IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2012-404-000739
[2012] NZHC 3041

UNDER	the Companies Act 1993
IN THE MATTER OF	an application under section 297 of the Companies Act 1993
BETWEEN	PETER ESMOND FARRELL AND SIMON PAUL ROGAN Plaintiffs
AND	GARY HOOKER Defendant

Hearing: 12 November 2012

Appearances: J MacGillivray and S Jass for Plaintiffs
P R Cogswell for Defendant

Judgment: 15 November 2012

JUDGMENT OF VENNING J

This judgment was delivered by me on 15 November 2012 at 3.30pm, pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date..........

Solicitors: Tompkins Wake, PO Box 258, Hamilton 3240
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Introduction

[1] L Stevens Builders Ltd (the company) was put into liquidation on 7 July 2011. The plaintiffs were appointed liquidators.

[2] Seven months earlier, by agreement dated 16 December 2010, Mr Hooker agreed to purchase the company's land and buildings, together with its plant and equipment, for $268,000 (inclusive of GST).

[3] The liquidators consider the sale was at an undervalue. They seek orders requiring the defendant to pay the difference between the market value and the price paid by the defendant for the land, buildings, plant and equipment.

Background

[4] The company was established by Lawrence Stevens. As the name suggests it was a building company. Lawrence Stevens was its director. Lawrence Stevens together with his sons Shannon and Adam Stevens were shareholders.

[5] The company operated in the Rotorua area. It was placed into liquidation by the High Court at Rotorua on the application of a creditor, Mr and Mrs Ogilvie. The company had pursued the Ogilvies for unpaid building work. The claim went to arbitration. The Ogilvies won at the arbitration. When the company failed to meet the costs award made against it the Ogilvies took steps to liquidate the company.

[6] Mr Hooker has known Adam Stevens for about 20 years. In early 2010 Mr Hooker approached Adam Stevens to see if he was interested in investing in a holiday home. Mr Hooker was interested in purchasing a holiday home and wanted someone to share the costs and expenses with. He mentioned that he had about $170,000 available to invest. Nothing came of that discussion, but Mr Stevens knew Mr Hooker had money to invest. In October 2010 Adam Stevens asked Mr Hooker if the company could borrow money from him to fund some of the legal costs it had incurred with the arbitration. Mr Hooker was told the company's legal advice was that they would win the case and recover the $30,000 claimed together with costs.

Mr Hooker agreed. He made two advances to the company: $15,000 on 21 October 2010 and $7,150 on 22 November 2010.

[7] In late November 2010 Adam Stevens told Mr Hooker the arbitration had been decided against the company. He said the company had received advice that it should sell down some assets to reduce its debt. He told Mr Hooker he was looking at selling the property at 40 Clayton Road owned by the company. Mr Hooker indicated an interest in purchasing the property. The parties discussed and negotiated a price between 13 December and 16 December. Ultimately they agreed on $268,000 for the land, buildings, plant and equipment. As part of the deal the $22,150 was to be taken into account and repaid so that the purchase price was actually $290,150. The parties also agreed a lease would be put in place in relation to both the buildings and the use of the plant and equipment. Mr Hooker said that after the purchase price was settled the parties negotiated the lease terms. The parties ultimately agreed to a rental of $18,000 plus GST with the tenant responsible for rates, insurance and general upkeep of the plant and equipment. The term agreed was three years with two renewals of three years each. The tenant was Tenmax Group Ltd, a company Mr Hooker assumed was associated with Adam Stevens.

[8] Shortly after the transfer of the property, the Ogilvies applied to the Rotorua High Court on 15 March 2011 to place the company into liquidation.

The law

[9] The application is made pursuant to s 297 of the Companies Act 1993:

> **297 Transactions at undervalue**
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> **[**(1) Under subsection (2) the liquidator may recover from a person (X) the amount C in the formula A − B = C, where—
>
> (a) A is the value that X received from a company under a transaction to which the company was or is a party; and
>
> (b) B is the value (if any) that the company received from X under the transaction.]
>
> [(2) The liquidator may recover the difference in value (that is, C in the formula in subsection (1)) from X if—

> (a) the company entered into the transaction within the specified period; and
>
> ...
>
> (i) the company was unable to pay its due debts when it entered into the transaction; ...

[10] In the present case the liquidators are required to establish:

(a) that the company agreed to sell its land, buildings, plant and equipment within the specified period (two years before 15 March 2011); and

(b) the company was unable to pay its due debts when it entered the agreement on 16 December 2010; and

(c) that the transaction was at an undervalue.

[11] The liquidators are not required to prove Mr Hooker's knowledge of the company's position.

[12] The transaction was clearly within the specified period. If the liquidators are able to establish the company was unable to pay its debts and that the sale was at an undervalue, Mr Hooker seeks relief under s 296(3) of the Act:

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

[13] In terms of s 296(3) the liquidators concede Mr Hooker can be said to have acted in good faith.

The issues

[14] The issues before the Court are:

(a) whether the liquidators can prove that, as at 16 December 2010, the company was unable to pay its due debts; and

(b) that the sale was at an undervalue; and, if so,

(c) whether Mr Hooker can prove that a reasonable person in his position would not have suspected, and Mr Hooker did not have reasonable grounds for suspecting, that the company was or would become insolvent; and

(d) whether Mr Hooker can prove he gave value for the property or altered his position in the reasonably held belief that the transfer of property to him was valid and would not be set aside.

Was the company unable to pay its debts as at 16 December 2010?

[15] The concept of an inability to pay debts as they became due was discussed in *Re Universal Management Ltd (In Liquidation).*[1] In that case Davison CJ adopted the formulation suggested by Richardson J in *Re Northridge Properties Ltd*.[2] For present purposes an important feature of the test is that, "as they become due" means as they "legally" become due. "Due debts" has the same meaning. It is not a matter of measuring assets against liabilities nor a matter of whether, given sufficient time, assets could be realised and debts paid. The section is directed at ability to pay debts as they become due. That imports an element of immediacy and the ability to readily provide cash from non-cash assets. The test is an objective one.

[16] Mr Farrell has reviewed the company's financial records and produced an estimated balance sheet as at 31 March 2010. He considers that, as from that date,

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1 *Re Universal Management Ltd (In Liquidation)* (1981) 1 NZCLC 95-026.
2 *Re Northridge Properties Ltd* M46/75 13 December 1977, Richardson J.

the company was unable to pay its due debts. As at that date the company had negative working capital, (excluding related party amounts of $94,000). In his view it was also insolvent as at that date.

[17] Mr Stevens disputes that. He says following the adverse result of the arbitration and the application to the Court to set the arbitration award aside he was advised to make the commercial decision to "let the company go". That would have been in December 2010. But he does not consider the company was ever insolvent nor accept that it was unable to pay its due debts.

[18] Mr Hooker has obtained an affidavit from Terence Roy Hillson, a forensic accountant of Auckland. Mr Hillson is experienced in liquidation work. He offers the opinion that he does not believe the company was insolvent in March 2010. In Mr Hillson's view Mr Farrell's review of the company does not take sufficient note of:

- director, shareholder and related party support;
- National Bank support;
- contingent assets;
- the value of the company's assets;
- the company's ability to realise assets.

[19] Mr Farrell has responded to Mr Hillson's affidavit. He questions Mr Hillson's ability to give expert evidence noting that Mr Hillson was suspended from the Institute of Chartered Accountants of New Zealand for five years after being adjudicated bankrupt on 30 April 2009.

[20] Neither Mr Farrell nor Mr Hillson were required to attend for cross-examination. The result is that I propose to take little account of their opinion evidence. In any event, this issue is not dependent on the opinion evidence of Mr

Hillson and Mr Farrell. I prefer to determine the issue on the other evidence before the Court. The following features emerge from the evidence, taken overall.

[21] Despite Mr Stevens' evidence the company was trading on and did not face claims from other creditors, it is apparent from Mr Farrell's reconstruction of the accounts that the company was not trading successfully. The company suffered losses of $70,500 approximately to 31 March 2010 with losses brought forward from 2009 of $43,350. There is no evidence to indicate the business turned around from 1 April 2010 on. Indeed, at commencement of the liquidation Mr Stevens Senior cited decreased building work as one reason for its liquidation.

[22] By the early part of 2010 the company was not able to pay its creditors in full. A part payment of $4,500 to Rotoma Timber and Hardware Ltd (Rotoma) was dishonoured by the bank on 27 April 2010. Akoranga Carpentry Services invoiced the company for $3,847.50 on 16 June 2009. That debt was still being paid off by instalments on 13 April 2010. Henderson Quarries Ltd invoiced the company for $2,049.80 on 31 January 2010. That was still being paid off by instalments on 13 April 2010.

[23] There is further evidence of the company's inability to pay all creditors in full close to the time of the relevant transaction. As at 30 November 2010 it owed creditors $69,882. Only $18,157 of that was current. The balance $51,725 was overdue. In the case of one substantial creditor, Rotoma, the total amount due was in excess of $20,000. Rotoma was not being paid when its accounts became due. On 21 November 2010 Rotoma had written to the company in the following terms:

> RE ACCOUNT CONDUCT
>
> Further to our numerous telephone conversations regarding the unsatisfactory conduct of your account it is disappointing to note that your account still has an outstanding balance of $22,968.12.
>
> As this is well outside our standard trading terms we must insist that a payment be made to the account within 10 working days. Interest will be charged to your account on the total outstanding balance if it is not cleared in full by the 20th December.

[24] Next, it appears the directors were considering liquidation. The company's accountants invoice dated 14 December 2010 records:

> To meeting with Adam 14 December 2010 regarding potentially liquidating the Company after the sale of the business workshop and land.

[25] I refer to the issues raised by Mr Hillson. Mr Hillson is correct that the company had director, shareholder and related party support by way of recorded advances. However, there is no evidence before the Court of the ability or willingness of those parties to continue to support the company. Further, while there were advances of approximately $93,000 from related parties as at March 2010 those related parties, including Mr Adam Stevens, had also withdrawn moneys from the company. The net effect of related parties' transactions to 31 March 2010 was in fact to reduce cash available to the company by just over $6,000 for the year. The requirement for the cash injection from Mr Hooker, a completely independent third party, in October and November 2010 would suggest the related parties were either no longer willing or able to support the company by that time.

[26] Nor do I consider the bank's support is an answer. The company's borrowing from the National Bank increased from approximately $144,000 on 1 April 2010 to in excess of $212,000 by 31 December 2010. Notwithstanding this support the company was still not in a position to pay its creditors when due.

[27] Mr Hillson also suggested the claim against the Ogilvies was a contingent asset. However, the arbitration award finding against the company was delivered in November 2010. By 16 December 2010 the company had no contingent assets. Rather it had a substantial additional liability as a result of the adverse arbitration award.

[28] Next, while Mr Hillson is correct in that the company's land and buildings were realised for in excess of the book value, that does not support the submission the company was able to pay its due debts. To meet that test the company needed to be able to readily provide cash from its non-cash resources. Mr Stevens' evidence was that, having obtained a market appraisal from Bayleys he put the word out to a number of people, including outside Rotorua, they were looking to sell the property.

Mr Stevens said that although there were a few people around Rotorua that they thought may have been interested they got no real interest. A verbal offer was presented but it was too low to be considered. The element of immediacy in the ability to provide cash from the non-cash assets was lacking. At best the unrealised equity might have supported further borrowing but, as noted, although the company increased its borrowing from the National Bank it was still not able to pay its creditors in full when due.

[29] The evidence satisfies the Court that, likely as at 31 March 2010, but certainly by 16 December 2010, the company was unable to pay its due debts.

Was the sale at an undervalue?

[30] The agreement for sale and purchase recorded the sale price of $268,000 (GST inclusive) for the land and buildings at 40 Clayton Road, Rotorua together with plant and equipment. Both Mr Stevens and Mr Hooker gave evidence that the sale price was also intended to include repayment of the loans Mr Hooker had previously made to the company. In other words, the purchase price was to effectively be $290,150 (inclusive of GST).

[31] I interpolate here that the liquidators suggest that if that is the position then in accordance with s 292 of the Act the loan was effectively repaid by set-off which would be a separate voidable transaction in itself. That, however, must be for another day as there is no such application before the Court.

[32] Although the agreement did not separately identify the price for the plant and equipment Mr Hooker thought the value placed on the plant and equipment was around $30,000 but it may have been $33,000. That price range seems appropriate. Mr Hooker had obtained an auction valuation for it which indicated a price range of between $25,000 to $30,000 plus GST. The plant and equipment was valued in the accounts as at $33,000 as at 31 March 2010.

[33] In round figures then, and allocating say $30,150 to reflect the value of the plant and equipment, (including GST, if any), the land and buildings at 40 Clayton

Road were transferred to Mr Hooker at $260,000 (GST inclusive). From the company's perspective it received $226,087 after accounting for GST. The issue is whether the transaction was at an undervalue.

[34] The liquidators rely on a valuation from Mr Russ, a registered valuer. He assessed the property's market value with vacant possession at $285,000 plus GST and tenanted at $300,000 plus GST.

[35] Mr Hooker obtained a report from a Cindy James, a registered valuer also practising in the Rotorua area. Ms James considers the property to have had a market value with vacant possession of $260,000 plus GST but, as tenanted, a market value of $247,000 plus GST. Ms James suggests that the rental at $18,000 per annum, which includes rental for the residence as well as rental for plant and equipment would appear to be significantly understated hence the lower figure for the "as tenanted" situation.

[36] Both Ms James and Mr Russ favour valuing the property on a market rental income approach. Mr Russ assessed the rental market value at $26,160 plus GST. On that basis he assessed the value with vacant possession in the range of $275,000 to $291,000 based on a yield towards the upper end of the normal range between 9 and 9.5 per cent. He adopts a value of $285,000 plus GST. Ms James considers the market rental to be $26,600 plus GST, which is close to Mr Russ' figure. However, she takes a yield of between 10 and 10.5 per cent to arrive at her valuation of $260,000 plus GST for vacant possession.

[37] I put to one side Ms James's estimate on the basis of the reduced figure for the property as "tenanted". The rental at $18,000 was fixed by agreement between Mr Stevens and Mr Hooker. It was negotiated after the price for the property had been agreed by Mr Hooker and Mr Stevens. The rental was not a factor which fed into fixing the value of the property for sale purposes.

[38] Neither Mr Russ nor Ms James were called for cross-examination. The Court was given little assistance on which of the two experts' approach should be preferred. Mr MacGillivray suggested that the Court might take a mid-range of

values. I am not prepared to adopt that approach. The issue is one of proof. The onus is on the liquidators to establish the transaction, in this case the sale of the land and building at an effective price of $260,000 inclusive of GST was at an undervalue. The onus is on them to establish the value they rely on. The valuers are very close on their assessment of a market rental. The major difference between them is in the appropriate yield to apply. In the absence of cross-examination or evidence other than the two competing reports I am not in a position to form a view as to whether the range of 10 to 10.5 per cent return relied on by Ms James to support $260,000 plus GST is any less reliable than the 9.0 to 9.5 per cent relied on by Mr Russ to support his value of $285,000 plus GST.

[39] I take the valuation advanced by Ms James on behalf of Mr Hooker at $260,000 plus GST as the value for the property.

[40] Mr Cogswell submitted that GST should not be taken account of as Mr Hooker was not registered for GST and the purchase price was inclusive of GST. But the focus of s 297 is on the difference between the value received by Mr Hooker from the transaction and the value the company received. There are two possible ways to approach this issue. It could be said that Mr Hooker received a property worth $299,000 (including GST). The company received $260,000 in exchange. Alternatively, looking at it from Mr Hooker's point of view, (consistent with s 297(1)(a)) the value of the property to him (because he is not registered for GST) is $260,000, but, as the company had to return GST on the sale of the property at $260,000 the value it actually received under the transaction (applying s 297(1)(b)) was $226,000 approximately, so the undervalue for the purposes of s 297(1) would be $34,000. Given the focus is on the undervalue of the property in the company's hands, the second approach may be the more appropriate.

[41] Mr Cogswell submitted that the Court should also give a discount for the fact that sale was negotiated directly between the parties without the need to engage a real estate agent. However, s 297(1) does not contemplate a deduction of that kind. The fact that the company might have received less if a real estate agent had been involved does not affect the value received by the company in relation to the transaction between Mr Hooker and the company.

[42] While I accept that a de minimus amount may not be sufficient to establish a transaction at an undervalue a figure of $34,000 is not de minimus.

[43] So, prima facie, the liquidators are entitled to recover the undervalue of $34,000 from Mr Hooker.

The s 296 defence

[44] The next issue is whether a reasonable person in Mr Hooker's position would not have suspected, and Mr Hooker did not have reasonable grounds for suspecting, that the company was or would become insolvent. The onus is on Mr Hooker. There are two aspects to the test, an objective one and Mr Hooker's subjective position.

[45] The objective test involves consideration of the information that Mr Hooker had and then considering whether a reasonable business person with that knowledge would have suspected the company was or would become insolvent. The hypothetical reasonable person is assumed to have the knowledge and experience of the average business person but not the skills and experience of a financial analyst or someone with legal training or any other kind of tertiary education: *Cusson as Liquidator of Akai Pty Ltd (in liq) v Federal Commissioner of Taxation*.[3] The second aspect of s 296(3)(b) involves consideration of whether Mr Hooker himself had reasonable grounds to suspect the company was or would become insolvent.

[46] Mr Hooker denies that he was aware of the company's insolvency. He says he did not know it could not meet its creditors. He says his relationship with Mr Stevens was not that close. He considered the company needed short-term funding to help it meet its commitments to its lawyers. He was aware the Court case had created cash flow difficulties but in 2010 did not consider that to be unusual.

[47] As at 16 December Mr Hooker had the following information:

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[3] *Cusson as Liquidator of Akai Pty Ltd (in liq) v Federal Commissioner of Taxation* (2004) 22 ACLC 1528.

(a) the company had been involved in an arbitration or Court proceedings to recover extras on a building project it had been involved in;

(b) in October and November 2010 Mr Hooker had been asked if he could lend some money to fund some of the legal costs the company was incurring;

(c) in November he was told the case had been determined against the company and it would not only not receive the expected money judgment but would have to pay costs; and

(d) the company's accountants had recommended the company should sell down some assets to reduce debt. It was characterised as a restructure, not a disaster.

[48] Objectively, a reasonable person might have suspected there were issues with the company's solvency given that Mr Stevens was asking Mr Hooker, a friend, to lend the company money on two separate occasions in both October and November to meet its commitments to its lawyers at that time. The position would only have worsened after the company lost the arbitration it expected to win. However, the matter is beyond doubt in any event on the second aspect of the test.

[49] Following the liquidators' investigation into the affairs of the company Mr Farrell had a telephone discussion with Mr Hooker on 12 September 2011. Mr Farrell recorded the substance of the conversation in a letter of 19 September to Mr Hooker. Mr Farrell attached a file note of the discussion to his letter. Mr Hooker replied inter alia to the notes:

> 3. The loans were made to the Company to help pay legal fees and to help Adam Stevens because as you put it, "he was struggling to keep the Company afloat",
>
> Correct.

[50] If Mr Hooker had said that to Mr Farrell, then clearly he must have had reasonable grounds to suspect the company was or would become insolvent. In cross-examination Mr Hooker initially denied making that statement to Mr Farrell,

but when taken to his letter he acknowledged his response to Mr Farrell. When pressed to acknowledge he did tell Mr Farrell that part of the reason for the loan was that Mr Stevens was struggling to keep the company afloat he did not directly answer the question.

[51] Another principal difficulty for Mr Hooker is that he knew the company was selling not only the land and buildings where it operated from but also its plant and equipment, including all its building equipment and tools. Clearly the company required the use of the plant and equipment if it was to continue operating. But despite that, the lease that the parties negotiated was in the name of another entity rather than that of the company. Mr Hooker must have had strong grounds for suspecting the company was insolvent and would likely be liquidated. How could the company carry on its building business without the plant and equipment to do so?

[52] In the circumstances it is unnecessary to determine the third issue, whether Mr Hooker gave value or whether he altered his position in the reasonably held belief the transfer was valid and would not be set aside. Mr Hooker cannot make out the second element of s 296(3)(b). At the very least, by 16 December he must have had reasonable grounds to suspect that the company was or would become insolvent. He is not entitled to relief.

Result

[53] (a) The plaintiffs are to have an order under s 297 of the Companies Act 1993 directing the defendant to pay them the sum of $34,000 to the plaintiffs as liquidators.

(b) The defendant is to pay interest on that sum from the date of the issue of these proceedings of 7 February 2012.

Costs

[54] The liquidators are to have costs on a 2B basis. Costs and disbursements as fixed by the Registrar.

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Venning J