some contribution under s 301 would be required.[26]

[138] *Re Wait Investments Limited (In Liquidation*) is at the other end of the spectrum.[27] In that case, Mr Webster was the primary driver behind Wait Investments. The company entered into an unconditional contract for sale and purchase of a commercial building at $1.6 million. The company was formed for the

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[24] At [83] (citations omitted).
[25] *Mason v Lewis*, above n 14, at [114].
[26] Quantum was referred back to the High Court for further inquiry.
[27] *Re Wait Investments Limited (In Liquidation)* [1997] 3 NZLR 96 (HC).

purchase. It had no capital and had borrowed the deposit. It had no bank accounts or company books, and it was registered for GST.

[139] Mr Webster was at that point the subject of a proposal under Part 15 of the (then) Insolvency Act 1967, having secured creditors valued at $8.35 million, and unsecured creditors of $9.5 million. For that reason, his wife Mrs Webster, was made sole director and owner of 99 out of the 100 shares in the company. But there was no doubt as to who was running it. The purchase failed because, despite the agreement being unconditional, finance could not be found. The vendors subsequently resold the building at a loss of $245,326. They sued in summary judgment for the loss and judgment was duly entered against the company for that sum.

[140] On those facts, Barker J felt he had no option but to hold Mr Webster liable to pay the liquidators of the company the entire amount of the company's liability under the failed contract. He also found Mrs Webster liable to pay half of that amount.

[141] The final case to mention in this contest is *Goatlands*, to which I have already made extensive reference in the context of the director's duties themselves. There, Lang J considered the Borrells' culpability to be modest. They were, he said, fully committed to selling their property in order to fund the failed purchase, and right to the end, they used their best endeavours to achieve that. They had also committed their own personal funds to improve the new property and lost that contribution when the purchase failed. Lang J also accepted that the Borrells had negotiated a delayed settlement to maximise the prospect of achieving the sale of their existing property, and they had also taken advice from professional advisors in structuring the transaction as they had. Lang J assessed the Borrells' contribution at 25 per cent of the GST refund, or $34,500.

[142] In this case, the liquidators argued that a 25 per cent contribution is too low in the context of this case – indeed, was too low even on the facts in *Goatlands*. They argue that *Wait Investments* is the case that most closely resembles the current facts.

[143] Like *Wait Investments*, the liquidators argue, neither company had assets or capital, nor any secure source of funding to complete the contracts to which they had each committed. The liquidators accepted that the Hildreds were not labouring under an insolvency proposal as Mr Webster was, but in other respects, they argued, the Hildreds' circumstances were worse. The liquidators pointed to the following aggravating features:

(a) the Hildreds negotiated a contract that was conditional on them obtaining finance, but declared the contract unconditional without actually obtaining finance;

(b) the bank had specifically refused to commit to fund the purchase, and the Hildreds knew they had a $2 million scaled security deficit when they made the purchase unconditional; and

(c) the Hildreds' purchase was four times larger than the *Wait Investments* purchase.

[144] Although I accept that culpability in this case is clearly higher than that of the Borrells in *Goatlands*, I do not think this case is, as the liquidators argue, at the most serious end of the scale warranting a 100 per cent contribution.

[145] The Hildreds were unrealistically optimistic and extremely naive in their approach to the purchase. I agree they actively blinded themselves to the economic storm clouds gathering around this transaction. I also agree they proved themselves quite incapable of undertaking any kind of assessment of the deteriorating situation in September when the agreement was executed and the first deposit payment made in RHL's name, in October when RHL repaid the advance from the Rowmata Trusts account, or in December when RHL paid the second tranche of the deposit. They showed no willingness to be flexible in their approach and, of course, no regard at all for the wellbeing of RHL. They simply trudged forward, come what may, trusting the shelter that RHL could provide them, and willing to sacrifice the company if required to protect their interests.

[146] As Barker J said in *Wait Investments*:[28]

> … those who avail themselves of the advantages of limited liability must learn the limits of operating under the umbrella of a company.

[147] But I do not, in this case, detect the cynicism present in *Wait Investments*. The economic situation in early September for New Zealand dairy farmers was less clear than in October, even if going unconditional without finance was not the behaviour of a reasonable and prudent director. And the Hildreds committed $75,000 of the Rowmata 1 and 2 trusts' money (albeit reluctantly) to compensate the vendors. They were well regarded as hardworking and successful dairy farmers. Mr Homer went in to bat for them to the bank's credit section to support the Hildreds' application. They worked hard right to the end, to make the deal work. They obtained willing equity investors despite the GFC and they made several attempts to restructure the transaction to obtain the support of either the bank or the vendors. Their selfish insistence (until the last minute) on not sharing the spoils with outside investors proved their undoing.

[148] Thus, while I am of the view that prudent and reasonable directors would have had financial arrangements either in place or well in hand before proceeding with the purchase, the GFC was in part responsible for the Hildreds' predicament, and the GFC was not their fault. They and many millions of others around the world fell victim to it.

[149] The Hildreds' culpability really arises from the fact that by 20 October when the risk to the company through failure of the purchase was real enough, they chose to make the company repay the $360,000 advance from the trust representing the first tranche of the deposit. And by 10 December, when the transaction stood a high likelihood of failure – with no bank support, falling land and stock values and no investors in hand – the Hildreds chose to disperse the second tranche of the deposit to the vendors. It is their lack of regard for the interests of the company and the preference of their own interests over those of the IRD as the primary creditor, that is the essence of their culpability here.

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[28] At 105.

[150] I would accordingly assess their contribution under s 301 at 70 per cent of the loss.

Transaction at undervalue

[151] Section 297 provides that a liquidator may claw back the difference between the greater value a party has received from a transaction to which the company in liquidation was also a party, and the under-value received in return by the company in liquidation. This applies only where certain requirements are met. They are relevantly:

(a) that the transaction occurred within two years of a creditor applying to the court to put the company into liquidation; and

(b) either –

(i) the company was unable to pay its due debts when it entered into the transaction; or

(ii) the company was unable to meet its due debts because of the transaction.

Arguments

[152] The plaintiffs in this case say s 297 applies because:

(a) RHL was not the purchaser and had no obligation under the agreement but paid the deposits on behalf of the purchaser;

(b) it was a party to those payments as payer;

(c) the payments were made within two years of the liquidation order;

(d) the Rowmata 1 and 2 trusts received $720,000 in value from those payments;

(e) RHL received zero value from those payments because the underlying purchase transaction was not completed;

(f) at the time the deposits were paid, and subsequently, RHL was unable to pay its due debts; and

(g) the liquidators are entitled to claw back the entire $720,000 as a result.

[153] For the Hildreds, Mr Anderson argues that this analysis is incorrect. RHL, he said, was the intended transferee, so the benefit from payment would ultimately accrue to RHL, not the trustees of the Rowmata 1 and 2 trusts. Thus, RHL did not receive zero value, rather it received equivalent value under the contract. In any event, RHL was entitled to claim the deposits back, on the basis of the *Falls Road* authority.

RHL was not the purchaser

[154] In my view, the liquidator's analysis is to be preferred. Although the intention was that RHL would take title, it was never the purchaser. The company received zero value at the time of payment because it had no right at that point under the contract. All it had was an unenforceable expectation that it would ultimately receive title when the purchasers directed the vendors to make the transfer accordingly. In addition, RHL ultimately received zero value from its $720,000 in expenditure because the transaction failed.

[155] The trustees on the other hand obtained an immediate extinguishment of their liability to pay the deposit, and ultimately a $720,000 subsidy toward their October 2010 settlement with the vendors following failure of the purchase.

RHL was a party to the deposit transaction

[156] There is no question but that RHL's payment of the deposit to the vendors was a transaction to which RHL was a party. The term transaction is very widely defined in s 292(3) of the Companies Act. It includes where the company "pay[s]

any money." As Miller J set out in *Kings Wharf Cool Store Limited (in receivership and liquidation) v Wilson*,[29] a party to a transaction includes a party to "a disposition or arrangement forming part of the transaction under which the property was transferred."

[157] In this case, the payments themselves were dispositions of property and, of course payments of money, but in any event they were part of an arrangement by which the farm was intended to be transferred. Either way they meet the description in the Act.

RHL could not pay its due debts

[158] Was RHL unable to pay its due debts as required by s 297(2)(b) either at the time of the transaction or as a result of it? The starting point is the solvency test in s 4 of the Companies Act. The plaintiffs cited *Blanchett v Joinery Direct Limited*,[30] as providing the relevant considerations. They are:

(a) The inquiry is made at the time of payment.

(b) Regard may also be had to the intervening period to determine whether the company has been unable to pay its debts as they became due.

(c) A consideration of the outstanding debts at the time the transaction is required.

(d) "As they become due", means as they become legally due.

(e) The ability to pay involves a substantial element of immediacy to provide payment from cash and non-cash resources. An excess of assets over liabilities will not be sufficient if there is no ability to

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29 *Kings Wharf Cool Store Limited (in receivership and liquidation) v Wilson* (2005) NZCCLR 1042 (HC) at [79].

30 *Blanchett v Joinery Direct Limited* HC Hamilton CIV-2007-419-1690, 23 December 2008 at [27].

realise assets or obtain finance against them within a relatively short period of time.

(f) The company's financial position in its entirety must be considered. A temporary lack of liquidity is not necessarily evidence of insolvency. Rather a consideration of the debtor's position over time is required.

(g) The test is an objective one.

[159] The overall assessment task in this case is rendered more difficult because RHL has no financial accounts or management records of any kind.

[160] The starting point on this question is that I have already concluded pursuant to s 136 that the Hildreds had no reasonable grounds upon which to believe that RHL would be able to repay the GST refund to the IRD. That conclusion applied as at 20 October when RHL repaid the $360,000 loan to the Rowmata 1 and 2 trusts' joint account, and at 10 December when RHL paid the second tranche of $360,000 directly to the vendors.

[161] Once again, the plaintiffs argue that RHL was required to repay the IRD immediately because it was not the purchaser under the agreement and had no right to the GST refund. The liquidators' fallback position is that RHL was entitled to the refund, then its liability to repay was contingent but nonetheless real.

[162] The Hildreds, as I have said, argued that RHL was entitled to receive the refund because RHL was named on the relevant invoice, and all parties were aware that it was the intended recipient of title on settlement.

[163] As I noted earlier, Mr Timothy Jones, a property solicitor, gave evidence on this question. He took the view that the time of supply in terms of s 9 of the GST Act was the point at which the contract became unconditional. That, he argued, was the point at which to assess who is entitled to claim a GST refund on the transaction. At 5 September 2008, the date upon which the contract became unconditional, RHL did not exist and the purchaser was the Rowmata 1 and 2 trusts. At that point,

Mr Jones' evidence was that only the trusts could claim the refund. It followed, he said, that RHL had no right to claim the GST and was required immediately to repay it.

[164] For the Hildreds, Mr Higgs took the view, as I have said, that the IRD had accepted RHL was entitled to the refund. Even if that was wrong, he said, RHL effectively purchased an interest in the land or the contract when it made its payment, and so did not receive zero value. Rather, he argued, RHL received equivalent value for the payment, effectively balancing the debit and credit sides of the ledger.

[165] Mr Higgs argued further that, even if RHL was not entitled to the refund, it would not be liable to make any repayment until it was reassessed by the IRD. He accepted however, that there would be an immediate contingent liability if the company received a refund that it should not have.

[166] As is made clear in the leading New Zealand text on GST,[31] land is a special category of transaction for GST purposes. For land transactions:

> … GST law is that a deposit under an unconditional contract comprises payment so as to trigger the GST time of supply.

[167] It must follow that whomever the purchaser may have intended to receive title in the future is irrelevant in assessing GST entitlements and obligations at the statutory trigger point under s 9(1) of the GST Act. I agree with the liquidators that to create statutory rights and obligations out of future intentions is too fraught with uncertainty. But in any event, the words of the statute when read in light of the authorities seem to make the position perfectly clear.

[168] Returning to the present facts then, the contract became unconditional on 5 September 2008. The first payment of $360,000 was made from RHL's account on the same date, although prior to that company's formal incorporation. The purchaser at that time was Rowmata 1 and 2 trusts. RHL did not exist, and there had been no pre-incorporation nomination or novation in its favour. The company therefore had

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31 Alastair McKenzie *GST: A practical guide* (9th ed, CCH, Auckland, 2012) at 77.

no right to the GST refund at that point. Nor did it have any right subsequently, despite the purchasers' intention at the date of supply because the purchasers did not at any stage give effect to that intention. There is therefore, in my view, a good argument for the proposition that RHL incurred an immediate liability to repay the refund on 17 October when it was received.

[169] The liquidators point to ordinary principles of restitution and to the UK House of Lords' decision in *Woolich Equitable Building Society v IRC*.[32] I note that *Woolich* actually stands for the proposition that an overpaying taxpayer has a prima facie right to restitution. It says nothing about the reverse situation, i.e. whether the Revenue has a right to restitution of a refund wrongly paid to an overpaid taxpayer. Nonetheless, the principle ought logically to be the same. The obligation on the taxpayer to repay a mistaken refund must be immediate even if the IRD has not yet undertaken any reassessment.

[170] In the end, the point is probably academic, because Mr Higgs accepted that if RHL was not entitled to the refund, it at least incurred a *contingent* liability to repay on reassessment. Accepting that analysis for the moment, there can be no doubt that such a reassessment would occur in due course, and repayment would inevitably be required. It must therefore have been necessary to take such a clear contingent liability into account in assessing the company's ability to pay its debts on 20 October and 10 December 2008. To ignore such an obligation would defy commercial reality as well as commonsense even if it was technically contingent only.[33] After all, the company had no money, no income and no assets in October 2008 and, in light of the financial situation of its principals, the attitude of its bank, and the prevailing economic climate, RHL had no reasonable prospect of acquiring any. It must follow that, as a result of the payments made to the Rowmata 1 and 2 trusts and the vendors, RHL was unable to pay its due debts at the relevant dates.

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[32] *Woolich Equitable Building Society v Inland Revenue Commissioners* [1993] AC 70 (HL).

[33] See for example *Northridge Properties Limited (in liquidation) v Williams* SC Auckland M36/75, 13 December 1977.

Conclusion

[171] Returning then to the terms of s 297, I conclude that RHL paid $720,000 on behalf of the trustees of the Rowmata 1 and 2 trusts and received nil value in return. I am satisfied that both payments were made by RHL within two years of 29 July 2010, the date upon which the IRD applied to liquidate RHL. RHL was rendered unable to meet its debts and they fell due as a result of making the two payments.

[172] The liquidators are therefore entitled to recover the entire expenditure in accordance with s 297 of the Act.

Transactions for inadequate consideration

[173] Section 298(2) provides that where a company has disposed of property or provided services to a director of the company or a trustee for a director of the company, the liquidator can recover from that person the difference between the amount paid and the actual value of the property or service. The claw back power relates to transactions within three years of the making of an application to this court to put the company into liquidation.

Arguments

[174] The plaintiffs argue:

(a) the two deposit payments are each "property";

(b) the payments were effectively made to the Rowmata 1 and 2 trusts;

(c) they occurred within three years of 29 July 2010;

(d) the three defendants were trustees for the Hildreds personally who were directors of the company; and

(e) the value of the two payments exceeded the value of any consideration received by the company by that amount.

[175] Mr Anderson argues that the claim is misconceived because RHL made no payment by way of deposit to the Hildreds or their trustees. Nor was there any suggestion that the payment was being made on behalf of the Hildreds. Such payments as RHL made, were made on its own behalf.

Assessment

[176] I am not satisfied that s 298 applies. The two deposits on 5 September and 10 December were made to the vendors not to the Hildreds, or to the Rowmata 1 and 2 trusts. I have already found that these payments benefitted the trusts but the test in s 298(2) is not benefit, but disposition. Under this section, the plaintiffs have focused on the two deposits, rather than the repayment on 20 October from RHL to the trusts. The repayment in any event would not have been caught by s 298 because it repaid an advance of the same sum meaning there was no value differential.

[177] I conclude therefore that s 298 does not apply to these transactions.

Insolvent transaction

[178] Section 292 provides that a transaction by the company is voidable by the liquidator if it is an insolvent transaction within two years of an application to this court to liquidate the company.

[179] An insolvent transaction is specifically defined as a transaction by a company that:[34]

> (a) is entered into at a time when the company is unable to pay its due debts; and
>
> (b) enables another person to receive more towards satisfaction of the debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.

[180] According to subsection (3), a transaction is broadly defined but includes, relevantly on these facts, "paying money".

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34 Companies Act 1993, s 292(2).

[181] The liquidators say that RHL's repayment on 20 October of the earlier advance from the Rowmata 1 and 2 trusts of $360,000 is voidable under this section because it was an insolvent transaction entered into within two years of the application to liquidate the company.

[182] The Hildreds argue that as at 20 October 2008, RHL did not have any due debts.

[183] There can be no question but that s 292 is satisfied. At the time RHL repaid the advance from the Rowmata 1 and 2 trusts, it either owed the IRD $720,000 or carried a contingent liability to pay that amount but had no income, cash or other assets and no reasonable prospect of obtaining any such income, cash or assets prior to the contingent liability crystallising.

[184] It is also clear that the repayment to the Rowmata 1 and 2 trusts of that advance meant in terms of s 292(b), that the trusts received more by that means than they would have received when the company was liquidated.

Intention to prejudice creditors

[185] The liquidators allege as their eighth cause of action that the deposit payments by RHL were caught by the provisions of subpart 6 of Part 6 of the Property Law Act 2007 in that RHL did not receive reasonably equivalent value in exchange for the payments it made and –

(a) RHL was insolvent at the time of or because of the payment; or

(b) RHL was about to complete the purchase of the Marshall Road property when its remaining assets were unreasonably small; or

(c) RHL intended to incur or believed, or reasonably should have believed that RHL would incur debts beyond its ability to pay.[35]

[35] These tests are contained in s 346.

[186] It is common ground that the liquidators have complied with the procedural requirements necessary before s 348 can be involved.[36] In such circumstances, s 348 provides that the court can set aside the deposits if satisfied that the IRD was prejudiced by them.[37] If the court is satisfied that an order is to be made, then it may order only one of the following:

(a) That the deposit be vested in the IRD.

(b) That the payee pay the IRD reasonable compensation.

[187] I note that the liquidators focus on the deposits and not RHL's repayment to the Rowmata 1 and 2 trusts of the advance they provided to RHL pre-incorporation. They challenge the actual deposits on 5 September and 10 December, not the repayment on 17 October. I agree with Mr Anderson that subpart 6 does not apply to the deposits because they were not paid to the Rowmata 1 and 2 trusts as required by s 348. Section 348(2) allows the court to do one of two things as I have said. Either order the recipient of the deposits to return them to the IRD or order the recipient to pay the IRD reasonable compensation. In this case, the recipient of the deposits was the vendors not the Rowmata 1 and 2 trusts. The liquidators have always proceeded on that basis. Nor was there any suggestion that RHL paid as trustee for the Rowmata 1 and 2 trusts. The evidence is clear that RHL paid the deposits on the expectation that, when the agreement was successfully completed, the company would take title in its own right.

[188] Section 349(1)(a) prohibits the Court from making an order under s 348 against a person who acquired property if that person proves that –

> The person acquired the property for valuable consideration and in good faith without knowledge of the fact that it had been the subject of a disposition to which [subpart 6] applies.

[189] There is no question but that the vendors in this case acted in good faith and without any knowledge that the dispositions could be set aside under s 348. It is also clear that, although the transaction ultimately failed, the vendors gave valuable

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36 See the requirements of s 347.

37 Section 348(1)(b).

consideration in exchange for the deposits – that is, they maintained the transaction on foot until after the contractual settlement date (indeed until well after it).

[190] In these circumstances, it would be quite inappropriate to require the vendors to return the deposits. Indeed to do so would potentially lead to the settlement between the vendors, the Rowmata 1 and 2 trusts and RHL being reopened. Nor for the same reason, would it be appropriate to require the vendors to pay reasonable compensation to the IRD. The appropriate source for such payments is obviously the Rowmata 1 and 2 trusts, not the vendors.

Restitution

[191] Finally, as a ninth cause of action, the liquidators argue that RHL is entitled to have the Rowmata Trusts repay the equivalent in value of the deposits because the condition upon which RHL made the payment was that the company would receive title on settlement and this condition failed completely. The liquidators rely on the House of Lords decision in *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd*,[38] a case in which a heavy machinery supply contract could not be fulfilled because of the outbreak of war in 1939. The purchaser had paid a deposit and the question was whether it was forfeit. The House of Lords found there had been a total failure of consideration and the deposit had to be repaid in the absence of the issue being expressly covered in the contract.

[192] Here, the liquidators argued, the Rowmata 1 and 2 trusts had been enriched to the extent of $720,000 at the expense of RHL. The payments were made on the condition of RHL receiving title. There is, they argued, therefore a similar total failure of consideration and an action for money paid could be brought where the Rowmata 1 and 2 trusts had derived benefit as a result of RHL paying money to a third party. The learned authors of *Goff and Jones: The Law of Restitution* confirm, it is argued, that such an action is available.[39]

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[38] *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 (HL).
[39] Gareth Jones (ed) *Goff and Jones: The Law of Restitution* (7th ed, Sweet and Maxwell, London 2007) at [1.001].

[193] For the Hildreds, Mr Anderson once again relied on the *Falls Road* decision.

[194] In my view, such a claim is really a common law version of the statutory restitution claim that I have allowed under s 297. The claim to restitution is clearly well founded. The Rowmata 1 and 2 trusts were unjustly enriched when they received benefit from RHL's two payments. Benefit arose (as I have said earlier) in two ways. The first way was in satisfying the Rowmata 1 and 2 trusts' obligation to pay the deposits in the absence of a successful novation or nomination under the contract. The second, and operative way in light of the failure of the purchase, was in such payments being treated by the parties to the transaction as reducing the Rowmata 1 and 2 trusts' overall liability by $720,000 when they came to calculate and agree on a final settlement sum in October 2009.

[195] The liquidators will be entitled to restitution of the sum paid accordingly.

Disposition

[196] The plaintiffs will be entitled to judgment accordingly. To summarise, I have, in this judgment, concluded:

(a) in relation to the first to fourth causes of action, the directors of RHL must pay 70 per cent of $720,000;

(b) in relation to the fifth and ninth causes of action, the plaintiffs are entitled to recover the full $720,000 from the trustees of the Rowmata 1 and 2 trusts; and

(c) in relation to the seventh cause of action, the plaintiffs are entitled to recover the repayment of $360,000 from the trustees of the Rowmata 1 and 2 trusts.

[197] There is an order accordingly that the defendant trustees pay the plaintiffs $720,000 plus interest. The plaintiffs will also be entitled to costs on a category 2B basis plus reasonable disbursements. If these cannot be agreed, memoranda may be filed.

Williams J

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