IN THE COURT OF APPEAL OF NEW ZEALAND

CA86/2012
[2012] NZCA 536

BETWEEN	GERALD STANLEY REA AND PAUL GRAHAM SARGISON Appellants
AND	RONALD LESLIE RUSSELL Respondent

Hearing: 18 September 2012

Court: O'Regan P, French and Asher JJ

Counsel: S O McAnally for Appellants
G J Judd QC for Respondent

Judgment: 16 November 2012 at 2.30 pm

JUDGMENT OF THE COURT

A The appeal is allowed.

B The payments made by Five Star Finance Ltd (in liquidation) to Ronald Leslie Russell as trustee of the Bowden No. 14 Trust between 26 September 2006 and 23 August 2007 totalling $928,937.79 are voidable and are set aside.

C Mr Russell is to pay to the applicants Messrs Rea and Sargison the sum of $928,937.79.

D The respondent will pay the costs of the appellants for a standard appeal on a Band A basis together with usual disbursements.

REASONS OF THE COURT

(Given by Asher J)

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Introduction

[1] Five Star Finance Ltd was one of the many New Zealand finance companies that became or were shown to be insolvent following the onset of the global financial crisis in 2007. It had been financed primarily by deposits from the public. The company went into receivership on 5 September 2007 and was put into liquidation by Court order on 13 June 2008. Following the liquidation, the liquidators found that Five Star Finance Ltd had creditors' claims of $43,834,842.58. Recoveries so far have come to $551,887.24.

[2] This appeal concerns allegedly voidable transactions made in the two years prior to the liquidation between 26 September 2006 and 23 August 2007. The payments amounted to $928,937.79 and were made to a trust, the Bowden No. 14 Trust. The respondent Ronald Leslie Russell was the sole trustee of that Trust during the period in question.

[3] On 22 February 2011 the liquidators served a notice under s 294 of the Companies Act 1993 ("the Act") to have these transactions set aside as voidable under s 292 of the Act. The application was heard by Associate Judge Bell. On 24 January 2012 he gave a decision concluding that the payments did not come within s 292 of the Act and that the liquidators were not entitled to an order setting them aside.[1] The liquidators, Gerald Stanley Rea and Paul Graham Sargison, appeal that decision.

Background

[4] The evidence before the High Court was in four short affidavits, two from the appellant Mr Sargison who is one of the liquidators of Five Star Finance Ltd ("the company"), one from the respondent Mr Russell, and one from an insolvency practitioner, Mr Boris van Delden, who was appointed by the Court as the receiver of the Bowden No. 14 Trust ("the trust").

[5] The Associate Judge in his decision referred to a number of matters that are not in dispute. It was accepted that the respondent, Mr Russell, who was the appointed trustee of the trust at the time of the payments, was the appropriate defendant. It was also accepted that the payments in question of $928,937.79 were made during the two year period referred to in s 292. Mr Russell did not contest the company's insolvency at the time the payments were made, and the Associate Judge's conclusion that it was insolvent is not challenged in this appeal.

[6] Mr Russell deposed that the trust was established by his brother-in-law Mr Neil Williams for the benefit of Mr Williams' family interests. At the time Mr Williams was working for the company. He played an active part in the management of the company but was not recorded at the Companies Office as being a director. Mr Williams was an undischarged bankrupt. Mr Williams was described by Mr Sargison as being in all but name a director of the company. The directors leading up to the liquidation were Nicholas George Kirk, Marcus Arthur MacDonald and Anthony Walpole Bowden. Mr Russell had known Mr MacDonald as his

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1 *Rea v Russell* [2012] NZHC 11.

solicitor and friend for approximately 30 years and Mr Kirk had been his accountant and friend for approximately 36 years.

[7] Mr Russell deposed that his interest as a trustee was to have an overview of the trust's asset position and make on advice the decisions whether to retain, dispose of or diversify investments. He referred to three property investments. He stated that he would delegate to Mr Kirk "some of the Trust's administrative activities". He did not delegate to him the right to make trust decisions in terms of borrowing or entering into financial arrangements, and did not hold him out as having that authority. He deposed that the company transactions which appeared to be as a running account for the trust were not within Mr Kirk's authority. Mr Russell also stated that they were not undertaken with his knowledge, consent or approval. He asserted that he did not delegate to Mr Kirk the ability to carry on or be involved in financial investments. He did not address whether he looked at the trust's bank accounts, nor, if he did, why the transactions with the company did not come to his attention.

[8] Mr Sargison in his affidavit in reply to Mr Russell's affidavit did not contest Mr Russell's assertion that he had no knowledge of the payments in issue. However, he produced an undated document signed by Mr Russell and addressed to Mr Kirk at Five Star headed "Re: Management of the Trust". In this Mr Russell stated that for many years he had delegated to Mr Kirk who in turn delegated to his staff the administration of the trust including income and expenditure and annual accounting and taxation obligations. It was stated in this document that Mr Kirk managed the assets of the trust on Mr Russell's behalf, including the Westpac bank account. It was also stated that all major transactions still required Mr Russell's signature and that this had been the position from the outset. Mr Russell did not file an affidavit in reply. He did not explain the context of this document.

[9] There was a loan ledger produced headed "Loan Details – R725". This purports to record detailed transactions between the company and the trust between 16 July 2002 and 23 August 2007. While the heading says "Advance, no interest – Ronald Russell trustee", the ledger shows that the trust was charged interest on a

revolving credit basis. The ledger shows a peak of $10,414,391.08 of advances to the trust in March 2006 and a closing balance on 23 August 2007 of $7,067,042.80.

[10] The liquidators of the company initially took the ledger at face value. However, on 18 December 2007 the High Court appointed Mr van Delden as receiver of the trust. While the trust was found to be insolvent, Mr van Delden took the view that the ledger was of little value and that the only transactions capable of being relied on were cash in and cash out, except where loans were documented, signed by the trustee and funds advanced. There were in fact no documents evidencing any loans between the company and the trust.

[11] Mr van Delden's reconstruction showed that by 1 March 2006 the trust owed the company $1.489 million. However, from then on this rapidly changed and payments from the trust to the company extinguished the former's indebtedness so that by 31 August 2006 the company owed the trust $2,114.40. From this point on the inter-company balance favoured the trust. The indebtedness peaked at $1,710,793.36 on 1 December 2006, but by the time the company went into receivership on 5 September 2007, as a consequence of payments made by it, $995,805.57 was all that remained owing to the trust. While the trust had continued to make some limited advances to the company, the company made 39 payments to the trust between 26 September 2006 and 23 August 2007 totalling $928,937.79.

[12] It is those 39 payments that the liquidators submit were voidable in terms of s 292 of the Act and which they sought to recover. The Associate Judge accepted that Mr Russell was not aware of any of these payments.

The decision

[13] The Associate Judge, having set out the background facts, found that the R725 loan ledger could not be relied on as an accurate record of transactions and proceeded on the premise that the summary of payments in and payments out relied on by the liquidator was accurate. Although on occasions Mr Judd QC for the respondent referred us to the loan ledger document R725 and commented on the lack of any explanation for the payments in and payments out, there has been no cross-

appeal in relation to this aspect of the judgment and we proceed on the basis that the Associate Judge's findings as to the payments were correct.

[14] Section 292 was amended on 1 November 2007. The Associate Judge considered whether the present version of s 292 applied or the pre 1 November 2007 version. After a detailed analysis, he concluded the proceeding should be determined by reference to the current version but that if it was voidable under the current version it would be saved under s 27(5) of the Companies Amendment Act 2006 unless it was also voidable under the earlier law. There has been no challenge to this determination and no submission that there could have been a different conclusion to that reached by the Associate Judge on the earlier wording. He went on to make the unchallenged findings that Mr Russell was the correct respondent, that the payments to the trust were made inside the specified two year period, and that at the time of the transactions the company was unable to pay its debts.

[15] Under the heading of "Are the payments between the trust and the company to be attributed to Mr Russell?", the Associate Judge found that the decisions to place funds with the company were made by Mr Kirk without reference to Mr Russell, and that they were not within the mandate given by Mr Russell to Mr Kirk. He found that Mr Russell had not held Mr Kirk out as having the authority to enter into those transactions.

[16] Under the heading "How are the payments between the trust and the company to be characterised?" he described the transfers from September 2006 as "... arranged by Mr Kirk, a fiduciary agent of the trust". He considered that these unauthorised transfers gave the trustee a number of potential remedies against the company for monies had and received, for knowing receipt and more importantly, a proprietary claim. He expanded his consideration of the proprietary claim of the trust by looking at various authorities on the law of tracing and concluded that the liquidators had shown that any proprietary claim for payments before 31 March 2007 was excluded because the company's bank accounts were in overdraft, but that it was

not extinguished for payments after that date.[2] This was a crucial finding to which we will return.

[17] The Associate Judge went on to find that when the company made the payments prior to 31 March 2007 it was "restoring trust funds it had received" and that the payments were therefore not transactions within the meaning of s 292.[3] He commented that the finding was sufficient to decide the outcome of the case, but went on to consider further issues. He declined to decide whether there was a preference under s 292(2)(b) in relation to the payments after 31 March 2007.

[18] The Associate Judge concluded that Mr Russell could not rely on there being a continuing business relationship under s 292(4B) of the Act and, after considering in the alternative the wording of the earlier version of s 292, he concluded that the payments were not in the ordinary course of business. He noted that Mr Judd accepted for Mr Russell that he did not have a defence under s 296(3) of the Act because Mr Russell did not give value for the payments and Mr Russell did not alter his position in reliance on the validity of the payments.

[19] The Associate Judge went on to state that if he had found that the payments were voidable transactions and had got to the stage of making orders under s 295 of the Act, he would have considered attaching a condition that Mr Russell not be personally liable, and that the order was to be satisfied only out of the assets of the trust, giving the liquidators a right to be subrogated in the claim against trust assets. He dismissed the liquidators' application.

Were these payments insolvent transactions under s 292 of the Act?

The words of the section

[20] Section 292(1)–(4A) provides:

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2 At [52].
3 At [55]–[56].

292 Insolvent transaction voidable

(1) A transaction by a company is voidable by the liquidator if it—

(a) is an insolvent transaction; and

(b) is entered into within the specified period.

(2) An **insolvent transaction** is a transaction by a company that—

(a) is entered into at a time when the company is unable to pay its due debts; and

(b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.

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

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

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

(c) incurring an obligation:

(d) undergoing an execution process:

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

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

(4) In this section, **transaction** includes a transaction by a receiver, except a transaction that discharges, whether in part or in full, a liability for which the receiver is personally liable under section 32(1) or (5) of the Receiverships Act 1993 or otherwise personally liable under a contract entered into by the receiver.

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

[21] The specified period of two years is set out in s 292(5) of the Act, and the restricted period at s 292(6).

[22] The definition of "transaction" at s 292(3) is broad. Subsection (e) refers to the payment of money and (f) anything done or remitted to be done for the purpose of entering into the transaction. It is clear from these words that the concept of "transaction" is broader than the dictionary definition of a "piece of … commercial

business done" or a "deal".[4] It is not necessary for the payment to arise from a contract or some other business. It can stand alone.

[23] The transaction must nevertheless be an "insolvent" transaction in terms of s 292(2). The company must be unable to pay its due debts. Importantly, the transaction must enable the recipient to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation. It is therefore essential that the payment must have the character of being in satisfaction of a debt owed by the company to the recipient. If the payment does not have this characteristic, it is not an insolvent transaction.

The burden of proof

[24] Questions of onus arose in submissions and Mr Judd suggested that there was an onus on the liquidator to prove that relevant payments were made into overdrawn accounts. We agree. There must be evidence put before the Court which meets the requirements set out in s 292 before an order will be made. That evidence must be provided by the applicant liquidator, although on occasions affidavits by respondents may add to the relevant material. The civil standard will apply and the Court must be satisfied on the balance of probabilities. Plainly if there is not sufficient evidence placed before the Court to prove the elements of an insolvent transaction, the Court will not make an order. If it is shown that the elements of s 292 have been met, the liquidator is prima facie entitled to an order setting aside the insolvent transaction. The respondent may put forward evidence to show that in fact there was no insolvent transaction, and this will be taken into account when assessing whether an insolvent transaction has been proven by the applicant. If on the other hand the respondent is asking the Court to exercise its powers under an ameliorating provision such as s 292(4B) the onus is on the respondent.[5] And if the respondent is seeking to go behind a transaction shown on its face to be a preference, then a liquidator does not have to disprove every possible explanation. There is an evidential burden on the creditor to provide the necessary evidence.

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4 Tony Deverson and Graeme Kennedy (eds) *The New Zealand Oxford Dictionary* (Oxford University Press, Oxford, 2005)

5 *Levin v Market Square Trust* [2007] NZCA 135, [2007] 3 NZLR 591 at [53]–[54].

A revolving credit facility?

[25] Mr Judd submitted that the transaction was in essence a revolving credit facility provided by the finance company to the trust. It was not a creditor/debtor relationship at all. He argued that if the payments were in fact loans, s 292 could not apply. This was a new point raised in the respondent's notice to rely on the decision on other grounds.

[26] There is nothing to show that there was in fact a revolving credit facility, save for the discredited R725 document which was headed "Loan Details". There is nothing to indicate that the company provided a credit arrangement to the trust. To the contrary, through the relevant period there were initially very significant payments by the trust to the company, and then ultimately a steady stream of transactions which reduced the previous imbalance of payments in favour of the trust. On any overview the company had received more funds than the trust had received. It was the receiver of the trust Mr van Delden's own analysis that showed that the R725 document was inaccurate and that the company in fact owed the trust money, which the company repaid. Mr van Delden's affidavit was filed by Mr Russell, and relied on by him, so it is difficult for Mr Russell to go behind that assessment.

[27] Given that the company owed money to the trust, even if the payments by the company to the trust were described or documented as loans, the effect of the payment would still be that the trust had enjoyed a preference. The trust as the recipient of the loan would, because of the underlying indebtedness of the company to the trust, have had a right of set off against any claim to recover the loan by the company. A set off can be a preference.[6] The effect of the payment by the company to the trust was that the trust ended up in a better position than a comparable creditor that was owed the same amount who had not received the payments. In terms of s 292(2)(b) the payment enabled the trust to receive more towards satisfaction of the debt owed to it than otherwise.

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6 *Trans Otway Ltd v Shephard* [2005] NZSC 76, [2006] 2 NZLR 289.

[28] Therefore, we do not accept that the payments were advances, but even if they were advances this would not have changed the application of s 292.

Transactions not "real"

[29] This also was a new point raised in the notice to rely on the decision on other grounds and not considered by the Associate Judge. Mr Judd argued that the transactions were not real because Mr Russell could not be said to have received the payments when he knew nothing about them and had given no authority to anyone to receive them on his behalf.

[30] This submission is inconsistent with Mr Russell's concession that he was and is the proper defendant. There was no doubt that he was the sole trustee at the time, and there is nothing to indicate that the account into which the monies were paid was a sham and not maintained for the benefit of the trust. Mr Russell did not depose that Mr Kirk was not authorised to accept payments into the trust's bank accounts. This is fatal to the submission.

[31] The appellants asserted in the course of submissions that the payments made by Mr Kirk were in fact made within his actual authority and therefore not made in breach of trust. This issue was not fully argued before us. We do not consider it necessary to decide the point as it does not affect the result of this appeal. Whether or not the payments were made in breach of trust, they remained as we have set out "real" transactions. We proceed on the assumption that the Associate Judge was correct to find that the payments were made in breach of trust.

Payments of a debt or restoration of property?

[32] The Associate Judge held:[7]

> The further transfers from September 2006 were arranged by Mr Kirk, a fiduciary agent of the trust, without the consent or authority of Mr Russell the trustee. These non-consensual transfers of trust property gave the trustee a number of potential remedies against the company: for money had and received, for knowing receipt and, more importantly, a proprietary claim.

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7 At [48].

(footnotes omitted)

[33] The Associate Judge went on to find that when Mr Kirk paid trust funds to the company without Mr Russell's authority, Mr Russell had the right to trace the funds into the company.[8] He observed that s 292 "is about transactions in a creditor-debtor relationship",[9] and held:[10]

> When the company made the payments in issue in this case into the trust's bank account, *it was restoring trust funds it had received*. Those payments went towards *partial satisfaction of the trust's proprietary claim*. The company brought about that satisfaction by appropriating funds it could draw on to that purpose.
>
> (emphasis added)

[34] The submission of Mr McAnally for the appellants in relation to this finding was that it was contradictory and unsupportable, as the payments went into an account in overdraft, and could not be traced and recovered.

[35] Mr Judd for the respondent supported the judgment by relying on the analysis of tracing by Lord Millett in *Foskett v McKeown.*[11] He submitted that as the company was giving the trust back part of its property, it was unnecessary for the property to be identified in the hands of the company. He did not accept that the fact that the payments were into an overdrawn account was fatal, or that the accounts were shown to be in overdraft through the relevant period. He submitted that the payments did not come under s 292, because in terms of s 292(2)(b) they were not payments "towards satisfaction of a debt owed by the company". The payments he submitted were rather the restoration of an asset.

[36] Tracing is not a cause of action or a remedy, and is to be distinguished from the ability of a claimant to follow an asset. It is a means, recognised by New Zealand courts, whereby property in which a party has a proprietary claim can be followed into different property, and that different property recovered in lieu of the original property. As was stated by Lord Millett in *Foskett v McKeown*:[12]

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8 At [51].
9 At [56].
10 At [55].
11 *Foskett v McKeown* [2001] 1 AC 102 (HL).
12 At 128.

> Tracing ... is merely the process by which a claimant demonstrates what has happened to his property, identifies its proceeds and the persons who have handled or received them, and justifies his claim that the proceeds can properly be regarded as representing his property.

[37] In this appeal the focus for tracing purposes is on the original payments by the trust to the company made by Mr Kirk. The Associate Judge held that Mr Kirk made the payments in breach of his fiduciary duty to the trust, and considered that this gave rise to a proprietary right on the part of the trust to recover the sums paid from the company.

[38] By using the word "restore" the Associate Judge appeared to conclude that the payments of the company to the trust through the relevant period were repayments of traceable proceeds. In the paragraph quoted at [35] above, he stated that the payments made by the company "went towards partial satisfaction of the trust's proprietary claim".[13]

[39] However, he had earlier observed in relation to the trust payments into the company's overdrawn account that:[14]

> The liquidators have shown that any proprietary claim for payments before 31 March *was extinguished* ...
>
> (emphasis added)

[40] We agree with the appellants' submission that these two statements, one assuming a proprietary claim, and the other saying that it was extinguished, were contradictory.

[41] We accept that repayments of traceable proceeds may not be payments made under s 292(2)(b) towards satisfaction of a debt owed by the company to the trust, in that such payments may not have the character of the repayment of a debt at all, but rather be the recovery of an asset. What must now be considered is the appellants' key submission that the accounts were in overdraft, and that because they were in overdraft there could be no tracing or restoration as directed by the Associate Judge.

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13 At [55].
14 At [52].

Payments into an account in overdraft

[42] When money is paid into a bank account, the money as such does not remain identifiable. It becomes legally and beneficially the property of the bank and not the account holder. An asset is substituted for the money that is paid into the bank, that asset being the debt of the bank back to the account holder. To put it the other way, the account holder no longer has the money, but has a chose in action against the bank. The money is not traced in and out of the account as there is no traceable money in the account. Rather, a single debt (the chose in action) can be identified that is of an amount equal to the final credit of the account holder.[15] The new asset, the chose in action, can be traced in place of the old property.

[43] In the case of a payment into an overdrawn account, there is no new asset created, as there is no debt of the bank to the account holder that is created, and the account holder gains no chose in action against the bank. Instead, the account holder's debt to the bank is in whole or in part repaid. The monies paid by the account holder can no longer be identified and there is no property or replacement asset that can be restored. This position was recognised in New Zealand by this Court in *Re Registered Securities Ltd*[16] where Somers J stated:

> … as a matter of logic it seems evident that where a claimant's money is paid into an overdrawn account there is no fund or property to which resort can be had. Nor does the position seem different when the account is further overdrawn and the additional sum is expended on some identifiable property. In such a case it is not possible to show that the claimant's money contributed to the new purchase

[44] The Court relied on the English decision of *Re Tilley's Will Trusts*,[17] and the Australian decision of *Re Goode; ex parte Mount*.[18] In the latter case it was held that where a bank account was always in debit, money paid into that account was dissipated and could not be traced. The Court also referred to *Re Diplock*[19] where tracing was refused in the case of funds mistakenly paid to charities and the monies applied by the charities to pay off a debt. The Privy Council also relied on

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15 *Foskett v McKeown*, above n 11, at 128.
16 *Re Registered Securities Ltd* [1991] 1 NZLR 545 (CA) at 554.
17 *Re Tilley's Will Trusts* [1967] 1 Ch 1179 (Ch) at 1193.
18 *Re Goode; ex parte Mount* (1974) 4 ALR 579 (SASC) at 593.
19 *Re Diplock* [1948] 1 Ch 465 (Ch) at 548–550.

Re Diplock in *Re Goldcorp Exchange Ltd (in rec)*[20] where it was observed that monies said to be impressed by a trust and paid into an overdrawn account thereupon cease to exist.[21]

[45] Thus, it is not possible to trace into an overdrawn account as the money wrongfully paid is not represented by property.[22] The overdrawn account is not an asset at all, and no traceable chose in action is created.

[46] The Associate Judge accepted, and it has not been challenged on appeal, that the payments prior to 31 March 2007 were into overdrawn accounts. Restoration was only possible through tracing, and there was no asset to which the payments could be traced. We are unable to see how any proprietary claim survived those payments into the overdrawn accounts. Therefore, assuming the trust had a proprietary claim against the company, that claim was extinguished once the payments from the trust were made to the company's overdrawn account. The claims available to the trust thereafter were not of a proprietary nature.

The payments following 31 March 2007

[47] The second aspect of this part of the appeal related to the Associate Judge's finding that in relation to the payments to the company following 31 March 2007, the liquidators had not shown that the bank accounts were in overdraft, and therefore there was a proprietary claim.[23]

[48] The Associate Judge appeared to justify this conclusion on the basis that there were overdrawn accounts available up to 1 April 2007, but there were no bank statements in relation to the position after 1 April 2007. The Associate Judge himself recorded that the proposition that the account had gone into credit seemed

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20 *Re Goldcorp Exchange Ltd (in rec)* [1994] 3 NZLR 385 (PC) at 405. See also the detailed analysis in *Shalson v Russo* [2003] EWHC 1637, [2005] Ch 281 at 138–140.

21 The same observation was made in *Fortex Group Ltd v MacIntosh* [1990] 3 NZLR 171 (CA) at 181.

22 A different view suggested by some commentators is referred to in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Brookers, Wellington, 2009) at [35.3.6]. See also Alastair Hudson *Equity and Trusts* (7th ed, Routledge, London, 2012) at [19.6.1].

23 At [52].

"improbable in the light of the company's insolvency and pending collapse".[24] But he considered that there was not enough evidence to exclude it.

[49] We do not agree with this conclusion. It seems obvious to us that if the bank accounts were significantly in overdraft in the months prior to 31 March 2007, that they remained in overdraft as the company moved towards receivership on 5 September 2007. The financial position of the company was hopelessly insolvent at the time of its receivership, and the suggestion that in the last six months of its existence it might have gone out from overdraft and into credit and then back into deep insolvency is improbable.

[50] As the Associate Judge himself recognised, there was evidence from which it could be inferred that the payments after 1 April 2007 were made into an overdrawn account. We consider it established on the evidence that the later payments must have been also into accounts in overdraft and could not be traced.

Conclusion on whether there were insolvent transactions

[51] On the evidence before the Associate Judge it was proven there were payments actually made by the company to the trust. In relation to the new points raised on appeal by Mr Judd, we are satisfied that these payments were not loans and were real. We are also satisfied that they cannot be seen as the restoration of funds in which the trust had a proprietary interest. Assuming the trust had a proprietary interest initially, tracing was not possible because the payments were into overdrawn accounts. The payments were made in reduction of the company's indebtedness to the trust. They had the effect of reducing the imbalance in favour of the trust by the amount of $928,937.79. They were insolvent transactions.

Section 292(4B)

[52] Section 292(4B) provides:

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[24] At [52].

(4B) Where—

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

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

then—

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

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

[53] The Associate Judge concluded that although there were numerous payments between the company and the trust over the period, Mr Russell could not rely on this subsection. His conclusion was based on the fact that Mr Russell was not involved in the transactions and did not know about them. The logic of this was not queried by either party.

[54] There was limited information provided about the exact nature of Mr Kirk's role in managing the payments. Mr Judd argued that if the appellant succeeded in establishing that the payments were insolvent transactions, then they were part of an ongoing business relationship. We consider the application of s 292(4B) on the basis that the trust received the payments irrespective of the extent of Mr Russell's involvement.

[55] The subsection requires that the multiple transactions arise:

(a) for commercial purposes;

(b) be an integral part of a continuing business relationship;

(c) that business relationship being between the company and a creditor of the company;

(d) there being increases and reductions from time to time in the company's net indebtedness to the creditor in the course of the relationship; and

(e) those transactions being a series of transactions forming part of the relationship.

[56] This section replaced the "ordinary course of business" exception under the old s 292(2). It introduced a running account concept and is a copy of s 588FA(3) of the Corporations Act 2001 (Cth). The assumption behind the running account concept is that the swings and roundabouts of an ongoing business relationship with a commercial purpose, inducing credits or benefits as well as debits to the company that is ultimately liquidated, should be seen as a single transaction. In *Trans Otway Ltd v Shephard* it was stated:[25]

> It is entirely proper and in accordance with commercial reality where the creditor is extending further credit to a debtor company to have regard to the net effect of the payments in determining whether overall the creditor has been preferred, and to set them aside only to that extent.

[57] There needs to be an integral business connection between the payments in and out. The test is objective and as Starke J pointed out in *S Richards & Co Ltd v Lloyd*[26] the section "looks to the effect of the transaction and not to the intent, or state of mind, of the debtor". It was observed in relation to a running account in *Airservices Australia v Ferrier*:[27]

> If the sole purpose of the payment is to discharge an existing debt, the effect of the payment is to give the creditor a preference over other creditors unless the debtor is able to pay all of his or her debts as they fall due. But if the purpose of the payment is to induce the creditor to provide further goods or services as well as to discharge an existing indebtedness, the payment will not be a preference unless the payment exceeds the value of the goods or services acquired.

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25 *Trans Otway Ltd v Shephard*, above n 6, at [11].
26 *S Richards & Co Ltd v Lloyd* (1933) 49 CLR 49 at 62.
27 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 502.

[58] In *Richardson v Commercial Banking Co of Sydney Ltd*[28] an ongoing account between a grocer and a debtor was given as an example, where the debtor pays off something on account which induces the shopkeeper to provide further supplies of groceries. In such a situation it is fair to see the payments as part of a larger commercial relationship, not designed to give a party preference but rather as a convenient means of continuing the business arrangement.

[59] But the key requirement is a continuing business relationship, where transactions for commercial purposes form part of that relationship. The transactions must arise in the context of that ongoing business relationship. Payments that have as their sole object the reduction of indebtedness rather than supporting ongoing business do not fall into such a category.

[60] In relation to the payments at issue there was a reduction of peak indebtedness of $1,710,793.36 at 1 December 2006 to $995,805.57 by the time of receivership on 5 September 2007. We are unable to infer any motivation for the payments, other than an intention to reduce the company's indebtedness to the trust at the time of payment. There is nothing to indicate that the payments by the company to the trust were integral to an ongoing business relationship, or indeed that there was an ongoing business relationship. They have not been shown to have been made to induce further credit.

[61] The relationship between the company and the trust cannot be defined, but appears to have been based on the convenience of the shareholders who, for undocumented and unexplained reasons, wanted to move funds between the company and the trust. The case is very different from that of a supplier of credit in the case of a bank, or the supplier of goods in the case of a retail purchaser relationship, where there is an ongoing commercial relationship. We conclude that s 292(4B) does not apply.

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[28] *Richardson v Commercial Banking Co of Sydney Ltd* (1952) 85 CLR 110.

Section 295

[62] Section 295 sets out a number of orders that the Court "may make" on setting aside a transaction. The Associate Judge stated that he would have moulded any orders directed to the beneficiaries of the voidable payments by requiring the orders to be satisfied out of the assets of the trust. We do not need to determine whether there is a discretion to make such an order as we are satisfied that it is not appropriate that such an order be made in this case.

[63] We have no details of the assets of the trust. There is a lack of detailed information about Mr Russell's role as a trustee and his involvement in the payments, but he gave a great deal of authority to Mr Kirk and did not involve himself in checking on the detail of the trust affairs. Mr Russell will have a right to indemnity against the assets of the trust if we make an order against him and he has indemnities from Messrs Kirk and MacDonald. We were also informed from the bar that there are monies held relating to this claim, although we were not given any details. The receiver of the trust was not a party to these proceedings but has sworn an affidavit and not sought to be heard to suggest an order other than that which is sought by the appellants. Mr Russell has conceded that he is the correct respondent.

[64] It was for Mr Russell to make out a basis for some order along the lines of that touched on by the Associate Judge. He did not do so. He is no longer a trustee, but that on its own cannot be a basis for relief. Mr Russell was the trustee of the trust that received the payments, and he must pay the $928,937.79.

[65] Mr Judd argued that the unavailability of the good faith defence at s 296(3) of the Act because of Mr Russell's lack of knowledge of the payments was a strong reason to exercise the discretion in Mr Russell's favour. We do not necessarily accept that this reasoning is permissible under s 295, but in any event note that Mr Russell as the sole trustee must bear responsibility for the conduct of the trust's affairs. There is nothing in the sparse details in his affidavit that would cause us to consider remission back for discretionary intervention to relieve him from personal liability.

Result

[66] The appeal is allowed.

[67] The payments made by Five Star Finance Ltd (in liquidation) to Ronald Leslie Russell as trustee of the Bowden No. 14 Trust between 26 September 2006 and 23 August 2007 totalling $928,937.79 are voidable and are set aside.

[68] Mr Russell is to pay to the appellants Messrs Rea and Sargison the sum of $928,937.79.

Costs

[69] The respondent will pay the costs of the appellants for a standard appeal on a Band A basis together with usual disbursements.

Solicitors:
Keegan Alexander, Auckland for Appellants
Short & Partners, Auckland for Respondent