Company and Securities Law in New Zealand

2nd Edition

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Preface

Rarely over the last five years has a week gone by without a story in the media about directors, corporate malfeasance or securities law breaches; all subjects of this treatise on company and securities law. But despite the prominence of company and securities law issues in the media, the statutory law to date has not been altered much since the first edition of this book in 2008, written prior to the global financial crisis. This is set to change. A major rewrite of our securities law has taken place with the introduction of the Financial Markets Conduct Bill. That Bill is due to be passed in 2013 and to come into force later in the year. Its architect and the then Commerce Minister Simon Power described it as a once-in-a-generation reform. This edition of Company and Securities Law in New Zealand is the first text to deal comprehensively with the new law while still retaining commentary on the existing legislation.

The fallout from the failure of the finance company sector has led to increased focus on the liability of directors when companies fail. The original version of the Financial Markets Conduct Bill made breach of a number of the duties of directors’ criminal offences; later versions of the Bill (some subsequent to the writing of this edition) place more focus on civil liability and compensation, reserving the main criminal sanctions for directors guilty of serious wrongdoing. The new edition contains discussion on criminal liability of directors. There is also discussion of a number of the cases involving liability of directors of the finance companies.

The second edition draws together the same author team as the 2008 edition and contains a new chapter on business structures. The author team would like to thank Thomson Reuters for their support and in particular Billie Little and Renay Taylor. We would like also to acknowledge the contributions of our research assistant Jenny Chen.

John Farrar and Susan Watson

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6.3 Legitimate use of the corporate form and the development of the piercing the veil doctrine

The legislation does not define the appropriate ends of incorporation and neither have the courts, although there have been specific enactments to restrict the scope of *Salomon* and decisions of the courts, from time to time, which pierce the corporate veil.

In *Attorney-General v Equiticorp Industries Group Ltd (in stat man)*, the Court of Appeal said:\(^{34}\)

> “The phrase ‘to lift the corporate veil’ is a description of the process by which in certain situations the Courts can look behind the corporate façade and identify the real nature of a transaction and the reality of the relationships created. It is not a principle. It describes the process, but provides no guidance as to when it can be used.”\(^{35}\)

As Rogers AJA said in the New South Wales Court of Appeal in *Briggs v James Hardie & Co Pty Ltd*:\(^{35}\)

> “The threshold problem arises from the fact that there is no common, unifying principle, which underlies the occasional decision of courts to pierce the corporate veil. Although an ad hoc explanation may be offered by a court which so decides, there is no principled approach to be derived from the authorities”.

It is difficult to start to rationalise these cases except under the broad, rather question-begging heading of policy and by describing the main legal categories under which they fall.\(^{36}\) These are:

1. Agency;
2. Fraud;
3. Group enterprises;
4. Trusts;  

\(^{34}\) *Attorney-General v Equiticorp Industries Group Ltd (in stat man) [1996] 1 NZLR 528 (CA) at 541.*

\(^{35}\) *Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549 (NSWCA) at 567.* See also McKay J in *Attorney-General v Equiticorp Industries Group Ltd (in stat man) [1996] 1 NZLR 528 (CA) at 541 (piercing the corporate veil is not a principle but a process).*

6.3.1 Agency

The Salomon case held that a company was not automatically the agent of its shareholders. It did not exclude the possibility of there being an agent relationship in fact. Occasionally the courts have seemed willing to construe an express or implied agency of the company for its members.\(^37\) It has, however, been held that a 98 per cent controlling interest in a company by itself does not create or manifest an agency relationship.\(^38\) The authorities were reviewed by Atkinson J in Smith, Stone & Knight Ltd v Birmingham Corp where he attempted, without much success, to identify the underlying principles.\(^39\) The facts of the case were that a company took over a business and continued it through a subsidiary company, which was treated as a department of the parent company. The parent company claimed compensation on the basis of injury by the corporation’s use of its powers of compulsory acquisition over the subsidiary’s land. Piercing the corporate veil was essential to the plaintiff’s claim since the corporation would otherwise escape paying compensation altogether by virtue of s 121 of the Lands Clauses Consolidation Act 1845 which enabled purchasers to get rid of occupiers with short tenancies by giving them notice. Counsel for the parent company used agency and group arguments, and Atkinson J accepted that the parent company could recover. He said that the overall question of whether the subsidiary was carrying on the business as the parent company’s business or as its own was a question of fact. In answering that question, six factors were weighed:

1. Were the profits of the subsidiary those of the parent company?
2. Were the persons conducting the business of the subsidiary appointed by the parent company?
3. Was the parent company the “head and brains” of the trading venture?
4. Did the parent company govern the venture?
5. Were the profits made by the subsidiary company a result of the skill and direction of the parent company?
6. Was the parent company in effective and constant control of the subsidiary?

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37 See Rainham Chemical Works Ltd v Belvedere Fish Guano Co [1921] 2 AC 465 (HL); Southern v Watson [1940] 3 All ER 439 (CA); Clarkson Co Ltd v Zlodko (1967) 64 DLR (2d) 457. For a detailed survey, see R Flannigan “Corporations controlled by shareholders” (1986) 51 Sask L Rev 23. Compare Re Polly Peck International plc (In Administration) (No 4) [1996] 2 All ER 433.
38 Kodak Ltd v Clark [1903] 1 KB 505 (CA); Denis Wilcox Pty Ltd v Federal Commissioner of Taxation (1998) 14 ACLR 156.
39 Smith, Stone & Knight Ltd v Birmingham Corp [1939] 4 All ER 116.
Conceptually, this is an incoherent approach; (4), (5) and (6) cover very much the same ground. Atkinson J held that the subsidiary was the “agent or employee; or tool or simulacrum of the parent”. For all its faults Smith, Stone & Knight was followed by Else-Mitchell J in the New South Wales Supreme Court case of Hotel Terrigal Pty Ltd v Latec Investments Ltd (No 2), where his Honour disregarded a purported sale by a mortgagee company of the mortgaged property to its wholly owned subsidiary for an improper purpose. The emphasis in compulsory acquisition cases has shifted more recently to the group enterprise argument.

6.3.2 Fraud

The courts are prepared to pierce the corporate veil to combat fraud, and they will not allow the Salomon principle to be used as a means of fraud. Fraud here covers criminal fraud but also includes equitable fraud. In Gilford Motor Co Ltd v Horne, a managing director of a company entered into a covenant in a service agreement not to solicit customers from his employers. Upon leaving the company’s employment he formed a company to solicit customers. It was held by the Court of Appeal that his company was a mere sham to cloak his wrongdoings and, therefore, he could be restrained from committing a breach. Similarly, in Jones v Lipman a man contracted to sell property but then changed his mind. In order to avoid an order for specific performance he transferred the property to a company. Russell J held that specific performance could be ordered against the company. It was “the creature of the first defendant, a device and a sham, a mask which he holds before his face to avoid recognition by the eye of equity”.

Again, in Re Bugle Press Ltd the use of a company as a device to fall within the provisions of s 209 of the Companies Act 1948 (UK) was disallowed. Section 209, which is re-enacted in s 979 of the Companies Act 2006 (UK), enables a takeover bidder who falls within the section and has acquired the requisite proportion of shares to acquire the minority compulsorily. Here there were three shareholders, two of whom wanted to buy out the third, who refused to sell. As the facts did not fall within the section the majority formed a company to make an offer for all the shares in order to bring the matter within the section. The Court of Appeal, looking to substance rather than form, disregarded the company as a mere sham or simulacrum. The minority shareholder, said Harman LJ, had only to shout and the walls of Jericho fell flat.

In such cases as the latter, the courts frequently use the terms “device”, “façade” or “sham”.

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40 Hotel Terrigal Pty Ltd v Latec Investments Ltd (No 2) [1969] 1 NSWLR 676 (NSWSC).
42 Jones v Lipman [1962] 1 All ER 442.
44 Re Bugle Press Ltd [1961] Ch 270 (CA). See also NZ Seamen Union IOUW v Shipping Corp of NZ Ltd (1989) 2 NZELC 96,708 (LC) (transferring ownership of ships to Hong Kong to evade New Zealand labour laws).
45 See eg, Woolson v Strathclyde Regional Council (1979) 38 P & CR 521; Re H (restraint order: realisable property) [1996] 2 All ER 391. For the use of such terms, see Lord Cooke of Thorndon Turning Points of the Common Law, Hamlyn Lecture 1996 (Sweet & Maxwell, London, 1997).
There has been an increasing tendency on the part of English courts and, on occasion, Commonwealth courts to use the language of “façade”, “sham” or “cipher”, echoing the earlier use of mask, cloak or simulacrum.  

Like much common law usage, this is question begging or a category of illusory or circular reference and better avoided. It does little more than imply a value judgment of disapprobation. Most of the cases are in fact examples of fraud in the broadest sense. Beyond this they represent an inarticulate attempt to mark the limits of legitimate incorporation.

The timing of the switch to a different corporate entity is crucial. Where it occurs before the accrual of the cause of action, the courts will not pierce the corporate veil, but it is otherwise where the switch is made after the cause of action accrued. Thus in *Adams v Cape Industries Pty Ltd* in 1990, the English Court of Appeal refused to pierce the corporate veil where a subsidiary company was set up to reduce potential tortuous liability.

However, it should be noted that the courts have not shown any great willingness to step in to protect creditors from abuse of the corporate form in the absence of fraud. Where reckless trading has taken place, s 135 of the Companies Act 1993 now enables the court to pierce the corporate veil.

**6.3.3 Group enterprises**

The courts have sometimes shown a willingness to look upon a group of companies as one economic unit. This is done by the accounting and disclosure provisions of the companies legislation to some extent and is now carried on by the courts on occasion. Indeed the legislation has been used as a justification for the case law even though not strictly relevant. In *Littlewoods Mail Order Stores Ltd v McGregor*, Lord Denning stated that the doctrine laid down in *Salomon* had to be carefully watched. It has often been supposed to cast a veil over a limited liability company through which the courts could not see. This was not accurate. The courts can and often do draw aside the veil to look at what really lies behind.

Parliament has shown the way: the courts should follow suit. A similar line was taken in *DHN Food Distributors Ltd v London Borough of Tower Hamlets*. This was a case of compulsory acquisition. One company of a group owned the freehold, and another company, which carried on the business on the premises, was a bare licensee. The Court of Appeal was prepared to recognise the economic unit of the group as a single entity to enable them to recover their compensation. The different members of the Court of Appeal seem to have been influenced by different factors. Lord Denning MR referred to the fact that the subsidiaries were wholly owned, but thereafter lapsed into metaphor. Goff LJ made it clear...
that not every group would be treated in this way but pointed to ownership, no separate business operations, and the nature of the question to be answered. Shaw LJ pointed to common directors, shareholdings, and common interest.

This approach seems to go too far and is inconsistent with the view of the High Court of Australia in *Industrial Equity Ltd v Blackburn* where it was said that the group accounts provisions did not operate to deny the separate legal personality of the company. The *DHN* case was not followed by the House of Lords in the Scottish appeal of *Woolfson v Strathclyde Regional Council*. A similar approach, again more consistent with *Salomon’s case*, was taken by the New Zealand Court of Appeal in the case of *Re Securitibank Ltd* (No 2). This involved an in-house bill where the client drew a bill of exchange on Merbank, which was then discounted by another member of the group, Commercial Bills. Counsel sought to argue that this involved an infringement of the money lending legislation because the essence of the transaction was a loan if one pierced the corporate veil. The Court of Appeal referred to the *Littlewoods* case and thought that it was putting the matter the wrong way round. The starting point should be the application of the *Salomon* principle and any departure from it must be looked at very carefully. *Woolfson v Strathclyde Regional Council* and *Re Securitibank Ltd* were considered by Young J in the New South Wales case of *Pioneer Concrete Service Ltd v Yelnah Pty Ltd*. This case involved a group of companies that had entered into a complicated commercial agreement with full legal advice. His Honour held that the Court would only pierce the corporate veil where it could see that there was in law or in fact a partnership between the companies, or where there was a mere sham or façade. Here there was a good commercial reason for having separate companies perform different functions and the veil should not be pierced.

After a review of the earlier cases, the Court held that each company in a group is a separate entity. It made the point that in many of the cases of “simple economic unit” there was some justification in the wording of the particular statute or contract. *DHN* could be explained in this way.

In the New South Wales Court of Appeal decision of *Briggs v James Hardie & Co Pty Ltd*, Rogers AJA made an interesting analysis of what he called “the unity of enterprise theory”, relying on Commonwealth and United States authorities. The majority gave a liberal interpretation to s 58 of the Limitation Act NSW 1969 to allow an extension of the limitation

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52  *Industrial Equity Ltd v Blackburn* (1977) 137 CLR 567 (HCA) at 577.
54  *Re Securitibank Ltd* (No 2) [1978] 2 NZLR 136 (CA).  
56  *Adams v Cape Industries Pty Ltd* [1990] Ch 433 (CA). See also *Bank of Tokyo Ltd v Karoon* [1987] AC 45 (CA) at 64 per Robert Goff J; and the Canadian cases; *Trident Leasing (Canada) Ltd v Saskatchewan Market Mall Ltd* (1996) 24 BLR 105 (Sask CA) and *Bow Valley Hickey v Saint John Shipbuilding Ltd* (1996) 21 BLR (2d) 265 (Newf CA).  
period in a case of multiple defendants. Rogers AJA said that the mere potential to exercise control over a subsidiary was not enough to justify piercing the corporate veil. The exercise of some control was also insufficient. Dominance may be part of the test, but Commonwealth company law was not settled on this nor on the degree of control, the extent, reliance, or undercapitalisation. The Salomon principle had survived the growth of corporate groups, and domination and control were not per se sufficient to pierce the corporate veil. It is unfortunate that his Honour does not appear to have been referred to the United States instrumentality doctrine which, when read in the context of the United States approach overall, completes the picture. In Re a Company in 1985, the English Court of Appeal was prepared to pierce the corporate veil by granting an injunction restricted to companies controlled by the defendant where the evidence showed that the defendant had created a corporate network to dispose of his assets and there was an allegation of fraud.

In New Zealand, in Chen v Butterfield, Tipping J said:

“In essence the corporate veil should be lifted only if in the particular context and circumstances its presence would create a substantial injustice which the Court simply cannot countenance. Whether that is so must be judged against the fact that corporate structures and the concept of separate corporate identity are legitimate facets of commerce. They are firmly and deeply engrained in our commercial life. If they are genuinely and honestly used they should not be set aside. In any event something really compelling must be shown to go behind them.”

His Honour thought the façade approach was not entirely satisfactory and preferred the approach of the New Zealand Court of Appeal in Re Securitibank. His Honour referred to substantial injustice and he said that from time to time the word “unconscionable” had been used. However, in Bentley Poultry Farm v Canterbury Poultry Farmers Cooperative Ltd (No 2), he said:

“I was in no way suggesting by my use of the word ‘unconscionable’ some general test whereby the corporate veil could be lifted if the Court considered that it was inequitable or unfair to allow the veil to remain. To suggest that the corporate veil can be lifted simply if the Court feels that its presence leads to some unfairness or inequity would be quite unsatisfactory and would lead to enormous commercial uncertainty.”

In Official Assignee v 15 Insoll Avenue Ltd, Paterson J applied both the façade and the substantial injustice test of Tipping J. He thought that s 15 of the Companies Act 1955 merely restated the common law position and did not prevent piercing the corporate veil.

In Hesketh Henry v Aotearoa Television Network Ltd, the Court held that it was not possible to ignore the form of transactions where there was no element of sham or façade.
In *McNamara v Malcolm J Lusby Ltd*, the Court was asked to lift the corporate veil to allow a negligence proceeding to be brought against a related company of the company that actually carried out the work. The Court found that in the absence of fraud or sharp practice, the fact that the companies used the same web site, yellow pages advertisements and the common use of a trade name were not compelling reasons to look beyond their corporate identities.

One area where the courts have been particularly reluctant to recognise the concept of group entity is in relation to corporate debts. It is not usually possible in the absence of an agency or trust relationship or wrongful trading to hold one group company liable for the debts of another. In the United States equitable doctrines are sometimes applied in this context, and in New Zealand s 271 confers on the court power to order a pooling of assets. Sometimes, however, even in the United Kingdom, the courts have been forced into this position due to the hopeless muddle which has faced them. In *Mountfort v Tasman Pacific Airlines of NZ Ltd*, the Court held that mere participation by a holding company in the management of subsidiary company would not be sufficient to justify a pooling order, but found that the subsidiary, Regional Airlines Ltd, had been a “slave” of the holding company Tasman Pacific Airlines of NZ Ltd. It was held that two airlines were so closely linked that Tasman’s insolvency made Regional insolvent, and a pooling order was granted.

The Court stated that s 271 was not to be used to dilute the principle of separate personality without solid reason grounded in the policies of the Act and that trading while insolvent was a sufficient reason.

### 6.3.4 Trust

Occasionally, the courts may pierce the corporate veil to look at the characteristics of the shareholders. In *Abbey Malvern Wells Ltd v Ministry of Local Government and Planning*, a school was carried on in the form of a company, but the shares were held by trustees on educational charitable trusts. The Court was prepared to pierce the corporate veil and look at the terms on which the trustees held the shares.

### 6.3.5 Tort

Although there are isolated cases where English courts have used tort remedies to pierce the corporate veil, it is not common in Commonwealth jurisdictions outside Canada. In Canada, however, there has been an increasing use of tort to bypass *Salomon’s* case.

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63 *McNamara v Malcolm J Lusby Ltd* [1951] Ch 728.
64 Ibid, at [38].
65 For a case where a claim under s 332 Companies Act 1948 (UK) failed, see *Re Augustus Barnett & Son Ltd* (1986) 2 BCC 989, noted in DD Prentice “Fraudulent Trading: Parent Company’s Liability For The Debts Of Its Subsidiary” (1987) 103 LQR 11. For a case where the House of Lords seemed willing to pierce the corporate veil or use the alter ego approach in equity, see *Winkworth v Edward Barns Development Co Ltd* [1987] 1 All ER 114 (HL).
67 *Mountfort v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104 (HC).
68 Ibid, at [86].
69 At [87].
70 Ibid.
71 At [80].
72 *Abbey Malvern Wells Ltd v Ministry of Local Government and Planning* [1951] Ch 728.
a breach of contract,\(^{73}\) deceit,\(^{74}\) and conspiracy\(^{75}\) have all been used in recent cases. In the British Columbia Court of Appeal case of *BG Preeco I (Pacific Coast) Ltd v Bon Street Holdings Ltd* the Court held that *Salomon’s* case was to be adhered to but that there was a direct remedy in deceit against the principal directors and shareholders where they had misled the plaintiff by switching the name of a company with assets to a shell company.\(^{76}\) The end result was the same. The House of Lords in *Standard Chartered Bank v Pakistan National Shipping Corp* thought that the presence of deceit took a case outside *Salomon’s* principle, but attempts to use negligence to the same end have failed in a number of cases including the Court of Appeal decision in *Trevor Ivory Ltd v Anderson* in 1992.\(^{77}\) The courts will not recognise a personal duty of care on directors in the absence of an assumption of personal responsibility or misleading or deceptive conduct under s 9 of the Fair Trading Act 1986.\(^{78}\) There would nevertheless appear to be potential here for undermining the rigour of the *Salomon* principle,\(^{79}\) and this perhaps reflects the fact that its application in the tort area has always been less justifiable than in contract. Many tort victims have no choice in the selection of tortfeasor.

### 6.3.6 Enemy

In times of war, the court is prepared to pierce the corporate veil to expose the controlling shareholders of companies. This was done during the First World War in *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd*, where shares in an English company were held by Germans.\(^{80}\)

### 6.3.7 Tax

From time to time, for reasons of fiscal policy, tax legislation disregards the separate legal personality of companies. The courts are prepared to disregard the separate legal personality of companies in the case of tax evasion or over-liberal schemes of tax avoidance without any necessary legislative authority. In such cases the courts frequently dismiss the company as a mere sham.\(^{81}\) The question of form and substance in tax law is quite complex and this is merely part of it.

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\(^{73}\) *McFadden v 481782 Ontario Ltd* (1984) 47 OR (2d) 134; *BG Preeco I (Pacific Coast) Ltd v Bon Street Holdings Ltd* (1989) 60 DLR (4th) 30.

\(^{74}\) *BG Preeco I (Pacific Coast) Ltd v Bon Street Holdings Ltd* (1989) 60 DLR (4th) 30.

\(^{75}\) *Lehndorff Canadian Pension Properties Ltd v Davis & Co* (1987) 10 BCLR (2d) 342.

\(^{76}\) *BG Preeco I (Pacific Coast) Ltd v Bon Street Holdings Ltd* (1989) 60 DLR (4th) 30.

\(^{77}\) *Standard Chartered Bank v Pakistan National Shipping Corp* [2003] 1 BCLC 244; *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517 (CA). See also *Gilford Motor Co Ltd v Horne* [1933] Ch 935 (CA) and *Ond v Bellhaven Pubs Ltd* [1998] 2 BCLC 447 (CA).


\(^{79}\) *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 (NSWCA) at 578, 580 as per Rogers AJA.

\(^{80}\) *Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd* [1916] 2 AC 307 (HL).

6.3.8 Other legislation

The locus classicus for legislation in general is perhaps the speech of Lord Diplock in Dimbleby & Sons Ltd v National Union of Journalists where he said:82

“My Lords, the reason why English statutory law, and that of all other trading countries, has long permitted the creation of corporations as artificial persons distinct from their individual shareholders and from that of any other corporation even though the shareholders of both corporations are identical, is to enable business to be undertaken with limited financial liability in the event of the business proving to be a failure. The ‘corporate veil’ in the case of companies incorporated under the Companies Acts is drawn by statute and it can be pierced by some other statute if such other statute so provides: but in view of its raison d’être and its consistent recognition by the courts since Salomon v A Salomon & Co Ltd … one would expect that any parliamentary intention to pierce the corporate veil would be expressed in clear and unequivocal language. I do not wholly exclude the possibility that even in the absence of express words stating that in specified circumstances one company, although separately incorporated, is to be treated as sharing the same legal personality of another, a purposive construction of the statute may nevertheless lead inexorably to the conclusion that such must have been the intention of Parliament.”

In that case, the House of Lords held that the phrase “an employer who is a party to the dispute” did not extend to another company which had identical shareholdings and the same parent company as the actual employer.

6.3.9 Conclusion

As Rogers AJA said in Briggs v James Hardie & Co Pty Ltd there is no clear underlying principle and the decisions to depart from the Salomon principle seem to be based on policy.83 The general principle seems to be that Salomon will be applied unless some strong reason to the contrary appears. There is a range from legitimate purposes where it will be applied to dishonest purposes where it will not be applied. The emphasis is on the negative. The courts will not allow it to be used as an engine of fraud or to defend crime, but reduction of potential tort liability short of fraud will not suffice. The courts seem to be reluctant to apply the principle in a pedantic way when it will cause injustice, and it should be emphasised that it is rare that the issue of separate legal personality is the only significant argument in a case. Instead it is usually part of the mix of facts, principles, and policies involved in the resolution of a case.

The question of legitimate use of the corporate form if pursued as a positive concept leads to a discussion of corporate social responsibility, which is an inherently controversial topic. Traditionally, a company has been identified, while solvent, with its shareholders rather than the firm as an enterprise. Increasingly it is being argued that there are a broader range of stakeholders, such as creditors, employees, and consumers, whose interests ought to be considered.

82 Dimbleby & Sons Ltd v National Union of Journalists [1984] 1 WLR 427 (HL) at 435.
83 Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549 (NSWCA) at 567.
8.1 Corporate capacity

8.1.1 Continuing relevance of corporate capacity

Corporate capacity is about the power or the ability of the legal entity to carry out an act. Section 16(1) of the Companies Act 1993 says that companies have full capacity to carry on or undertake any business or activity, do any act or enter into any transactions, and for those purposes have full rights, powers and privileges. Companies have full capacity both within and outside New Zealand. The statutory capacity of companies is couched therefore in the widest terms possible. A company can do anything that it is possible for a company to do and is bound by everything it does.

Life would be simpler if that were the end of the matter and the messy and complex path the law followed to get to this point was consigned to the legal history books. Certainly the position for almost all companies is now that straightforward, but by virtue of s 16(2) it remains possible to restrict the capacity of a company in its constitution. Still potentially applicable therefore, for companies that have constitutions with clauses that limit their capacity, are rules derived from the common law such as the doctrine of constructive notice, the indoor management rule and the ultra vires rule. But it must be stressed that for the vast majority of companies that have no such capacity-limiting clauses in their constitutions, those common law rules are largely no longer relevant.¹

8.1.2 Development of corporate capacity principles

The notion of corporate capacity has its origins in the Middle Ages.² In the modern era of registered companies, the capacity of a company was set out in a publicly registered document called a memorandum of association. The memorandum governed the relationship of the company with the outside world. One of the requirements for incorporation was inclusion in the memorandum of association of a list of objects and powers of the company. Objects were the purposes or objectives of the company. (An example might have been “to carry on business as furniture manufacturers”.)
Section 16(1)(a) of the Companies Act 1993, by describing a company as having full capacity to carry on or undertake any business or activity, do any act or enter into any transaction could therefore be seen as equating capacity with the objects included in the memorandum of association of a company incorporated under an earlier Act. Powers were the means or ways to achieve the objects. (An example might have been “to purchase timber, fabric or other materials”.) A common power was the power to borrow. The second part of s 16(1), which states that a company (for the purposes set out in the first part of s 16(1)) has full rights, powers and privileges, could be equated with the powers given in the memoranda of pre-1993 Act companies. A simple analogy is to view objects as the ends and powers as the means.

The objects and powers contained in the memorandum of association were notice — by the company, to the world — of the extent of its capacity. If a third party was considering entering into a transaction with a company, that third party was obliged to check the memorandum of association of the company to see whether the proposed transaction was encompassed by the objects and powers of the company. Importantly, whenever financial institutions were considering lending money to a company, a check was made to ascertain whether the company had the power to borrow.

If a company entered into a contract that was beyond its objects and powers contained in its memorandum, that contract was ultra vires; that is, outside the powers of the company. If a company entered into an ultra vires transaction, the transaction was not regarded as illegal — rather it was considered that the company lacked the competency or power to

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1 The one exception may be statutory corporations; that is corporations created by statute for a specific purpose such as the companies created pursuant to the State-Owned Enterprise Act 1986. State-owned enterprises such as New Zealand Post Ltd and Meridian Energy Ltd are a form of statutory corporation. State-Owned Enterprises must, pursuant to s 14 of the State-Owned Enterprises Act 1986, provide shareholding ministers with statements of corporate intent, which, it could be argued restrict the type of activities that the SOE can undertake. In Communities Economic Development Fund v Canadian Pickles Co (1991) 1 SCR 388, a Canadian case involving an Act with provisions very similar to the Companies Act 1993, the statutory corporation was given the powers of a natural person but in another section of the Act was prohibited from making loans in contravention of the Act. The Canadian Supreme Court decided that the loans made in contravention of the Act were ultra vires. It could certainly be argued that SOEs that undertake activities not included in their statements of corporate intent are acting ultra vires. (Section 14 states that each statement of corporate intent shall specify for the group comprising the State enterprise and its subsidiaries (if any), in respect of that financial year and each of the immediately following 2 financial years, the following information: (a) the objectives of the group, (b) the nature and scope of the activities to be undertaken.) Another example of an exception may be corporations formed under the Te Ture Whenua Maori Act 1993/Maori Land Act 1993.

2 For a discussion of the origins of corporate capacity, see MS Bilder “The Corporate Origins of Judicial Review” (2006) 11 Yale LJ 502. The analysis carried out by many begins with Case of Sutton’s Hospital (1612) 10 Co Rep 1, involving a corporation established by Royal Charter. However, the Bilder analysis reveals the origins to be more ancient and more complex than Lord Coke’s seminal discussion. Lord Coke’s analysis in Sutton is generally taken to mean that corporations established by Royal Charters had all the powers of a natural person as far as outsiders were concerned. Intended limits on corporate activity were an internal matter with an action (in the nature of quo warranto) possible to restrain an action beyond the limits. In the mean time, as far as outsiders were concerned, the actions would be fully effective. But, for corporations created by statute and, significantly, for companies registered under the new Companies Acts of the mid-19th century, Sutton was not applied. Instead the doctrine of ultra vires, which made acts beyond the capacity of the company void, developed. For a contemporary discussion, see S Brice The Doctrine of Ultra Vires (Baker, Voorhis & Co, New York, 1880).
make the contract. Any such contract was void at common law and could not be enforced by the company or the third party.

8.1.3 Reform of corporate capacity principles

Clauses in a memorandum of association were viewed as a protection for the investors of the company; both for the original investors who incorporated the company and signed the memorandum of association and for those who later acquired shares in the company after viewing the memorandum of association. However, many people who incorporated companies did not want to be constrained in the operation of their businesses by restrictive objects or powers clauses in the memorandum of association. For that reason, much ingenuity was applied to drafting object and power clauses as widely as possible. For many companies, objects and power clauses were drafted so widely and were so lengthy that their effect was to give the company full capacity.

Eventually, with the passage of the Companies Amendment Act 1983, the statutory provisions in New Zealand were altered to reflect what for some time had been the true position for most companies. Companies incorporated after 6 December 1983 did not have to state their objects and powers in their memoranda. Companies were automatically given the rights, powers and privileges of a natural person. It was also possible to limit powers of companies expressly.

It seemed therefore that companies had, in effect, full capacity. But problems inherent in anthropomorphising the powers of the company by using the term “natural person” emerged. In Re Arahi Properties Ltd, a company, in a prospectus, issued options for shares to existing members. The terms of the contract for the options gave the option-holders the right to attend meetings of the company and to vote at those meetings as if they were shareholders. This contract was challenged because it was argued the company did not have the power to give non-shareholders the right to attend and vote at meetings. Tompkins J accepted that the 1983 amendment did not expressly give the power to attend and vote at meetings. There were certain things a company could not do that a natural person could do. (However, the Judge said as a body corporate the company had the power to hold meetings and permit non-members to vote.)

In the Companies Act 1993, specifically to counter the unsuccessful argument in Re Arahi Properties and to pre-empt any similar arguments being brought in future cases, the capacity of companies was depersonalised. Rather than having the powers of a natural person, the default position for all companies is that they have full capacity. Notwithstanding anything contained in their memoranda of association, all existing companies reregistering under

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3 See Lord Cairns in Ashbury Railway Carriage & Iron Co Ltd v Riche (1875) LR 7 HL 653.
4 One technique was the insertion in the memorandum of Cotman v Brougham clauses; declarations that none of the subclauses, objects or powers would be deemed subsidiary to others. The purpose was to prevent a restrictive construction of objects clauses: Cotman v Brougham [1918] AC 514 (HL).
5 Companies Act 1955, s 14A.
6 Companies Act 1955, s 15A(1).
7 Companies Act 1955, s 15A(3).
8 Re Arahi Properties Ltd (1989) 4 NZCLC 64,884 (HC).
9 An option is a conditional contract giving the holder the right to purchase shares at a later date.
10 Re Arahi Properties Ltd (1989) 4 NZCLC 64,884 (HC).
11 Companies Act 1993, s 16(1).
the Companies Act 1993 were automatically given full capacity. The only way that the capacity of any company can now be restricted is to file a constitution with clauses restricting capacity. For companies in existence prior to the implementation of the Companies Act 1993, this restriction normally took place on re-registration. For all other companies this restriction on capacity can take place either when the company is incorporated or at any later time. The capacity of a company can be limited by filing a constitution or by amending an existing constitution to limit the capacity of the company. Limiting the capacity of a company remains unusual; it is in those rare situations where a company restricts its capacity in its constitution that the vestigial remnants of the common law doctrines and common law principles such as the doctrine of ultra vires become relevant.

Other jurisdictions have dealt with issues around the capacity of companies in a similar way. In the Companies Act 2006 (UK), the common law position is altered so that any objects of a company are included in its articles of association. Companies registered under the Companies Act 2006 (UK) no longer have object clauses in their memoranda of association. A memorandum of association for companies registered under the Companies Act 2006 (UK) now need only state that the subscribers wish to form a company and agree to become members. Section 31(1) of that Act states that unless a company’s articles specifically restrict the objects of the company, its objects are unrestricted. For existing companies with memoranda of association, the objects clauses will be treated as part of their articles of association. In Australia, s 124 of the Corporations Act 2001 gives companies the legal capacity of an individual and all the powers of a body corporate. Section 15(1) of the Canadian Business Corporation Act 1975 gives a corporation the capacity and, subject to the Act, the rights, powers and privileges of a natural person.

### 8.2 Limits on corporate capacity

If they choose to do so, companies can restrict their capacities in their constitutions. However, it is never possible to restrict statutory powers set down in the Companies Act 1993 unless the section setting out the relevant power specifically empowers companies to do so. If a company that has restricted its capacity alters its constitution to remove a restriction on capacity, any shareholder who voted against the alteration has buy-out rights.

It might also be argued that there are further restrictions on the capacity of a company. For example, companies cannot be appointed as directors since s 151(1) of the Companies Act 1993 states that only natural persons can be directors of companies. Section 199 prohibits

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12 Companies Act 2006 (UK), s 8(1).
13 Companies Act 2006 (UK), s 28(1).
14 Companies Act 1993, s 16(2). The equivalent provision in the Corporations Act 2001 (Aus) is s 125, which permits companies to limit their powers and set out their objects. Section 6(1) of the Canadian Business Corporations Act 1975 permits a corporation to include in its articles of association any restriction on the business that the corporation may carry on. Section 31 of the Companies Act 2006 (UK) permits a company to restrict its objects.
15 Companies Act 1993, s 110(a)(i). See 21.5 for a discussion of buy-out rights. It is not clear whether a revocation of the constitution, which has the same effect of removing restriction on capacity as an alteration of the constitution, triggers buyout rights. Section 110(a)(i) talks only of alteration. The reference in s 110(a)(i) back to s 106(1)(a), which refers to adoption, alteration or revocation of a constitution, makes it appear that it was clearly intended by the legislature that alterations of the constitution include revocation of the constitution.
a company from acting as an auditor. Companies cannot be employees. Companies might breach a provision of their constitutions not relating specifically to capacity. It is suggested that such restrictions should not be viewed as limits on capacity. In *LSI Logic Corp of Canada Inc v Logani*, the Supreme Court of Canada stated that the equivalent provisions of the Canadian legislation make it clear that companies have full capacity and, even if transactions are contrary to the constitution, they are not invalid. In *Continental Bank Leasing Corp v Canada*, discussing, obiter, equivalent provisions in the Canadian banking legislation, Bastarache J stated that any conduct that was contrary to the Act was not beyond the capacity of the Bank and therefore invalid, but merely contrary to the Act. The provisions of the Act and the general law would provide the penalties for engaging in such prohibited actions. Commenting that there was now legal capacity to perform any act, even though it might constitute an offence, Bastarache J opined: “Like man, in Milton’s view, they have been created capable of standing, but free to fall.”

A company is not a natural person; it cannot do the things that a natural person can do such as marry or have children. It is suggested that many of these restrictions should not be viewed as limits on capacity, since the further restrictions are beyond the capabilities as well as the capacity of the company. Companies in New Zealand no longer have all the powers of a natural person; they only have full capacity conferred upon them legislatively by means of s 16(1). The significance of this is that the powers of companies are no more than full capacity to do everything that it is possible for a company to do. In other words, it will never be possible for a company to act beyond its capabilities, whereas it is entirely possible for a company to act beyond its capacity, but only if it has limited its capacity. Actions beyond the limited capacity of a company are the situations where the doctrine of ultra vires remains relevant.

### 8.2.1 Doctrine of ultra vires

Imagine a scenario where a company has limited its capacity in its constitution to state that it cannot carry on business selling food. If the company then signs an agreement for sale and purchase of a fish and chip shop, the company is acting ultra vires. The term ultra vires is a Latin expression which means acts taken beyond the legal powers of those who have purported to undertake them. What effect does this act beyond the capacity of the company have on the enforceability of the sale and purchase agreement? Answering this question requires an understanding of the doctrine of ultra vires.

A transaction is beyond the capacity of the company if the company has restricted capacity pursuant to s 16(2) of the Companies Act 1993. Prior to the 1983 amendment to the Companies Act 1955, if a company acted within its powers and objects set out in its memorandum of association, the action was said to be intra vires. If the company entered into a transaction which was outside its objects and powers, as stated in the memorandum, the action was said to be ultra vires.

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18 Although any such act will prima facie be invalid.
The consequence at common law was that any act or transaction committed or entered into ultra vires the company was void. Such an action was treated as if it had never occurred. Therefore any such transaction was unenforceable:

- By the company against the outsider; and
- By the outsider against the company.

The ultra vires principle, as it relates to companies, was outlined in the landmark case of Ashbury Railway Carriage and Iron Co v Riche.\(^9\) In that case, the memorandum of association of the company restricted the company’s activities to the construction of railway carriages in England. The company proposed to run a railway operation in Belgium. The House of Lords held that this proposal was ultra vires and void. Lord Cairns said: “The memorandum is, as it were, the area beyond which the company cannot go” and further, “the question is not as to the legality of the contract; the question is as to the competency and power of the company to make the contract.”\(^20\)

Ashbury Railway has dominated this area of the common law ever since. The case has been rationalised by those who favour an associative or contractual view of the company on the basis that if an investor buys a company’s shares on the understanding it will make and sell railway carriages in England, that investor should have a remedy if the company embarks on the different business of raising finance to fund a railway in Belgium. In other words, the decision protects shareholders, which was always the intent behind the inclusion of a requirement for object clauses in memoranda of association. But it is suggested that what Ashbury Railway really does is make clear the statutory basis of the capacity of a company. Lord Cairns, by highlighting the difference between issues around the legality of contracts and issues around the competency and power of companies to make contracts also marks out the difference between the capacity of a company, the allocation of powers within the company and the legal authority of the agents of a company to enter into transactions. As pointed out by Ross Grantham, the House of Lords, “faced with a choice between equating the new registered company with chartered corporations and partnerships, which had the powers of a natural person, or with a statutory corporation, whose powers were limited by the authorising statute, chose the latter option.”\(^21\)

Historically, the ramifications of the doctrine of ultra vires often had an adverse effect on third parties dealing with the company. For example, if a creditor lent money to the company in good faith, the company might then refuse to repay the loan because it was ultra vires its objects and powers. Cabaret Holdings Ltd v Meeanee Sports and Rodeo Club\(^22\) involved an incorporated society where the same ultra vires rules apply. Meeanee Sports was suing to enforce a debt owed to it by Cabaret Holdings Ltd. Cabaret Holdings Ltd argued successfully that it did not have to repay the debt since Meeanee Sports had no power to enter into the transaction and the debt was therefore ultra vires and void. The common law rule, therefore, enabled companies and other organisations to which the doctrine of ultra vires applied, to escape what many would have considered to be their rightful obligations.

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\(^9\) Ashbury Railway Carriage & Iron Co Ltd v Riche (1875) LR 7 HL 653.
\(^20\) Ibid, at 659.
\(^22\) Cabaret Holdings Ltd v Meeanee Sports and Rodeo Club [1982] 1 NZLR 673 (CA).
A further complication brought about by the rule was the technical distinction recognised between an object and a power. Powers were intended to be used solely for the purpose of achieving objects. In the English case Re Introductions Ltd, the company’s objects were to provide facilities for tourists.\textsuperscript{23} The company switched to the business of pig-breeding. The memorandum of association of the company included an objects clause empowering the company to borrow. The company borrowed money from its bank for the pig-breeding business and gave a debenture as security. The bank was given a copy of the company’s memorandum of association and knew its sole business at the time was pig-breeding. However, the bank relied on the power of the company to borrow. It was held that the company’s power to borrow was not an end in itself, but had to be used for a purpose of the company set out in its memorandum. The debenture could not be enforced by the bank.

Critics argued that requiring those dealing with companies to interpret the memorandum to determine whether a particular transaction was within the objects of a company, even though it was within its powers, imposed an unreasonable burden on third parties. Some also argued that the court in Re Introductions had confused the issue of the power of the board to enter into a transaction with the capacity of the company.

Elsewhere it was at times suggested that the exercise by the board of powers allocated to shareholders, the exercise of powers of the board in breach of the fiduciary duties of directors or otherwise not in the best interests of the company,\textsuperscript{24} or transactions that were illegal\textsuperscript{25} or an abuse of power by the board\textsuperscript{26} were ultra vires. Authority suggests that many of these wider applications of the doctrine of ultra vires confused the capacity of the company with the issue of whether a particular act benefits the company.\textsuperscript{27}

### 8.2.2 Reform of the doctrine of ultra vires

However sound the rationale behind the doctrine of ultra vires may have been, it became clear that legislative intervention would be needed\textsuperscript{28} to modify a common law rule which was, as Professor Gower commented, “a nuisance to the company and a trap for unwary third parties.”\textsuperscript{29} The New Zealand Law Commission commented in 1989 that ultra vires:\textsuperscript{30}

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\textsuperscript{23} Re Introductions Ltd [1970] Ch 199 (CA) cf Rolled Steel Products (Holdings) Ltd v British Steel Corp [1986] Ch 246 (CA).

\textsuperscript{24} “Charity cannot sit at the boardroom table … There are to be no cakes and ale except for the benefit of the company.” Hutton v W Cork Railway (1883) 23 Ch D 654 at 673 per Bowen LJ. Powers could only be exercised in the best interests of the company and that any act carried out by a company for altruistic reasons like, for example, donation of money to charity, was, it was argued, an ultra vires act. Re Lee Behrens & Co Ltd [1932] 2 Ch 46. See G Shapira “Ultra Vires Redux” (1984) 100 LQR 468. It was also argued, unsuccessfully, that a guarantee was ultra vires because it was not given by the director bona fide and in the best interests of the company: Charterbridge Corp Ltd v Lloyds Bank Ltd [1970] Ch 62, [1969] 2 All ER 1185.

\textsuperscript{25} Re Introductions Ltd [1970] Ch 199 (CA) at 203 cf Equitiorp Industries Group Ltd (in stat man) v Attorney-General (No 47) [1998] 2 NZLR 481 (HC).

\textsuperscript{26} Re Introductions Ltd [1970] Ch 199 (CA) at 208.

\textsuperscript{27} Re Halt Garage (1964) Ltd [1982] 3 All ER 1016; Rolled Steel Products (Holdings) Ltd v British Steel Corp [1986] Ch 246 (CA).

\textsuperscript{28} The reforms were set out in the MacArthur Report Final Report of the Special Committee to Review the Companies Act [1973] AJHR H7.

\textsuperscript{29} PL Davies and LCB Gower Principles of Modern Company Law (5th ed, Sweet & Maxwell, London, 1992) at 168. The doctrine could also be a trap for the company itself, where the company could not sue on an ultra vires contract: Bell Houses Ltd v City Wall Properties Ltd [1966] 2 QB 656.

\textsuperscript{30} Law Commission Company Law: Reform and Restatement (NZLC R9, 1989) at [344].

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"...was designed for the protection of shareholder expectations, but has been for many years a protection available mainly in theory because from a very early stage companies commonly appropriated to themselves objects of such breadth that they were illusory standards against which to measure company action or director conduct. The reforms of 1983 simply bowed to reality in permitting companies to have the powers of natural persons and removed a source of much problem for third parties dealing with the company."

Uncharacteristically for company law of the time, New Zealand acted before the United Kingdom by essentially abolishing the doctrine of ultra vires. Inserted as an amendment to the Companies Act 1955, s 18A came into effect on 6 December 1983. The new section introduced new rules concerning acts which were ultra vires a company with the aim of creating commercial certainty for companies and for those who dealt with companies. The amendment restricted the ultra vires doctrine; no transaction was to be void or invalid only because the company was without the legal capacity or power to enter into it. The amendment affected transactions of all companies, even companies incorporated before the 1983 amendment.

One rationale offered up in support of the doctrine of ultra vires had been that it protected the subscribers to the memorandum and those who later acquired shares by requiring the company to carry out the business agreed to in the memorandum of association. That protection continued to some extent after the amendment with insiders (that is shareholders and debenture holders but not unsecured creditors) still able to restrain the company from acting outside the powers set out in memoranda of companies. Insiders could obtain an injunction, but the Court had wide discretionary power to order compensation for damages caused by such prevention.

The statutory position on ultra vires remained essentially unchanged for companies with the introduction of the Companies Act 1993. No act of a company or transfer of property is invalid “merely because the company did not have the capacity, the right or power to do the act”. The use of the word merely leaves the door open for exceptions. The breaches that nevertheless give rise to a cause of action by an insider are listed. These are:

- The right of the company, a director, shareholder or person in the position of a shareholder to apply for an injunction to stop the company acting outside its constitution, the Act or the Financial Reporting Act 1993 (s 164). An action under s 164 is available only for transactions not yet completed.

31 The reforms in the United Kingdom did not take place until the implementation of the Companies Act 1989 (UK). Most Canadian jurisdictions, however, acted sooner and the New Zealand provisions appear to have been influenced by the Companies Act 1991 (Aust), s 67, the Ontario Business Corporations Act, s 15, and the US Model Business Corporations Act, s 6. See JH Farrar and MW Russell Company Law and Securities Regulation in New Zealand (Butterworths, Wellington, 1985) at 65.


33 See the discussions of the doctrine of ultra vires and its possible continuing application to a company registered under the Te Ture Whenua Maori Act 1993 in Bridgecorp Ltd v The Proprietors of Matauri X Incorporation [2004] 2 NZLR 792 (HC) and in Dorechester Finance Ltd v Ngahuia Ltd HC Auckland CIV-2009-404-2529, 8 February 2010 at [115]–[121].

34 Companies Act 1993, s 17(1).
• An order restraining the company from completing a transaction that could prejudice the other party to the proposed transaction. If such an order is made, the Court may exercise its powers under s 164(3) to award consequential relief to the prejudiced party.

• The right of directors and shareholders to bring an action on behalf of the company (a derivative action) (s 165). Therefore, action could be brought against those directors who propose to cause, or who have caused, the company to act beyond its capacity. On the application of a shareholder or director, the Court may order that all or part of the reasonable costs of bringing the proceedings be met by the company (s 166).

• The right of shareholders to bring an action against the directors (s 169). The action would be brought because the directors had failed in their duty to ensure that the company complied with its constitution in accordance with s 134. Following LSI Logic Corp of Canada Inc v Logani, where the Supreme Court of Canada stated that the equivalent provisions of the Canadian legislation make it clear that companies have full capacity and, even if transactions were contrary to the constitution, they are not invalid; an action under s 17(2)(c) could, it is suggested, only be brought by the shareholders for a breach of a provision that specifically limits the capacity of the company. Section 169 of the Companies Act 1993 sets out which duties of directors are owed to the company as a whole and which duties are owed to individual shareholders. Section 134 is not included on either list. The most likely explanation for this is that whether a breach of the Act or the constitution (that is thus a breach of s 134) is a breach of a duty owed to the company as a whole or individual shareholders (or both), will depend on the nature of the breach. It is suggested that shareholders would have an individual right to bring an action under this section. The loss to the individual shareholder would, however, need to be something more than a reduction, or lack of increase, in the value of the company’s shares (s 169(2)). It is because of the existence of a personal action for shareholders against directors if a company acts beyond its capacity, that the breadth of the application of s 17(b) becomes significant.

• The right of shareholders to bring an action requiring directors to take action under the constitution. The Canadian Business Corporations Act 1985 states that no act of a corporation including any transfer of property to or by a corporation is invalid by reason only that the act or transfer is contrary to its articles or the Act. Section 39(1) of the Companies Act 2006 (UK) states that the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company’s constitution. Section 125(2) of the Corporations Act 2001 (Aus) states that an act of the company is not...
invalid merely because it is contrary to an express restriction or prohibition in the company’s constitution.

8.2.3 The continuing relevance of the doctrine of ultra vires in New Zealand

Several principles may be set out as reasonably clear:

(1) Acts that are not in the best interests of the company are not beyond the capacity of the company: s 17(3) specifically states that the fact that an act is not or would not be in the best interests of the company does not affect the company’s capacity to carry out the act. That provision was inserted to counter the finding in some cases that such acts were beyond the capacity of the company. Indeed, there was even an indication in Equitcorp Industries Group Ltd (in stat man) v Attorney-General (No 47) that if a company “goes about it in the right way [it can] specifically elect to enter into an improvident transaction.”

(2) In the absence of a specific clause in its constitution, a company has full capacity to do anything that it is possible for a company to do. This means that a company can carry on or undertake any business or activity, do any act or enter into any transaction.

(3) Companies that carry out illegal acts are not acting beyond their capacity.

(4) The exercise of a power allocated to shareholders by the board is not an instance of the company acting beyond its capacity.

One significant area of uncertainty remains. It had been stated in Westpac Banking Corp v New Zealand Guardian Trust, a pre-1993 Act High Court decision, that ultra vires does not only include companies acting outside their capacity, but extends to “incorporate the

41 Re Lee Behrens & Co Ltd [1932] 2 Ch 46 cf Re Hadi Garage (1964) Ltd [1982] 3 All ER 1016; Rolled Steel Products (Holdings) Ltd v British Steel Corp [1986] Ch 246 (CA). The common law position had evolved to the point that such acts were not considered to be ultra vires for that reason so s 17(3) essentially records the common law position.

42 Equitcorp Industries Group Ltd (in stat man) v Attorney-General (No 47) [1998] 2 NZLR 481 (HC).

43 It had been suggested that illegal transactions are ultra vires transactions. However, in Ashbury Railway Carriage & Iron Co Ltd v Riche (1875) LR 7 HL 653 Lord Cairns was careful to distinguish between contracts that were contrary to public policy and illegal in themselves and contracts that were beyond the competency and power of the company to make. Only the latter type of contracts were ultra vires. See R Grantham “Illegal Transactions and the Powers of Company Directors” (1999) 115 LQR 296.


45 Noteworthy also was the fact that debenture holders no longer have the right to stop a company carrying out ultra vires acts. Again, this is sensible. Insiders of a company are traditionally considered to be the directors and shareholders of the company. If the company becomes insolvent, the creditors might be regarded as the investors of the company (having essentially supplanted the shareholders). However, in a constitutional sense creditors are not an “organ” of the company (like the board and the shareholders in general meeting) and creditors do not have the ability to be involved in the decision making of the company. The relationship of creditors to a company is contractual.
of the Act “should be seen as a restatement of basic duties [developed by the common law] in an endeavour to promote accessibility to the law” represents the predominant view. What is clear is that the Companies Act 1993 does not codify or set out the remedies for breaches of duties. For that reason litigants often rely on the co-existing non-statutory duties when framing causes of action.\textsuperscript{21}

15.2 Section 131: act in good faith and the best interests of the company

15.2.1 Origin and nature of s 131

Section 131 states that, when exercising powers or performing duties, a director must act in good faith and what the director believes to be in the best interests of the company.\textsuperscript{22} This duty is considered to be fundamental and indeed, the Law Commission favoured this duty prevailing over all others.

As will be discussed further in chapter 16, although New Zealand does not have a business judgment rule, courts have long been reluctant to intervene in the decisions of directors. In 1812 Lord Eldon protested that the court was “not to be required to take the management of every playhouse and brewery in the Kingdom.”\textsuperscript{23} The business judgment rule discussed in chapter 16 is founded on the same rationale. But directors of a company have a fiduciary obligation to act bona fide in the best interests of the company as a whole when exercising those management powers.

As discussed in chapter 12, the management powers of the company are conferred on the board; that is the directors collectively in s 128. However, the statutory duty of good faith in s 131(1) is owed individually by each director to the company. Thus, when making decisions collectively as part of the board, each individual director must act in good faith and in the best interests of the company. Professor Sealy points out that the “duty” of good faith is not so much a duty but rather grounds “upon which a corporate decision may be challenged as irregular and held to be void or voidable.”\textsuperscript{24} In determining this irregularity, the decision-making of each individual director who comprises the board and took part in the decision can be scrutinised. If the decisions of directors come under scrutiny, directors may be obliged to show not just that they acted in a way that they subjectively believed to be in the interests of the company but that they took steps to consider all alternatives before deciding on a course of action.

\textsuperscript{19} It was suggested in Manukau City Council v Lawson HC Auckland CP210/SW99, 21 May 1999 that the duties’ provisions are a code. See N Campbell [2001] CSLB 53; P Watts [2001] NZ Law Rev 293; JH Farrar Corporate Governance: Theories, Principles and Practice (3rd ed, Oxford University Press, Melbourne, 2008) at 110.

\textsuperscript{20} Benton v Priore [2003] 1 NZLR 564 (HC) at [46], followed in Sojourner v Robb [2006] 3 NZLR 808 (HC).

\textsuperscript{21} C Noonan and S Watson “The Dog that Didn’t Bark in Kawhia Offshore Services Ltd v Rutherford” (2004) 10(2) NZBLQ 103. However, in Robb v Sojourner [2007] NZCA 493, [2008] 1 NZLR 751, the Court of Appeal allowed account of profits for a breach of the statutory duty of good faith set out in s 131. See the discussion at 15.2.2

\textsuperscript{22} Companies Act 1993, s 131(1).

\textsuperscript{23} Carlen v Drayn (1812) 1 Ves & B 154 at 158 in P Redmond Companies and Securities Law: Commentary and Materials (LBC Information Services, Sydney, 2000) at 362, 419.

\textsuperscript{24} LS Sealy “‘Bona Fides’ and ‘Proper Purposes’ in Corporate Decisions” (1989) 15 Mon LR 265 at 268.
The Law Commission favoured the test of what was in the best interests of the company being objective, so that the director had to hold the belief on reasonable grounds. This version of s 131 would have resembled the equivalent Australian provision where directors are required to exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose. In the Companies Act 1993, however, the test is expressed as being subjective, based on what the director actually believes. The requirement to exercise powers for a proper purpose is included in s 133 and arguably imposes an objective element. In addition, it is suggested that in the application of s 131(1) by the courts it is becoming increasingly clear that any such belief held by directors must be reasonably held.

Section 131(1) is itself an adoption of the principles set out in the English Court of Appeal case Re Smith v Fawcett Ltd. In that case, a (private) company’s constitution provided that “the directors may at any time in their absolute and uncontrolled discretion refuse to register any share transfer.” A and B were both directors and owned 40,001 shares each. A died, and his executor applied to have his name entered on the register of shareholders. B refused, but offered to register A’s executor if 2000 of A’s shares were first transferred to B. A’s executor applied to the Court, claiming that this was an improper use of the director’s powers to refuse to register shares. Lord Greene, MR stated:

“The principles to be applied in cases where the articles of association of a company confer a discretion on directors … are free from doubt. They must exercise their discretion bona fide in what they consider — not what a Court may consider — to be in the interests of the company and not for any collateral purpose … [T]his type of Article is one which is for the most part confined to private companies …but from the business and personal point of view they are much more analogous to partnerships than to public corporations. Accordingly, it is to be expected that, in the articles of such a company, the control of the directors over the membership may be very strict indeed.”

His Honour confirmed that the issue was simply whether, on the true construction of a particular provision, the directors were limited by anything except their good faith view of the interests of the company. As long as they acted in good faith directors had an absolute and uncontrolled discretion.

The statements by Lord Greene in Re Smith v Fawcett Ltd lend support to a view that to satisfy the duty of good faith set out in s 131, directors need do no more than show that they acted in a way that they genuinely believed to be in the best interests of the company. Viewed contextually, the statements also seem related to a conception that the transfer of

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27 Re Smith v Fawcett Ltd [1942] Ch 304 (CA) at 304–305.

28 Re Smith v Fawcett Ltd [1942] Ch 304 (CA).
shares to a new shareholder is akin to the admission of a new partner to a partnership and, as such, a decision to be made at the discretion of the existing “partners”.

The conception of companies as a form of quasi-partnership has waned in recent years as the consequences of incorporation by registration are more fully understood and may therefore bring into question the interpretation of the term “bona fide in the interests of the company” in *Smith v Fawcett*. It appears that compliance with the duty in fact requires more than mere honesty. In Professor Sealy’s view, the common law duty to act bona fide in the interests of the company as a whole is best given the meaning that a decision must be “genuine”, rather than merely “in good faith”, meaning honest.29 The New Zealand statutory provision uses the term “in good faith” but, as discussed below, in the application of s 131 the Courts are tending to impose a requirement of genuineness in the exercise of powers.

15.2.2 Application of s 131

In *Hedley v Albany Power Centre Ltd (in liq)*30 Wild J stated that in order to form a view about what was in the best interests of a company, the directors needed to:31

“(a) Identify the options available to [the company];

“(b) Assess each of those options: its present and prospective value to [the company]; its advantages and disadvantages, again both present and prospective; and

“(c) Compare each option on the basis of (b).”

In *Robb v Sojourner*, the Court of Appeal, by rejecting an argument to the contrary, accepted that a defence based on s 138, which allows directors to rely on the advice of competent and reliable delegates, should be available as a defence for a breach of s 131.32 The apparent acceptance by the Court that relying on competent and reliable employees and delegates is a defence introduces a further element of objectivity into the test in s 131. Similarly, in the same case, the Court of Appeal opined that evidence of payment of fair value in terms of s 141 would have meant that the remedy of account of profits would not have been available.33 It thus appears that the statutory formulation of s 131(1), as applied by the New Zealand Court of Appeal, requires that opinions that underpin decisions made by directors in good faith must be reasonably held. Conversely, reliance on objectively formed information will be used as evidence of good faith by directors.

A director complies with the duty in s 131 if the director’s primary motivation is to act in a manner that the director genuinely believes to be in the best interests of the company. Negligence, even gross negligence, is not the same as disloyalty and is, therefore, unlikely to be considered a breach of s 131.34 If the director has mixed motives, there is authority that says that the courts should determine what the main purpose of the directors was.35 It

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29 LS Sealy “‘Bona Fides’ and ‘Proper Purposes’ in Corporate Decisions” (1989) 15 Mon LR 265 at 269. The example of the genuineness requirement Professor Sealy uses is the case *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1016 where Oliver J struck down as not a genuine award of remuneration the payment of a substantial salary to a bedridden director.


31 Ibid, at [64].


33 Ibid, at [30].
is not required that directors in all cases avoid personal gain as a result of their honest and
good faith supervision and management of the company, either directly through
remuneration or, indirectly, through the increased value of any shares in the company that
the director might hold.36

So long as the primary motivation of directors is to act in the best interests of the company,
directors may favour other interests that they have. In Hunan Holdings Ltd v Virionyx Corp
Ltd, Winkelmann J explained:37

“directors who enter into transactions with a company are free to exercise contractual
rights under those contracts, and in so doing, prefer their own interests over the
interests of the company. The disclosure regime of the Companies Act 1993 would
of course need to be complied with to ensure the transaction’s validity. Were the
director to vote on the transaction in his capacity as director, he would be required
to exercise the power to vote bona fide in the best interests of the company. However,
the director is not constrained to exercise his contractual rights in the best interests
of the company. Were the law otherwise, it would operate as a disincentive to
directors of private companies providing debt capital, as it would most likely prevent
them from ever seeking repayment.”

Directors cannot, however, take actions that favour their own interests where the directors
cannot genuinely believe they are acting in the best interests of the company. In Sojourner v
Robb in the High Court Fogarty J stated categorically that director/shareholders of a
company who sold the business of an insolvent company at an undervalue to a new
company they controlled were not acting in good faith.38 The fact that the directors
personally thought they were acting in the interests of the company was irrelevant:39

“When considering the solvency of the company the directors did not bring into
account the intangible asset of the company — that is its ability to earn a good income
from its skilled staff and long-standing relationships with customers; ie they did not
value its goodwill. Second, they appear to have disregarded the interests of the
plaintiffs because the plaintiffs were not current creditors or creditors. Third, and as
a direct consequence of these other errors, they did not recognise that their duty to
the company included doing their best to ensure the company met all its obligations,
current and contingent. With this personal state of mind they were no longer correctly
understanding their duties as directors and for that reason were not acting in good
faith.”

In Sojourner the directors approved the sale of the assets of the company to another company
controlled by the directors. In assessing the value of the assets, the Court of Appeal, which

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34 See Motorworld Ltd (in liq) v Turners Auctions Ltd HC Auckland CIV-2007-404-6558, 17 February 2010
(HC) and see the discussion of the case in P Watts “Gross negligence and the director’s duty of loyalty—
two recent cases”[2010] CSLB 99.
35 Mills v Mills (1938) 60 CLR 150 (HCA). See also the discussion of the proper purpose doctrine at 15.3
below.
36 Peoples Department Stores Inc (Trustee of) v Wise [2004] 3 SCR 461, 244 DLR (4th) 564 (CanSC).
37 Hunan Holdings Ltd v Virionyx Corp Ltd HC Auckland CIV-2005-404-1480, 13 December 2005 at [116].
38 Sojourner v Robb [2006] 3 NZLR 808 (HC). The decision was upheld on appeal and the discussion by
Fogarty J of good faith apparently accepted by the Court of Appeal: Robb v Sojourner [2007] NZCA 493,
[2008] 1 NZLR 751.
39 Sojourner v Robb [2006] 3 NZLR 808 (HC) at [103].
affirmed the High Court decision, included the value of the goodwill in the business, including the value attached to directors as employees. The failure by the directors to include their own goodwill value when determining the price of the business was treated by the Court of Appeal as evidence of a lack of good faith. It is suggested that this is because, at the time the decision about the sale price was made, the directors must have been aware of their own intentions to continue through other entities to act as customers and to work as employees in the company purchasing the business. As such, a remedy of account of profits for the breach of the duty of good faith that took into account the value of the goodwill was justified.

Considering the fundamental importance of the provision, there has been a surprising dearth of cases where s 131(1) of the Companies Act 1993 has been invoked on its own. Often in cases where a director has usurped a business opportunity of the company, counsel prefer to frame their submissions on the basis that there has been a breach of fiduciary duty by directors, ignoring the Companies Act 1993 altogether or referring to it in only a cursory way. An example where s 131(1) was ignored altogether is Kawhia Offshore Services Ltd v Rutherford. A director took over a business opportunity that belonged to the company. By putting his own interests ahead of those of the company, the director would clearly have breached s 131, but instead the case was decided on the basis that the director breached fiduciary duties that he owed to the company.

One explanation as to why actions have not been brought on the basis that directors have breached duties set out in the Companies Act 1993 might be that there is an absence of remedies in the legislation itself. Although disaffected parties can seek leave to bring a derivative action for a breach of s 131, it is not clear what remedies are available for a breach of the statutory duty. By way of contrast, successfully establishing a breach of fiduciary duty by a director will open up a range of equitable remedies for a successful litigant. It is for that reason that the 2007 decision of the Court of Appeal in Robb v Sojourner is significant. The Court of Appeal allowed a creditor, bringing an action pursuant to s 301 of the Companies Act 1993, to obtain the equitable remedy of account of profits against directors to the company for a breach of s 131(1). It would appear that the equitable remedies will now be available for breaches of the statutory duties relating to honesty and loyalty. In Blanchett v Keshvara the Court said that on the facts of a case involving payments to related parties, there was no difference between the general fiduciary duty at common law and the duty set out in s 131.

15.2.3 The scope of s 131(1)

The definition of director found in s 126 of the Companies Act 1993 extends the application of s 131 beyond those who are appointed directors in accordance with s 153 and those who

40 See eg, Stichbury v One4All Ltd (2005) 9 NZCLC 263,792 (HC); Bendall v Marshall (2005) 5 NZCLC 263,772 (HC).
46 See 14.5 for a discussion of the deemed director provisions.
are de facto directors by occupying the position of director in terms of s 126(1)(a). Any person who nominates a director is a deemed director in terms of s 126(1)(b)(i) and therefore subject to the good faith obligation set out in s 131(1) if that person is in any way involved in decision-making. A “shadow director” who controls the board is similarly a deemed director in terms of s 126(1)(b)(ii) and similarly subject to the good faith obligation. Any person who is delegated management control powers is, in terms of s 126(1)(c), a deemed director who must exercise those powers in good faith and in the best interests of the company. Any person who is allocated powers in the constitution which would otherwise be exercised by the board is deemed a director pursuant to subs 126(1)(b)(iii) and, in any exercise of those powers, subject to a similar constraint. A shareholder who exercise powers allocated to shareholders in the constitution or makes a decision on the exercise of those powers must also act in good faith and in the best interests of the company when making those decisions.

15.2.4 What are “the interests of the company”? Conceptually the Law Commission’s proposed hierarchy of duties was significant since the “hierarchy makes explicit the equation of ‘the company’ with the enterprise itself.”484 Earlier in its report, the Law Commission highlighted the confusion about whether the “best interests of the company” requires assessment “of the company as the collective shareholders or as the enterprise itself.”494 Pointing out that the notion of the company equating with the collective shareholders derived from the old joint stock company concepts from the mid-19th century, the Law Commission explained that such a conceptualisation of the company does not take into account the notion of corporate personality perfected in case law. The Law Commission continued:

“Since it has been held that the collective shareholders include future shareholders, identification of the company with the enterprise may have been largely achieved in law. The uncertainty does, however, mean that there is considerable scope for directors to rationalise decisions that are against the interests of existing shareholders.”

Since the hierarchy of duties favoured by the Law Commission and others did not survive in the final version of the Companies Act 1993, it remains debatable how far directors can legitimately stray from considering the interests of existing shareholders when making decisions that are “in the best interests of the company.”504 Although there is authority that suggests that the phrase “the company as a whole” in effect means the existing shareholders of the company,514 increasingly the conceptualisation of the company has moved beyond the association of shareholders to the commercial entity or enterprise. When considering the interests of the company, there is no doubt that directors may at the very least look to

47 Companies Act 1993, s 126(2), (3). See 14.5 for a discussion of the provision.
49 Ibid, at [188].
50 The Law Commission described the current law in the area as confused — it was not clear whether the interests of the company required assessment of “the company” as the collective shareholders or the enterprise itself. The Law Commission considered that identification of the company with the enterprise might have been largely achieved in law but that the uncertainty meant that there was scope for directors to rationalize decisions that were against the interests of existing shareholders: (Law Commission Company Law: Reform and Restatement (NZLC R9, 1989) at [188], [189]).
51 Greenhalgh v Arden Cinemas Ltd [1951] Ch 286 (CA) at 291.
the future of the company and the interests of future shareholders. The interests of the shareholders are almost always considered to be profit maximisation (although proponents of ethical investment or shareholder happiness would argue that profit maximization may not be the sole interest of shareholders). The board may carry out acts which have no short term benefit for the company but which will be to the benefit of the enterprise in the long term. An example might be a charitable donation or a sponsorship of an event, which may initially be a cost for the company, but will improve its profile and image in the community.

In the absence of a special fiduciary relationship that might arise between directors and specific shareholders, directors do not owe fiduciary duties to individual shareholders at common law. Nor are they obliged to consider the interests of specific classes of shareholders.

More contentious is whether it is legitimate or in fact in some situations mandatory for directors to consider the interests of other “stakeholders” in the company such as employees or creditors. Should directors when making decisions take into account environmental concerns? Shareholder primacy theory of the company has predominated North American law and economics scholarship. A variant, director primacy, treats the board as a type of Platonic guardian serving the nexus of all the contracts making up the corporation with an obligation to maximize the value of the shareholders’ residual claim. By way of contrast, stakeholder theorists argue that it is legitimate for directors to take into account wider concerns. In team production theory, for example, the board is regarded as a mediating hierarchy between all the “teams” in the company, such as employees, creditors, shareholders and managers. Opponents of stakeholder theory argue that if directors are obliged or required to take into account these wider concerns, the risk is that they will become accountable to no one. These opponents assert that it is the shareholders as residual claimants to the funds of the company who are best equipped to monitor management.

56 Percival v Wright [1902] 2 Ch 421.
57 Mills v Mills (1938) 60 CLR 150 (HCA); Peters’ American Delicacy Co Ltd v Heath (1939) 61 CLR 457 (HCA).
58 See F Dawson “Acting in the Best Interests of the Company — For Whom Are Directors “Trustees”?” (1984) 11 NZULR 68 where the author argues that there is danger in extending the range of interests that directors must consider because there is then risk that all control will be lost over the propriety of decisions made by directors.
The debate is a long-standing one in company law, perhaps epitomized by the series of articles on corporate accountability which took place between A A Berle and E M Dodd in the 1930s. It was Berle’s view that corporate powers were powers in trust exercisable for the benefit of all the shareholders. Berle’s views may form the foundation of shareholder primacy theory. Berle’s arguments also fit neatly with a conception of English company law where the board is regarded as the agent of the shareholders and the source of its powers. On the other hand, Dodd saw corporations as economic institutions that had responsibilities not only to shareholders but to employees, customers and the public. Dodd’s arguments form the foundation of stakeholder theory.

As far as employees are concerned, the Companies Act 1993 in s 132 states that nothing in s 131 limits the power of a director to make provision for the benefit of employees when the company ceases to carry on all or part of its business. This provision specifically counters the effect of cases such as Parke v Daily News Ltd where such considerations were not considered by the Court to be in the best interests of the company.

Section 132 does not extend as far as the provision proposed in the Law Commission draft, which would have allowed a director to have regard to the interests of creditors and employees. It also does not go as far as the equivalent provision in the Companies Act 2006 (UK). That provision mandates that a director must act in a way that the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. If the company has purposes other than the benefit of its members, the duty is to act, in good faith, in a way most likely to achieve those purposes. As far as is reasonably practicable, the director must have regard to a number of other considerations. These include the long term consequences of any decision, the interests of employees, the need to foster the business relationships of the company with suppliers, customer and others and the impact on the community and environment. They also include the desirability of the company maintaining a reputation for high standards of business conduct and the need to act fairly between members of the company. The duty is expressed to be subject to the requirement that directors, in certain circumstances must consider or act in the interests of creditors.

Much will be written about this provision. It is suggested that, first, the drafters of the provision must have had in mind a certain paradigm company that does not take account

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63 EM Dodd “For Whom are Corporate Managers Trustees?” (1932) 45 Harv L Rev 1145.
67 Companies Act 2006 (UK), s 172.
68 Companies Act 2006 (UK), s 172(1).
69 Companies Act 2006 (UK), s 172(2).
70 Companies Act 2006 (UK), s 172(3).
71 Companies Act 2006 (UK), s 172(4).
of, for example, holding companies and non-trading companies, and, secondly, the
provision risks, as Francis Dawson pointed out in his 1984 article, by broadening the range
of considerations for directors, making directors essentially accountable to no one.\textsuperscript{72} Also,
as was evidenced by the application of s 4 of the State-Owned Enterprises Act 1986 in New
Zealand, provisions that allow boards to take into account wider concerns than the interests
of the shareholders (equated with the profitability of the enterprise) risk being read down
by the courts so that the wider interests can only be taken into account if they do not affect
profitability. Until the courts are convinced that the nature of the legal relationship between
shareholders and boards is such that the interests of the company do not always align with
the interests of the shareholders, such provisions may, it is suggested, remain ineffective.

Within New Zealand, and with the exception of employees in the specific situation set out
in s 132, no express statutory obligation on directors to consider any interests beyond those
of the company exists.\textsuperscript{73} However, statutory directors’ duties, which support an assertion
that “the company” includes other groups, have been included in the Companies Act
1993. Although in s 169(3) the duties set out in s 135 (the reckless trading provision) and
s 136 (the obligation on directors not to allow the company to enter into obligations it will
not be able to perform) are stated to be owed to the company, it is suggested that these
duties can only have been included to protect the interests of creditors of the company.\textsuperscript{74}
The common law equivalent of the obligation in s 131 acts as a defence for directors against
existing shareholders of the company if directors do, in fact, consider the interests of
creditors. There can be little doubt that the statutory provision would operate in a similar
way if existing shareholders brought an action on the basis that the directors of the company
considered the interests of the creditors of the company ahead of their own, at least when
the company was insolvent.

The extent to which directors, in order to comply with s 131(1), can consider the interests
of creditors of the company was discussed in \textit{Mountfort v Tasman Pacific Airlines of NZ Ltd}.\textsuperscript{75}

“I am satisfied that the ‘general obligation [under the former legislation] to maintain
the company’s capital’ recorded by Richardson J in \textit{Nicholson v Permakraft}\textsuperscript{[76]}
has now
been superseded by what may be expressed as a general, albeit imperfect, obligation
not to trade while insolvent, which is to be inferred from the whole scheme of the
Act. The obligation to maintain solvency could not be absolute, because that would
destroy the very justification for limited liability which requires the protection of
directors who, acting reasonably and in good faith, are unable to prevent the failure
that is both a regular fact of business life and the justification for limited liability.
The obligation is imperfect because breach does not, per se, attract legal

\textsuperscript{72} F Dawson “Acting in the Best Interests of the Company — For Whom Are Directors ‘Trustees’?” (1984)
11 NZULR 68 at 79.
\textsuperscript{73} The Law Commission favoured the inclusion of a provision that allowed a director to have regard to the
interests of creditors and employees when performing duties as a director: Law Commission \textit{Company
\textsuperscript{74} The Law Commission discussed the duties. The argument that the company is a legal entity distinct from
its shareholders and that the interests of creditors must be considered when there is a substantial risk to
creditors of the company is supported by Miller J in \textit{Kings Wharf Coldstore Ltd (in rec and liq) v Wilson} (2005)
2 NZCCLR 1042 (HC).
\textsuperscript{75} \textit{Mountfort v Tasman Pacific Airlines of NZ Ltd} [2006] 1 NZLR 104 (HC) at 112.
\textsuperscript{76} \textit{Nicholson v Permakraft} (NZ) Ltd [1985] 1 NZLR 242 (CA) at 255.
consequences for the directors. But it is nevertheless an obligation because it is the premise on which there is unconditional entitlement to continue to trade.

“Such conclusion is consistent with the explicit obligations now stated in s 131 (to act in good faith in the best interests of the company (or holding company)), s 135 (not to allow substantial risk of serious loss), and s 136 (need for belief on reasonable grounds in ability to perform obligations); and ss 194 and 300 (need to keep accounting records) are mandatory.”

In *Vercauteren v B-Guided Media Ltd*, a director who advised his co-directors to declare dividends when the company was not solvent was in breach of s 131(1). The Judge considered that creditors are persons to whom the company has ongoing obligations; “the best interests of the company include the obligation to discharge those obligations before rewarding the shareholders.” Directors will not breach s 131 if they consider the interests of creditors if the director has reason to doubt the solvency of the company. In *FXHT Fund Managers Ltd (in liq) v Oberholster*, Venning J considered that where a director has reason to doubt the solvency of the company, the duty in s 131 may require the director to consider the position of creditors as opposed to the interests of shareholders. In that case, it was argued that a director ensured trade creditors were paid to protect his potential personal liability as guarantor, and also to ensure that the company was making a profit, which would benefit him as a shareholder. Venning J did not consider that to be a breach: “it can hardly be said to be a breach of s 131 to ensure trade creditors are paid, and to ensure the company was making a profit.”

A rationale for considering the interests of creditors when a company is insolvent is that in insolvency the creditors become the residual claimants, just as in a solvent company the shareholders are the residual claimants. This rationale was set out in the judgment of Fogarty J in *Sojourner v Robb* (also discussed above), quoting from the then current edition of Gower and Davies. In that case directors of Company A, who were also its shareholders, sold the stock and plant to Company B. Company B was a phoenix company that the directors of Company A owned and controlled. The directors of Company A had realised that Company A would be unable to complete two long-term boat orders, with the progress payments already spent. Company A subsequently went into liquidation and the two creditors who had made the boat orders brought actions against the directors. The directors argued that the transfer was a legitimate alternative to liquidation and was in the best interests of the company. Fogarty J somewhat acerbically commented that “[d]irectors of a company who are also the only shareholders of the company do not naturally believe that the best interests of the creditors of the company are the best interests of the company.”

77 *Vercauteren v B-Guided Media Ltd* [2011] NZCCLR 9 (HC) at [52] quoting Fogarty J in *Sojourner v Robb* [2006] 3 NZLR 808 (HC) at [102].
79 Ibid, at 264,566.
81 *Sojourner v Robb* [2006] 3 NZLR 808 (HC).
83 *Sojourner v Robb* [2006] 3 NZLR 808 (HC) at [98]. See also the discussion of Clifford J in *Jordan v O’Sullivan* HC Wellington CIV-2004-485-2611, 13 May 2008 at [69].
Fogarty J also took the opportunity to discuss the statutory duty set out in s 131(1), indicating that a belief that an action is in the best interests of the company may not be enough to satisfy the obligation set out in that section:\textsuperscript{84}

“In this context the standard in s 131 is an amalgam of objective standards as to how people of business might be expected to act, coupled with a subjective criterion as to whether the directors have done what they honestly believe to be right. The standard does not allow a director to discharge the duty by acting with a belief that what he is doing in the best interest of the company, if that belief rests on a wholly inappropriate appreciation as to the interests of the company. If a director believes that the duty to act in the best interests of the company is a duty always to act in the best interests of the shareholders, and never in the interests of the creditors, in a situation of doubt as to the solvency of the company, the director cannot be said to be acting in good faith. Creditors are persons to whom the company has ongoing obligations. The best interests of the company include the obligation to discharge those obligations before rewarding the shareholders.”

When affirming the High Court decision, the Court of Appeal rationalised the basis of the obligation owed to creditors by directors in a slightly different way, quoting from a judgment by Gummow J:\textsuperscript{85}

“It is clear that the duty to take into account the interests of creditors is merely a restriction on the right of shareholders to ratify breaches of the duty owed to the company. The restriction is similar to that found in cases involving fraud on the minority. Where a company is insolvent or nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overridden by the shareholders. This restriction does not, in the absence of any conferral of such a right by statute, confer upon creditors any general law right against former directors of the company to recover loses suffered by those creditors … the result is that there is a duty of imperfect obligation owed to creditors, one which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator.”

The reasoning in\textit{Sojourner} can be contrasted with the reasoning in\textit{Peoples Department Stores Inc (Trustee of) v Wise}\textsuperscript{86} where the Supreme Court of Canada held that, while directors owe a duty of care to creditors, they do not owe a fiduciary duty to the creditors of the corporation. However, the Supreme Court did state that when a company approaches the vicinity of insolvency the directors must balance the competing interests of shareholders and creditors, acting honestly and in good faith and taking care not to favour the interests of any one group of stakeholders. If the directors fail to do this, then creditors have an array

\textsuperscript{84} \textit{Sojourner v Robb} [2006] 3 NZLR 808 (HC) at [102]. The decision of Fogarty J was upheld by the Court of Appeal: \textit{Robb v Sojourner} [2007] NZCA 493, [2008] 1 NZLR 751.


\textsuperscript{86} \textit{Peoples Department Stores Inc (Trustee of) v Wise} [2004] 3 SCR 461, 244 DLR (4th) 564 (CanSC).
of other remedies without needing to read into the statutory fiduciary duty the interests of creditors.  

In *Levin v Ikiua*, the company in question, OPC, was also the corporate trustee of a trust where the beneficiaries included the family trusts of the OPC directors. OPC’s liquidators claimed that the directors gave away significant funds of the company contrary to ss 131, 133, 135 and 137 of the Act. The High Court observed that although OPC was a corporate trustee, its directors continued to owe obligations as directors of OPC, and accepted that, if directors knowingly made distributions to beneficiaries in priority to a creditor of OPC, the directors may be in breach of their duties. The High Court found that in this case, the directors were careful to ensure that operating liabilities were met before making the distributions to beneficiaries and had acted in good faith and with due care. However, the Court held that once the directors were aware that the company had been overpaid, they were both in breach of their duties to the company in making distributions to family trusts, and it allowed the liquidators to recover those specific payments.

It is generally accepted that the obligation to act in good faith set out in s 131(1) is trustee-like in nature. The remedies are therefore similar to those available for a breach of trust. In *Hedley v Albany Power Centre Ltd (in liq)*, Wild J confirmed that for a breach of s 131 the account of profits or equitable compensation approaches are available under s 131. In *Robb v Sojourner*, the remedy for a breach of s 131(1) was also held to be account of profits.

15.2.5 Nominee directors

Many companies listed on the NZX have institutional investors or other shareholders who hold large blocks of shares. Many companies are either wholly or partially owned...
A person invalidly appointed as liquidator is not entitled to be paid anything on a quantum
meruit basis for services rendered in the liquidation, unless a properly appointed liquidator
makes use of the person’s work.\(^{812}\)

The fees and expenses properly incurred by a liquidator are the first preferential claim to
be paid out of the assets of the company in liquidation,\(^{813}\) the usual rule being that the
expenses incurred in the liquidation are to be paid before the liquidator’s remuneration.\(^{814}\)
The term “assets” for this purpose does not include assets subject to a charge unless the
charge is surrendered or taken to be surrendered under s 305.\(^{815}\) However, a liquidator who
in good faith realises assets subject to a charge is entitled to recover his or her expenses
from those proceeds as a charge over the proceeds notwithstanding the rights of the secured
creditor over that property.\(^{816}\)

### 31.6 Voidable transactions

The voidable transaction provisions in the Companies Act 1993 enable a liquidator to avoid
certain transactions entered into by a company in specified pre-liquidation periods.

#### 31.6.1 Insolvent transactions (transactions having a preferential effect)\(^{817}\)

Liquidators have a longstanding right to avoid certain transactions entered into by a
company in the period leading up to its liquidation and which result in a creditor receiving
more than the creditor would otherwise have done in an equal distribution of assets in the
liquidation.\(^{818}\) However, it has never been the case that liquidators have been able to avoid
all pre-liquidation transactions having this effect. As the Law Commission recognised in
1989, there are competing interests: the creditors of the company and those who
have engaged in “fair transactions” with the company.\(^{819}\)

Under s 309 of the Companies Act 1955, a liquidator seeking to avoid a transaction, as what
was then known as a voidable preference, had to establish that a company had entered into
a transaction in favour of a creditor whilst it was insolvent and, subject to one
exception,\(^{820}\) with a view to giving that creditor a preference over other creditors. The
requirement that a company enter into a transaction with a view to giving a preference was

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\(^{812}\) *Allison v Johnson and Foster Ltd* [1904] 2 KB 327; *Re Wood and Martin (Bricklaying Contractors) Ltd* [1971] 1 WLR 293.

\(^{813}\) Companies Act 1993, s 312, sch 7, cl 1(1)(a). See also 31.9.6.


\(^{815}\) Companies Act 1993, s 312(2).

\(^{816}\) *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171 (HCA) at 174.


\(^{819}\) Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) at [696].


\(^{821}\) The exception was that, in the case of a voluntary winding up, transactions occurring in the month prior
to the commencement of liquidation were, other than transactions in respect of liabilities incurred or
accruing due in that month, voidable if made in favour of a creditor and at a time when the company
was unable to pay its debts as they fell due from its own money: Companies Act 1955, s 309.
interpreted to mean that a company must enter into a transaction with the dominant intention of preferring a creditor.822 A payment made by a company to a creditor in response to genuine pressure or threats from the creditor fell outside the ambit of s 309 because it could not be said that the company made the payment of its own free will.823 If a company made a payment to a creditor for a variety of reasons and a view to prefer was one of these reasons, but not the dominant reason, then again the payment was not caught by s 309.824 An idea of the prevailing attitude towards the burden borne by a liquidator in proving a view to prefer by a company can be seen from a submission made to the Court of Appeal in Tyree Power Construction Ltd v Official Liquidator of D S Edmonds Electrical Ltd (in liq) that it was “often not thought worthwhile for the Official Assignee to invoke the section … in a company winding up.”825

When the Companies Act 1993 was enacted, such transactions, under s 292, were renamed transactions having a preferential effect and the requirement of an intention to prefer on the part of a company was abandoned. The emphasis changed to a consideration of the effect of a transaction,826 although this general rule was qualified by the requirement that a transaction occur outside the ordinary course of business. Section 27 of the Companies Amendment Act 2006 made substantial amendments to s 292, amendments which came into force on 1 November 2007. The present position is that a transaction by a company is voidable by the liquidator if it:

- Is a transaction of a defined kind; and827
- Is entered into at a time when the company is unable to pay its due debts; and828
- Is entered into within the specified period prior to commencement of liquidation; and829
- Enables another person to receive more towards the satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company’s liquidation.830

The key changes made by s 27 of the Companies Amendment Act 2006 are the removal of the ordinary course of business exception and the adoption of a special rule in relation to transactions occurring as part of a continuing business relationship. Section 27 also renamed transactions that are voidable under s 292 as “insolvent transactions”. However, the rules under the unamended s 292, in particular the ordinary course of business exception, will continue to be of relevance for some time because s 27(5) of the Companies Amendment Act 2006 provides that nothing within s 27 makes voidable a transaction that was completed before s 27 came into force, if that transaction would not have been voidable if s 27 had not been in force.831

823 See eg, Re Austro-Rest Furniture Ltd (in liq) (No 2) (1986) 3 NZCLC 99,837 (HC).
824 See eg, Stiassny v Total Roofing Ltd (1992) 6 NZCLC 68,155 (HC).
826 Law Commission Company Law: Reform and Restatement (NZLC R9, 1989) at [696].
827 Companies Act 1993, s 292(1)(a), (3).
828 Companies Act 1993, s 292(1)(a), (2)(a).
829 Companies Act 1993, s 292(1)(b), (3).
830 Companies Act 1993, s 292(1)(a), (2)(b).
831 See eg, Rea v Wolfgram [2010] NZCCLR 6 (HC).
The fact that a transaction is voidable under s 292 does not prevent a creditor from seeking to deny recovery by the liquidator under s 296(3) of the Act.832

(1) **Transaction by a company**

The liquidator bears the onus of establishing that a transaction of a specified kind has occurred. Section 27(2) of the Companies Amendment Act 2006 substituted the following definition of “transaction” in a new s 292(3):

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

“(a) conveying or transferring the company’s property:

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

“(c) incurring an obligation:

“(d) undergoing an execution process:

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

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

There are three changes of note in the substituted definition of “transaction”. First, the definition is prefaced by the words “means any of the following steps”. Secondly, s 292(3)(d) refers to “undergoing” rather than “the acceptance” of an execution process. Thirdly, the inclusion of a new s 292(3)(f), the effect of which is to put transactions entered into outside the specified period in which a liquidator may act, but implemented within that period, within the ambit of s 292.

If A owes a debt to B, and A then agrees to sell an asset to B, the setting off of these two sums as a result of an express agreement between A and B to this effect is a payment of money for the purposes of s 292(3)(e). This was the finding of the Court of Appeal in *Trans Otway Ltd v Shephard*,833 where the court went on to state that “the expression ‘payment of money’ is not necessarily dependent on the physical passing of cash or a cheque”.834 The court then cited the following comments of Lord Mustill in *Charter Reinsurance Co Ltd v Fagan*:

“Unquestionably, it [payment of money] is no longer confined to the delivery of cash or its equivalent. In ordinary speech it now embraces transactions which involve the crediting and debiting of accounts by electronic means, not only transfers between bank accounts by payment cards and direct debits, but also dealings with credit cards and similar instruments.”

832 See 31.6.5(2).

833 *Trans Otway Ltd v Shephard* [2005] 3 NZLR 678, 685 (CA). Note that this aspect of the Court of Appeal’s judgment was not challenged on appeal in the Supreme Court: *Trans Otway Ltd v Shephard* [2006] 2 NZLR 289 (SC) at [8].

834 *Trans Otway Ltd v Shephard* [2005] 3 NZLR 678, 685 (CA). See eg, *Re Peter Austin Ltd (in liq)* [1990] 2 NZLR 245 (HC), where a transfer of funds by a creditor from an account where it held funds on behalf of the debtor company to its general account was held to be both a payment of money and a transfer of property. See also *Re Butler* [1981] 2 NZLR 149 (HC).

There will be no payment of money for the purposes of s 292(3)(e) where a company and a creditor agree to vary a contractual agreement so that a monetary obligation is discharged by means other than payment of money. An example of such a transaction is where a creditor agrees to accept goods or the assignment of a book debt in lieu of a monetary payment. However, such an arrangement is caught under s 292(3)(a) as a transfer of property.

The Court of Appeal in Trans Otway distinguished the situation before it from one where a creditor acts on the basis of a prior agreement between it and the company to unilaterally set-off mutual money obligations between it and the company. It noted that there is conflicting Australian authority as to whether a transaction by the company has occurred in this circumstance. A payment made by an agent of the company out of funds supplied by the company is a transaction by a company, as is a payment by a company out of funds it has been advanced by a third party. So too is a payment made at the company’s direction by a third party out of proceeds that the third party owes to the company.

In the event that a payment of money is made by a company, a liquidator is not obliged to show that that company made the payment out of its own property.

(2) Company unable to pay its due debts

Under s 292(2)(a), unamended by s 27 of the Companies Amendment Act 2006, the test for insolvency was whether a transaction was made “at a time when the company was unable to pay its due debts.” Now, under the amended s 292(2)(a), the test is whether a transaction by a company “is entered into at a time when the company is unable to pay its due debts”.

The test for insolvency remains an objective test.

A company need not have on hand sufficient cash reserves to pay its due debts. It is acceptable if the company possesses other assets which can be converted to cash within a short time period and the conversion is in the ordinary course of its business. On the other hand, “care must be taken in counting as assets cash resources which are available...”
only if the [company’s] business is sold.\textsuperscript{845} Unused overdraft facilities may be taken into account when assessing whether a company is solvent.\textsuperscript{846}

The fact that a company’s total liabilities exceed its total assets is not conclusive evidence of its ability to pay its due debts.\textsuperscript{847} The test is “not concerned with the state of a company’s balance sheet, but rather with whether it has funds available to it with which to pay its debts as they fall due in the ordinary course of business.”\textsuperscript{848}

A transaction must occur “at a time” when a company is unable to pay its due debts. On the face of it, this phrase requires that a “still shot” be taken of a company’s financial position in the sense that it is the company’s financial position at the date that it enters into a transaction that is under scrutiny,\textsuperscript{849} rather than the “moving picture”, or short period of time, that was taken into account under s 309 of the 1955 Act.\textsuperscript{850} As a due debt is one that is legally due in the sense that a creditor is able to sue the debtor to judgment for payment,\textsuperscript{851} this would mean that debts that are contingent or prospective at the date of a transaction, but which become due within a very short time after the transaction, would be excluded in the assessment of solvency. Such a result does not accord with the view of Richardson J, expressed in the context of s 309 of the 1955 Act in \textit{Re Northridge Properties Ltd}, that when it is clear that contingent or future debts will become due within a very short time after the occurrence of a transaction having a preferential effect, it is “flying in the face of commercial reality to disregard [them]”.\textsuperscript{852} An approach more in line with commercial reality is to define “time” as a “duration”, rather than a “moment”, so that the short period before and after the date of a transaction is taken into account when it comes to assessing the solvency of a company. This approach that has been adopted in a number of decisions.\textsuperscript{853}

The liquidator has the onus of establishing insolvency except during the “restricted period” where a rebuttable presumption applies to the effect that a transaction was made at a time when the company was unable to pay its due debts.\textsuperscript{854} The restricted period differs according to the method by which liquidation commenced. In the case of a company that was put into liquidation by the court, the restricted period is the period of six months before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date on which, and at the time at which,
the order of the court was made.\textsuperscript{855} If an application was made to the court to put a company into liquidation, but after the making of the application a liquidator was appointed by the board or by special resolution, the restricted period is the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date and at the time of the commencement of liquidation.\textsuperscript{856} In all other cases, the restricted period is the period of 6 months before the date of commencement of liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed.\textsuperscript{857}

The presumption of insolvency in s 292(3)(a), as unamended by s 27 of the Companies Amendment Act 2006, referred to a company being unable to pay its “debts” rather than its “due debts”. Given the wider meaning of “debts”, this imposed a greater burden on creditors in the restricted period than liquidators faced outside it. Section 27(2) of the Companies Amendment Act 2006 addresses this anomaly: s 292(4A) now provides that “[a] transaction that is entered into within the restricted period is presumed, unless the contrary is proved, to be entered into at a time when the company is unable to pay its due debts”.

(3) Specified period

A transaction is voidable on the application of the liquidator if, assuming all other criteria in s 292 are met, it occurred during the specified period.\textsuperscript{858} The specified period differs according to the method by which liquidation commenced. In the case of a company that was put into liquidation by the court, the specified period is the period of two years before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date on which, and at the time at which, the order was made.\textsuperscript{859} If, however, an application was made to the court to put a company into liquidation and after the making of the application to the court a liquidator was appointed by the board or by special resolution, the specified period is the period of two years before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date and at the time of the commencement of liquidation.\textsuperscript{860} Otherwise, the specified period is the period of 2 years before the date of commencement of liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed.\textsuperscript{861}

(4) Preferential effect

Section 292(2)(b), unamended by s 27 of the Companies Amendment Act 2006, provided that the liquidator had the onus of establishing that a transaction enabled another person to receive more towards satisfaction of a debt than the person would otherwise have received, or be likely to have received, in the company’s liquidation.\textsuperscript{862} In \textit{Gray v Chilton Saint James School}\textsuperscript{863} a company directed a third party which owed it funds to pay a debt of one

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\begin{enumerate}
\item Companies Act 1993, s 292(6)(b).
\item Companies Act 1993, s 292(6)(c).
\item Companies Act 1993, s 292(6)(a).
\item Companies Act 1993, s 292(1)(b).
\item Companies Act 1993, s 292(5)(b).
\item Companies Act 1993, s 292(5)(c).
\item Companies Act 1993, s 292(5)(a).
\end{enumerate}
\end{footnotesize}
of its directors. The Court of Appeal held that the wording of s 292(2)(b), its statutory context and the relevant legislative history all supported a reading of it as applying only to debts owed by the company in liquidation, meaning that the payment by the third party fell outside its ambit. Now, under the substituted s 292(2)(b), a liquidator has to establish that a transaction “enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company’s liquidation.”

“Debt” in this context means an existing or antecedent debt.865

The test for preferential effect requires a comparison “between the amount the creditor actually received from the company and the amount that creditor would have received as part of the general body of creditors in the liquidation had the payment not been made.”867 “The degree of any preferment is to be measured against what the creditors would receive in the actual liquidation.”

In *Managh v Morrison* a company assigned its principal asset, two causes of action, to a trust existing for the benefit of its former director. Courtney J rejected an argument that the liquidator was required to show that a transaction will result in a greater recovery for the creditor than would otherwise be the case, holding instead that “enable” in s 292(2)(b) “only requires that the creditor is given the means to improve its position over that of other creditors, not that it will necessarily succeed in doing so.”869 Courtney J also noted that the words “would receive or would be likely to receive” suggested “a threshold akin to the balance of possibilities”.870 Although it was not possible to put an exact value of the causes of action assigned, Courtney J concluded on the given facts that the company would make a recovery. Given that the value of the assigned asset was so much greater than the debt owed to the trust, the assignment was held to have enabled the trust to receive more towards payment of its debt than it would have been likely to receive in the liquidation.

In *Pharmacy Wholesalers (Wellington) Ltd v Graham*,871 a creditor sought to argue that no element of preference arose in respect of payments it had received because it was the only creditor in the liquidation. If the payments were set aside, it argued, it would be entitled to file a claim in the liquidation and the liquidator would be obliged to repay these sums to it. Master Lang rejected this argument on two grounds. The first was that before making a payment to the creditor, the liquidator would be obliged to pay certain costs, including his own as liquidator, meaning that any dividend the creditor received would be for a lesser sum than the impugned payments. Secondly, the Master accepted that the phrase “likely to have
received in the liquidation” was sufficiently broad to take into account the likelihood that
the only secured creditor was likely to surrender its security and claim as an unsecured
creditor in the liquidation.

In Trans Otway Ltd v Shephard,\textsuperscript{872} an outstanding debt was cleared by a payment effected by
a set-off. It was argued for the creditor that regard had not been had to s 310(1) of the Act,
which would have applied if liquidation had been commenced after the agreement had been
entered into, but before it had been carried out. The Supreme Court accepted as a point of
general principle that “[y]ou cannot prefer a man … by merely putting him in the very
position in which he would be if a bankruptcy followed,”\textsuperscript{873} but, on the facts before it, found
that the creditor fell within the exception in s 310(2), that is, at the time of the transaction,
it had reason to suspect that the company was not able to pay its debts as they fell due.\textsuperscript{874}

(5) Transactions occurring as part of a continuing business relationship

Section 292, unamended by s 27 of the Companies Amendment Act 2006, made no
reference to transactions occurring as part of a continuing business relationship between a
creditor and a debtor company. Section 27(2) of the Companies Amendment Act 2006
inserted a new s 292(4B),\textsuperscript{875} adopting s 588FA(3) of the Corporations Act 2001 (Aust).\textsuperscript{876}
Section 292(4B) provides:

“Where—

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

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

“then—

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

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

The rationale of such a provision is to prevent the unfairness that could result if each and
every payment made to, or benefit received by, a creditor who had an ongoing business
relationship with a company during the specified period was set aside because its effect was

\textsuperscript{872} Trans Otway Ltd v Shephard [2006] 2 NZLR 289 (SC).
\textsuperscript{873} Re Washington Diamond Mining Co [1893] 3 Ch 95 at 104 (CA).
\textsuperscript{874} See 31.9.4.
\textsuperscript{875} Section 27(2) of the Companies Amendment Act 2006 came into force on 1 November 2007.
\textsuperscript{876} Section 588FA(3) codified many of the rules developed by the Australian courts; see eg, Airservices
Australia v Ferrier (1996) 185 CLR 483 (HCA).
considered in isolation from the wider trading relationship between the creditor and the company.\textsuperscript{877}

As to the issue of on whom the onus of proof falls under s 292(4B), Santow J said in \textit{Sutherland v Eurolinx Pty Ltd} that:\textsuperscript{878}

"the codification of the so-called running account has become definitional of what is an 'unfair preference'. That means that, in terms of onus, what was once merely a defence is now an ingredient or element of that which the plaintiff liquidator must prove in establishing whether it is a preference (and its dimension). The onus in that sense has shifted to the party attacking the payments."

In \textit{Rea v Wolfgram}\textsuperscript{879} and \textit{Blanchett v McEntee Hire Holdings Ltd}\textsuperscript{880} the following extracts from the High Court of Australia’s decision in \textit{Airservices Australia v Ferrier} were cited:\textsuperscript{881}

"If a payment is part of a wider transaction or a ‘running account’ between the debtor and the creditor, the purpose for which the payment was made and received will usually determine whether the payment has the effect of giving the creditor a preference, priority or advantage over other creditors. If the sole purpose of the payment is to discharge an existing debt, the effect of the payment is to give the creditor a preference over other creditors unless the debtor is able to pay all of his or her debts as they fall due. But if the purpose of the payment is to induce the creditor to provide further goods or services as well as to discharge an existing indebtedness, the payment will not be a preference unless the payment exceeds the value of the goods or services acquired. In such a case a court, exercising jurisdiction under s 122 of the Bankruptcy Act, looks to the ultimate effect of the transaction. Whether the payment is or is not a preference has to be ‘decided not by considering its immediate effect only but by considering what effect it ultimately produced in fact … ’ To have the effect of giving the creditor a preference, priority or advantage over other creditors, the payment must ultimately result in a decrease in the net value of the assets that are available to meet the competing demands of the other creditors … If the purpose of a payment is to secure an asset or assets of equal or greater value, the payee receives no advantage over other creditors. The other creditors are no worse off and, where the value of the assets has increased, they are actually better off.”

Santow J put the matter in the following way in \textit{Sutherland v Eurolinx Pty Ltd}:\textsuperscript{882}

"First, there must be no cessation of that mutual assumption of payment and reciprocal supply throughout the relevant period. Second, those payments must continue to have as at least one operative, mutual purpose, namely inducing further

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\item \textsuperscript{877} \textit{Airservices Australia v Ferrier} (1996) 185 CLR 483 (HCA).
\item \textsuperscript{878} \textit{Sutherland v Eurolinx Pty Ltd} (2001) 37 ACSR 477 at 508.
\item \textsuperscript{879} \textit{Rea v Wolfgram} [2010] NZCCLR 6 (HC) at [32].
\item \textsuperscript{880} \textit{Blanchett v McEntee Hire Holdings Ltd} (2010) 10 NZCLC 264,763 (HC) at [47]. See also Jollands v Mitchill Communications Ltd HC Auckland CIV-2009-404-8146, 11 April 2011.
\item \textsuperscript{881} \textit{Airservices Australia v Ferrier} (1996) 185 CLR 483 (HCA) at 501–502.
\item \textsuperscript{882} \textit{Sutherland v Eurolinx Pty Ltd} (2001) 37 ACSR 477 at [148]. These same points were summarised with approval by Christiansen AJ in \textit{Blanchett v McEntee Hire Holdings Ltd} (2010) 10 NZCLC 264,763 (HC) at [49].
\end{itemize}
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supply. I would add that such purpose must not come to be subordinated to a predominant purpose of recovering past indebtedness.”

In *Airservices Australia v Ferrier*, the appellant supplied air navigation services to a company up until the commencement of its liquidation. The liquidators sought to set aside nine payments, totalling $10.35 million, made by the company to the appellant in the specified pre-liquidation period of six months. In the same time period, the company’s indebtedness to the appellant increased by $8.18 million. A running account was found to be in existence up until the last payment by the company to the appellant. The end result — for the period a running account was held to exist — was that the appellant received no preference as during this period the value of the services it provided to the company exceeded the payments it had received from the company.

The liability of a taxpayer to pay sales tax to the Commissioner of Taxation has been held not to involve a running account or a continuing business relationship for several reasons: there was no contractual relationship between the parties, no services were provided by the Commissioner, and there was no fluctuating balance as a result of entries on both sides of the ledger. Progress payments under a building contract have also been held not to be payments made in the course of a running account or a continuing business relationship.

There is conflicting Australian authority on the issue of whether a creditor’s knowledge or suspicion of a company’s insolvency will bring a continuing business relationship to an end. In *Blanchett v McEntee Hire Holdings Ltd* a continuing business relationship was found to have ended on the date that a creditor issued a stop credit notice to a company. There was found to be no trading relationship between the parties for a four month period after that time and the only invoice issued by the creditor during that time was for the costs the creditor incurred in referring the company’s outstanding debt to a debt collection firm.

Australian authority applies the following rule in determining when a “single transaction” begins and ends in the case of a continuing business relationship:

“Thus I would measure the preference, if any, by reference to the period of the relevant transactions constituting the running account, within the 6 months relation back period. I would do so by reference to the highest amount owing during the relation back period, not necessarily ‘at the beginning’, compared to the amount owing on the last day”.

In *Blanchett v McEntee Hire Holdings Ltd* Christiansen AJ noted that if his conclusion on the end date of the continuing business relationship was wrong, he was prepared to hold that

884  *Sands and McDougall (Wholesale) Pty Ltd (in liq) v Commissioner of Taxation* [1999] 1 VR 489.
885  *Wily v Eastern Elevators Pty Ltd* (2003) 45 ACSR 261; *Walsh v Salters Constructions Pty Ltd* (2001) 3 VR 305 (CA). These authorities have since been applied in *Jollands v Mitchill Communications Ltd* HC Auckland CIV-2009-404-8146, 18 April 2011.
886  *Rothmans Export Pty Ltd v Mistmore Pty Ltd* (1994) 12 ACLC 936 at 946 cf *Olifent v Australian Wine Industries Pty Ltd* (1996) 14 ACLC 510. These authorities were referred to by Christiansen AJ in *Blanchett v McEntee Hire Holdings Ltd* (2010) 10 NZCLC 264,763 (HC) at [50].
In my judgment a liquidator has the option to choose the starting point of a transaction period for the purpose of an assessment of the extent of a creditor’s preference; that liquidators ought to be able to cherry pick a date that best suits the general body of creditors because s 292(4B) does not limit a liquidators ability to do so and if the liquidators ability was to have been limited then the Act should have done that. Also, the creditor has access to the good faith/no reasonable cause of suspicion/value for payment defence. It makes sense that if that defence fails a liquidator should retain the ability to act in a manner that benefits all creditors of the liquidated company.”

Fixing on a peak indebtedness date within the specified period picked by a liquidator is not the only possible option when it comes to determining the opening balance for the purpose of the continuing business relationship rule. Alternative options are the beginning of the specified period or the date on which the continuing business relationship began. If the continuing business relationship began before the commencement of the specified period, picking the date of commencement of that relationship as the start date will mean that “the opening balance …, if it were not a nil balance, [would] be no more than the opening entry on the account and it is almost inevitable that, in circumstances where the debtor company eventually goes into liquidation, the closing balance would exceed the opening balance. In that case, a preferential payment would rarely occur.” However as Master Burley pointed out in Olifent v Australian Wine Industries Pty Ltd, if the continuing business relationship began after the commencement of the specified period, the choice of the beginning of the specified period as the opening balance date is as arbitrary as allowing a liquidator to choose a peak indebtedness date. Master Burley also noted that “[o]n the other hand, if the continuing business relationship commenced during the … [specified period], a cogent argument might be put forward that that is the balance to be taken as the opening balance for the purpose of determining whether or not there has been, when the transactions are agglomerated, an effective preference.” Although the wording of s 292(4B) is adopted from s 588FA(3) of the Corporations Act 2001, the wider context in which the Australian rule operates differs to some degree from that in New Zealand. Australian liquidators can only set aside transactions occurring in the six month period prior to commencement of liquidation and do not have the benefit of a general presumption of insolvency in that period. Given these differences, there is room for argument that the peak indebtedness approach ought not to be adopted as a blanket rule in New Zealand, leaving it open for an alternative approaches to be adopted in appropriate cases.

889 Blanchett v McEntee Hire Holdings Ltd (2010) 10 NZCLC 264,763 (HC) at [69].
892 Ibid.
893 Ibid.
894 Ibid.
895 Ibid.
896 Corporations Act 2001 (Cth), s 588FA(3).
897 Corporations Act 2001 (Cth), s 588E.
The running account defence, as it developed in Australia at common law, was rejected in two early High Court cases in relation to s 292 (as unamended by s 27 of the Companies Amendment Act 2006). In Chatfield v Mercury Energy Ltd, Randerson J distinguished the Australian continuing business relationship doctrine as it had developed at common law on the ground that the legislative provision giving rise to it was significantly different to s 292(2)(b). The then applicable Australian provision made reference to a transaction “in favour of a creditor having the effect of giving that creditor a preference, priority, or advantage over other creditors.” Randerson J viewed references to a running account and the existence of a continuing business relationship as being more relevant to issues arising under a consideration of a debtor’s intention in entering into a transaction as was required by s 309 of the Companies Act 1955. This view was endorsed by Gallen ACJ in Re Island Bay Masonry Ltd (in liq). It can be argued that Randerson J and Gallen ACJ overestimated the significance of a debtor’s intention in the continuing business relationship doctrine. The majority judgment of the High Court of Australia in Airservices Australia v Ferrier states that the intention of the debtor is of evidentiary significance in assessing the existence of a continuing relationship, but clearly acknowledges that an objective assessment of the effect of a transaction is required. Further, as has been noted, although the unamended s 292(4) precludes any account being taken of an intention to prefer a creditor on the part of a company (except as it otherwise provides), this only applies to a determination of whether a transaction is in the ordinary course of business, rather than to the enquiry as to preferential effect. More recently, in Porter Hire Ltd v Blanchett Associate Judge Doogue, without deciding the matter, expressed the view that “the Australian line of authority perhaps cannot be easily dismissed on the basis that there are legislative differences between the New Zealand and Australian commonwealth legislation”. In Trans Otway Ltd v Shephard, an argument was made to the Supreme Court that, by analogy with the Australian running account cases, the agreement between the parties should be looked at as a whole and account taken of the reasons why the parties had entered into it when determining the preferential effect, if any, of a transaction. Although it rejected this argument on the facts before it, the court cited with approval the following extract from the High Court of Australia decision in Richardson v Commercial Banking Co of Sydney Ltd:

“In considering whether the real effect of a payment was to work a preference its actual business character must be seen and when it forms part of an entire transaction which if carried out to its intended conclusion will leave the creditor without any preference priority or advantage over other creditors the payment cannot be isolated and construed as a preference.”

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

(6) Ordinary course of business

Under s 292(2), unamended by s 27 of the Companies Amendment Act 2006, a transaction will not be set aside as a transaction having preferential effect if it took place in the ordinary course of business. An overview of the ordinary course of business test now follows.

The first point of note is that the liquidator bears the onus of establishing that a transaction was not in the ordinary course of business in the specified period. The onus of proof is reversed in the restricted period, where a creditor must rebut a presumption that a transaction took place otherwise than in the ordinary course of business.

The rationale behind the ordinary course of business exception was explained by the Court of Appeal in Waikato Freight and Storage (1988) Ltd v Meltzer:

“Parliament did not consider it appropriate to make payments having a preferential effect absolutely voidable. … The creditor can keep the payment if able to show, the onus being on it, that the payment was made by the debtor company in the ordinary course of business. Parliament thereby intended a commercially unremarkable payment to stand, even if having preferential effect. It must have been Parliament’s view that otherwise the ordinary processes of commerce would be unduly undermined.”

After some initial confusion, the general principles applicable in determining whether a transaction took place in the ordinary course of business are now settled. They are:

- The transaction must be examined in the actual setting in which it took place;
- The transaction must be such that it would be viewed by an objective observer as having taken place in the ordinary course of business;
- The observer is the court which must look at the circumstances as are objectively apparent at the time of the transaction;
- Reference may be had to business practice in the commercial world in general, but the focus is on the ordinary operational activities of businesses as going concerns, rather than on responses to abnormal financial difficulties.


907 See 31.6.1(3).


909 Companies Act 1993, s 292(3)(b).


912 Countrywide Banking Corp Ltd v Dean [1998] 1 NZLR 385 (PC) at 395.

913 Ibid.


915 Countrywide Banking Corp Ltd v Dean [1998] 1 NZLR 385 (PC) at 395.
• Reference may also be had to particular customs or practices within the field of commerce concerned;\textsuperscript{916}
• The prior dealings between the company and the particular creditor are of relevance;\textsuperscript{917}
• Where the impugned transaction is made as part of an ongoing business relationship, as opposed to a one-off transaction, regard should be had primarily to the company’s prior course of conduct towards the creditor and towards its creditors generally;\textsuperscript{918}
• The business context in which a transaction occurs includes its particular contractual context — the question must be asked whether a payment made was in fulfillment of a company’s contractual obligation or in response to a situation of insolvency;\textsuperscript{919}

It has been accepted that although the statements of principle for determining whether a transaction is in the ordinary course of business are settled, there is often difficulty in applying these principles to the facts of any given case.\textsuperscript{920} Certainly, as the summary of principles set out above makes clear, it is the particular factual situation in which a transaction occurs that is determinative of whether it takes place in the ordinary course of business. With that caveat, the following is a summary of some of the results in cases decided in the period since the principles for determining whether a transaction is in the ordinary course of business were settled.

Transactions held to be in the ordinary course of business:
• Lump sum payments that do not relate to any particular invoice, but which are common place in the industry in which the company and creditor trade and/or the trading relationship between the parties;\textsuperscript{921}
• A lump sum payment made late but in accordance with the past practices of the debtor company in relation to the creditor;\textsuperscript{922}
• A payment in repayment of a debt on the due date of the debt.\textsuperscript{923}

Transactions held not to be made in the ordinary course of business:
• A payment of a debt that was not due and owing;\textsuperscript{924}
• A lump sum payment clearing all outstanding arrears made at a time when the company was in the throes of disposing of its business;\textsuperscript{925}

\textsuperscript{916} Waikato Freight and Storage (1988) Ltd v Meltzer [2001] 2 NZLR 541 (CA) at 551.
\textsuperscript{917} Countrywide Banking Corp Ltd v Dean [1998] 1 NZLR 385 (PC) at 395; Re Modern Terrazzzo Ltd (in liq) [1998] 1 NZLR 160 (HC) at 175.
\textsuperscript{918} Carter Holt Harvey Ltd v Fatupaito (2003) 9 NZCLC 263,285 (CA) at [21].
\textsuperscript{919} Ibid.
\textsuperscript{920} See eg, Re Wienk Industries Ltd (in liq) HC Auckland CIV-2003-404-816, 17 September 2004 at [24].
\textsuperscript{922} Re Terralink Ltd (in rec and liq) HC Wellington M122-02, 13 November 2002; Porter Hire Ltd v Blanchett (2006) 9 NZCLC 264,070 (HC).
\textsuperscript{923} Larsen v Mounford HC Auckland M562-IM01, 6 August 2002.
\textsuperscript{924} Carter Holt Harvey Ltd v Fatupaito (2003) 9 NZCLC 263,285 (CA).
\textsuperscript{925} Cobb and Co Restaurants Ltd v Thompson (2004) 9 NZCLC 263,638 (HC); See also Takanini Rentors Ltd v Waikato Dive Centre Ltd (in liq) HC Hamilton CIV-2003-419-1637, 10 June 2004; Countrywide Banking Corp Ltd v Dean [1998] 1 NZLR 385 (PC) at 395.
31.6 Voidable transactions

- A payment made outside the usually observed terms of trade between a company and a creditor;
- Payments made in response to a compromise made with the creditor and to avoid legal action;
- A payment made after the withdrawal of credit by a creditor in order to have that credit reinstated;
- Lump sum payments made to a creditor franchisor in response to notices that were issued as a preparatory step to the creditor terminating the franchise agreement.

Under s 292(4), as unamended by s 27 of the Companies Amendment Act 2006, in determining whether a transaction took place in the ordinary course of business, no account is to be taken of any intent or purpose on the part of a company:

"(a) To enable another person to receive more towards satisfaction of a debt than the person would otherwise receive or be likely to receive in the liquidation; or

"(b) To reduce or cancel the liability, whether in whole or in part, of another person in respect of a debt incurred by the company; or

"(c) To contribute towards the satisfaction of the liability, whether in whole or in part, of another person in respect of a debt incurred by the company—

"unless the other person knew that that was the intent or purpose of the company."

In Waikato Freight and Storage (1988) Ltd v Meltzer, the Court of Appeal said in an obiter statement that even if a creditor was aware of an intention of a kind specified in s 292(4) on the part of a company, it points towards a transaction being outside the ordinary course of business, but is not determinative of the point. In Graham v Pharmacy Wholesalers (Wellington) Ltd, the Court of Appeal regarded a creditor as being aware it was being treated preferentially when, on the balance of probabilities, it was “practically inevitable” that it knew that:

- The company was insolvent at the time it made payments to the creditor;
- The company was not meeting its obligations to a secured creditor; and
- If the company was put into liquidation, the payments made to it would diminish the pool of assets available to other creditors.

The Ministry of Economic Development explained the reasons supporting the removal of the ordinary course of business exception in a 2001 Discussion Document. It said that a combination of two factors (uncertainty as to the meaning of the exception and the practical difficulty in applying it) had led to a considerable amount of costly litigation. The Ministry’s conclusion, adopted in s 27 of the Companies Amendment Act 2006, was that

932 Ministry of Economic Development Voidable Transactions Discussion Document (Wellington, 2001) at [4.3].

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the flexibility offered by the ordinary course of business test was outweighed by the disadvantages associated with it.  

(7) Receivers and transactions having a preferential effect

Prior to s 27 of the Companies Amendment Act 2006 coming into force, it had been held that a payment by a receiver made pursuant to a post-receivership contract with a creditor, that fell within the ambit of s 32(1)(a) of the Receiverships Act 1993, was not subject to s 292 of the Act. 934 s 32(1)(a) provides that a receiver is personally liable on any contract entered into by the receiver in the exercise of any of the receiver’s powers. Section 27(2) of the Companies Amendment Act 2006 inserted a new s 292(4) codifying this rule. 935 The new s 292(4) provides:

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

(8) Administrators and transactions having a preferential effect

Section 239ACB of Part 15A of the Act provides that the voidable transaction provisions in the Act do not apply to a transaction by a company in administration if the transaction is carried out by or with the authority of the administrator or deed administrator, or is specifically authorised by the deed of company arrangement and carried out by the deed administrator.

31.6.2 Voidable charges

(1) The general rule

Under s 293(4), a charge given by a company over its property or undertaking in the specified period prior to liquidation is voidable on the application of the liquidator if, immediately after the giving of the charge, the company was unable to pay its due debts. Charges given to secure existing indebtedness and which improve the position of a previously unsecured creditor are targeted by s 293: 936 exceptions to the general rule confer protection for charges falling outside this category.

The grantee of a charge that is voidable under s 293 may still seek to deny recovery by the liquidator under s 296(3) of the Act. 937

“Charge” is defined in s 2 of the Act to include “a right or interest in relation to property owned by the company, by virtue of which a creditor of the company is entitled to be paid in priority to creditors entitled to be paid under s 313; but does not include a charge under a charging order issued by a court in favour of a judgment creditor”. 938

933 Ibid, at [5.1.2].
935 The new s 292(4) came into force on 1 November 2007.
936 Fisk v Mahoney HC Wellington CIV-2010-485-2518, 13 June 2011 at [20].
937 See 31.6.5(2).
938 See eg, Mayo-Smith v Raymond [2010] NZCCLR 26 (HC).
A charge is given on the date that the document creating it is executed.939

A prior equitable charge that has ceased to have effect through application of the principle of merger and extinguishment on the execution of a subsequent charge is not revived if the later charge is avoided under s 293.940

A charge may only be avoided under s 293(1) as from the commencement of liquidation. A charge that has been redeemed prior to the commencement of liquidation falls outside s 293(1), notwithstanding the fact that it could have been avoided if it had still been in force at the commencement of liquidation.941 The redemption of a charge within this category may be able to be challenged by a liquidator under s 292 of the Act.942

(2) Specified period

The specified period differs according to the way in which the liquidation of the company commenced. The length of the specified period was extended from one year to two years by s 28(4) of the Companies Amendment Act 2006, making s 293, in this respect, consistent with s 292.943 In the case of a company that was put into liquidation by the court, the “specified period” is the period of two years before the making of the application to the court together with the period commencing on the making of the application and ending on the date on which, and at the time at which, the order was made.944 If, however, an application was made to the court to put a company into liquidation and after the making of the application a liquidator was appointed by the board or by special resolution, the specified period is the period of two years before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date and at the time of commencement of liquidation.945 In all other circumstances, the specified period is “the period of two years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed”.946

The liquidator bears the onus of establishing that a charge was given in the specified period.

(3) Company solvent immediately after the giving of a charge

A charge given during the specified period is voidable unless the company was able to pay its due debts immediately after the charge was given.947 In the restricted period, the liquidator has the advantage of a rebuttable presumption of insolvency: s 293(2) provides that, unless the contrary is proved, a company giving a charge within the restricted period is presumed to have been unable to pay its due debts immediately after giving the charge. The restricted period differs according to the manner in which liquidation commenced. In the case of a company put into liquidation by the court, it is the period of six months before the making

942 See 31.6.1.
943 The amendment made by s 28(4) of the Companies Amendment Act 2006 came into force on 1 November 2007.
944 Companies Act 1993, s 293(6)(b).
945 Companies Act 1993, s 293(6)(c).
946 Companies Act 1993, s 293(6)(a).
947 Companies Act 1993, s 293(1)(b).
of the application to the court together with the period commencing on the date of the
making of the application and ending on the date on which, and at the time at which, the
order of the court was made. If, however, an application was made to the court to put a
company into liquidation, and after the making of the application a liquidator was appointed
by the board or by special resolution, the restricted period is the period of six months before
the making of the application to the court together with the period commencing on the date of
the making of the application and ending on the date, and at the time of, the
commencement of the liquidation. In all other circumstances, the restricted period is the
period of six months before the date of commencement of the liquidation together with
the period commencing on that date and ending on the date on which, and at the time at
which, the liquidator is appointed.

A debt is due when it is legally due, that is, the creditor is able to sue the debtor for
payment.

On a first reading it might be thought that the test for insolvency in s 293(1) calls for an
assessment of a company’s ability to pay its due debts at the point in time when the charge
is given rather than over a period of days or even weeks. However, if the test is interpreted
as relating to an instant rather than a period of time, it would not reflect commercial reality,
a factor the court has consistently said is relevant in the assessment of solvency in the
context of transactions having a preferential effect under s 292, as information about a
company’s ability to pay its due debts in the weeks immediately before and after the
transaction would be discounted. Such information is likely to enable a more accurate
assessment of the company’s solvency than a tally of the company’s liquid assets and due
debts at a given instant.

(4) **The exceptions**

There are three exceptions to the rule in s 293(1). The first two exceptions are set out in
s 293(1A), which provides:

“(1A) Subsection (1) does not apply if—

"(a) the charge secures money actually advanced or paid, or the actual price
or value of property sold or supplied to the company, or any other
valuable consideration given in good faith by the grantee of the charge
at the time of, or any time after, the giving of the charge; or

"(b) the charge is in substitution for a charge given before the specified
period.”

The third exception, where a charge secures the unpaid purchase price of property, is set
out in s 293(4).

948 Companies Act 1993, s 293(7)(b).
949 Companies Act 1993, s 293(7)(c).
950 Companies Act 1993, s 293(7)(a).
951 Re Peter Austin Ltd (in liq) [1990] 2 NZLR 245 (HC).
952 See 31.6.2(2).
953 See eg, Re Seafresh New Zealand Ltd (in liq) (2004) 9 NZCLC 263,629 (HC); Rural Log and Lumber Ltd (in
rec and liq) v Yack (1997) 8 NZCLC 261,329 (HC).
The grantee of a charge can seek to establish that the charge falls within more than one exception.\(^{954}\) It is possible for a charge to be held to be valid only to the extent that the grantee can establish that it falls within one of the specified exceptions.\(^{955}\)

Whether or not a charge falls into one of the specified exceptions is to be assessed “from a business point of view” at the time when it was entered into by the company and the grantee. The emphasis is on the substance of a transaction rather than its form.\(^{956}\)

The grantee of the charge bears the onus of establishing that the elements of one or more of the exceptions are made out.\(^{957}\)

(a) Money paid or advanced, goods sold or supplied, valuable consideration supplied in good faith

The first exception catches those charges which secure:

• Money actually advanced or paid; or
• The actual price or value of property sold or supplied to the company; or
• Other valuable consideration given in good faith.

All three specified forms of consideration are qualified by the requirement that they must be given by the grantee of the charge at the time of, or at any time after, the giving of the charge.\(^{958}\) There must be continuity between the giving of the consideration and the execution of the charge so that they can be seen to be part of one continuous transaction.\(^{959}\) The two events must be linked so that there is “no break in the chain.”\(^{960}\) The court has recognised that some flexibility is necessary, but the onus is on the grantee to justify a delay of any longer than a few days.\(^{961}\) Furthermore, a grantee who has caused or acquiesced in a delay in the execution of a charge cannot rely on this exception.\(^{962}\) An example of circumstances where the necessary link was held to be missing is Re C and D Webster Ltd (in liq), where allegedly valuable consideration was given in good faith three months before the execution of the charge.\(^{963}\)

The wording “the charge secures” applies to all three forms of consideration, meaning that the new consideration supplied by the grantee must be something that is secured by the charge.\(^{964}\) In Re C and D Webster Ltd (in liq), a company gave a charge in return for an

\(^{955}\) Re C and D Webster Ltd (in liq) [1995] 3 NZLR 590 (HC).
\(^{956}\) Re Mātārau Motors Ltd [1981] 1 NZLR 289 (CA); Re Mathew Ellis Ltd [1933] 1 Ch 458 (CA); See eg, Re Manson and James Ltd (1984) 2 NZCLC 99,092 (HC).
\(^{957}\) Re Seafresh New Zealand Ltd (in liq) [2004] 9 NZCLC 263,629 (HC); Re Equiticorp Industries Group Ltd (in stat man) [1990] 5 NZCLC 66,361 (HC); Men v Official Assignee [1987] 2 NZLR 1 (CA).
\(^{958}\) Companies Act 1993, s 293(1A); Parsons v Norris [2002] 2 NZLR 497 (CA) at [34].
\(^{959}\) Re C and D Webster Ltd (in liq) [1995] 3 NZLR 590 (HC); Re Port Supermarket Ltd (in liq) [1978] 1 NZLR 330 (SC).
\(^{960}\) Re C and D Webster Ltd (in liq) [1995] 3 NZLR 590 (HC) at 596.
\(^{961}\) Re Port Supermarket Ltd (in liq) [1978] 1 NZLR 330 (SC).
\(^{963}\) See also Re Columbian Fireproofing Co Ltd [1910] 2 Ch 120 (CA); Tui Sales and Marketing Ltd v Crawford Food Distributors Ltd (in liq) HC Christchurch M171/91, 17 June 1993; Re Central Ceilings Ltd (in liq) (1992) 6 NZCLC 68,016 (HC).
\(^{964}\) Re C and D Webster Ltd (in liq) [1995] 3 NZLR 590 (HC); Re Seafresh New Zealand Ltd (in liq) (2004) 9 NZCLC 263,629 (HC).
agreement by one of its suppliers to continue to deal with it rather than with its customers. The charge was held not to fall within this exception because the agreement was not, and was not capable of being, secured by the charge.\textsuperscript{965}

The issue of whether money has been “actually advanced or paid” does not necessarily depend on there being a physical passing of cash or a cheque from the grantee of the charge to the company.\textsuperscript{966} In Re Mataura Motors Ltd, an unpaid seller of land, who had retained title to the land and had various rights against the purchaser company, but who gave up those rights and transferred title in return for a debenture, was held to have advanced money to the company within the terms of the then applicable s 311A of the Companies Act 1955. The Court of Appeal emphasised that it was necessary to consider the substance of a transaction rather than its form.\textsuperscript{967}

“Valuable consideration” does not have the same meaning in this context as it does in the law of contract. It means something that has a real and substantial value and is of real worth to the debtor, as explained by Miller J in Re Seafresh New Zealand Ltd (in liq):\textsuperscript{968}

“In summary, the authorities show that a mortgagee who seeks to rely on a forbearance to sue as valuable consideration for the mortgage faces three formidable obstacles in proving consideration. The first is the need to show that the forbearance has a real worth to the debtor in the circumstances. Inability to refinance is not enough. The second is quantifying that worth. Because it is not enough to show that the mortgagee gave a horse or a hawk, or a robe, or any other consideration that is sufficient in law to support a contract, the mortgagee must show that the forbearance has a value that corresponds approximately to the value of the security. The third is that the mortgage must secure the new consideration — the forbearance — and not merely the existing debt. For these reasons, it is doubtful whether a forbearance to sue, without more, could survive a challenge under s 293.”

A grantee of a charge who wishes to show that a charge secures valuable consideration given in good faith must show that he or she honestly obtained the charge in circumstances when he or she did not know, and had no good reason to suspect, that other creditors would be left unpaid.\textsuperscript{969} If there is doubt on this point, the grantee of the charge will have failed to discharge the burden of proof.\textsuperscript{970} In Re Austin (a bankrupt),\textsuperscript{971} a mortgagee was held not to have acted in good faith in the following circumstances: it, through its solicitor, was aware that a cheque in part payment of arrears of debt had been twice dishonoured; it had made threats, which it eventually acted upon, to commence bankruptcy proceedings; and it was aware other creditors were suing the debtor.

\textsuperscript{965} See also Re Seafresh New Zealand Ltd (in liq) (2004) 9 NZCLC 263,629 (HC).
\textsuperscript{966} Re Mataura Motors Ltd [1981] 1 NZLR 289 (CA).
\textsuperscript{967} Note, however, that this case pre-dated the 1980 amendment to s 311 of the Companies Act 1955 which introduced the exception in its present form, that is “valuable consideration supplied in good faith”.
\textsuperscript{968} Re Seafresh New Zealand Ltd (in liq) (2004) 9 NZCLC 263,629 (HC). See also Meo v Official Assignee [1987] 2 NZLR 1 (CA); Re Austin (a bankrupt) [1982] 2 NZLR 524 (HC); Barton v Official Receiver (1986) 161 CLR 75 (HCA).
\textsuperscript{969} Re C and D Webster Ltd (in liq) [1995] 3 NZLR 590 (HC); Re McColl [1935] GLR 105; Re Hold (a bankrupt) [1974] 2 NZLR 455 (SC); Re Austin (a bankrupt) [1982] 2 NZLR 524 (HC); Meo v Official Assignee [1987] 2 NZLR 1 (CA).
\textsuperscript{970} Re C and D Webster Ltd (in liq) [1995] 3 NZLR 590 (HC).
\textsuperscript{971} Re Austin (a bankrupt) [1982] 2 NZLR 524 (HC).
(b) **Substituted charges**

The second specified exception to the general rule in s 293(1) is a charge that is in substitution for a charge given before the specified period.\(^{972}\)

This exception does not apply to the extent that:\(^{973}\)

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“(a) The amount secured by the substituted charge exceeds the amount secured by the existing charge; or
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“(b) The value of the property subject to the substituted charge at the date of substitution exceeds the value of the property subject to the existing charge at that date.”
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This exception has no application where the original charge was unregistered.\(^{974}\)

“Substitution” carries its ordinary meaning in this context: it denotes “an element of replacement or exchange.”\(^{975}\)

(c) **Charge secures unpaid purchase price of property**

The third exception, set out in s 293(4), is for a charge given by a company to secure the unpaid purchase price of property, whether or not the charge is given over that property, if the instrument creating it is executed not later than 30 days after the sale of the property or, in the case of the sale of an estate or interest in land, not later than 30 days after the final settlement of the sale.\(^{976}\)

(5) **Exclusion of the rule in Clayton’s Case**

The rule in *Clayton’s Case*\(^{977}\) is that, in the absence of any statutory requirement or binding arrangement between a debtor and creditor to the contrary,\(^{978}\) receipts on a current account are applied to repay the earliest outstanding debt.\(^{979}\) The effect of this can be seen in *Re Yeovil Glove Co Ltd*,\(^{980}\) a case where a company granted a floating charge to its banker to secure post-charge indebtedness, but where, in the time between the giving of the charge and the appointment of a receiver, the indebtedness of the company to its banker remained constant. The company made deposits into its account that in total exceeded the amount of pre-charge indebtedness, but made payments out of its account totaling almost the same amount. Harman J noted that an application of the rule in *Clayton’s Case* allowed the grantee to pay itself out of moneys received after the charge was given for indebtedness incurred prior to the giving of the charge with the result that its pre-charge unsecured indebtedness was replaced with post-charge secured indebtedness. The rule in *Clayton’s Case* is now abrogated by s 293(5), which provides:

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972 Companies Act 1993, s 293(1A)(b).
973 Companies Act 1993, s 293(3).
974 *Fisk v Mahoney* HC Wellington CIV-2010-485-2518, 13 June 2011 at [40], adopting the analysis of the Court of Appeal in *Parsons v Norris* [2002] 2 NZLR 497 (CA) at [21]–[23].
975 *Re Kerr* [1993] 2 NZLR 378 (HC).
976 Companies Act 1993, s 293(4).
977 *Devaynes v Noble* (1816) 1 Mer 592.
978 *Re Registered Securities Ltd* [1991] 1 NZLR 545 (CA).
979 *Re C and D Webster Ltd (in liq)* [1993] 3 NZLR 590 (HC).
980 *Re Yeovil Glove Co Ltd* [1962] Ch 148 (CA).
“(5) For the purposes of subsection (1A)(1) and subsection 4 of this section, where any charge was given by the company within the period specified in subsection (1) of this section, all payments received by the grantee of the charge after it was given shall be deemed to have been appropriated so far as may be necessary—

“(a) Towards repayment of money actually advanced or paid by the grantee to the company on or after the giving of the charge; or

“(b) Towards payment of the actual price or value of property sold by the grantee to the company on or after the giving of the charge; or

“(c) Towards payment of any other liability of the company to the grantee in respect of any other valuable consideration given in good faith on or after the giving of the charge.”

The inter-relationship between s 293(5) and charges falling within the exception in s 293(4) was considered by Blanchard J in *Re C and D Webster Ltd (in liq)*. He noted that although there is a reference to s 293(4) at the beginning of s 293(5), paragraphs (a–)(c) of s 293(5) only refer to payments received by the grantee of the charge after the giving of the charge. To give the reference to s 293(4) in s 293(5) some effect, he held that in the case before him, where a surplus remained after payments received by the grantee had been appropriated to repay post-charge indebtedness, the surplus was to be appropriated towards payment of any unpaid purchase price arising before the giving of the charge, but which had accrued in the 30 day period specified in s 293(4).

31.6.3 Procedure for setting aside voidable transactions and charges

The procedure a liquidator must follow to set aside a transaction under s 292 or a charge under s 293 is set out in s 294. Section 29 of the Companies Amendment Act 2006 inserted a substituted s 294 into the Act. Under the substituted s 294, as was the case under the original, a liquidator must undertake two sequential steps.

- First, under s 294(1)(a), file in the court a notice to the effect that he or she wishes to set aside a transaction under s 292 or a charge under s 293 and which meets the requirements set out in s 294(2).

Section 294(2) provides that the liquidator’s notice must:

- be in writing; and
- state the liquidator’s postal, email and street addresses; and
- specify the transaction or charge to be set aside; and
- describe the property or state the amount that the liquidator wishes to recover; and

982 The substituted s 294 came into force on 1 November 2007.
984 There is no requirement that the notice be signed by the liquidator in person or be filed by the liquidator in person or give an address for service: *Glengarry Hanwicks Ltd v 48 High Ltd (in liq)* (1999) 8 NZCLC 261,978 (HC). There is no requirement that the notice be filed in court as soon as reasonably practicable: *Blanchett v McEntee Hire Holdings Ltd* (2010) 10 NZCLC 264,763 (HC) at [14].
“(e) state that the person named in the notice may object to the transaction or charge being set aside by sending to the liquidator a written notice of objection that is received by the liquidator at his or her postal, email or street address within 20 working days after the liquidator’s notice has been served on that person; and

“(f) state that the written notice of objection must contain full particulars of the reasons for objecting and must identify any documents that evidence or substantiate the reasons for objecting; and

“(g) state that the transaction or charge will be set aside as against the person named in the notice if that person does not object; and

“(h) state that if the person named in the notice does object, the liquidator may apply to the Court for the transaction or charge to be set aside.”

The notice must comply with r 31.37 and r 31.38 of the High Court Rules. Under the original s 294(2), a notice that failed to specify matters similar to those set out in the substituted s 294(2) was invalid, and the same consequence can be expected in the case of a notice that does not meet the requirements of the substituted s 294(2). The court has no power to amend a liquidator’s notice, but it is open to a liquidator to recall a notice and issue a replacement notice.

The second sequential step is that, under s 294(2)(b), the liquidator must serve the notice as soon as practicable on the other party to the transaction or the charge holder or any other party from whom the liquidator intends to recover. It has consistently been held that a notice filed in the court by a liquidator under the original s 294(2)(a) is not a legal proceeding for the purposes of the High Court Rules. A liquidator’s notice must therefore, in accordance with reg 40 of the Companies Act 1993 Liquidation Regulations 1994, be served on a natural person in accordance with s 391 of the Act. A liquidator’s notice must be served on a company in accordance with s 387 of the Act.

A transaction or charge will be automatically set aside as against a person on whom the liquidator has served a notice if that person fails to send a written notice of objection that is received by the liquidator at his or her email, postal or street address within 20 working days after service of the liquidator’s notice. The notice of objection must contain full particulars of the reasons for objecting and must identify any documents that evidence or substantiate those reasons. If the other party to the transaction or charge holder does

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985 High Court Rules, r 31.1(2).
987 See High Court Rules, r 11.
990 Right Point Investments Ltd (in liq) v Mottram (2006) 9 NZCLC 264,173 (HC).
992 Companies Act 1993, s 294(3).
serve a notice of objection on the liquidator, the liquidator may elect to apply to the court for an order setting aside the transaction or charge: s 294(5) provides that a transaction or charge that is not automatically set aside may still be set aside by the court on the liquidator’s application. It is at this point that the substituted s 294 differs most from the original. Under the original s 294(2), the onus was on the person who would be affected by the setting aside of the transaction or charge specified in the liquidator’s notice to apply to the court for an order that the transaction or charge not be set aside.994 The substituted s 294(3) is a result of criticism that, despite the guidelines issued by the Joint Insolvency Committee of the New Zealand Law Society and the Institute of Chartered Accountants in April 1999, the original procedure was being abused by some liquidators.

The setting aside of a transaction or charge under s 294 lays the basis for recovery by the liquidator, which he or she will then usually effect by means of an application for an order under s 295 of the Act.995

31.6.4 Orders the court may make if a transaction or charge is set aside

The court, under s 295, as substituted by s 30 of the Companies Amendment Act 2006,996 has the discretion to make one or more of the following orders on the application of a liquidator:

“(a) an order that a person pay to the company an amount equal to some or all of the money that the company has paid under the transaction:

“(b) an order that a person transfer to the company property that the company has transferred under the transaction:

“(c) an order that a person pay to the company an amount that, in the Court’s opinion, fairly represents some or all of the benefits that the person has received because of the transaction:

“(d) an order that a person transfer to the company property that, in the Court’s opinion, fairly represents the application of either or both of the following:

“(f) money that the company has paid under the transaction:

“(i) proceeds of property that the company has transferred under the transaction:

“(e) an order releasing, in whole or in part, a charge given by the company:

“(f) an order requiring security to be given for the discharge of an order made under this section:


994 Companies Act 1993, s 294(2).

995 Gleeson v Stiassny (1999) 8 NZCLC 262,082 (CA). See also 31.6.4.

996 The substituted s 295 came into force on 1 November 2007.

997 See Re First Investments Ltd (in liq) (1999) 8 NZCLC 261,932 (HC), where a liquidator failed to obtain an order because the sum of money in which an order was sought under s 295(c) had been paid into the creditor’s overdrawn bank account and, hence, had ceased to exist: see also Liggett v Kensington [1993] 1 NZLR 257 (CA); Bishopsgate Investment Management Ltd (in liq) v Homan [1995] Ch 211 (CA); Re Goldcorp Exchange Ltd (in rec) [1994] 3 NZLR 385 (PC).
“(g) an order specifying the extent to which a person affected by the setting aside of a transaction or by an order made under this section is entitled to claim as a creditor in the liquidation.”

There are two changes of note in the substituted s 295. The first is that s 295(a) and (c), in permitting payment of “some or all” of money or benefits received, overturn the Court of Appeal decision in Carter Holt Harvey Ltd v Fatupaito.\(^998\) The Court of Appeal had held that if the elements for a transaction to be of preferential effect were made out, that transaction was wholly voidable because a transaction could not be apportioned into voidable and non-voidable parts.

The other change of note is to s 295(a) where the requirement that payment be made to the liquidator is replaced with a direction that payment be made, instead, to the company. Under the unamended s 295(a), an order that money be paid to a liquidator in his or her own right, rather than to the company, meant that such sums were not subject to a charge held by a secured creditor.\(^999\) Australian authority confirms that this remains the position notwithstanding the direction that monies recovered are now to be paid to the company.\(^1000\)

In the case of a transaction set aside under s 292 the purpose of an order made under s 295 is to eliminate any element of preference benefitting a creditor,\(^1001\) there is no scope for an order having a punitive effect.\(^1002\)

In the event that the transaction for which an order of recovery is made is a payment of money, the court may also order payment of interest on that sum from the date of liquidation, being the date at which the liquidator’s cause of action arose, until the date of judgment.\(^1003\)

Section 295 does not create an exclusive code.\(^1004\) If a company pays a sum of money to a recipient in circumstances which amount to a transaction having a preferential effect, the liquidator may, on or after the transaction is set aside as such, recover the sum paid in an action to recover a debt or for money had and received.\(^1005\)

If a creditor upon whom the liquidator serves a notice under s 294 takes no steps so that the transaction or charge in issue is automatically set aside, the creditor cannot, when the liquidator makes an application for an order under s 295, raise an argument that the transaction or charge was not voidable under s 292 or s 293 of the Act.\(^1006\) This point does

\(^{998}\) Carter Holt Harvey Ltd v Fatupaito (2003) 9 NZCLC 263,285 (CA) at 263,293.
\(^{999}\) Re Hibiscus Coast Marine Centre Ltd (in liq) (1986) 3 NZCLC 99,615 (HC); Re Yagerphone Ltd [1935] Ch 392.
\(^{1000}\) Tolcher v National Australia Bank Ltd (2003) 174 FLR 251 at [19]–[20].
\(^{1002}\) Reynolds v HSE Holdings Ltd HC Whangarei CIV-2009-488-738; 17 September 2010 at [28].
\(^{1003}\) Westpac Banking Corp v Nangeela Properties Ltd (in liq) [1986] 2 NZLR 1 (CA). The court’s jurisdiction to make an award of interest derives from s 87 of the Judicature Act 1908 and s 295(a) of the Companies Act 1993.
\(^{1004}\) McKinnon v Falla Holdings NZ Ltd (in liq) (1999) 8 NZCLC 262,034 (HC).
\(^{1005}\) McKinnon v Falla Holdings NZ Ltd (in liq) (1999) 8 NZCLC 262,034 (HC); Westpac Banking Corp v Nangeela Properties Ltd (in liq) [1986] 2 NZLR 1 (CA).
\(^{1006}\) Re Huberg Distributors Ltd (in vol liq) (No 2) (1987) 3 NZCLC 100,211 (HC); Re Ashton Gregory Promotions Ltd (in liq) (1991) 5 NZCLC 67,075 (HC); Stiassny v Gleeson (1999) 8 NZCLC 261,944, 12 PRNZ 684 (HC); McKinnon v Falla Holdings NZ Ltd (in liq) (1999) 8 NZCLC 262,034 (HC).
not preclude the recipient of a sum of money set aside as a transaction having a preferential effect from raising as a defence to an action by the liquidator to recover this sum as a debt or as money had and received, any matter other than an argument that the payment was not voidable under s 292 of the Act.\textsuperscript{1007}

The fact that a transaction or charge has been automatically set aside under s 294 does not preclude the court from denying recovery, wholly or in part, under s 296(3) of the Act.\textsuperscript{1008}

31.6.5 Additional provisions relating to setting aside transactions and charges

(1) Third party protection

Third party bona fide purchasers for value are protected under s 296(1) and (2) of the Act. In the event that a transaction is set aside under s 294(3), or an order is made under s 295, this does not affect the title or interest that a third party has acquired in property from a person, other than the company, for valuable consideration and without knowledge of the circumstances under which the property was acquired from the company.\textsuperscript{1009}

In the event that a charge is set aside under s 294(3) or an order is made under s 295, this does not affect the title or interest of a person in property which that person has acquired, as a result of the exercise of a power of sale by a grantee of the charge, for valuable consideration, and without knowledge of the circumstances relating to the giving of the charge.\textsuperscript{1010}

(2) Denial of recovery by liquidator

If the elements set out in s 296(3) are met, the court has the discretion to deny the recovery of property or its equivalent value either wholly or in part. “Property” in this context includes recovery of money paid by the company.\textsuperscript{1011}

The court has jurisdiction to deny recovery whether or not the liquidator is seeking the recovery of property or its equivalent value under s 295, any other section of the Act, any other enactment, or in law or in equity.\textsuperscript{1012}

It is the person seeking an order under s 296(3) who bears the onus of establishing each of the elements within it.\textsuperscript{1013} Usually, but not always, it will be the person from whom recovery is sought who seeks an order under s 296(3). However in Meltzer v Fastlane Auto Ltd,\textsuperscript{1014} liquidators, who became aware after a transaction had been automatically set aside under s 294 that it was not in fact voidable, invited the court to make an order under s 296(3).

\textsuperscript{1007} McKinnon v Falla Holdings NZ Ltd (in \textit{liq}) (1999) 8 NZCLC 262,034 (HC). See also Reynolds v HSE Holdings Ltd HC Whangarei CIV-2009-488-738, 17 September 2010 at [32].

\textsuperscript{1008} See 31.6.5(2).

\textsuperscript{1009} Companies Act 1993, s 296(1).

\textsuperscript{1010} S 296(2).

\textsuperscript{1011} MacMillan Builders Ltd (in \textit{liq}) v Morningside Industries Ltd [1986] 2 NZLR 12 (CA).

\textsuperscript{1012} Companies Act 1993, s 296(3).


Substantial changes to this defence were made by s 31 of the Companies Amendment Act 2006 and came into force on 1 November 2007. The cumulative elements in unamended s 296(3) were:

- The person from whom the recovery is sought received the property in good faith;
- The person from whom the recovery is sought has altered his or her position in the reasonably held belief that the transfer to him or her was validly made and would not be set aside; and
- In the opinion of the court, it is inequitable to order recovery or recovery in full.

The cumulative elements in s 296(3), as substituted by s 31 of the Companies Amendment Act 2006 and which are based on s 588FG(2) of the Corporations Act 2001 (Aust), are:

- X (the person from whom recovery is sought) acted in good faith;
- A reasonable person in X’s position would not have suspected, and X did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and
- X gave value for the property or altered his or her position in the reasonably held belief that the transfer of the property was valid and would not be set aside.

The most obvious change in the substituted s 296(3) is the abandonment of the assessment of inequity by the court. Now, if the grounds in s 296(3) are made out, the Court must not order recovery.1016

The given explanation for the abandonment of this element is to avoid value judgments “which could potentially lead to uncertainty and unfairness.”1017 Its replacement is intended to enable “the court to take a more objective view of whether the creditor ought to have known of the debtor’s financial position.”1018

The amended s 296(3) applies to all transactions found to be voidable and set aside under s 294 after 1 November 2007.1019

(a) Good faith

To establish “good faith”, in the context where recovery is sought because a transaction having a preferential effect has occurred, a person must show that he or she honestly believed that no element of undue preference was involved.1020 This is a wholly subjective test. This element will not be established if a person is aware of an intention to prefer him or her on the part of a debtor company.1021 The fact that a transaction has already been found to be outside the ordinary course of business for the purposes of the unamended

1015 Blanchett v The Roofing Specialists Ltd (2009) NZCCLR 42 (HC) at [41].
1016 Reynolds v Glynery Hancocks Ltd HC Auckland CIV-2008-404-4745, 7 July 2009 at [24].
1018 Ibid.
Liquidation

s 292 of the Act\textsuperscript{1022} does not mean it is possible to reason from this fact alone that property was received otherwise than in good faith.\textsuperscript{1023}

In Levin v Market Square Trust, Blanchard J said:\textsuperscript{1024}

“a creditor is likely to fail this test where he or she has actual or implied knowledge of the company’s financial difficulties, due to the company’s cheques being dishonoured, its failure to pay its debts on time, or other circumstances indicating serious cash-flow problems.”

(b) Suspicion of insolvency

Suspicion of insolvency is assessed as at the time that a person received the property of the company. As noted above, this new criterion is based upon s 588FG(2)(b) of the Corporations Act 2001 (Aust), which provides:

“(b) at the time when the person became such a party:

"(i) the person had no reasonable grounds for suspecting that the company was insolvent at the time or would become insolvent as mentioned in paragraph 588FG(b); and

"(ii) a reasonable person in the person’s circumstances would have had no such grounds for so suspecting.”

The amended s 296(3) refers to a reasonable person in X’s “position”, rather than to a reasonable person in X’s “circumstances”, but the Australian authorities treat these two words as being interchangeable.\textsuperscript{1025} In Cussen v Commissioner of Taxation, Spiegelman CJ noted that the legislature had chosen to adopt the word “circumstances” rather than “position”, a term that had been utilised in authorities pre-dating the enactment of this statutory defence,\textsuperscript{1026} but that the two words had similar connotations.\textsuperscript{1027}

The following points, applicable to the substituted s 296(3)(b), have emerged from the Australian and New Zealand case law:

\begin{itemize}
  \item The assessment of whether a reasonable person in X’s position would not have suspected that the company was, or would become, insolvent (the first test) is an objective test.\textsuperscript{1028} Whether X did not have reasonable grounds for so suspecting is a subjective test based on objective criteria.\textsuperscript{1029} In Blanchett v McEntee Hire Holdings Ltd it was said that the second test involves an enquiry as to the state of a creditor’s knowledge.\textsuperscript{1030}
  \item New South Wales authority holds that the first test: \textsuperscript{1031}
\end{itemize}

\textsuperscript{1022} See 31.6.1(6).
\textsuperscript{1023} Re Number One Men Ltd (in liq) (2001) 9 NZCLC 262,671 (CA); Cobb and Co Restaurants Ltd v Thompson (2004) 9 NZCLC 263,638 (HC).
\textsuperscript{1024} Levin v Market Square Trust [2007] 3 NZLR 591 (CA) at [54]. See also Cussen v Federal Commissioner of Taxation (2004) 51 ACSR 530 at [123].
\textsuperscript{1025} See Sands and McDougall (Wholesale) Pty Ltd (in liq) v Commissioner of Taxation (1996) 22 ACSR 383.
\textsuperscript{1026} See Queensland Bacon Pty Ltd v Rees (1966) 115 CLR 266 (HCA) at 303.
\textsuperscript{1027} Cussen v Federal Commissioner of Taxation (2004) 51 ACSR 530 at [29]–[31].
\textsuperscript{1028} D’Abia v Federal Commissioner of Taxation (2003) 203 ALR 609 (FCA) at [18].
\textsuperscript{1029} Ibid.
\textsuperscript{1030} Blanchett v McEntee Hire Holdings Ltd (2010) 10 NZCLC 264,763 (HC) at [32].
“does not require an examination whether the particular creditor, acting reasonably, would have had reasonable grounds for suspecting insolvency, with the consequence that if the creditor happens to be a bank (or a tax collecting authority) one asks whether a reasonable bank (or a reasonable tax collecting authority) would reasonably have had such a suspicion. Rather, whether or not the creditor would have reasonably had a suspicion is determined according to the presumed perception of ‘the ordinary person on the Bondi bus’. … That pithy phrase simply denotes that an objective test is to be applied and the standard measurement is that of a hypothetical person who is assumed to have the knowledge and experience of the ‘average business person’, but certainly not the skills and experience of an expert financial analyst or someone with legal training or any other kind of tertiary education”.

This is so, explained the New South Wales Court of Appeal in *Cussen v Federal Commissioner of Taxation*, because the words “position” and “circumstances” refer to external factors rather than to the “particular perspicacity, financial acumen, etc” of a particular creditor.1032 In contrast, the Full Court of South Australia, in *Sims v Celcast Ltd* took the view, following the way in which the standard of a “reasonable person” is assessed in the law of tort, that the reference to a reasonable person “in the person’s circumstances” enables “evidence of the creditor’s knowledge and business qualifications [to] be used in a limited way [to establish] ‘the person’s circumstances’”.1033 In *D’Alia v Federal Commissioner of Taxation*, Merkel J, in the Federal Court of Australia, went so far as to say in an obiter comment that a “reasonable person in the creditor’s circumstances” is “a reasonable person with the knowledge and business qualifications of the creditor”.1034

- The New South Wales Court of Appeal in *Cussen v Federal Commissioner of Taxation* held that a reasonable person in X’s circumstances “must be assumed to have the full range of information actually available” to X, which “include[s] knowledge of a fact that some things were not known because no request for additional information has been made”, but “does not encompass information which is not in fact available but which a ‘reasonable person’ would have sought and, presumably, received.”1035 However, the court did note that the absence of any such information is of significance in determining whether a reasonable person would have had reasonable grounds for suspicion.1036

- The test for suspicion is that stated by Kitto J in *Queensland Bacon Pty Ltd v Rees*1037

  “A suspicion that something exists is 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’s Dictionary


1032 *Cussen v Federal Commissioner of Taxation* (2004) 51 ACSR 530 (NSWCA) at [29]–[30].


1035 *Cussen v Federal Commissioner of Taxation* (2004) 51 ACSR 530 (NSWCA) at [114].

1036 Ibid, at [123].

1037 *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266 (HCA) at 303. This test was cited with approval in *Blanchett v McEntee Hire Holdings Ltd* (2010) 10 NZCLC 264,763 (HC) at [33]; *Jollands v Mitchell Communications Ltd* HC Auckland CIV-2009-404-8146, 11 April 2011 at [26].
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 in sub-s (4) 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 sub-section describes — a mistrust of the payer’s ability to pay his debts as they become due and of the effect which acceptance of the payment would have as between the payee and the other creditors.”

- In *Sutherland v Eurolinx Pty Ltd*, Santow J said with reference to the second test:

> “The case law illustrates that there is no single factor whose presence invariably establishes that there was, or should have been, the requisite suspicion. Rather it is a question of looking not in hindsight but through the contemporary eyes of the parties, at the commercial circumstances then prevailing between them. This is to identify in that context those factors pointing towards insolvency of the debtor. This in turn is in order to ascertain which of those factors were apparent to the payee, and then the cumulative impact that knowledge of them should have had, or did have, upon the payee. There will also be potentially countervailing factors and circumstances to be weighed in the balance which could have tended to dispel suspicion at the time.”

- In *Blanchett v McEntee Holdings Ltd*, Christiansen AJ, citing *Sutherland v Eurolinx Pty Ltd* accepted that “undue weight should not be placed on a late payment, since solvent persons often do not pay debts on time”. Christiansen AJ added that “[t]he fact that a company sought and a creditor has agreed to indulge its beyond contractual due dates, is not decisive, but may be a factor in all the circumstances. Nor is the defence precluded necessarily in a situation where a dishonoured cheque has been paid even after the issue of a Statutory Demand.” As has been noted by David Brown and Thomas Telfer, the factors accepted by the Australian courts as pointing towards the insolvency of a company “are similar to those in ‘ordinary course of business’ cases”.

In *Blanchett v McEntee Holdings Ltd*, a creditor received payments after it had issued the debtor company with a stop credit notice. After the issue of this notice there was a four month break in the parties’ trading history, the only such break in the trading history of the parties. The payments sought to be set aside all occurred within the break in trading and after the creditor had referred the company’s account to a debt collection agency. The evidence showed that the creditor only referred an account to a debt collection agency in instances of suspected insolvency. Christiansen AJ noted that “[o]n the basis of this evidence the Court can also assume that a reasonable person in McEntee’s position would have suspected the Company was insolvent because McEntee itself did so and that is why it referred the matter to a debt collection agency.”

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1038 *Sutherland v Eurolinx Pty Ltd* (2001) 37 ACSR 477 at [43]. See also *Blanchett v McEntee Hire Holdings Ltd* (2010) 10 NZCLC 264,763 (HC) at [34].

1039 *Sutherland v Eurolinx Pty Ltd* (2001) 37 ACSR 477.

1040 *Blanchett v McEntee Hire Holdings Ltd* (2010) 10 NZCLC 264,763 (HC) at [35].

1041 Ibid, citing *KEL Builders (Queensland) Pty Ltd v Brett Nash Electrics Pty Ltd* [2001] QSC 178.

1042 *Blanchett v McEntee Hire Holdings Ltd* (2010) 10 NZCLC 264,763 (HC) at [40].
suspecting insolvency was given by a director who had no day-to-day control of the company’s account and who conceded that he had no knowledge of the company’s financial position at the time the stop credit notice was issued. Christiansen J concluded that there was no evidence before the court of the creditor’s reasons for not suspecting insolvency.

- In the context of a continuing business relationship, the relevant time for assessment of both of the elements within s 296(3)(b) is the entire duration of the continuing business relationship.1043

(c) Value

“Value” in the context of the substituted s 296(3)(c) means something that has a real and substantial value and is of real worth to the debtor.1044 Australian authority accepts that past consideration in supplying credit to a company constitutes a supply of value in this context.1045 Without reference to this line of authority, in two recent New Zealand decisions it has instead been assumed that a new supply of value is required.1046

(d) Alteration of position

The alteration of position element has two limbs.1047 First, that there is an alteration of position. Secondly, the alteration of position must be accompanied by a reasonably held belief that the transfer of property was validly made and would not be set aside. If the person from whom recovery is sought can show conscious and deliberate conduct on his or her part, whether an act or omission, that the person would not otherwise have undertaken, but for a belief in the validity of the transaction, this element will be satisfied.1048 However, demonstration of conduct of this nature is not an absolute requirement. In Re Number One Men Ltd (in liq)1049 a liquidator served notices setting aside a transaction more than three years after the commencement of liquidation. The Court of Appeal stated that given the particular creditor had no suspicion that it was being preferred and the absence of any notice by the liquidator or any other questioning of the validity of the transaction for such a long period after the commencement of liquidation, the creditor’s assumption in the validity of the transaction, illustrated by its failure to take other action to recover the debt owed to it, satisfied this element.1050 Mere receipt of a payment in the absence of circumstances akin to those in Re Number One Men Ltd (in liq) is insufficient to establish an alteration of position.1051

1044 Burton v Official Receiver (1986) 161 CLR 75 (HCA) at 86.
1045 Taylor v White (1964) 110 CLR 129; M Gronow and R Mason McPherson’s Law of Company Liquidations (online looseleaf ed, Lawbook Co) at [11.1650].
1046 Blanchett v McEntee Hire Holdings Ltd [2010] 10 NZCLC 264,763 (HC) at [42]; Jollands v Mitchell Communications Ltd [2011] NZCLC 20 (HC) at [32].
1047 Re Number One Men Ltd (in liq) [2001] 9 NZCLC 262,671 (CA).
1049 Re Number One Men Ltd (in liq) [2001] 9 NZCLC 262,671 (CA).
1050 Ibid, at [38]. See also Meltzer v Reidpaints Ltd (2001) 9 NZCLC 262,745 (HC).
In *Harte v Wood*,\(^{1052}\) the Court of Appeal approved the following test set out in *Baker Timber Supplies v Apollo Building Associates (Tauranga) Society Ltd (in liq)*:\(^{1053}\)

“The main purpose of s 311A(7) [of the Companies Act 1955, the predecessor to s 296(3)], as I see it, is to assist the creditor if he has deliberately gone down one path in the reasonable expectation that he has received a valid payment, only to find that he is not only required to repay the money but that in the meantime he has also lost a valuable alternative opportunity. In other words, he must have acted to his detriment on the strength of the insolvent company’s payment.”

In *Harte v Wood*,\(^{1054}\) creditors argued that they had altered their position after receipt of a payment by not negotiating a compromise with their creditors or, alternatively, declaring themselves bankrupt. The Court of Appeal was prepared to accept that the partnership operated by the creditors was in a difficult financial position at the time the payment under scrutiny was made. However, there was no evidence that they were about to take the steps outlined, but then chose not to.

The Court of Appeal in *MacMillan Builders Ltd (in liq) v Morningside Industries Ltd* said of the requirement that a person have a reasonably held belief in the validity of a transaction:\(^{1055}\)

“It will seldom be the case that a person who receives a cheque in the ordinary course of business has any occasion to address his mind consciously to the validity of the payment to him. He will assume it in the absence of some reason to the contrary. In such cases the fact that a payment is received in good faith must of itself be sufficient, when accompanied by an alteration of position as a consequence of the receipt, to satisfy the provisions of subsec (7)(a) [the equivalent to s 296(3) in the Companies Act 1955].”

It does not follow from the fact that a transaction has already been found to be outside the ordinary course of business for the purposes of s 292, as unamended by s 27 of the Companies Amendment Act 2006, that, from this fact alone, it can be reasoned that a creditor cannot show a reasonably held belief in the validity of the transaction.\(^{1056}\)

The point in time at which a person’s belief in the validity, or otherwise, of a transaction is assessed may be different from the point in time at which the assessment of whether property was received in good faith is made.\(^{1057}\)

### 31.6.6 Land Transfer Act 1952

Nothing in the Land Transfer Act 1952 restricts the operation of ss 292–295 of the Act.\(^{1058}\)

### 31.6.7 Transactions at undervalue

A liquidator, under s 297 of the Act, has a cause of action in respect of transactions entered into by a company at undervalue in the specified period prior to liquidation. The rationale

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\(^{1053}\) *Baker Timber Supplies v Apollo Building Associates (Tauranga) Society Ltd (in liq)* (1990) 5 NZCLC 66,791 (HC) at 66,793.


\(^{1055}\) *MacMillan Builders Ltd (in liq) v Morningside Industries Ltd* [1986] 2 NZLR 12 (CA).

\(^{1056}\) Re *Number One Men Ltd (in liq)* [2001] 9 NZCLC 262,671 (CA).

\(^{1057}\) Ibid.

\(^{1058}\) Companies Act 1993, s 296(4).
behind s 297 is that to the extent that a transaction entered into by a company in the period leading up to the commencement of liquidation is at undervalue, there is less available for distribution to the company’s creditors.

Section 32(1) of the Companies Amendment Act 2006, which came into force on 1 November 2007, significantly expanded the ambit of s 297. Section 297(1) and (2), as substituted by s 32(1) of the Companies Amendment Act 2006, provide:

“(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

“(b) either—

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

“(ii) the company became unable to pay its due debts as a result of entering into the transaction.”

The key change, making it far easier for a liquidator to proceed under s 297, is the removal of a requirement under the unamended s 297(1) and (2) to establish that the party from whom recovery is sought knew or ought to have known of specified matters relating to the company’s financial position.1059

(1) **Transaction**

Under s 297, unamended by s 32(1) of the Companies Amendment Act 2006, the only guide to the meaning of “transaction” was s 297(3), which provided that “transaction” included the giving of a guarantee by the company. However in *Kings Wharf Coldstore Ltd (in rec and liq) v Wilson*, Miller J said:1060

“A transaction for the purposes of s 297 comprises at a minimum a disposition of a company asset to another person. It may also take the form of a contract or arrangement, or a series of them where the series is properly characterised as a single

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1059 Under the unamended s 297(1)(c), a liquidator had to establish that when the transaction was entered into, the other party knew, or ought to have known, that the company was (i) unable to pay its due debts, or (ii) was engaged, or about to engage, in business for which its financial resources were unreasonably small, or (iii) incurred an obligation knowing that the company would not be able to perform the obligation when required to do so. Under the unamended s 297(2)(d), a liquidator had to establish that when the transaction was entered into, the other party to the transaction knew, or ought to have known, that the company would become unable to pay its due debts as a result of the transaction.

1060 *Kings Wharf Coldstore Ltd (in rec and liq) v Wilson* (2005) 2 NZCCLR 1042 (HC) at [79].
transaction, that results in property of the company being transferred to another person.”

Section 32 of the Companies Amendment Act 2006 inserted a new s 297(3)(a) which provides that a transaction for the purposes of s 297 has the same meaning as in s 292(3).  

(2) “Party to a transaction”

Section 297, unlike ss 292 and 293, does not require that a party to a transaction have a past legal relationship with the company. In Kings Wharf Coldstore Ltd (in rec and liq) v Wilson, Miller J noted that a person other than the recipient of company property may be a “party to the transaction”. He added:

“Because the section is concerned with the transfer of property, the better view is that it uses ‘party to’ in the narrower sense of a side to a contract or litigation, or in this case, to a disposition or arrangement forming part of the transaction under which the property was transferred.”

(3) Value

The value which a liquidator may recover is fixed by the arithmetical formula in s 297(1): the court appears to have no flexibility when determining the amount, if any, to be recovered if the requirements of s 297 are made out by a liquidator.

“Value” for the purposes of s 297 means “market value”. In Managh v Jordan the former director and shareholder of a company purchased a car from the company within the specified period. As consideration for the car, the former director and shareholder assumed liability for a $19,730 loan. Six weeks later the car was sold on Trade Me for $26,000. There was no evidence that improvement or maintenance work had been carried out on the car prior to its sale. The former director and shareholder was held liable to pay to the liquidator the difference in value between the liability he assumed and the price for which he later sold the car.

(4) Insolvency

The issue of whether a company is unable to pay its due debts is discussed in the context of s 292.

(5) Specified period

Section 32 of the Companies Amendment Act 2006 extended the specified period under s 297 from one year to two years, making the specified period in s 297 consistent with that in s 292. The definition of specified period for the purposes of s 297 depends on the way in which liquidation commenced. If a company was put into liquidation by the court, the specified period is the period of two years before the making of the application to the court together with the period commencing on the date of the making of the application and

1061 Companies Amendment Act 2006, s 32(2). See also 31.6.1(1).
1063 Kings Wharf Coldstore Ltd (in rec and liq) v Wilson (2005) 2 NZCCLR 1042 (HC) at [79].
1064 Motorworld Ltd (in liq) v McGregor HC Auckland CIV-2007-404-6558, 9 October 2008 at [74].
1065 Managh v Jordan [2010] NZCCLR 4 (HC) at [22].
1066 See 31.6.1(2).
ending on the date on which, and at the time at which, the order of the court was made.\textsuperscript{1067} If, however, an application was made to the court to put a company into liquidation, and after the making of the application a liquidator was appointed by the board or by special resolution, the specified period is the period of two years before the making of the application to the court together with the period commencing on the date of the making of the application to the court and ending on the date and at the time of the commencement of liquidation.\textsuperscript{1068} In all other cases, the specified period is the period of two years before the date of commencement of liquidation together with the period commencing on the date and ending at the time at which the liquidator is appointed.\textsuperscript{1069}

31.6.8 Transactions for inadequate or excessive consideration with directors and certain other persons

Under s 298, a cause of action accrues to the liquidator on commencement of liquidation where a company has entered into transactions for inadequate or excessive consideration with directors and certain other persons. “The purpose of the section is to enable liquidators to claw back inadequate or excessive consideration arising in the context of a transaction with an insider.”\textsuperscript{1070} A liquidator does not have to establish that the company was insolvent at the time a transaction falling within the ambit of s 298 occurred.

(1) \textit{Acquisition by company of business, property, or services from a director or other specified persons}

If, during the specified period, the company has acquired a business or property from, or the services of, a person falling within the categories listed below, the liquidator may recover from that person any amount by which the value of the consideration given for the acquisition of the business, property or services exceeded the value of the business, property or services at the time of the acquisition.\textsuperscript{1071}

The categories of persons against whom the liquidator may seek an order are:

- A person who was, at the time of the acquisition, a director\textsuperscript{1072} of the company, or a nominee or relative or a trustee for, or a trustee for a relative\textsuperscript{1073} of, a director of the company;
- A person, or a relative of a person, who, at the time of the acquisition, had control of the company;
- Another company that was, at the time of the acquisition, controlled by a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company;
- Another company that was, at the time of the acquisition, a related company.\textsuperscript{1075}

\textsuperscript{1067} Companies Act 1993, s 297(3)(b)(ii).
\textsuperscript{1068} Companies Act 1993, s 297(3)(b)(iii).
\textsuperscript{1069} Companies Act 1993, s 297(3)(b)(i).
\textsuperscript{1070} Levin v Ikiua [2010] NZCA 509, [2011] 1 NZLR 678 at [54].
\textsuperscript{1071} Companies Act 1993, s 298(1).
\textsuperscript{1072} “Director” is defined in s 126 of the Act.
\textsuperscript{1073} “Relative” is defined in s 2 of the Act.
\textsuperscript{1075} “Related company” is defined in s 2(3) of the Act.
When it comes to determining control of a company, the provisions of s 7 of the Act apply with any necessary modifications.  

The liquidator bears the onus of proof with respect to the elements set out above.

(2) **Company disposing of business, or property, or providing services to, directors and other specified persons**

If, during the specified period, a company has disposed of a business or property, or provided services, or issued shares to any person or company falling into one of the categories listed in 31.6.8(1), the liquidator may recover from that person or company “any amount by which the value of the business, property, or services, or the value of the shares, as at the time of the disposition, provision, or issue, exceeded the value of any consideration received by the company.”

(3) **Those from whom recovery may be sought**

A liquidator may only recover from a party to whom a company has disposed of or acquired business, property or services.

(4) **Property**

The term “property” as it appears in s 298(1) and (2) arguably includes a payment of money. A disposition by a company of voting rights in respect of its shares to one of its directors is a disposition of property by the company.

Section 298(2), said the Court of Appeal in *Levin v Ikiua*, “can only sensibly apply to transactions where the directors are duty bound in the Company’s interests to obtain fair value in return for the disposition.” The distribution of trading profits by directors of a corporate trustee to the beneficial owners of a business was held not constitute a disposition of the property for the purposes of s 298(2).

(5) **Consideration**

As noted above, the liquidator bears the onus of establishing a discrepancy in the value of the consideration given or received by a company sufficient to attract the operation of s 298. The liquidator, therefore, bears the onus of establishing the true and proper value for what has occurred. The fact that there is a scarcity of evidence as to true and proper value should not preclude the court from granting relief, as the court should look at the entire available evidence. If a person from whom recovery is sought has a different view.

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1079 *Kings Wharf Coldstore Ltd (in rec and liq) v Wilson* (2005) 2 NZCCLR 1042 (HC) at [94].


1081 *Re Burgess Homes Ltd* [1987] 1 NZLR 513 (CA).


1084 Ibid.
as to the true and proper value of consideration given or received by the company, that person bears an evidential onus to point to material supporting this view.\textsuperscript{1085}

The Court of Appeal in \textit{Re Burgess Homes Ltd (in liq)} said of s 311C of the Companies Act 1955, the predecessor to s 298, that:\textsuperscript{1086}

“It has a wide scope, which the Court should not abridge, but in our opinion it is designed within that wide scope for reasonably clear cases of inadequate consideration. The Court should be slow to condemn under it a bona fide commercial or family bargain negotiated at arm’s length and with no intention of defeating creditors.”

For the purposes of s 298(2) it has been suggested that although the company must receive consideration, the consideration need not be received directly from the person from whom recovery is sought.\textsuperscript{1087} The Court of Appeal expressly chose not to express a view on the correctness of this proposition in \textit{Wilson v APG (Holdings) Ltd (in liq)},\textsuperscript{1088} a case where payments that were not authorised by a company were categorised as misappropriations of company property. Although an obligation to repay arose as a remedy for wrongful conversion, the Court of Appeal noted that such an obligation did not constitute consideration for the purposes of s 298(2).\textsuperscript{1089}

For the purposes of s 298, the value of a business or property includes the value of any goodwill attaching to the business or property.\textsuperscript{1090}

(6) \textit{Specified period}

The specified period differs according to the way in which liquidation commenced. If a company was put into liquidation by the court, the specified period is the period of three years before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date on which, and at the time at which, the order of the court was made.\textsuperscript{1091} If, however, an application was made to the court to put a company into liquidation and after the making of the application a liquidator was appointed by the board or by special resolution, the specified period is the period of three years before the making of the application to the court together with the period commencing on the date of the making of the application to the court and ending on the date and at the time of the commencement of liquidation.\textsuperscript{1092} In all other cases, the specified period is the period of three years before the date of commencement of liquidation together with the period commencing on the date and ending at the time at which the liquidator is appointed.\textsuperscript{1093}
31.6.9 Court may set aside certain securities and charges

Under s 299 of the Act, a liquidator of a company that is unable to meet all its debts may apply to the court for an order setting aside, as against the liquidator, a security, or charge, or part of it, created by the company over any of its property or undertaking in favour of the same categories of persons as are specified in s 298. The court may make such an order if it considers it just and equitable to do so after having regard to the circumstances in which the charge was created, the conduct of the grantee of the charge in relation to the affairs of the company, and any other relevant circumstances. The court may make other orders as it thinks proper to give effect to any order it makes under s 299.

The court may not make an order in respect of a security or charge that has been transferred by the person in whose favour it was originally created and has been purchased by another person (whether or not the purchase was from the person in whose favour the charge was originally granted) if:

- At the time of the purchase, the purchaser did not fall within one of the categories of persons specified s 298; and
- The purchase was made in good faith and for valuable consideration.

The grantee of a security or charge that is voidable under s 299 may seek to deny recovery by the liquidator under s 296(3) of the Act.

31.7 Actions to swell the pool of assets available for distribution to creditors

The court may make a number of orders, on the application of the liquidator of a company or specified others, which have the effect of swelling the pool of assets available for distribution to creditors and/or shareholders. The common theme of these orders is that they may sound in personal liability for those who have caused or contributed to an insolvent liquidation. The orders the court may make are:

- Pooling and contribution orders under ss 271–272 of the Act;
- An order against directors under s 300 of the Act where proper accounting records have not been kept and
- An order under s 301 requiring a person to pay compensation to a company, or to repay money or return property to a company.

Other provisions in the Act that a liquidator may be able to rely upon to swell the pool of assets available for distribution in a liquidation are:

- Section 384, which provides that in the event that a person has acted as a director of a company in contravention of ss 382 and 383 of the Act, that person is personally liable to the liquidator for every unpaid debt incurred by the company;

1094 See 31.6.8(1).
1096 Companies Act 1993, s 299(3).
1097 Companies Act 1993, s 299(2).
1098 See 31.6.5(2).
1099 See 10.4 and 18.2.2.
33.1 Introduction

One of the purposes of Securities Act 1978 was the establishment of the Securities Commission. The Securities Advertising Bill was introduced into Parliament in 1977. The Bill did not include a regulatory body, even though the Bill was based on the Macarthur Committee Report that had proposed the creation of a Companies Commission to oversee prospectuses, control exemptions and generally oversee the law on the offer of shares and debentures to the public. However, the Government took heed of submissions and decided to create an “independent” Securities Commission. The Securities Act 1978 created the Securities Commission, set out its functions, its membership, administration and procedures. Its role was broadly in line with the suggestions of the Macarthur Committee. In the late 1980s, the idea of a mega regulatory authority was mooted and rejected. The time was then not ripe for such a body.

4 Securities Act 1978, s 10.
5 Securities Act 1978, ss 11–14C.
7 See 35.2(1).
However, things changed over the course of the first decade of this century. In early 2010, the Minister of Commerce announced the intention to create a single regulator for New Zealand’s financial markets. This change was overtly a response to the collapses in the finance company sector in the preceding few years and part of the Government’s plans to restore the confidence of “Mum and Dad” investors in financial markets. Too often, suggested the Minister, investor’s money had fallen “to the floor through the cracks between regulators”. One authority, responsible for financial services, securities markets, trustees, auditors, financial advisers and financial service providers, would better ensure appropriate regulatory responses. The 2004 IMF report had previously noted flaws in the regulatory architecture, but it was the loss of value in the finance company sector that proved the catalyst for change. An establishment board was created in May 2010 and, in September 2010, the government introduced a bill into the House. That Bill was enacted as the Financial Markets Authority Act 2011. The new authority is called the Financial Markets Authority (“FMA”). It became operational on 1 May 2011.

In many respects, the FMA is similar to the Securities Commission, particularly in a structural sense. However, there are some significant differences. It is intended that the FMA will have a more active surveillance and enforcement role in respect of financial markets and therefore the FMA has been given some additional functions and powers. In particular, the FMA was given the front-line regulatory role in respect of registered exchanges. It was also given the power to take over a person’s right of action against a “financial markets participant”. This chapter focuses on the general changes to the structure of the regulator and on its powers and policies in relation to securities, their offer and trading.

33.2 Establishment of the Financial Markets Authority: its structure and governance

The FMA was established as a Crown entity, as from 1 May 2011, by the Financial Markets Authority Act 2011. Membership of the FMA’s Board is not fewer than 5 and no more than nine members, although the Minister has power to appoint up to five associate members. One of the criticisms of the Securities Commission was that it did not conform to its own best practice guide in that the roles of chief executive and chair vested in the same person. The FMA has separate roles of Board Chairman and Chief Executive. Provision is made for the FMA’s powers to be exercised by separate divisions of the FMA. Current divisions include:

- Enforcement (civil and criminal investigations, evidence and enforcement);
- Compliance monitoring (commercial and infrastructure: compliance policy, issuer and commercial surveillance, infrastructure oversight);
- Primary regulatory operations (licensing, retail surveillance, prospectus review, novel applications, new product/services, regulatory policy);

8 Financial Markets Authority Act 2011, s 34; “financial markets participant” defined in the s 4.
9 Readers who are interested in the role of the Securities Commission are referred to the first edition of this book.
10 Financial Markets Authority Act 2011, ss 2, 6 and 7.
12 Financial Markets Authority Act 2011, ss 14 to 16.
13 FMA Website (<www.fma.govt.nz>), “About us - Who we are” (Organisation Chart).
• Strategic intelligence (information research, analysis, issue identification and strategy and solution);
• Stakeholder management (stakeholder (Government sector, public, media and co-regulation) relationships, communications);
• Business performance and strategy (operations, technical and shared services);
• Legal (internal legal expertise, risk management and corporate governance).

With limited exceptions, the functions, duties and powers of the disestablished Securities Commission vested in the FMA on 1 May 2011. The assets, liabilities, obligations and entitlements of the disestablished Securities Commission also vested in the FMA on 1 May 2011 and the Commission’s employees and proceedings were transferred to the FMA on 1 May 2011.

The Minister may, by notice, request that the FMA inquire into and report on any matter related to financial markets, market participants or other persons engaged in conduct relating to financial markets.

The FMA, its members and employees, are not liable for anything that they do, or fail to do, in the course of carrying out their functions and duties, unless it is shown that they acted in bad faith or without taking reasonable care. However, the liability for offences under specific sections of the Crimes Act 1961, including conspiracies and attempts to commit those offences, is still possible.

Currently the Financial Markets Authority is funded by a mixture of cost recovery fees, paid by financial markets participants, and Crown funding. This cost recovery includes fees charged to licensed financial advisers and advising entities to meet the cost of the financial advisers’ regulatory regime.

33.2.1 Relationship with other bodies

(1) **Council of Financial Regulators**

The FMA is a member of the Council of Financial Regulators, which met for the first time in September 2011. Permanent members of the Council include the FMA and the Reserve Bank. The Treasury and Ministry of Economic Development are associate members. The purpose of the Council is to share information, identify trends and issues and ensure appropriate responses to these issues through coordinated action.

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14 Financial Markets Authority Act 2011, ss 2 and 72(1)(a).
15 Financial Markets Authority Act 2011, ss 2 and 72(1)(b)-(f) and (h).
17 Financial Markets Authority Act 2011, s 22.
18 Financial Markets Authority Act 2011, s 22. The relevant sections of the Crimes Act 1961 are: ss 78 (espionage), 78A(1) (Wrongful communication, retention, or copying of official information), 105, 105A and 105B (which relate to the corrupt use of information, bribery of officials and wrongful disclosure of personal information). “Financial markets participant” includes, amongst others, a person who is, or is required to be, registered, licensed, appointed, or authorised under, or for the purposes of, financial markets legislation.
19 “Financial markets participant” includes, amongst others, a person who is, or is required to be, registered, licensed, appointed, or authorised under, or for the purposes of, financial markets legislation.
20 FMA Website (<www.fma.govt.nz>), “About us - How we are funded”. See also pt 4, subpt 1 (Fees, charges, costs and levies), of the Financial Markets Authority Act 2011.
21 FMA Website (www.fma.govt.nz), “About us - Relationships with other financial regulators”.

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The FMA is the financial markets regulator, while the Reserve Bank remains the prudential regulator. This design is similar to the Australian model (ASIC and APRA) and is sometimes referred to as the “twin peaks” model. The FMA and the Reserve Bank are party to a Memorandum of Understanding (“MOU”), signed on 7 December 2011, at a meeting of the Council of Financial Regulators. This separate MOU relates to pt 5C of the Reserve Bank of New Zealand Act 1989, and sets out a transparent and readily available record of how they will work together as regulators of designated settlement systems.

NZX

The FMA is responsible for approving exchange conduct rules, and is able to request changes to existing rules. NZX continues to be responsible for the enforcement of its own rules, but the functions of the NZ Markets Disciplinary Tribunal have been transferred to the FMA’s new statutory Rulings Panel. The Panel has jurisdiction over significant breaches of the NZX conduct rules, while NZX retains jurisdiction over minor breaches.

The FMA has the power to require NZX to provide it with information to conduct market surveillance, including real-time trading information. The NZX is also required to prepare annual reports and provide them to the FMA, in order to assist in the FMA’s annual oversight review. As at October 2012, the FMA and NZX were engaged in negotiating a Memorandum of Understanding on their respective roles.

The Government has the power to make market conduct regulations that can either replace or be inserted into the NZX rules, where desirable to preserve the integrity of the market. The FMA is in charge of enforcing these regulations through the Rulings Panel.

33.3 FMA’s Powers

The FMA retained all the powers of the Securities Commission and at the time the FMA was created a number of additional powers were given to it. The history of the Securities Commission was of a body that was given more powers from its inception in 1978 until its abolition in 2011. At a relatively high degree of generalization, it can also be said that the Securities Commission’s role was to begin with principally limited to primary market activity, but in the first decade of the 21st century it assumed a more significant role in secondary market regulation and assumed in both markets an increased role as an enforcer of liability.

The FMA has the power to:

- Grant exemptions;
- Recommend regulations;
- Carry out inspections.

Settlement in this context refers to the making of a payment or the transfer of the title to, or an interest in, property. Reserve Bank of New Zealand Act 1989, s 156M.


Securities Act 1978, s 5(5) and see 34.3.4.

Securities Act 1978, s 70.

Securities Act 1978, s 67, 67A and 68.
• Suspend or prohibit prospectuses or investment statements;\textsuperscript{27}
• Prohibit advertisements;\textsuperscript{28} and
• Approve or revoke approval for trustees and statutory supervisors.\textsuperscript{29}

These are all powers that the Commission had had since its inception or very soon after.

In 2002, the following powers were added or modified and these now vest in the FMA:

• Acceptance of enforceable undertakings;\textsuperscript{30} and
• Receive evidence about securities law and practice, buttressed by the power to summons any person to appear before the Commission for this purpose.\textsuperscript{31}

In 2008 the Commission was given further powers, including:

• The ability to take action where there have been misstatements in prospectuses or advertisement by seeking pecuniary penalties and compensatory orders;\textsuperscript{32}
• The ability to seek orders freezing assets when an investigation of a breach of securities laws is being investigated;\textsuperscript{33} and
• Power to apply for management banning orders.\textsuperscript{34}

There had been a quite dramatic and fundamental change in the Commission’s powers in relation to the Securities Markets Act 1988 and secondary market regulation since legislation was first passed in 1988. The Securities Commission had only two powers under this legislation when it was first passed. The Commission was required to give its consent before a public issuer could be required to seek a legal opinion on whether the public issuer had a right of action against an insider.\textsuperscript{35} The Commission had the power to apply to the court for an order where there was non-disclosure of a substantial security holder interest.\textsuperscript{36} The 2006 amendments to the Securities Markets Act 1988 resulted in the Commission having extensive powers of enforcement. These powers were transferred to the FMA in 2011.

The FMA is empowered to apply to the court for pecuniary penalty orders, compensatory orders and other civil remedy orders for breach of any of the disclosure obligations or abusive practice prohibitions.\textsuperscript{37} In addition, it has power to require disclosure, make prohibition and corrective orders, issue infringement notices and make certain banning orders.\textsuperscript{38}

When established, the FMA was given two important new powers:

\textsuperscript{27} Securities Act 1978, s 38B and 44 and see 34.4.2 and 34.4.3.
\textsuperscript{28} Securities Act 1978, s 38B and see 34.4.1.
\textsuperscript{29} Securities Act 1978, s 48 and see 34.4.4.
\textsuperscript{30} Securities Act 1978, s 69J.
\textsuperscript{31} Securities Act 1978, s 69B; the 2006 amendment enables the Commission to receive evidence regardless of whether the evidence would be admissible in a court: Securities Act 1978, s 69B.
\textsuperscript{32} See further at 34.6.2.
\textsuperscript{33} See further at 34.6.4.
\textsuperscript{34} See further at 34.6.6.
\textsuperscript{35} Securities Markets Act 1988, s 17. This Act was known as the Securities Amendment Act 1988 until 2002.
\textsuperscript{36} Securities Markets Act 1988, s 31.
\textsuperscript{38} Securities Markets Act 1988, pt 5, subpt 3 and see 35.5.
\textsuperscript{39} Securities Markets Act 1988, pt 5, subpt 1 and see 35.5.
The investigatory powers were buttressed by new powers of search and seizure.

Later in 2011, the FMA was given powers to license auditors and modified powers in relation to the licensing of trustees and statutory supervisors.

These changes between 2002 and 2006 were consistent with the underlying transformation of the primary role of the Commission: from a law reform body to enforcement body. While the creation of the FMA was heralded as a significant change, and the new entity was anxious that it was not seen as a simply rebranded Securities Commission, the shift to a “super-regulator” had been occurring for some time.

Since its creation, the FMA has published its enforcement policy and articulated its compliance philosophy. Certainly its first year of operation was dominated by the continued ramifications of the finance company collapses. It began to chart out its proposed course for the future. It engaged on a range of consultations, including the development of a guidance note on effective disclosure. The FMA also conducted a stakeholder survey of its effectiveness. It also released a comprehensive enforcement policy document that contains statements about the FMA’s compliance philosophy. The FMA’s strategy is to:

- work with industry to help them comply with our expectations, so there is an improvement in overall behaviour and performance across financial markets;
- where breaches are identified, to take appropriate and timely action.

The FMA has signaled that it will use the full range of enforcement tools and is proportionate when taking enforcement action. It uses notices, warnings and directions where appropriate and proceeds to suspensions, removal of licences and litigation where serious wrongdoing is detected. It identifies priority areas of market activity and practices, and allocates investigation and enforcement resources accordingly. It also has a case selection policy that includes selecting appropriate cases to clarify the boundaries of the law. FMA publishes the outcome of significant investigation and enforcement actions to deter other potential offenders.

It has published its Enforcement Policy to assist financial markets participants to have a clearer understanding of FMA’s role, functions and priorities. Raising the standard of corporate governance in New Zealand is one of FMA’s principal aims. It states that it takes a two-pronged approach: educating and engaging with financial markets participants,

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40 For a discussion on the tensions between the two roles, see Ministry of Commerce Review of the Securities Commission: Discussion Document Wellington (Ministry of Commerce, 1997) at 29–34.

41 Financial Markets Authority Guidance Note: Effective Disclosure (June 2012); it did however take a rather tortuous route to get to this Note as the first draft was roundly criticized by market participants, <www.fma.govt.nz/laws-we-enforce/policy/closed-consultations/submissions-on-the-proposed-guidance-note-kiwisaver-performance-fees/>.

42 It would appear that this policy is only readily available on line, see <www.fma.govt.nz/about-us/what-we-do/investigations-and-enforcement/>.
investors and other stakeholders; and taking enforcement action where necessary. The four principles underpinning the Enforcement Policy are:

- The FMA will use the full regulatory toolbox, which includes criminal prosecution, taking actions on behalf of investors under s 34 of the FMA Act, and requiring financial markets participants to provide compensation for losses sustained due to unlawful conduct.
- The use of FMA’s resources will be prioritised. The full force of FMA’s scrutiny will be applied to matters involving large numbers of investors at risk of significant or potential loss; where there is evidence of intentional unlawful behaviour; and where there is a need to send a clear regulatory signal.
- The FMA is committed to an open and educative approach so that all financial markets participants have clear and well-understood responsibilities.
- Where necessary FMA will use its powers to bring test cases that will clarify “grey areas” of the law.
- The FMA will not pursue every act of misbehaviour or insignificant breach, but will focus primarily on those areas of misconduct where the failings or breaches are intentional or reckless or involve other serious unlawful conduct, and where the perpetrator set out to intentionally mislead or deceive investors or third parties. The Enforcement Policy is a guide for market participants rather than an exhaustive or legally-binding document, and will be revised from time to time as regulatory objectives and priorities change. The FMA will also consult with interested parties, including other public sector agencies and industry bodies, as to the application and effectiveness of this policy.

In addition, the FMA has investigation and enforcement powers under several Acts including the:

- Financial Markets Authority Act 2011;
- Securities Act 1978;
- Securities Markets Act 1988;
- Financial Reporting Act 1993;
- Financial Advisers Act 2008;
- Anti-Money Laundering and Countering Financing of Terrorism Act 2009;
- Financial Service Providers (Registration and Dispute Resolution) Act 2008;
- KiwiSaver Act 2006, pts 4 and 5 and schs 1 and 2;
- Securities Transfer Act 1991;
- Superannuation Schemes Act 1989;
- Unit Trusts Act 1960;
- Securities Trustees and Statutory Supervisors Act 2011; and
- Auditor Regulation Act 2011.

Under these Acts FMA has a range of investigation and enforcement powers.
The chapter now reviews some specific powers of the FMA that are not covered elsewhere in the Part.

### 33.4 FMA’s general information-gathering powers

#### 33.4.1 Investigation and surveillance

The FMA has much broader information gathering powers than the Securities Commission. The FMA’s general information-gathering powers are set out in pt 3 of the Financial Markets Authority Act 2011. They include:

- The power to obtain information, documents, and evidence;\(^{45}\) and
- The power to enter and search a place, vehicle or other thing.\(^{46}\)

The Securities Commission also had a general information gathering power.\(^{47}\) If the Commission considered it “necessary”, after first considering whether the information could be gained from other sources, it could inspect documents. The FMA, if it considers it “necessary or desirable”, can require persons to supply it with any information. There are some obvious differences. First, the FMA is not required to consider other potentially less intrusive ways of getting the information and secondly the FMA requires a person to supply information (not merely documents, presumably to deal with computer stored information) to it.

The Securities Commission had no powers to enter and search property. The FMA may authorise a person to enter a “place, vehicle or other thing” if it suspects a contravention of financial markets legislation and the search will reveal evidence. The entry and search can be with consent of the occupier or person in charge of the property or if there is not such consent, after having obtained a search warrant from a judge.\(^{48}\) Section 21 of the New Zealand Bill of Rights Act 1990 protects against unreasonable search and seizure. One would expect that s 29 must be subject to the protections afforded by the standards of reasonableness. In the context of the even broader power of search and seizure in the Tax Administration Act 1994 (in the case of business premises no consent or warrant is necessary and in domestic premises a warrant must be obtained), the Court of Appeal has held that the power is subject to the general standard of reasonableness.\(^{49}\)

The FMA’s search power, as initially drafted, was limited to the power to enter and search a “place”. It was extended to include references to a “vehicle” and “other thing”, on the recommendation of the Commerce Select Committee. The Ministry of Economic Development noted, in its report of 8 February 2011 to the Committee, that although giving the FMA the power to search vehicles might seem excessive, ponzi schemes have in the past “operated out of campervans”. The extended power explicitly permits vehicle searches. The extended power to search “other thing[s]” is intended to facilitate searches of computer files, and remote-access searches of computer systems.\(^{50}\)

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47. Securities Act 1978, ss 67 to 68E.

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33.4.2 FMA’s power to share information and documents

The FMA’s powers to share information and documents with other law enforcement or regulatory agencies, and overseas regulators, and to act on requests of overseas regulators, are set out in pt 3 subpt 2.

The FMA has the power to share information with other law enforcement of regulatory agencies and overseas regulators if FMA considers that the information will assist the agency in the performance or exercise of its activities. However, the FMA can only provide information to an overseas regulator if it is satisfied that appropriate protections are, or will be, in place to protect the confidentiality of any information that is personal information within the meaning of the Privacy Act 1993.

In response to a request from an overseas regulator, the FMA may inquire into any matter relating to the functions of the overseas regulator, provided that compliance with the request will not substantially affect the performance of the FMA’s other functions and personal information will remain confidential. In order to comply with a request of an overseas regulator, the FMA may require persons to supply information, produce documents or give evidence and exercise its powers to receive evidence. Any information gathered can be sent to the overseas regulator in any manner that the FMA considered appropriate and may be subject to conditions relating to the storage and use of the information that the FMA deems it necessary to impose.

33.4.3 FMA’s incidental powers

The FMA’s incidental powers are set out in pt 3 subpts 4 and 5 of the Act. They include the power for the FMA to: make confidentiality orders under s 44; accept undertakings under s 46; state a case for the opinion of the High Court under s 48; require its warnings to be disclosed under s 49; and authorise a person to obtain information or documents under s 52.

The FMA’s power under s 49 to require its warnings to be disclosed was modified, on the recommendation of the Commerce Select Committee. It now includes the power in s 49(1)(e) for the FMA to require its warnings to be disclosed in specified offer documents. The power, as initially drafted, would have required FMA warnings, including warnings in respect of unsolicited ‘low-ball’ offers, to be disclosed by the offeror only on the offeror’s internet site. The modification is intended to ensure that in situations where the offeror does not maintain an Internet site, offerees will still become aware of the FMA’s warnings in respect of the offer. Other provisions designed to deal with “low-ball” offers are set out in the Securities Markets Amendment Act 2011.

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50 On the general difficulties in accessing computer stored data that is subject to encryption see Avowal v District Court at North Shore [2010] NZCA 183, [2010] 3 NZLR 661.
51 Financial Markets Authority Act 2011, s 30.
52 Financial Markets Authority Act 2011, s 30.
53 Financial Markets Authority Act 2011, s 31.
54 Financial Markets Authority Act 2011, s 32.
55 Financial Markets Authority Act 2011, s 31. The powers referred to are found in ss 25 and 26.
56 Financial Markets Authority Act 2011, s 31(4).
57 Financial Markets Authority Act 2011, s 33.
33.5 Conclusion

During its first year of operation, the FMA’s Chief Executive made it clear that he considered that “the efficient markets hypothesis, or ‘light touch regulation’ [had] been tested and found wanting.” A more “invasive supervision” of markets was required. Now the FMA had an “increased regulatory reach and a better-stocked toolbox.” This meant that New Zealand was well advanced on the journey to rectify its “weaknesses and deficiencies exposed by the GFC and restore investor confidence.” It will take some time before we know whether this confidence is warranted.

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