IN THE HIGH COURT OF NEW ZEALAND
ROTORUA REGISTRY

CIV 2012-463-000175
[2012] NZHC 2874

UNDER	the Companies Act
IN THE MATTER OF	the liquidation of Contract Engineering Limited
BETWEEN	PETER ESMOND FARRELL AND SIMON PAUL ROGAN AS LIQUIDATORS OF CONTRACT ENGINEERING LIMITED (IN LIQUIDATION) Applicants
AND	ACME ENGINEERING LIMITED Respondent

Hearing: 24 October 2012

Appearances: K F Shaw for the Applicants
S A Barker for the Respondent

Judgment: 1 November 2012

JUDGMENT OF
ASSOCIATE JUDGE CHRISTIANSEN

This judgment was delivered by me on
01.11.12 at 4:30pm, pursuant to
Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar
Date……

Solicitors/Counsel:
K Shaw, Harkness Henry, Hamilton –Karen.shaw@harkness.co.nz
S Barker, Buddle Findlay, Auckland – scott.barker@buddlefindlay.com

[1] This judgment ought to be read together with that issued simultaneously in another case of like kind affecting the liquidators of Contract Engineering in CIV 2012-463-514, in particular with respect to s 296(3)(c) of the Companies Act 1993.

The application

[2] The applicants are the liquidators of Contract Engineering Limited (the Company). The Company was put in liquidation by its shareholders on 5 July 2011.

[3] On 3 April 2012 the applicants served a Notice to Set Aside Voidable Transactions on the respondent. The notice claimed that the applicants wanted to set aside nine payments of $10,000 each made weekly by the Company to the respondent beginning on 13 August 2010 and concluding on 8 October 2010; together with a payment of $15,484.50 made on 22 October 2010. The payments totalled the sum of $105,484.50.

The respondent's case in defence of the voidable transaction claim

[4] On about 30 April 2012 the respondent served a notice of objection in which it asserted the Company was able to pay its due debts and that the respondent did not receive more towards satisfaction of its debt than it would likely have received in the Company's liquidation. It also claimed that the respondent:

(a) Received the payments in good faith.

(b) Did not have reasonable grounds for suspecting the Company's actual and impending insolvency.

(c) Gave value for the payments or altered its position in the reasonably held belief that the payments were valid and would not be set aside.

[5] The respondent relies upon the affidavit of its Mr Fraser. He says the respondent is a large and versatile general engineering company; that on 22 February 2010 the Company sought a quote from the respondent for the construction and

supply of a flash silencer - an item of equipment used in relation to the production of geothermal energy, which reduces the noise of discharged steam.

[6] After Mr Fraser received the Company's request for a quote he performed his own due diligence on the Company; he searched the Company's website and reviewed the current project the Company was involved in. He learned that the Company was a well established engineering company with over 20 years experience working for an established client (Ngati Tuwharetoa) who in turn used a well regarded and experienced engineering consultant on its current project. Mr Fraser said he found nothing in his search that gave rise to concern or led him to question the solvency of the Company. He considered that the Company's decision to subcontract out the construction and delivery of the flash silencer were ordinary and unremarkable activities of the Company. Therefore on 1 March 2010 the respondent provided a quote to the Company for the flash silencer.

[7] On 17 March 2010 the Company accepted the quote and the flash silencer was delivered to it on 19 May 2010. When Mr Fraser emailed Mr Williams of the Company seeking an order number to quote on the invoice, this was provided. There was he says no indication that the payment was likely to be a problem.

[8] The respondent invoiced the Company for its services on 25 May 2010. Mr Fraser said that had he been aware of any financial distress on the part of the Company the respondent would not have delivered the flash silence without payment upfront.

[9] Mr Fraser says that by late July the invoice for the flash silencer (originally issued for payment the following month) had become a 60 day invoice. As a result he telephoned Mr Williams of the Company to enquire about payment. There was nothing he says in the response that gave any indication that payment would be a problem. He said Mr Williams forwarded Mr Fraser's query on to a Ms Ion, the Company's finance administrator, who made contact with Mr Fraser on 6 August 2010. A payment proposal was subsequently agreed.

[10] Mr Fraser stated that payment plans were not uncommon in the engineering industry given the manner in which projects were funded; that it was not uncommon for contractors on construction projects to experience short term cash flow issues during projects because the time for payments to suppliers and subcontractors may arise before any progress payment for the main project is received.

[11] Mr Fraser said that the agreed proposal was for weekly payments of $10,000 from the beginning of August until the amount outstanding and the invoice was paid in full. He said the first payment was received on 13 August 2010 and when he followed this matter up again on 20 August 2010 he received confirmation from Ms Ion of further payments. He provided copies of an email exchange to that effect.

[12] Mr Fraser states that as managing director he follows up overdue invoices as a matter of routine. The respondent has a number of clients who pay on a 60 day timeframe and this is managed accordingly. Mr Fraser says that in this instance the Company met every payment deadline it had agreed on. He was not concerned about the Company's ability to meet the amount due because of the payment plan. A substantial amount of money was involved.

[13] Mr Fraser is concerned that the affect of the applicants' application would allow the Company to receive the flash silencer free of charge.

[14] Upon receipt of the payments from the Company, and Mr Fraser says in reliance on their validity, the respondent included the payments as part of its revenue stream. The respondent relied on those payments to meet its own due debts and finance the ongoing trading of its engineering business. Those payments he said were included in the budgets and forecasts to enable the respondent to meet its due debts and commitments.

[15] Mr Fraser says that until advised of the Company's receivership the respondent had no reason to believe the Company was unable to meet its debts or that it had financial difficulties. Reference is also made to the fact that the receivers first report of 22 February 2011 noted that the receivers elected to allow the Company to continue trading; that the Company was experiencing one of its "busiest

periods". Later, apparently, the receivers sold the business of the Company as a going concern.

[16] As well as relying in its defence upon s 296(3) the respondent asserts the Company was able to pay its due debts and it rejects the liquidators claim that the payments to the respondent enabled it to receive more in satisfaction of its debt than it would have in liquidation. In essence it challenges the sufficiency of the evidence of the applicants to show that the Company was in that two month period between 13 August and 22 October 2010 insolvent by virtue of its being unable to meet its debts as they fell due.

The applicants' case

[17] In his response on behalf of the applicants Mr Farrell accepts that a repayment plan may not always point to a lack of good faith or a reasonable suspicion on insolvency. Notwithstanding, in this case he considers a combination of factors should have alerted the respondent to the Company's insolvency, namely:

(a) The Company had failed to pay, what was a substantial debt to it on time and the payment was 60 days overdue.

(b) The respondent had to chase the Company for payment in late July.

(c) The respondent does not appear to have received immediate assurance from the Company. Rather on 6 August 2010 Ms Ion advised "We are currently working on this and we will be in contact with you this Monday, 09th August 2010".

(d) It still took the Company over two months from the date of the first payment on 13 August 2010 to repay the respondent in full.

[18] Mr Farrell states that the repayment plan ought to have alerted the respondent to the Company having serious cash flow problems. He asserts that the respondent did not provide any new value to the Company following any of the payments made to it; that although the respondent would be worse off if ordered to repay the

$105,484, there was a long list of unsecured creditors in this liquidation, many of whom have supplied goods and services and who have not been paid.

[19] Mr Farrell says that the respondent has not provided any detailed evidence in support of any alteration of position following its receipt of the payments from the Company. He says those should not include the payment of existing debts or the financing of the respondent's ongoing trading of its business.

[20] Mr Farrell's evidence is that he calculated the Company had overdue tax creditors as at June 2010 in the sum of $729,808. As well, he says, there were other liabilities that the Company was failing to pay when they were due at about that time.

[21] Mr Farrell says that the first receivers report on 22 February 2011 records that the amount due to unsecured creditors at the date of the receivers appointment was $3,235,740 and that, due to the extent of unsecured creditors claims, there were unlikely to be any funds available for distribution to those unsecured creditors at the conclusion of the receivership.

[22] Mr Farrell says that the payments due to the respondent were all made within four months of the appointment of the receivers and that he did not consider it was possible that the Company was solvent in August 2010 given the receivers statement that the Company's assets exceeded liabilities by $5,489,886 only four months later.

Considerations

Solvency

[23] The applicants bear the onus of proof of insolvency at the relevant time. In this case all of the payments comprising the transaction occurred outside of the six month restricted period wherein a presumption of insolvency arises; instead the payments were all received within the two year specified period wherein the liquidator may chose to treat them as voidable.

[24] The respondent's challenge in this instance relates to what it considers to be the absence of relevant evidence to show insolvency. For the purpose of its enquiry the Court focuses upon that time during which the payment or payments are made and in respect of which regard may be had to the recent past to see if the debtor was able to pay debts as they became due. A consideration of the outstanding debts at the time is required. An ability to pay involves a substantial element of immediacy to provide payment from cash and non cash resources. An excess of assets over liabilities will not itself satisfy the test if there is no ability to pay. What will satisfy the test is inability to procure sufficient funds to pay debts within a relatively short period of time. Therefore the Company's financial position needs to be considered in its entirety because a temporary lack of liquidity does not necessarily evidence insolvency and it is for that reason a consideration of a debtor's position over a period of time is required. [1]

[25] In his challenge of the adequacy of available evidence Mr Barker submits that major liabilities like bank loans should not be classified as due debts unless the time for full repayment is past. The applicants' evidence focuses upon the Company's situation as at June 2010 or in the period of about two to four months before the Company made its payments to the respondent.

[26] Mr Barker submits in this case that if the bank loan of about $2.7M is not included in the assets and liabilities equation (because it is not a due debt) then the Company's assets would exceed its liabilities.

[27] Although the IRD was owed $135,394 as at the date of the Company's liquidation, only $17,290.95 was owed in June 2010 and that was being paid off pursuant to a "payment arrangement". Mr Barker submits that it is only in respect of due debts that recovery can be made and upon which an assessment of inability to pay debts ought to be considered.

[28] Mr Barker submits the liquidators calculation of a net deficit of $5,178,256 as at the date of liquidation is unhelpful because it does not make allowance for the

[1] *Blanchett v Joinery Direct Ltd*, 23/12/08, Associate Judge Faire, HC Hamilton CIV 2007-419-1690 at [27].

substantial recoveries the liquidators have made and nor does it include the substantial assets of the Company like plant and equipment.

[29] The ability of a company to meet payments of its debts is therefore is a matter for objective assessment. In this case I consider the liquidators' evidence overwhelmingly supports proof of insolvency at the relevant time. As Faire AJ noted in *Blanchett* (supra) the issue of a company's solvency requires consideration of the company's position in its entirety and for that reason consideration was required over a period of time.

[30] That the Company owed $2.7M to the bank two months before payments were made to the respondent, and when one considers that within four months after those payments the Company was placed into receivership – presumably by the bank acting on the securities they held, there is a sufficient basis for proof of insolvency.

Section 296

[31] The section provides:

> (3) A court must not order recovery of property (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or equity, if the person from whom recovery is sought proves that when [it] received the property [the payment] –
>
> (a) [it] acted in good faith;
>
> (b) a reasonable person in [its] position would not have suspected and [it] did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and
>
> (c) [it] gave value for the property or altered [its] position in the reasonably held belief that the transfer of the property [payment] to [it] was valid and would not be set aside.

[32] The onus of proof of these matters lies upon the respondent.

[33] It does not appear from the evidence that the applicants challenge the respondent's claims of acting in good faith at the time the payments were received. However there is a challenge to the respondent's claims that a reasonable person in

the position of the respondent would not have suspected insolvency and that the respondent did not have reasonable cause to suspect the insolvency of the Company.

[34] The Court accepts the evidence that at the relevant time the Company was insolvent. Accordingly the respondent must satisfy the Court that it received the payments in good faith and at a time when it had no reasonable grounds for suspecting that the Company was insolvent.

[35] Also the respondent must show that it gave good value for the payments received or that it altered its position in the reasonably held belief the payments it received would not be set aside.

[36] In this case the Company's payments all post-dated the respondent's supply and invoicing for the flash silencer. The applicants submit therefore that the respondent did not give any new value to the Company after the transactions commenced on 13 August 2010; that although the respondent provided materials and labour in exchange for the payments, there was no provision of materials or labour after receiving the payments from the Company.

[37] I do not propose to review the opposing arguments of counsel on the issue of whether 'value' necessarily refers to consideration having been provided after payment was received for the work previously done. In the related case by the applicants against Fences & Kerbs Limited in CIV 2012-463-000514 I concluded that s 296(3)(c) permitted the Court to focus upon the value of consideration given at the time when consideration is given and not at the time when payment is received from the insolvent Company.

[38] I propose simply to adopt my reasons for that conclusion in the said related case. It follows that in this case the Court accepts the respondent did provide value for the payment received; it provided the flash silencer as it contracted to do.

[39] Mr Barker appears to accept and certainly the Court is of the view that on the facts as disclosed in the affidavits, there is not a sufficient basis from which the respondent can in the alternative claim that it has altered its position since the

Company's payment was received by it. In that respect I accept the submission of Ms Shaw that there has not been provided any specific details of the respondent's reliance on any of the payments. Instead, the Court is invited to assume such would in the normal course occur. It seems accepted by counsel that alteration of position does not include a respondent meeting its own due debts or financial obligations, or its ongoing business trading.

[40] The only issue remaining concerns whether a reasonable person in the respondent's position would not have suspected and the respondent did not have reasonable grounds for suspecting that the Company was or would become insolvent.

Reason to suspect

[41] Regardless of whether or not the Court accepts the applicants submissions on the issue of value received, Ms Shaw submits the respondent does not meet the elements of good faith or reasonable cause to suspect. As to the first she submits a creditor is likely to fail where it has actual or implied knowledge of the Company's financial difficulties. Usually such occurs when a company's cheques are dishonoured or where it fails to pay its debts on time, even though an awareness of financial difficulty will not of itself be sufficient to give rise to a conclusion that any actions were not made in good faith. [2]

[42] In this case Ms Shaw submits that the Company's debt to the respondent was approximately one and half months overdue before payments were made; that the fact that the account was overdue coupled by the fact that it was apparent that the Company could only repay the debt by instalment payments, should have indicated that the Company had serious cash flow problems.

[43] The issue of suspicion of insolvency is one to be assessed at the time a creditor has received payment. It is an objective test but, whether or not the creditor did have reasonable grounds for so suspecting is a subjective test based on objective criteria. It involves an enquiry into the state of a creditor's knowledge.

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[2] Re *Island Bay Masonry Limited (In Liq); First Industries Limited v Gray* (1998) 8 NZCLC 261, 751.

[44] The test for suspicion is that stated by Kitto J in *Queensland Bacon Pty Limited v Rees* [3]:

> A suspicion that something exists if more than a mere idle wondering whether it exists or not; it is a positive feeling of actual apprehension or mistrust, amounting to "a slight opinion, but without sufficient evidence as Chambers Dictionary expresses it. Consequently, a reason to suspect that a fact exists is more than a reason to consider or look into the possibility of its existence. The notion which "reason to suspect" expresses... is, I think, of something which in all the circumstances would create in the mind of a reasonable person in the position of the payee an actual apprehension or fear that the situation of the payer is in actual fact that which the section describes – a mistrust of the payer's ability to pay his debts as they become due and the effect which acceptance of the payment would have as between the payer and the other creditors.

[45] Ms Shaw submits that a reasonable person in the respondent's submission would have suspected insolvency in the circumstances of the late commencement of payments (a 60-day invoice) coupled with the lump sum instalment payments (over a two month period).

[46] Commenting upon Mr Fraser's reference to certain factors in the engineering industry, Ms Shaw submits that the respondent has not provided any independent evidence of those practices.

[47] In this case the Court considers that some of the usual indicia of insolvency might have alerted a reasonable businessman in the position of the respondent to suspect financial difficulties. However the Court is satisfied in this case that although objectively there may have been that cause, it does not show in this case that the respondent did not act in good faith. The difficulty for liquidators in these kinds of applications is to refer to evidence other than of a general and indicative kind. By contrast the evidence on behalf of a respondent usually refers to specifics and actual events.

[48] In this case no challenge has been made to the evidence of Mr Fraser except by addressing in an objective sense the reliability of it.

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[3] (1967) 115 CLR 266 at 303.

[49] It is this Court's assessment that Mr Fraser's evidence is consistent with an honest belief that the transactions would not involve any element of undue preference to the respondent.

[50] Mr Fraser looked at the Company; at the job; he became familiar with the Company; he believed it had a good reputation; and there were no references to whispers or financial anecdotes of difficulties. Mr Fraser believed there were no issues and contracted on that basis. When he had not received the payment he telephoned and emailed. An arrangement was put in place and it was honoured. There were not threats or demands.

[51] In this case there was no suggestion of mistrust of the Company. Evidence of a temporary lack of liquidity is inconclusive. The contract had certain industry specific elements to it. The acceptable evidence is that the use of instalment payments is not exceptional when such may be a common practice in the industry. As Mr Farrell appeared to knowledge, debts are not always paid on time by solvent debtors.

[52] In this case the Court accepts the respondent has satisfied the onus of proof upon it to satisfy the requirements of good faith and reasonable belief.

Conclusion

The evidence shows the respondent acted in good faith and in the circumstances of this case satisfies s 296(3) elements of reasonable belief. As well the Court is satisfied that the respondent gave value to the extent it was required by s 296(3)(c), to do so.

Judgment

[53] The application is dismissed.

The applicants shall pay the respondent's costs calculated on a category 2B basis, together with approved disbursements.

Associate Judge Christiansen