IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2014-404-000103
[2015] NZHC 538

UNDER	The Companies Act 1993
IN THE MATTER	of Petranz Limited (in liquidation)
BETWEEN	VIVIEN JUDITH MADSEN-RIES and DAVID STUART VANCE as liquidators of Petranz Limited (in liquidation) First Plaintiffs
	PETRANZ LIMITED (in liquidation) Second Plaintiff
AND	DARRELL WARREN KARANEIHANA PETERA First Defendant
	DIANA JOY PETERA Second Defendant

Hearing: 9-12 March 2015

Appearances: N H Malarao and K Wakelin for plaintiffs
Defendants in person

Judgment: 24 March 2015

JUDGMENT OF LANG J

This judgment was delivered by me on 24 March 2015 at 1.30 pm, pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date……………

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[1] This proceeding concerns a company called Petranz Limited (the company). Petranz was placed in liquidation on the application of the Commissioner of Inland Revenue on 30 January 2009. The plaintiffs are Petranz's liquidators.

[2] The defendants, Mr and Mrs Petera, were the sole shareholders and directors of the company from the date of its incorporation in 2002. The company carried on business in the greater Auckland area as a cartage contractor. It specialised in the cartage of containers using three trucks, one of which was driven by Mr Petera. The company employed drivers to drive the other two trucks.

[3] The liquidators seek recovery from Mr and Mrs Petera of funds they withdrew, spent or transferred from the company's bank accounts before it went into liquidation. In addition, the liquidators contend that Mr and Mrs Petera breached duties they owed to the company and its creditors under the Companies Act 1993 (the Act). The liquidators seek orders under ss 300 and 301 of the Act requiring Mr and Mrs Petera to meet both the company's debts and the costs of the liquidation, including the costs incurred in bringing this proceeding.

The company's indebtedness

[4] Six creditors have filed claims in the liquidation. They are as follows:

KE (employee) – last two days pay and holiday pay	$4,546.52
ET (employee) – last two days pay and holiday pay	$3,918.82
Commissioner of Inland Revenue - unpaid tax and costs awarded by the Court in the liquidation proceeding	$120,555.33
Bartercard facility	$2,621.89
Accounts Online Limited	$713.13[1]
	$132,355.69

[5] The debts owing to the two employees were incurred within the last few days before the company was placed in liquidation. The indebtedness to Accounts Online Limited was incurred in September 2008. The debt owing to Bartercard was incurred during the period between September 2008 and January 2009, and related to

[1] A further proof of debt filed by Chevron (trading as Caltex Oil) in the sum of $7,210.86 was originally filed, but this debt has now been paid by Mr and Mrs Petera. Mr and Mrs Petera also filed claims totalling $7975.64, but these are disregarded for present purposes.

a facility that enabled Petranz to pay its debts using Bartercard dollars and enabled Petranz's customers to pay debts owing to Petranz in the same way.

[6] The debt owing to the Commissioner in respect of unpaid taxes is obviously the company's major liability, and it was incurred over a significant period of time. For present purposes it is the only debt of any real significance.

The debt owing to the Commissioner

[7] The company's indebtedness to the Commissioner arises in relation to outstanding income tax, child support payments, PAYE tax deductions (PAYE) and goods and services tax (GST).

Income tax

[8] The company was incorporated on 21 August 2002. It first defaulted on its tax obligations when it failed to pay income tax in the sum of $3,232.02 for the year ended 31 March 2003. That tax remains unpaid.

[9] The Commissioner has no record of receiving income tax returns for the company in respect of the years ended 31 March 2004 and 31 March 2005. The returns filed in respect of the 2006, 2007, 2008 years resulted in assessments totalling $13,966.92. These remain unpaid and, along with the 2003 assessment, have attracted late payment penalties and interest. The company now owes a total sum of $30,012.70 in respect of unpaid income tax.

Child support

[10] The company has outstanding employer child support contributions in respect of the periods ended 30 April and 31 May 2008, and 31 January and 28 February 2009. A total sum of $375.91 is owed under this head.

PAYE

[11] Tax deductions in respect of the periods ended 31 December 2005 and 31 January 2006 remain unpaid. These are for the sums of $551.36 and $2,479.85 respectively.

[12] The company then paid PAYE up until the period ending 31 January 2009. On six occasions these were late, resulting in late payment penalties and interest being charged. A total sum of $12,951.77 remains outstanding in respect of PAYE tax deductions.

Goods and services tax

[13] This is the most significant debt. The company filed GST returns for the taxable periods between 31 July 2005 and 30 September 2008. With the exception of two periods, however, the company did not make any payments in respect of the assessments contained in the returns. The sum of $79,911.02 remains owing in respect of unpaid GST inclusive of late payment penalties and interest.

When did the company become insolvent?

[14] Section 4 of the Act prescribes the solvency test for companies. Section 4(1) provides that a company will satisfy the test if it is able to pay its debts as they fall due in the normal course of business, and if it owns assets greater in value than its actual and contingent liabilities.

[15] Ms Vivien Madsen-Ries gave evidence on behalf of the plaintiffs. She is an insolvency specialist with more than 25 years experience working in the insolvency and debt recovery fields. Ms Madsen-Ries considers that Petranz was insolvent by no later than 30 September 2005. By that stage it was considerably in arrears with both income tax and GST, and had no obvious means of paying these debts. She acknowledges, however, that the lack of accounting records makes it impossible to provide a detailed analysis in relation to this issue.

[16] I consider that Ms Madsen-Ries's opinion is likely to be correct. By September 2005, the company owed income tax in respect of the year ending

31 March 2003 and it had failed to file income tax returns in respect of the following two years. More importantly, it failed for the first time to pay GST in respect of the period ended 31 July 2005. Thereafter it defaulted persistently in its obligations to pay GST. This suggests that the company's cash flow had begun to prevent it from paying GST as well as its other creditors.

[17] When she gave evidence, Mrs Petera confirmed that this was the case. She said that she and her husband had made a conscious decision to pay other trade debts but not GST in order to ensure that their business could continue. She said that if, for example, they had elected not to pay the monthly fuel bill or the finance payments in respect of the vehicles, those creditors could very quickly take steps to stop the company trading. For that reason they chose to pay trade debts but not GST and income tax. This evidence alone is sufficient to confirm that by 30 September 2005 the company was unable to pay its debts as they fell due.

Recovery of monies drawn or paid from the company's bank accounts

[18] The company operated bank accounts with Westpac and the National Bank of New Zealand. The lack of company records meant that the liquidators were forced to reconstruct the company's transactions using bank statements obtained from the banks. This process led the liquidators to conclude that Mr and Mrs Petera had withdrawn or used substantial sums from the company's bank accounts for their own purposes. In the absence of any contemporaneous records regarding the purpose of these payments, the liquidators have treated the payments as drawings that must be debited to the shareholders' current account.

[19] There can be no dispute that drawings of this type are debts owed by the shareholder to the company, and are repayable on demand.[2] They retain that status unless and until a resolution of the shareholders or directors provides them with a different character or classification.[3]

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2 See eg *Thom Contractors (in liquidation) v Thom* HC Auckland CIV-2008-404-6829, 28 April 2009*; New Zealand Game Meats Export Ltd (in liquidation) v Yat Fan Lau* HC Whangarei CP 34/98, 19 March 1999.

3 *Re Samurang Developments Ltd (in liquidation)* HC Christchurch CIV-2003-409-2094, 30 September 2004 at [55].

Funds taken for miscellaneous personal expenses - $2558.36

[20] A summary of these payments is as follows:

Date	Narration from bank statements		Amount
18/06/07	Foodtown – Takanini	Westpac	$130.33
16/07/07	Mamma Mia Pizzeria	Westpac	$79.50
23/10/07	KFC Mangere East 533	Westpac	$10.20
10/12/07	Cheapies Chicken	Westpac	$210.00
18/12/07	McDonalds Manurewa	Westpac	$20.60
10/01/08	Eves Pantry Botany	Westpac	$21.40
17/01/08	Dennys Restaurant	Westpac	$42.00
18/01/08	Happy Liquor Store	Westpac	$42.99
5/02/08	McDivitt Superette	Westpac	$8.30
28/03/08	Savill Liquor Store	Westpac	$20.00
15/05/08	Nj Sullivan Seafoods	Westpac	$61.00
6/06/08	Saunders Lunchbar	NBNZ	$7.40
6/06/08	Denny's Restaurant	NBNZ	$48.00
4/07/08	Wendy's Old Fashioned	NBNZ	$9.00
11/08/08	Life Pharmacy Metro	NBNZ	$69.99
19/11/08	KFC Balmoral 525	NBNZ	$21.60
19/11/08	Telecom – home	NBNZ	$225.45
5/12/08	Lee-Hangs Catering	NBNZ	$70.00
5/12/08	Cheapies Chicken	NBNZ	$299.00
23/12/08	The Mad Butcher	Westpac	$72.10
8/01/09	Super Liquor Manurewa	NBNZ	$19.99
13/01/09	Telecom – home	NBNZ	$204.11
16/01/09	Churchill Liquor	NBNZ	$37.00
19/01/09	Young World Fashions	NBNZ	$285.00
27/01/09	Eyecatcher Shoes	W	$412.00
	TOTAL		$2,658.36

[21] Mrs Petera accepted in evidence that several of the payments were for personal purchases, and are therefore properly categorised as drawings. These include the payments to Michael Hill Jeweller, Young World Fashions and Eyecatcher Shoes. She contended, however, that much of the remaining expenditure was made on the company's behalf for business-related purposes. By way of example, she said her husband would regularly buy lunch or dinner from takeaway outlets for the company's drivers, who were working long hours. The company also stored its trucks at a yard in South Auckland on the basis that from time to time it would provide liquor or other benefits to the occupier of the yard. She said that this explains many of the payments to liquor stores. She says that the payments made in December 2007 and December 2008 relate to Christmas work functions, and gifts of hams to the company's drivers.

[22] Mrs Petera said she coded these payments as business-related expenses when she received bank statements from the bank. She also said that her husband kept receipts in respect of many of these items of expenditure. Unfortunately, however, neither the receipts nor the bank statements can now be found. As a result, Mrs Petera accepts that she cannot substantiate her claims regarding the nature of the payments.

[23] In this context the onus is on the defendants to establish that the disputed items relate to business expenditure.[4] Notwithstanding the absence of documentation, I am prepared to accept that the payments on 10 December 2007, 5 December 2008 and 23 December 2008 relate to business expenditure. They are of amounts that appear inconsistent with personal use, and were made at a time when it might be expected that the company would be making expenditure of the type that Mrs Petera describes.

[24] In the absence of receipts or some other form of contemporary documentation, however, I am not prepared to accept that any of the remaining payments should be classified as business expenditure. They do not have that character, and the general explanations that Mrs Petera has provided are not sufficient to persuade me that her evidence on the point should be accepted. The company is therefore entitled to recover the sum of $2,007.26 under this head.

Funds withdrawn via teller or cheque withdrawals

[25] The liquidators have identified four occasions on which funds have been withdrawn from the company's bank accounts either by cheque or withdrawal through a bank teller. These total $6,650.00 and are summarised as follows:

Date	**Narration from bank statements**		**Amount**
14/11/07	Westpac 0355 Teller W/Drawal	Westpac	$2,000.00
20/03/08		Westpac	$1,350.00
2/07/08	Cheque / Withdrawal	NBNZ	$2,000.00
15/09/08	Cheque / Withdrawal	NBNZ	$1,300.00
	TOTAL		$6,650.00

4 *Morgenstern v Jeffreys* [2014] NZCA 449 at [58].

[26] Mr and Mrs Petera contend that these payments form part of the salary that they received from the company in their capacity as the company's employees. They are unable to say, however, to whom the payments should be attributed. Moreover, all of the payments occurred after 31 October 2007, by which date Mr Petera was receiving wages that both he and the company declared for taxation purposes. The last transaction also occurred after 29 May 2008, when Mrs Petera began to receive wages that she and the company both declared for taxation purposes. It is difficult to see why they would receive both wages that were declared for taxation purposes and wages that were not. For these reasons, and also for other reasons I give later in this judgment, I do not accept that this argument has merit. The liquidators are accordingly entitled to recover the sum of $6,650.00 from Mr and Mrs Petera under this head.

Funds taken via ATM withdrawals

[27] The liquidators have identified further withdrawals from the company's bank accounts through withdrawals from ATM machines. These total $9,260.00 and are summarised as follows:

Date	**Narration from bank statements**		**Amount**
28/08/06	184 Gt Sth R WBC ATM	Westpac	$700.00
26/10/06	ASB 3250 At ASB ATM	Westpac	$100.00
20/11/06	Manurewa #2 ANZ ATM	Westpac	$200.00
27/11/06	228 Gt Sth R WBC ATM	Westpac	$100.00
8/12/06	Botany At Th WBC ATM	Westpac	$200.00
13/12/06	ASB 3250 at ASB ATM	Westpac	$660.00
15/12/06	ASB 3250 At ASB ATM	Westpac	$200.00
19/12/06	ASB 3250 At ASB ATM	Westpac	$500.00
5/01/07	184 Gt Sth R WBC ATM	Westpac	$200.00
23/04/07	Otahuhu WBC ATM	Westpac	$40.00
12/06/07	Papakura Boo Kiwi ATM	Westpac	$800.00
12/07/07	Botany WBC ATM	Westpac	$100.00
13/07/07	ASB 32590 At ASB ATM	Westpac	$100.00
23/07/07	Manurewa BNZ ATM	Westpac	$100.00
6/09/07	Manurewa WBC ATM	Westpac	$600.00
12/09/07	Manurewa WBC ATM	Westpac	$720.00
13/09/07	Manurewa WBC ATM	Westpac	$700.00
24/12/07	Auckland WBC ATM	Westpac	$700.00
24/12/07	ASB 3250 At ASB ATM	Westpac	$800.00
7/01/08	Botany Junct WBC ATM	Westpac	$160.00
7/01/08	St Heliers BNZ ATM	Westpac	$300.00
18/01/08	Mangere WBC ATM	Westpac	$40.00
31/03/08	BP Mangere B ANZ ATM	Westpac	$20.00
7/07/08	ANZ S3A689896 BP Dairy Flat	NBNZ	$20.00

20/10/08	Auckland WBC ATM	Westpac	$200.00
1/12/08	Warehouse Pa WBC ATM	Westpac	$100.00
1/12/08	Manurewa (2) NBNZ ATM	Westpac	$300.00
2/12/08	Manurewa WBC ATM	Westpac	$100.00
3/12/08	Takanini WBC ATM	Westpac	$100.00
9/01/09	BNZ Z3344 Btoany New World 175609	NBNZ	$200.00
12/01/09	Auckland WBC ATM	Westpac	$200.00
	TOTAL		$9,260.00

[28] Mr and Mrs Petera also contend that these payments form part of their salary, notwithstanding the fact that many of the payments were made after they began receiving wages that they and the company declared for taxation purposes. I reject this argument for the same reasons I have rejected their argument under the previous head. The company is are accordingly entitled to recover the sum of $9,260.00 from Mr and Mrs Petera jointly under this head.

Funds transferred to pay mortgage

[29] Between 21 September 2007 and 21 January 2009, a total sum of $20,250.00 was transferred from the company's Westpac account into the bank account of Mr and Mrs Petera's mortgagee. When interviewed by the liquidators, Mrs Petera accepted that these were mortgage payments and should be regarded as drawings. She now contends that she and her husband believed the payments formed part of their salary package. I reject this argument for the same reasons as I reject their earlier arguments to similar effect. The company is accordingly entitled to recover the further sum of $20,250.00 from Mr and Mrs Petera jointly.

Transfers of funds to Mrs Petera's personal bank account

[30] The liquidators have identified numerous transfers of funds from the company's Westpac account to Mrs Petera's personal bank account between 18 July 2006 and 23 October 2007. These are in lump sums, usually of $500.00, $1,000.00, $1,500.00 or $2,000.00. They total $85,600.00, and form by far the biggest part of the claim for recovery of monies drawn from the company's accounts. The transfers can be summarised as follows:

Date	**Narration from bank statements**		**Amount**
18/07/06	To 0355-0338684-00	Westpac	$200.00
21/07/06	To 0355-0338684-00	Westpac	$300.00
26/07/06	To 0355-0338684-00	Westpac	$1,000.00

1/08/06	To 0355-0338684-00	Westpac	$1,000.00
23/08/06	To 0355-0338684-00	Westpac	$2,000.00
25/08/06	To 0355-0338684-00	Westpac	$1,000.00
5/09/06	To 0355-0338684-00	Westpac	$1,000.00
22/09/06	To 0355-0338684-00	Westpac	$1,000.00
26/09/06	To 0355-0338684-00	Westpac	$1,500.00
4/10/06	To 0355-0338684-00	Westpac	$2,000.00
12/10/06	To 0355-0338684-00	Westpac	$1,000.00
17/10/06	To 0355-0338684-00	Westpac	$1,000.00
27/10/06	To 0355-0338684-00	Westpac	$2,000.00
3/11/06	To 0355-0338684-00	Westpac	$1,000.00
15/11/06	To 0355-0338684-00	Westpac	$1,000.00
20/11/06	To 0355-0338684-00	Westpac	$1,000.00
24/11/06	To 0355-0338684-00	Westpac	$1,200.00
28/11/06	To 0355-0338684-00	Westpac	$1,000.00
5/12/06	To 0355-0338684-00	Westpac	$1,000.00
11/12/06	To 0355-0338684-00	Westpac	$1,000.00
20/12/06	To 0355-0338684-00	Westpac	$1,000.00
21/12/06	To 0355-0338684-00	Westpac	$1,000.00
29/12/06	To 0355-0338684-00	Westpac	$1,000.00
3/01/07	To 0355-0338684-00	Westpac	$1,000.00
10/01/07	To 0355-0338684-00	Westpac	$600.00
16/01/07	To 0355-0338684-00	Westpac	$500.00
22/01/07	To 0355-0338684-00	Westpac	$1,000.00
26/01/07	To 0355-0338684-00	Westpac	$1,000.00
1/02/07	To 0355-0338684-00	Westpac	$1,000.00
5/02/07	To 0355-0338684-00	Westpac	$1,000.00
9/02/07	To 0355-0338684-00	Westpac	$1,000.00
13/02/07	To 0355-0338684-00	Westpac	$1,000.00
19/02/07	To 0355-0338684-00	Westpac	$1,000.00
20/02/07	To 0355-0338684-00	Westpac	$500.00
21/02/07	To 0355-0338684-00	Westpac	$500.00
26/02/07	To 0355-0338684-00	Westpac	$1,000.00
26/02/07	To 0355-0338684-00	Westpac	$1,000.00
1/03/07	To 0355-0338684-00	Westpac	$1,000.00
5/03/07	To 0355-0338684-00	Westpac	$1,000.00
12/03/07	To 0355-0338684-00	Westpac	$1,000.00
16/03/07	To 0355-0338684-00	Westpac	$1,500.00
19/03/07	To 0355-0338684-00	Westpac	$1,000.00
23/03/07	To 0355-0338684-00	Westpac	$300.00
28/03/07	To 0355-0338684-00	Westpac	$1,000.00
5/04/07	To 0355-0338684-00	Westpac	$1,000.00
10/04/07	To 0355-0338684-00	Westpac	$3,000.00
16/04/07	To 0355-0338684-00	Westpac	$1,000.00
18/04/07	To 0355-0338684-00	Westpac	$1,000.00
24/04/07	To 0355-0338684-00	Westpac	$1,000.00
30/04/07	To 0355-0338684-00	Westpac	$1,000.00
4/05/07	To 0355-0338684-00	Westpac	$1,000.00
10/05/07	To 0355-0338684-00	Westpac	$1,000.00
16/05/07	To 0355-0338684-00	Westpac	$1,000.00
18/05/07	To 0355-0338684-00	Westpac	$1,000.00
25/05/07	To 0355-0338684-00	Westpac	$1,000.00
28/05/07	To 0355-0338684-00	Westpac	$2,000.00

31/05/07	To 0355-0338684-00	Westpac	$500.00
8/06/07	To 0355-0338684-00	Westpac	$1,000.00
11/06/07	To 0355-0338684-00	Westpac	$600.00
21/06/07	To 0355-0338684-00	Westpac	$1,000.00
26/06/07	To 0355-0338684-00	Westpac	$500.00
2/07/07	To 0355-0338684-00	Westpac	$1,000.00
5/07/07	To 0355-0338684-00	Westpac	$700.00
9/07/07	To 0355-0338684-00	Westpac	$1,000.00
11/07/07	To 0355-0338684-00	Westpac	$1,000.00
17/07/07	To 0355-0338684-00	Westpac	$1000.00
23/07/07	To 0355-0338684-00	Westpac	$1,000.00
23/07/07	To 0355-0338684-00	Westpac	$2,000.00
30/07/07	To 0355-0338684-00	Westpac	$500.00
8/08/07	To 0355-0338684-00	Westpac	$500.00
21/08/07	To 0355-0338684-00	Westpac	$1,500.00
23/08/07	To 0355-0338684-00	Westpac	$1,000.00
3/09/07	To 0355-0338684-00	Westpac	$800.00
4/09/07	To 0355-0338684-00	Westpac	$1,000.00
7/09/07	To 0355-0338684-00	Westpac	$1,000.00
21/09/07	To 0355-0338684-00	Westpac	$200.00
24/09/07	To 0355-0338684-00	Westpac	$1,000.00
27/09/07	To 0355-0338684-00	Westpac	$200.00
1/10/07	To 0355-0338684-00	Westpac	$1,000.00
1/10/07	To 0355-0338684-00	Westpac	$1,000.00
2/10/07	To 0355-0338684-00	Westpac	$1,000.00
5/10/07	To 0355-0338684-00	Westpac	$1,000.00
8/10/07	To 0355-0338684-00	Westpac	$500.00
18/10/07	To 0355-0338684-00	Westpac	$1,000.00
23/10/07	To 0355-0338684-00	Westpac	$2,000.00
	TOTAL		$85,600.00

[31] Mrs Petera again argues that these payments form part of the salary that the company paid to her. There is no pattern to the payments, however, and the varying amounts paid do not have the character of wages. By way of example, Mrs Petera received five payments totalling $7750 in July 2007. She then received three payments totalling $3000 in August 2007, followed by four payments totalling $4200 in September 2007. These suggest that withdrawals were made on the basis of personal need rather than pursuant to a regime under which she was receiving wages.

[32] The payments can also usefully be compared to those that Mrs Petera received after she began to receive a declared wage from the company in May 2008. Thereafter Mrs Petera received regular payments of $500 per week. The withdrawals that the liquidators seek to recover under this head are therefore

markedly different in amount and nature to the amounts Mrs Petera drew in wages after May 2008.

[33] For these reasons, and also those that I give later in this judgment, I reject Mrs Petera's argument and hold that the company is entitled to recover the sum of $85,600 from Mrs Petera.

Transfers of funds to Mr and Mrs Petera's joint personal account

[34] The liquidators have identified 11 further payments totalling $16,367.44 to Mr and Mrs Petera's joint personal account. These are summarised as follows:

Date	**Narration from bank statements**		**Amount**
7/08/06	To 0355-0338705-00	Westpac	$2,000.00
25/09/06	To 0355-0338705-02	Westpac	$300.00
10/11/06	To 0355-0338705-00	Westpac	$2,000.00
1/12/06	To 0355-0338705-91	Westpac	$1,156.17
1/12/06	To 0355-0338705-00	Westpac	$1,500.00
1/12/06	To 0355-0338705-92	Westpac	$2,464.95
3/01/07	To 0355-0338705-00	Westpac	$2,000.00
10/05/07	To 0355-0338705-91	Westpac	$373.45
10/05/07	To 0355-0338705-00	Westpac	$1,000.00
10/05/07	To 0355-0338705-92	Westpac	$2,972.87
30/05/07	To 0355-0338705-00	Westpac	$600.00
	TOTAL	Westpac	$16,367.44

[35] Mr and Mrs Petera repeat their argument that these were salary payments. There is no pattern, however, to the timing or amounts of the payments. For that reason they do not have the character of wages. Rather, they are suggestive of funds drawn to pay personal accounts and to fund living expenses. Although all of the payments were made before Mr and Mrs Petera began to receive wages from the company, I also reject this argument for the reasons that follow.

Other reasons for rejection of the argument that the payments represent the payment of wages or salary

[36] Mr Malarao pointed out in his closing submissions for the liquidators that Mr and Mrs Petera's argument that the transactions represent payments of wages or salary faces numerous difficulties. The most obvious of these is the fact that there is no contemporaneous (or subsequent) documentation substantiating that claim. The bank account entries do not record this to be the case, and there is no other

documentary evidence to suggest that they were anything other than drawings against current account.

[37] Secondly, the payments have a wholly different character to the payments that were clearly designated as the payment of wages or salary. Between 31 October 2007 and 27 January 2009, Mr Petera declared net remuneration from the company totalling $72,633.84. The liquidators were able to identify regular payments to him consistent with that remuneration. The company also paid PAYE to the Commissioner in respect of these payments.

[38] Similarly, between 6 May 2008 and 27 January 2009 Mrs Petera declared for tax purposes that she had received net remuneration from the company in the sum of $21,126.40. The liquidators have been able to identify regular payments to her consistent with the payment of that remuneration. The company's bank statements also recorded that these represented salary payments, and the company paid PAYE in respect of them.

[39] Furthermore, Mr and Mrs Petera have never declared the payments as forming part of their income for taxation purposes. It follows that, if their argument is correct, the company has failed to deduct PAYE from the payments and Mr and Mrs Petera have never paid tax on the amounts they received. All of these factors render it inherently unlikely that the payments were for wages or salary.

[40] Thirdly, to the extent that payments were made to Mr Petera after 31 October 2007 and to Mrs Petera after 2 May 2008, they were made in addition to the wages that they and the company declared in respect of that period. It is difficult to see why the company would make further irregular lump sum payments of salary or wages to Mr and Mrs Petera during a period when it was already paying wages or salary to them and declaring those payments for taxation purposes.

[41] Fourthly, s 161 of the Act provides as follows:

> **161 Remuneration and other benefits**
>
> (1) The board of a company may, subject to any restrictions contained in the constitution of the company, authorise—

> (a) The payment of remuneration or the provision of other benefits by the company to a director for services as a director or in any other capacity:
>
> …
>
> if the board is satisfied that to do so is fair to the company.
>
> (2) The board must ensure that forthwith after authorising the making of the payment or the provision of the benefit or the making of the loan or the giving of the guarantee or the entering into of the contract, as the case may be, particulars of the payment or benefit or loan or guarantee or contract are entered in the interests register.
>
> (3) The payment of remuneration or the giving of any other benefit to a director in accordance with a contract authorised under subsection (1) of this section need not be separately authorised under that subsection.
>
> (4) Directors who vote in favour of authorising a payment, benefit, loan, guarantee, or contract under subsection (1) of this section must sign a certificate stating that, in their opinion, the making of the payment or the provision of the benefit, or the making of the loan, or the giving of the guarantee, or the entering into of the contract is fair to the company, and the grounds for that opinion.
>
> (5) Where a payment is made or other benefit provided or a guarantee is given to which subsection (1) of this section applies and either—
>
> (a) The provisions of subsections (1) and (4) of this section have not been complied with; or
>
> (b) Reasonable grounds did not exist for the opinion set out in the certificate given under subsection (4) of this section,—
>
> the director or former director to whom the payment is made or the benefit is provided, or in respect of whom the guarantee is given, as the case may be, is personally liable to the company for the amount of the payment, or the monetary value of the benefit, or any amount paid by the company under the guarantee, except to the extent to which he or she proves that the payment or benefit or guarantee was fair to the company at the time it was made, provided, or given.
>
> …

There is no evidence in the present case that the company ever complied with the requirements of this section. Mrs Petera did not suggest when she gave evidence that she and her husband had ever turned their minds to this issue.

[42] Fifthly, there is evidence to suggest that Mr and Mrs Petera did not intend that the payments made during the year ended 31 March 2007 were to be treated as being payments of wages or salary. The financial statements prepared in respect of

the year ended 31 March 2008 record that the company paid wages in the sum of $183,492.00 during that year. Explanatory notes accompanying the accounts confirm that this figure includes salaries of $60,000.00 and $35,346.00 paid to Mr and Mrs Petera respectively in respect of which PAYE had been deducted.

[43] If this is correct, the company paid its other two drivers a total of approximately $88,000 during the 2008 year. Mrs Petera said that each of the two drivers employed by the company earned around $900.00 per week. This equates to an annual salary for each driver of around $45,000.00. This appears to be consistent with the 2008 wages figure of $183,492.00 once the salaries paid to Mr and Mrs Petera during that year are taken into account.

[44] Although financial statements for the year ended 31 March 2007 were not produced in evidence, the 2008 financial statements contain comparative figures from the 2007 year. These record that the company paid wages in the 2007 year totalling $84,719.00. This suggests that the only persons to whom the company paid wages during that year were the two drivers employed by the company. The obvious inference to be drawn from this is that Mr and Mrs Petera elected not to receive wages during the 2007 year.

[45] It is not now possible for Mr and Mrs Petera to attempt to reclassify the funds that they withdrew or spent from the company's bank accounts as wages or salary when neither they nor the company have ever classified them in that way before. They may well have caused the payments to be made in the belief or expectation that they would ultimately be classified as salary or wages. Unfortunately, however, that step was never taken. The payments therefore retain their status as advances or drawings that are repayable on demand.[5]

Summary

[46] The company has succeeded in establishing that it should recover the following sums from Mr and Mrs Petera under this head:

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[5] *Thom Contractors Ltd (In liquidation) v* Thom, above n 2 at [26]; *Chesterton Holdings Ltd v Durney* HC Napier CIV-2011-441-007, 19 May 2011 at [27].

Mrs Petera

(a) The sum of $85,600 being the funds paid to Mrs Petera's bank account.

Mr and Mrs Petera jointly

(b) The sum of $2,007.26 in respect of company funds spent on personal items.

(c) The sum of $6,650 in respect of funds taken via teller transactions or cheques written on the company's bank account.

(d) The sum of $9,260 in respect of funds taken via ATM withdrawals.

(e) The sum of $16,367.44 in respect of funds transferred to Mr and Mrs Petera's joint bank account.

(f) The sum of $20,250 in respect of funds transferred to Mr and Mrs Petera's mortgagee.

[47] My conclusion that the company is entitled to recover these payments means that I am not required to determine the liquidators' alternative claims under s 297 and 298 of the Companies Act 1993.

Recovery of wages or salaries that were declared for taxation purposes

[48] The liquidators also challenge Mr and Mrs Petera's entitlement to receive the salaries that they declared for taxation purposes, and in respect of which the company paid PAYE. The liquidators point out that Mr and Mrs Petera failed to comply with the requirements of s 161 of the Act when setting the salaries they were to receive from 31 October 2007 and 6 May 2008 respectively. The payments were not authorised by a resolution of the directors as required by s 161(1), the directors failed to record particulars of the payments in the interests register as required by s 161(3) and the directors also failed to complete the certificate required by s 161(4).

The payments were therefore unauthorised, and the directors will be personally liable to repay them by virtue of s 161(5) unless they prove that the payments were fair to the company at the time they were made.

[49] There can be no dispute that Mr and Mrs Petera failed to comply with the requirements of s 161 when they caused the company to pay the salaries. Mr Malarao points to numerous authorities confirming that the issue in this context is not whether the payments were fair in a general sense so far as Mr and Mrs Petera are concerned, but rather whether they can properly be regarded as being fair to the company having regard to the actual and contingent creditors of the company at the time they were made.[6] Payments to a director may not be regarded as being fair to a company when they are made at the expense of the company's creditors.

[50] I acknowledge the liquidators' concerns regarding the payment of wages or salaries to the company's directors during a period in which the company was unable to meet its tax obligations. I consider, however, that they are answered to some extent by the fact that the company paid PAYE in respect of the payments. To that extent the debt owing to the Commissioner did not become larger during the period in which the payments were made. More importantly, Mrs Petera's unchallenged evidence was that during this period Mr Petera worked 60 to 70 hours per week overseeing the company's operations and driving one of the company's trucks. Mrs Petera worked approximately 20 hours per week attending to the administrative needs of the company.

[51] I consider that the company gained full value from the work carried out by Mr and Mrs Petera notwithstanding the fact that the company's liability for GST continued to increase during the same period. In particular, the company was able to derive profit from Mr Petera's work because it was able to charge customers for the driving duties that he undertook on the company's behalf. Its administrative needs were fulfilled by Mrs Petera. I therefore consider that Mr and Mrs Petera have

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[6] *Victoria Street Apartments Ltd (In liquidation) v Sharma* HC Auckland CIV 2009 404 8377, 14 October 2011 at [159]-[160]; *Richard Geewhiz Consultants Ltd (In liquidation) v Gee* [2014] NZHC 1483 at [54]-[55]; *Wellington Audio Visual Ltd v Euro Boston Group Ltd* HC Auckland CIV 2007 404 1089, 19 March 2010

proved that the salaries they received and declared were fair to the company at the time they were made. The liquidators' claims under this head fail as a result.

Breach of duties under the Companies Act 1993

Breach of duties under ss 131, 135, 136 and 137 of the Companies Act 1993

[52] The liquidators contend that Mr and Mrs Petera breached their statutory duties under ss 131, 135, 136 and 137 of the Act. These require directors to act in good faith and in the best interests of the company,[7] and prohibit directors from permitting 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.[8] Directors are also prohibited from permitting the company to incur an obligation unless they believe on reasonable grounds that the company will be able to perform the obligation when it is required to do so,[9] and are required to exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances.[10]

[53] The liquidators contend that Mr and Mrs Petera conducted the company's affairs in a manner that breached all of these obligations. It is convenient to deal with the claims together, because the allegations underpinning each claim are essentially the same.

The liquidators' argument

[54] The liquidators rely on the fact that the company was insolvent as from at least September 2005, and that it continued to trade thereafter notwithstanding an acknowledged inability to meet its taxation obligations. In addition, the directors continued to withdraw funds from the company during this period knowing that their actions would contribute to the company being unable to meet its taxation obligations. This caused the company's financial situation to deteriorate to the point where it was ultimately placed in liquidation. The liquidators also contend that Mr and Mrs Petera ought to have recognised at a much earlier stage that the company

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7 Companies Act 1993, s 131(1).
8 Section 135.
9 Section 136.
10 Section 137.

was unable to meet its tax obligations, and that they should therefore have caused the company to cease trading well before the date upon which it was ultimately placed in liquidation. Had they done so, the Commissioner would not have suffered the level of loss that has now eventuated.

The case for Mr and Mrs Petera

[55] Mrs Petera's evidence was to the effect that, although she was generally aware of the level of the company's tax debt, she believed that the company's best interests lay in continuing to pay the other creditors rather than the Commissioner. She said she believed that the company's best option was to reduce the debt that it owed to its financier in respect of borrowings relating to the acquisition of the company's vehicles. Once that was done, the company would be in a better position to begin reducing its tax liabilities.

Decision

[56] I accept the liquidators' argument. The decision to pay trade debts and not to pay outstanding income tax and GST was a serious error of judgment on the part of the directors. Although the Commissioner did not have the ability of other trade creditors to immediately stop the company trading, the taxation liability escalated quickly due to the imposition of late payment penalties and interest. The company's inability to meet this indebtedness ultimately led to its demise.

[57] Mrs Petera contended that this strategy amounted to a plan. I consider it was a plan based largely on hope and conjecture. As I discuss later, Mrs Petera should have tested it by undertaking cash flow and profitability forecasts to determine whether or not it was realistic and feasible. Those steps were never taken. The company continued to trade, and the GST debt continued to accumulate.

[58] Events that occurred in late 2007 provide an illustration of the approach that Mrs Petera took to the company's financial difficulties. On 13 November 2007, Mrs Petera signed the company's income tax return in respect of the year ended 31 March 2007. This revealed that the company had an income tax liability for that year in the

sum of $10,008.24. By that stage the company also had outstanding GST of more than $35,000, together with accumulated penalties and interest. Furthermore, it had not paid income tax of $5,707 together with penalties and interest in respect of the 2003 and 2006 years.

[59] Mrs Petera candidly accepted in evidence that she knew when she signed the 2007 return that the company did not have the money to pay the tax assessed in the return. Notwithstanding this, she took no steps to contact the Commissioner to sort out a repayment plan.

[60] With the benefit of hindsight, it seems relatively clear that the only way in which the company could have been saved was by Mr and Mrs Petera introducing a significant amount of working capital from their own resources at an early stage. They did not investigate this option, however, until very shortly before the company was placed in liquidation. At that point Mr and Mrs Petera obtained a loan offer from the company's financier that would have enabled the company to pay the sum of $105,000 to the Commissioner. By that stage it was too little and too late to save the company.

[61] The events that led to the company being placed in liquidation are also worth considering at this point. The Commissioner served a statutory demand on the company on 9 May 2008 seeking payment of the sum of $95,199.43. The demand was served on the company's registered office, which was Mr and Mrs Petera's home address. Mrs Petera acknowledges that she must have received the demand, but cannot now remember what her reaction was when she received it. Obviously, however, she did not take any steps at that time either to contact the Commissioner or to ensure that the demand was satisfied.

[62] The application for an order placing the company in liquidation was served on Mr and Mrs Petera's home address on 22 July 2008. The notice of proceeding that accompanied the application advised the company that the proceeding was listed for call on 30 October 2008. Mrs Petera does not recall receiving these documents, but says that at this time she was relying on the company's tax agent to negotiate a repayment plan with the Commissioner. She relies in this context on an invoice

dated 31 July 2008 rendered by the company's tax agent. The invoice related to the preparation of the 2008 financial statements and tax returns as well as "advice on negotiating debt repayment arrangement with IRD".

[63] I accept this evidence as far as it goes, but it was incumbent on the directors to ensure that the company responded appropriately to the impending liquidation proceeding. Mrs Petera responded by instructing a lawyer to appear on 30 October 2008 to seek an adjournment so that settlement discussions could occur. The Associate Judge granted an adjournment until 30 January 2009, but noted that this was a final adjournment. It was therefore essential that Mr and Mrs Petera took steps promptly to negotiate a settlement with the Commissioner. Their lawyer did not approach the Commissioner, however, until 29 January 2009. Moreover, the letter that their lawyer sent to the Commissioner on that date asked only that the Commissioner should consider withdrawing the proceeding so as to give the company time to negotiate a repayment plan. It did not advise the Commissioner of the fact that the directors had received a loan offer that would enable them to pay the bulk of the tax debt. The Commissioner was not advised of the existence of the loan offer until some hours after the company had been placed in liquidation.

[64] By 29 January 2009 it also appears that Mr and Mrs Petera were resigned to the fact that the company would be placed in liquidation. On that date they incorporated a new company, and signed an agreement under which Petranz sold its vehicles to the new company for the sum then owing to the company's financier. The agreement was conditional upon the debts owing to the financier being transferred to the new company, and the liquidators subsequently declined to agree to this aspect of the transaction. For that reason the sale of the company's assets to the new company did not proceed.

[65] The events that occurred just before the company was placed in liquidation are not directly relevant to the alleged breaches of statutory duty that are now in issue. The approach that Mr and Mrs Petera took at that late stage reflects, however, their approach to the company's financial affairs generally. In effectively ignoring the statutory demand and the liquidation proceeding Mr and Mrs Petera failed to appreciate the risk they were taking. This mirrors their approach in relation to the

accumulation of the company's taxation liability. Rather than contact the Commissioner immediately after the company began to default persistently in the payment of GST, Mr and Mrs Petera elected to bury their heads in the sand. This is demonstrated by the fact that Mrs Petera said in evidence that she reached the point where she would not open letters from the Commissioner for fear of what they contained.

[66] This leads to the next point, which is that Mr and Mrs Petera continued to use significant sums of the company's money for their own purposes during a period in which they knew the company could not meet its tax obligations. This was clearly inappropriate, and obviously contributed to the failure of the company.

[67] Section 131 imposes a duty on the directors of a company to act in good faith and in what the director believes to be the best interests of the company. This is a principle of long standing.[11] As the Court of Appeal observed in *Morgenstern v Jeffreys*, a breach of s 131 involves the breach of a fiduciary obligation and requires strict proof of causation.[12] If proved, the director will be liable to pay the fiduciary measure of damages which may be calculated on a "restitutionary" or account of profits basis.[13]

[68] Mr and Mrs Petera's deliberate decision not to pay the increasing tax liability, coupled with their decision to continue using the company's funds for their own purposes, establishes that they failed to have regard to one of the company's most important creditors, despite being in a situation of insolvency. They also put their own interests ahead of the interests of both the company and that creditor. In doing so I consider that Mr and Mrs Petera breached their obligations under s 131 to act in good faith and in what they believed to be the best interests of the company.

[69] Section 135 of the Act prohibits company directors from causing or allowing the business of the company to be carried on in a manner likely to create a substantial risk to the company's creditors. I consider that Mr and Mrs Petera's

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11 *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461, cited in *Robb v Sojourner* [2008] 1 NZLR 751 at [27].
12 *Morgenstern v Jeffreys*, above n 4 at [99].
13 At [99].

decision to continue operating the company's business in that manner also amounted to a breach of s 135, because it created a substantial risk that the Commissioner would suffer serious loss. Mr and Mrs Petera must have been well aware of that risk, yet they elected to cause the company to continue to run the risk for a significant period. The risk ultimately became reality when the company was placed in liquidation.

[70] Furthermore, from at least early 2006 Mr and Mrs Petera could not have believed on reasonable grounds that Petranz would be able to meet the GST obligations that it thereafter incurred. By that stage the company had been unable to pay its income tax of $3,232.02 in respect of the 2003 year, and it had also accumulated core GST debt of $9,796.55 together with penalties and interest. In the absence of reliable forecasts to the contrary, they must have known that the company would not be able meet any further GST liability that it might incur in the future. Section 136 of the Act prohibits the directors of a company from incurring an obligation unless they believe on reasonable grounds that the company will be able to meet the obligation when it is required to do so. Mr and Mrs Petera breached their obligations under s 136 by causing the company to continue incurring GST liabilities after that date.

[71] Finally, section 137 of the Act requires directors to exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances having regard to the nature of the company, the nature of the decision and the position and responsibilities undertaken by the director. I consider that the strategy adopted by Mr and Mrs Petera clearly breached this duty. No reasonable director in Mr and Mrs Petera's position would have elected to stop paying GST and income tax whilst at the same time continuing to apply the company's funds for personal use. Both decisions fell well below the standard of care, diligence and skill required of a director in their position.

Breach of duty under s 194 to keep proper accounting records

[72] The liquidators also contend that Mr and Mrs Petera failed to keep proper accounting records as required by s 194 of the Act, and that the company failed to

meet its obligation under s 10 of the Financial Reporting Act 1993 to prepare financial statements for the years ended 2004, 2005, and 2007.

[73] The liquidators submit that the failure to keep these records contributed to the inability of the company to pay its debts, it resulted in substantial uncertainty as to the assets and liabilities of the company and has substantially impeded the orderly liquidation of the company. As a result, the liquidators argue that the Court should exercise its power under s 300(1) of the Act to declare that Mr and Mrs Petera are personally responsible for the payment of the company's debts.

[74] Section 194 of the Act provided at the relevant time:

> **194 Accounting records must be kept**
>
> (1) The board of a company must ensure that there are kept at all times accounting records that—
>
> (a) correctly record the transactions of the company; and
>
> (b) will enable the company to ensure that the financial statements or group financial statements of the company comply with generally accepted accounting practice (if the company is required to prepare such statements under this Act or any other enactment); and
>
> (c) will enable the financial statements or group financial statements of the company to be readily and properly audited (if those statements are required to be audited).
>
> (2) The board of a company must establish and maintain a satisfactory system of control of its accounting records.
>
> (3) The accounting records must be kept—
>
> (a) in written form in English; or
>
> (b) in a form or manner in which they are easily accessible and convertible into written form in English.
>
> (4) If the board of a company fails to comply with the requirements of this section, every director of the company commits an offence and is liable on conviction to the penalty set out in section 374(3).

[75] The courts of New Zealand have adopted a consistent approach in realtion to the manner in which s 194 and its predecessor, s 151 of the Companies Act 1955, are to be applied. A company must keep such records as may be necessary and in

whatever form as may be necessary to achieve the objectives set out in s 194(1).[14] The obligation to keep such records includes an obligation to ensure the records are created where they are not already in existence.[15]

[76] Ms Madsen-Smith gave evidence that when she asked Mrs Petera to provide her with all of the company's records, Mrs Petera provided such a small number of records that they would fit within a shoe box. Enquiries that the liquidators made of accountants who had acted for the company since 2003 did not produce a great deal more in the way of records.

[77] The liquidators have been unable to find any bank statements within the records provided, there were no cashflow or management reports and no records of receipts, payments and non-cash transactions. The only financial statements that the liquidators have been able to find are those in respect of the 2006 and 2008 years, and the liquidators have concluded that these are highly unreliable. By way of example, the 2008 financial statements recorded that the company owned two vehicles, but the liquidators discovered subsequently that the vehicles were owned by another entity. Neither is signed as required by the Financial Reporting Act 1993.

[78] Mrs Petera denied that the company failed to keep proper records. She said she kept folders of invoices and receipts, and that she also coded the transactions recorded in the company's bank statements as soon as she received them. She said that copies of all relevant accounting records were attached to the GST assessments that she prepared and then provided to her tax agent for submission to the Commissioner. She was at a loss to explain where all the records could have gone.

[79] With the exception of the debt owing to the Commissioner, the fact that Mrs Petera arranged for virtually all creditors other then the Commissioner to be paid suggests that she must have kept reasonably accurate and up to date records relating to the liabilities of the company. I consider, however, that the company's records were woefully inadequate in relation to two important areas. First, the bank statements appear to be the only record kept by the company of the payments that the

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[14] *Maloc Construction Ltd (in liq) v Chadwick* (1986) 3 NZCLC 99,794 (HC) at 99,802.
[15] *R v Bennett* (1985) 2 NZCLC 99,279 (CA) at 99,281.

directors made to themselves or for their own purposes. No ledger or other internal record was kept to record drawings against the shareholders' current account. This meant that the liquidators had no option but to reconstruct transactions involving the shareholders using bank statements they obtained from the company's banks. This would have been an extremely time consuming task, because the bank statements came from two different banks and spanned seven years. In addition, the bank statements recorded only the fact that money had been withdrawn from the company's accounts. They provided no explanation regarding the nature of those transactions.

[80] Failure to keep these records means that Mr and Mrs Petera breached the requirements of s 194(1)(a) of the Act, which requires accounting records to be kept that correctly record and explain the company's transactions. The absence of proper records regarding the payments to the directors and shareholders has obviously impeded the orderly liquidation of the company, and has resulted in substantial uncertainty regarding the company's assets.

[81] Secondly, the company never produced cashflow reports or management accounts to enable the directors to ascertain the financial position of the company at any time with reasonable accuracy as s 194(1)(b) requires. The regular creation of this type of management tool was essential in the present case given the fact that the directors were aware from an early stage that the company was unable to meet its tax obligations. Had such records been kept, Mrs Petera would not have been surprised or shocked to learn that the company owed more than $100,000 in tax arrears. She would have been aware of that fact because the company's accounting records would have kept her abreast of the true position at all times.

[82] This meant that to a large extent the directors were effectively flying blind so far as the company's true financial position was concerned. This may have contributed to some extent to the company's inability to pay its debts, because the directors did not know with any certainty how large the tax debt was or whether they had any reasonable prospect of meeting it.

The statutory defences under s 138 and s 300(2)

[83] I propose to deal with these issues together, because both subsections provide defences to claims alleging breaches of the type alleged in this case where a director has reasonably relied upon another competent and reliable person to fulfil or perform the duties normally imposed on directors.

[84] The sections provide as follows:

> **138 Use of information and advice**
>
> (1) Subject to subsection (2) of this section, a director of a company, when exercising powers or performing duties as a director, may rely on reports, statements, and financial data and other information prepared or supplied, and on professional or expert advice given, by any of the following persons:
>
> (a) An employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned:
>
> (b) A professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence:
>
> (c) Any other director or committee of directors upon which the director did not serve in relation to matters within the director's or committee's designated authority.
>
> (2) Subsection (1) of this section applies to a director only if the director—
>
> (a) Acts in good faith; and
>
> (b) Makes proper inquiry where the need for inquiry is indicated by the circumstances; and
>
> (c) Has no knowledge that such reliance is unwarranted.
>
> **300 Liability if proper accounting records not kept**
>
> …
>
> (2) The Court must not make a declaration under subsection (1) of this section in relation to a person if the Court considers that the person—
>
> (a) Took all reasonable steps to secure compliance by the company with the applicable provision referred to in paragraph (a) of that subsection; or

> (b) Had reasonable grounds to believe and did believe that a competent and reliable person was charged with the duty of seeing that that provision was complied with and was in a position to discharge that duty.
>
> …

[85] In the present case Mrs Petera said on several occasions whilst giving evidence that she and her husband relied upon their tax advisers to tell them what to do, and that they have been let down by those persons. Whilst not absolving herself from blame entirely, she appeared to be intent on shifting a large measure of responsibility to her advisers.

[86] This argument faces numerous hurdles. The first is that Mrs Petera has not disclosed the instructions that she gave to her tax advisers, and has not called them to give evidence. As a result, the Court has no means of knowing whether and to what extent Mrs Petera sought advice from them, and has no evidence as to what that advice was. In this context Mr Malarao reminded me that the Court will usually expect a director who relies upon either of these affirmative defences to call evidence establishing the nature and scope of the advice sought, and the circumstances justifying the director's reliance on that advice.[16]

[87] In addition, as Heath J observed in *R v Moses*, the quality of advice "is only as good as the information provided to the professional, on the basis of which he or she is asked to advise".[17] The Court has no knowledge in the present case whether Mrs Petera told her advisers both that she was deliberately not paying the company's tax liabilities and that she and her husband were nevertheless continuing to use the company's funds for their own purposes.

[88] I take the view that the unanswerable hurdle to the defences in the present case is that, as Mrs Petera freely accepted, no reasonable tax advisor would ever suggest or agree to a business strategy involving the deliberate non-payment of significant tax liabilities over a lengthy period whilst the directors continued to use company funds for personal purposes during the same period. Indeed Mrs Petera did not say that she ever received advice to this effect. Her evidence went no further

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16 *Morganstern v Jeffreys*, above n 4 at [75]-[78].
17 *R v Moses* HC Auckland CIV-2009-004-1388, 8 July 2011 at [100].

than saying she was told that the company could withhold paying tax for a limited period, but would need to take positive steps to address the situation sooner rather than later.

[89] Mrs Petera's evidence falls well short of establishing defences under either s 138 or s 300(2).

Remedy

[90] My conclusion that Mr and Mrs Petera breached their statutory obligations under ss 131, 135, 136 and 138 provides the Court with jurisdiction to make an order under s 301(1)(b)(ii) of the Act requiring Mr and Mrs Petera "to contribute such sum to the assets of the company by way of compensation as the Court thinks just".

[91] My conclusion in relation to the failure to keep proper records also provides the Court with jurisdiction under s 300 of the Act to declare that Mr and Mrs Petera are personally responsible for all or part the company's debts.

Approach

[92] Mr Malarao advised me that the liquidators do not have a preference as to whether orders should be made under s 300 or s 301. He submitted, regardless of which statutory route the Court chooses to follow, it should make orders designed to ensure that Mr and Mrs Petera are required to pay all of the company's debts in full, together with the liquidators' costs and legal costs. He therefore submitted that the Court should order Mr and Mrs Petera to pay the following sums:

Amount payable to creditors inclusive of interest	132,355.75
Liquidators' costs (including legal costs) up to start of trial	280,647.64
Liquidators' costs and legal costs in relation to trial (estimated)	40,000.00
	$453,003.39

[93] I respectfully consider this approach to be overly simplistic, and it also ignores the language used in ss 300 and 301. It would signal an approach under which directors of a company become liable in respect of matters that have no direct connection with the conduct that has led to liability being imposed. Furthermore, it

would not encourage either liquidators or their legal advisers to adopt a cost-effective and proportionate approach to litigation of this type.

Remedy for breaches under ss 131, 135, 136 and 137

[94] I propose to deal first with the appropriate remedy under s 301 for the breaches of statutory duty I have found to be established other than the duty under s 194 to keep proper financial records. Under this head it is important to bear in mind that the Court is empowered to order the offending party to contribute a sum to the assets of the company "by way of compensation".[18] The compensation in question must, in my view, relate to loss the company has suffered as a result of the acts or omissions underpinning the relevant breach of duty.

[95] The culpability of Mr and Mrs Petera's conduct in this context has two distinct but interrelated aspects. First, they permitted the company to continue to trade for a period when they knew it could not meet its tax debts. Secondly, they continued to use the company's funds for their own purposes during that period when they could have used it to pay the tax.

[96] I do not consider they should be required to compensate the company in respect of their use of company funds, however, because the liquidators will obtain judgment against Mr and Mrs Petera in this proceeding in respect of the funds they used for their own purposes. A further award under s 301 would lead to the company being compensated twice in respect of that loss.

[97] The real issue under this head relates to the extent to which Mr and Mrs Petera should be required to compensate the company for allowing it to continue trading when they knew it was unable to meet its tax obligations. Although I accept that the company may have become unable to pay its tax by September 2005, I do not consider it would be appropriate to require Mr and Mrs Petera to compensate the company for losses incurred from that point. The courts have recognised that directors are not required to ensure that a company ceases to trade the moment it

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[18] Section 301(1)(b(ii).

becomes insolvent.[19] There are limits, however, to the extent to which the directors can permit a company to continue trading in the hope that things will improve. The justification for such hope is also likely to be less where the company is indebted to the Commissioner for unpaid PAYE or GST, because such payments are only meant to be held for a short time before being paid to the Commissioner.[20]

[98] By 31 March 2006, Petranz was significantly in arrears with the payment of GST, income tax and PAYE. This meant that Mr and Mrs Petera needed to take two steps as a matter of urgency. First, they needed to accurately determine the company's current financial position so as to be able to decide whether it could meet its existing debt. This would have required the directors to prepare, at the very least, year end accounts accurately depicting the company's current indebtedness to creditors. They also needed to prepare realistic forecasts relating to future profitability and cash flow.

[99] These management tools would have enabled Mr and Mrs Petera to determine whether the company could pay existing creditors from future cash flow. If it could not, they would need to consider injecting working capital into the company, preferably from their own resources. Mrs Petera's evidence makes it clear that the first of these alternatives was not a realistic option because the company was facing cash flow difficulties caused by its customers not paying their bills on time. She maintained, however, that she and her husband could have injected funds into the company by borrowing against their house.

[100] Secondly, Mr and Mrs Petera needed to determine whether the company could meet its future debts, including its ongoing tax obligations, if it was to continue to trade. This required a realistic analysis of the company's future prospects, and necessarily involved careful consideration of the extent to which the company could afford to remunerate them for the work they were to carry out on its behalf. If this analysis led Mr and Mrs Petera to conclude that it was safe for the company to continue trading in the expectation that its financial position would improve, they needed to ensure that management accounts were prepared on a

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19 See eg *Richard Geewiz Consultants Ltd (In liquidation) v Gee*, above n 6 at [99].

20 At [100].

regular basis. These would measure the company's actual performance and cashflow position against the forecasts, thereby providing guidance as to whether the directors' expectation was realistic or overly optimistic.

[101] Unfortunately, however, the company's financial statements for the 2006 year were not produced until approximately December 2006. This showed that the company owed the Commissioner more than $33,000 in unpaid tax as at 31 March 2006. This was a very significant debt given that the company only made a profit of $7500 in the 2006 year.

[102] No cashflow forecasts were ever prepared, and no management accounts were ever produced. As a result, Mr and Mrs Petera were never in a position to accurately judge whether the company remained viable after 31 March 2006. Their failure to act appropriately at this critical stage led them subsequently to breach their obligations under ss 131, 135, 136 and 137 of the Act.

[103] These factors render it just that they should now bear the consequences for the fact that they caused the Commissioner to suffer loss because they continued to allow the company to trade without formulating a coherent plan designed to address the issue of current and future liabilities.

[104] It should have been possible for the company's accountants to prepare financial statements for the 2006 year and cashflow forecasts for the coming year no later than 31 May 2006. This would have enabled Mr and Mrs Petera to decide no later than 31 July 2006 how the company was to meet its existing debts, and whether it could realistically continue to trade on. I therefore consider that their failure to take those steps by 31 July 2006 means that they should contribute to the assets of the company by paying compensation reflecting the losses the Commissioner suffered after that date. I do not consider, however, that Mr and Mrs Petera should be required to compensate the company in respect of the final two payments of PAYE. The company always found a way to meet its PAYE obligations up until December 2008, even if payments were sometimes late. The arrears of child support payments are so small as to be insignificant in the present context.

[105] It follows that Mr and Mrs Petera should be required to contribute to the assets of the company by paying it compensation in the sum of $53,217 to reflect the GST that the company failed to pay after 31 July 2006. They should also be required to pay compensation in the sum of $11,491 to reflect the income tax that the company failed to pay in respect of the 2007 and 2008 years.

Remedy for breach of the obligation to keep proper financial records and to produce financial statements

[106] I have already found that the failure to create and keep adequate financial records may have contributed to the inability of the company to pay its debts. To a large extent, however, Mr and Mrs Petera will be required to compensate the company for this by means of the compensation they will be required to pay under s 301. I do not consider it would be appropriate to also require Mr and Mrs Petera to be personally responsible for the company's debts under this head.

[107] It is manifestly clear, however, that the failure to keep proper records created uncertainty in relation to the company's assets and liabilities, and that it impeded the orderly liquidation. The liquidators should not have been put to the expense and inconvenience of having to reconstruct the company's affairs using documents obtained from third parties. The company's own records ought to have enabled the liquidators to ascertain and understand the transactions that the company had entered into with its directors. I consider that this factor also warrants discrete recognition. The difficulty, however, is that the liquidators have not adduced any evidence regarding the costs attributable to the reconstruction of the company's affairs.

[108] For that reason I propose to make an award under this head, but it must necessarily be arbitrary and should therefore be relatively modest. I have concluded that this factor can be recognised by requiring Mr and Mrs Petera to be personally responsible for the company's debts to the extent of the sum of $20,000.

Other relief sought by the liquidators

[109] Mr Malarao also asked the Court to make an order requiring Mr and Mrs Petera to meet the liquidators' costs both in relation to the administration of the

liquidation generally and in relation to the present proceeding. In addition, they sought an order requiring Mr and Mrs Petera to meet all of the liquidators' legal costs.

The costs of administering the liquidation

[110] Mr Malarao referred me in this context to *Bay Kiwifruit Contractors Ltd (in liquidation) v Ladher*.[21] In that case Faire J directed that directors who had been found to be in breach of their obligations under ss131, 135 and 136 of the Act were to meet the costs of administering the liquidation including the costs of the proceeding. In doing so he followed in part the approach taken by Brown J in *Richard Geewiz Guarantee Consultants Ltd (In liquidation) v Gee*.[22] In that case Brown J ordered a director to pay compensation under s 301 that included the liquidators' costs to the extent that those costs did not relate to the proceeding itself.[23]

[111] Gilbert J took a somewhat different approach in *Madsen-Ries v Twine.*[24] In that case he observed:

> [10] The question of whether compensation should also be ordered in relation to the liquidators' costs in undertaking the liquidation is less straight-forward. Such costs may well be recoverable in a case where, for example, liquidators have been required to incur expense in reconstructing books of account because the directors failed to keep proper records in breach of their duty to do so. However, that is not the situation here. In this case, the directors ought to have ceased trading by early 2008, if not earlier. But it is not clear from the evidence that the costs incurred by the liquidators in carrying out the liquidation would have been any less if they had been appointed earlier. The liquidators would still have had to realise the company's assets for the benefit of creditors and take all other steps required in any liquidation. It appears that a significant part of the liquidators' costs were incurred in preparing the present proceeding. Such costs are not normally recoverable. For these reasons, I am not persuaded that an order requiring the directors to meet the costs of the liquidation is appropriate in this case.

[112] As Gilbert J points out, the costs of administering a liquidation will generally be incurred regardless of whether or not the company's directors are liable under

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21 *Bay Kiwifruit Contractors Ltd (In liquidation) v Ladher* [2015] NZHC 63.
22 *Richard Geewiz Guarantee (in Liquidation) v Gee*, above n 6.
23 At [122]-[125].
24 *Madsen-Ries v Twine* [2015] NZHC 227.

s 300 or s 301. There may, however, be situations where it is nevertheless appropriate to require a director to be responsible for meeting some or all of those costs. The present case is an illustration of the example given by Gilbert J being put into practice. Another example of a situation in which it might be appropriate to make such an order is where the actions that give rise to liability under s 300 or s 301 render an otherwise healthy company insolvent. That could theoretically provide the necessary link between the impugned conduct and an award under s 301. I do not consider, however, that a director should be liable to meet the general costs of the liquidation unless there is a link between the incurring of those costs and the director's conduct.

[113] Ms Madsen-Ries gave evidence that the liquidators had charged or incurred costs up to the date of trial in the sum of approximately $280,000. Of this sum, approximately $145,000 comprises legal costs relating to the present proceeding. She also said that only approximately 20 per cent of the liquidators' costs related to work unconnected with the proceeding. I therefore take her to be saying that the liquidators have charged total costs amounting to approximately $135,000, and that approximately $108,000 of this sum relates to work relating to this proceeding. This means that costs of approximately $27,000 have been charged in respect of issues unrelated to this proceeding.

[114] The evidence does not establish that Petranz failed solely because Mr and Mrs Petera used company funds for their own purposes. I consider there is a reasonable possibility that it would have failed even if they had not taken that step. The company defaulted on its tax obligations at a very early stage, and defaulted completely in meeting its GST obligations from July 2006. I am therefore not convinced that Mr and Mrs Petera's actions caused an otherwise healthy company to fail. It follows that I am not prepared to require them to meet the general costs of the liquidation.

The liquidators' costs in relation to the present proceeding

[115] The passage cited above from *Twine* and the approach taken by Brown J in *Richard Geewiz* suggest that, under New Zealand law as it presently stands,

liquidators are not generally entitled to recover costs associated with proceedings of this type. I acknowledge that Faire J took the opposite approach in *Bay Kiwifruit,* but that case proceeded on a formal proof basis and the Judge did not have the benefit of argument in opposition to the liquidators' claim.

[116] I note also the following observations by the Court of Appeal in *Peace and Glory Society Ltd (In liquidation) v Samsa*:[25]

> [41] The Judge remarked that it was a curious feature of this case that no accounts from the liquidators were put in evidence. On the face of it, with a company having no assets at the date of liquidation and only one proved creditor, this would have all the appearances of a straightforward liquidation able to be completed at modest cost. Yet the liquidators' costs exceeded $60,000. *However, it appeared that the liquidators' charges included all their solicitors' fees, both generally in relation to the liquidation and specifically in relation to this litigation. The liquidators accepted that, at best, only the former could be included in the claim, leaving the latter to be dealt with in the usual way.* However, because of the result reached on the legal issues, no further consideration of that aspect of the matter was required.
>
> (Emphasis added)

This passage suggests that counsel for the liquidators in that case had agreed with a suggestion from either the Judge at first instance or a member of the appellate panel that the liquidators could not recover their costs to the extent that they related to the proceeding in question. Although the Court of Appeal upheld the High Court's judgment, it did not comment further on the correctness of that proposition.

[117] This issue involves a conflict between two competing policy principles. The first, identified by Faire J in *Bay Kiwifruit*, is that creditors should not have to meet the costs incurred by liquidators who are required to pursue delinquent directors.[26] The second is the general principle that a litigant cannot recover his or her own costs in relation to a court proceeding.

[118] On balance, I prefer the latter approach because it reflects the preponderance of authority at the present time. If it is to be altered, I consider that should occur at

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25 *Peace and Glory Society Ltd (in liquidation) v Samsa* [2009] NZCA 396, [2010] 2 NZLR 57 at [41].

26 *Bay Kiwifruit Contractors Ltd (in liquidation) v Ladher*, above n 18 at [50].

appellate level. For that reason I make no order or declaration permitting the liquidators to recover their costs in relation to the present proceeding.

Recovery of liquidators' legal costs

[119] As I have already recorded, the liquidators had incurred legal costs amounting to $145,000 up until the commencement of the hearing. Mr Malarao advised me in his closing address that the costs of trial were likely to add approximately $30,000 to this figure. He seeks an order that effectively requires Mr and Mrs Petera to meet all of the liquidators' legal costs.

[120] Mr Malarao relies principally in this context on the approach taken by William Young J in *Mako Holdings Ltd (in liquidation) v Crimp.*[27] In that case William Young J required two company directors to meet all of the company's debts and to pay indemnity costs to the liquidators of a company after finding they had breached their duties to the company and been guilty of reckless trading. The Judge explained his reasons for taking this step as follows:

> [71] I am of the view that Messrs Crimp and Carswell elected to secure an immediate payment to Andrew Housing, because this was far more desirable to Mr Crimp than a liquidation and the possibility of long delays. If there had been a liquidation, there was the possibility that a liquidator or court may have taken a less favourable view of the Andrew Housing claim than Mr Crimp did. The corollary of all this, in my view, is that they should have ensured that other creditors were not out of pocket. I regard this as the baseline against which compensation should be assessed. If they had acted on that basis there would have been no creditors' liquidation and all the other creditors would have been paid. This means that the compensation awarded must extend to all expenses of the liquidation and I am of the view that that includes the expenses associated with this case. Unless this happens, I do not see how the creditors can be paid in full (which is what I think should happen). As well, this liquidation is fundamentally their fault and it is right and proper that they pay the costs of it.
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> …
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> [75] I appreciate that Messrs Crimp and Carswell may feel somewhat aggrieved at my willingness, subject to any further argument as to costs, to require them to pay the costs of this litigation on what will, in substance, be a solicitor and own client basis. However, unless the liquidator makes a full recovery someone is going to be out of pocket over this case. I see the case as being, entirely the fault of Messrs Crimp and Carswell. There was an element of malevolence in Mr Crimp's attitude to the solicitors and quantity

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[27] *Mako Holdings Ltd v Crimp* HC Christchurch CP23/99, 28 November 2000.

> surveyors. There was greed on the part of Mr Carswell who could hardly honestly believe that he was entitled to $15,000 ahead of the professional firms he had commissioned to act on behalf of Mako Holdings. Both were in gross breach of their duties. There are very small sums of money at stake in this case. Unless full costs are awarded the creditors will not get paid and, unless judges take a film line with those who choose to act in this way, we will wind up creating incentives for directors to strip their companies on the basis that they can argue about it later.
>
> [76] I might say that the case as to liability anyway struck me as being hopeless from the point of view of the defendants — an attempt to defend the indefensible which was finally rightly abandoned by Mr Eagles in his submissions.

[121] I regard *Crimp* as being an exceptional case that should not be regarded as creating any general principle in this area of the law. Generally speaking, the costs to be awarded to a successful party are governed by the High Court Rules. Although costs are at the discretion of the Court, the principles contained in the High Court Rules are generally applied because they promote consistency in approach.

[122] The High Court Rules permit a successful party to receive an award of increased or indemnity costs, but only in certain circumstances. In particular, the courts have been careful to restrict the right to claim indemnity damages to situations where the party against whom such damages are awarded has acted in an egregious manner.[28] Although the facts in *Crimp* arguably fell within that category of case, many cases will not meet that threshold test.

[123] I do not consider that relief under ss 300 and 301 should be tailored to ensure that legal costs are paid in full by the defendant. The obvious disadvantage to that type of approach is that it would provide no incentive to those acting for liquidators to ensure that they conduct the proceeding in a cost effective manner. The objective of the High Court Rules is "to secure the just, speedy and inexpensive determination" of civil proceedings.[29] That objective could easily be undermined by the approach suggested by Mr Malarao.

[124] For that reason I decline to make an order under s 300 or s 301 requiring Mr and Mrs Petera to meet the liquidators' legal costs in full.

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28 See eg *Bradbury v Westpac Banking Corporation* [2009] 3 NZLR 400 (CA) at [27]-[28].
29 High Court Rules, r 1.2.

Result: summary

[125] I enter judgment as follows:

(a) In favour of the second plaintiff against Mrs Petera in the sum of $85,600.[30]

(b) In favour of the second plaintiff against Mr and Mrs Petera jointly as follows:[31]

(i) In the sum of $2,007.26

(ii) In the sum of $6,650.00.

(iii) In the sum of $9,260.00.

(iv) In the sum of $16,367.44.

(v) In the sum of $20,250.

[126] I make an order under s 301(1)(b)(ii) of the Act requiring Mr and Mrs Petera jointly to contribute to the assets of the company by paying the sum of $64,708 by way of compensation for breaching their duties under ss 131, 135, 136 and 137 of the Act.[32]

[127] I make a declaration under s 300(1) of the Act that Mr and Mrs Petera are personally responsible without limitation of liability for the debts of the company to the extent of the sum of $20,000.[33]

Costs

[128] The plaintiffs have succeeded and are entitled to costs. During his closing submissions Mr Malarao suggested that he would seek an increased award of costs.

[30] See [46].
[31] See [46].
[32] See [105].
[33] See [108].

In the event that the parties cannot reach agreement regarding costs, Mr Malarao is to file and serve a short memorandum (no greater than 5 pages in length) in support of the orders he seeks. The defendants will then have 14 days within which to file and serve a memorandum in reply. Thereafter I will deal with costs on the basis of the memoranda that have been filed.

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Lang J

Solicitors:
Meredith Connell, Auckland
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Defendants