The Law of Insolvency
in New Zealand

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FOREWORD

I was very pleased to be asked to write the foreword for this important work. The book begins by saying that it is about New Zealand insolvency law. This simple statement does not capture the magnitude of the task. The book covers both personal insolvency law as well as that relating to companies and other entities. Both formal and informal procedures are examined. Further, a book on insolvency law cannot be confined to New Zealand and as such, a discussion of cross-border insolvency is also included in this text.

The book has not neglected to address the human cost of insolvency, both for debtors and creditors and in many cases for the wider community. At various points the motivations of both debtors and creditors are discussed, thus anchoring the discussion in the real world. In order to provide context, chapter 1 briefly traverses the history of insolvency law and various academic theories, suggesting that the New Zealand framework, with its diverse and sometimes conflicting aims, most clearly fits the “multiple values/eclectic” approach put forward by Vanessa Finch.

As is obvious from the book's length, the treatment of the topic is comprehensive. It discusses both statutory provisions and the relevant case law and it is logically organised. The first part of the book deals with personal insolvency, starting with a general overview of the statutory scheme. It then moves through various topics, such as the effects of bankruptcy and in particular with regard to the debtor's property (including what is and what is not included in this term), creditors’ claims and discharge and annulment. There are chapters on the role of the Official Assignee and the courts, as well as on irregular transactions, offences relating to bankruptcy and on insolvent deceased estates. The interrelationship with other legislation, including the Property (Relationships) Act, is also examined. Alternatives to bankruptcy are outlined, including proposals to creditors and summary instalment orders.

The book then turns to liquidation of companies, starting again with an overview of the relevant statutory scheme. The detailed discussion begins with the commencement of liquidation and the four ways a liquidator may be appointed in terms of the Companies Act 1993. It then proceeds through liquidators’ duties and powers, the role of the courts, claims by creditors and the distribution of assets. As with personal insolvency, there are options for companies in financial distress, apart from liquidation. There are sound policy reasons for having schemes allowing the rehabilitation of businesses where possible. As the explanatory note to the Insolvency Law Reform Bill 2005 observed, such approaches can enhance business
Confidence and ensure that overseas investors are not deterred from investing in New Zealand. Compromises, arrangements and amalgamations are also discussed. As the book notes, this part of the Companies Act is not well understood, but this discussion will surely go some way to remedying this. Other potential options for companies include voluntary administration, receivership and statutory management. Each has its own chapter.

The authors then turn their attention to some potentially overlooked components of insolvency, including discussion on the insolvency of agricultural and pastoral societies, building societies, charitable trust boards, credit unions, friendly societies, industrial and provident societies, licensed insurers, Māori incorporations and trading trusts. Finally there is a chapter on cross-border insolvency. These chapters demonstrate how comprehensive this book is in its coverage.

I am sure the book will be a very useful resource for those affected by insolvency and for those working in the area.

Susan Glazebrook
Supreme Court
8 April 2016
SAMPLE

Preface

Rarely in recent years has a week gone by without media focus on some aspect of insolvency law, a reflection of the often far-reaching consequences of the state of insolvency for an insolvent individual and the others with whom that individual has had dealings.

This book aims to provide a comprehensive account of New Zealand insolvency law. We have addressed not only the formal procedures available in the case of an insolvent individual or company, but the procedures applicable to a range of other entities and/or business structures such as incorporated societies and limited partnerships. Although our primary focus is on domestic law, an account of the law of cross-border insolvency is also included.

We were fortunate to be writing during a period of interesting and frequent legal developments. The impact and meaning of the amendments to the insolvency law framework arising from the enactment of the Insolvency Act 2006 and the Companies Amendment Act 2006 were (and are still) being settled by the courts. We were able to express a view as to the efficacy of many of these changes and also identify areas where further change is warranted. Insolvency-related litigation arising from the fallout of the global financial crisis of 2007/2008 and subsequent recession ensured a steady volume of case law for us (and now you, the reader) to digest. A week passing without an insolvency related decision of note was (and continues to be) the exception, rather than the norm.

With the goal of ensuring a clear passage for readers through the sheer volume of material that is New Zealand insolvency law, we have endeavoured to state legal rules with a degree of generality with illustrative examples then following. We have also sought to set legal rules in their historical and, where relevant, international context.

We thank the staff of Thomson Reuters for their support and in particular Ian McIntosh and Clare Barrett.

Writing a new text is always a large undertaking, not only for the writers, but for those who share their lives. We also thank our families for their unstinting love, support and forbearance.

The law is as stated at 31 December 2015.

Lynne Taylor and Grant Slevin
February 2016
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26.1 Introduction

The voidable transaction provisions in the Companies Act 1993 (the Act) enable a liquidator to avoid certain transactions entered into by a company in specified pre-liquidation periods. Provision is also made for the liquidator to recover money or property from the other party to the voidable transaction. In most circumstances, money or property recovered by the liquidator goes to augment the pool of assets available for distribution to creditors. The Act defines five types of voidable transactions:

- insolvent transactions: s 292;
- voidable charges: s 293;
- transactions at undervalue: s 297;
- transactions for inadequate or excessive consideration with directors and certain other persons: s 298; and
- charges and securities in favour of directors and other related companies: s 299.

Each of the five forms of voidable transaction is discussed in this chapter, as is the statutory defence provided in s 296(3). A further option outside the Companies Act 1993 that may be available to a liquidator is also addressed: an application for an order under s 348 of the Property Law Act 2007 setting aside a disposition of property that prejudices creditors. This last option is considered at the end of the chapter.

26.2 Insolvent transactions

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 received in an equal distribution of the available assets in the liquidation.\(^1\) This right is conferred to achieve the following purposes:\(^2\)

“\(\begin{align*}
\text{(a)} & \quad \text{Equality as between creditors according to priorities set out in the Act;} \\
\text{(b)} & \quad \text{Promoting a collective, orderly and cost-effective approach to the management of failed companies; and} \\
\text{(c)} & \quad \text{Sharing the burden of loss associated with corporate financial collapse.}
\end{align*}\)

\(^1\) See Andrew Keay “In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions” (1996) 18 Syd LR 55.

However, liquidators have never been able to avoid all pre-liquidation transactions having this effect. As the Law Commission recognised in 1989, there are competing interests: three of the creditors of the company and those who have engaged in “fair transactions” with the company. These competing interests were described in more detail by the majority of the Supreme Court in Allied Concrete Ltd v Meltzer:

“(a) On the one hand, a key purpose of the voidable transaction regime is to protect an insolvent company’s creditors as a whole against a diminution of the assets available to them resulting from a transaction which confers an inappropriate advantage on one creditor by allowing that creditor to recover more than it would in a liquidation. The pari passu principle requires equal treatment of creditors in like positions and facilitates the orderly and efficient realisation of the company’s assets for distribution to creditors.

“(b) On the other hand, Parliament has long accepted that creditors who enter into transactions with companies which have reached the point of insolvency are entitled to protection in some circumstances. This acknowledges that considerations of fairness to individual creditors are engaged in this context and that there are risks to commercial confidence if what appear to be normal, everyday commercial transactions are reopened long after the event. This consideration has particular relevance in New Zealand with its high proportion of small business enterprises and the two-year period in advance of liquidation during which transactions may be voidable under the Act.”

The rules regulating insolvent transactions have undergone a number of substantial changes over the past 25 years.

Under s 309 of the Companies Act 1955, a liquidator seeking to avoid a transaction, as was then known as a voidable preference, had to establish that a company had entered into the transaction in favour of a creditor whilst it was insolvent and, subject to one exception, 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 interpreted to mean that a company must enter into a transaction with the dominant intention of preferring a creditor. A payment made

3 Law Commission Company Law: Reform and Restatement (NZLC R9, 1989) at [696].
4 Law Reform Commission General Insolvency Inquiry (ALRC 45, 1988) at [629].
6 See the extensive discussion of the legislative background to s 292 of the Companies Act 1993 in the majority judgment in Allied Concrete Ltd v Meltzer [2015] NZSC 7, (2015) 13 TCLR 833 at [28]–[53].
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. 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 covered by s 309. A submission made to the Court of Appeal in *Tyree Power Construction Ltd v DS Edmonds Electrical Ltd (in liq)* conveys an idea of the prevailing attitude towards the burden borne by a liquidator in proving a view to prefer by a company: it was “not often … thought worthwhile for the Official Assignee to invoke the section … in a company winding up.”

When s 292 of the Companies Act 1993 was originally enacted, voidable preferences 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, 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, which came into force on 1 November 2007, made substantial amendments to s 292 of the Act. Key changes were 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 s 292, as originally enacted, in particular the “ordinary course of business” exception, have been relevant 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.

The present position under s 292 is that a transaction by a company is voidable by the liquidator if it is an insolvent transaction that was entered into within the two-year specified period prior to commencement of liquidation. An insolvent transaction by a company is a transaction of a defined kind that the company

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7 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.
9 See, for example, *Re Austro-Rest Furniture Ltd (in liq)* (No 2) (1986) 3 NZCLC 99,837 (HC).
10 See, for example, *Stiassny v Total Roofing Ltd* (1992) 6 NZCLC 68,155 (HC).
12 Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) at [696].
13 See, for example, *Rea v Wolfgram* [2010] NZCCLR 6 (HC).
14 Companies Act 1993, s 292(1).
entered into at a time when it was unable to pay its due debts and 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.16

As the majority of the Supreme Court noted in Allied Concrete Ltd v Meltzer, a transaction that has a preferential effect is not absolutely voidable: a creditor may avoid this outcome by recourse to the statutory defence set out in s 296(3) of the Act.17

26.2.1 A transaction by a company

The liquidator bears the onus of establishing that a transaction of a specified kind has occurred. A “transaction” for the purposes of s 292 of the Act is defined in 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.”

The current definition of “transaction” differs from that originally enacted in three ways.18 First, the definition is prefaced by the words “means any of the following steps”. The second change, expanding the ambit of s 292(3)(d), is the reference to “undergoing an execution process” rather than, as was previously the case, “the acceptance by the company of execution under a judicial proceeding”. The final change is the inclusion of s 292(3)(f), which covers any incidental act or omission for the purpose of entering into or giving effect to any of the specific transactions specified in paras (a)–(e) of s 292(3).19

15 “Transaction” for the purposes of s 292 of the Companies Act 1993 is defined in s 292(3): see [26.2.1].
16 Companies Act 1993, s 292(1)(a) and (2)(b).
18 The definition of “transaction” in s 292(3) was substituted by s 27(2) of the Companies Amendment Act 2006.
19 Farrell v Fences & Kerbs Ltd [2013] NZCA 91, [2013] 3 NZLR 82 at [53]. For an example of the application of s 292(3)(f) of the Companies Act 1993, see Madsen-Ries v Boyd-Dunlop [2013] NZHC 2153 at [23].
In the context of payments sought to be set aside as insolvent transactions, a majority of the Supreme Court accepted in an obiter comment in Allied Concrete Ltd v Meltzer that s 292(3) is phrased in exclusive terms and relates to the “impugned payments rather than to the broader transactions to which those payments were referable (ie, the antecedent supply of goods or services)”.

Australian authority confirms that a “transaction” in this context “is not confined to transactions that are lawful or enforceable”.

(1) Paying money (including paying money in accordance with a judgment or an order of a court): s 292(3)(e)

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) of the Act. This was the finding of the Court of Appeal in Trans Otway Ltd v Shephard, where the Court went on to state that “the expression ‘payment of money’ … is not dependent on the physical passing of cash or a cheque”. The Court then cited the following comments made by 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.”

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, the Court noting conflicting Australian authority as to whether a transaction by the

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22 This statement of law was adopted in Fisk v Galvanising (HB) Ltd [2013] NZHC 3543 at [32].
23 Trans Otway Ltd v Shephard [2005] 3 NZLR 678 (CA) at 685. 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 [2005] NZSC 76, [2006] 2 NZLR 289 at [8].
24 Trans Otway Ltd v Shephard [2005] 3 NZLR 678 (CA) at 685. What has been termed the “substance-focused approach” of the Court of Appeal has been followed in a number of subsequent High Court decisions: see Blanchett v Tr Kapua Investments Ltd [2013] NZHC 2130 at [19]; Harris v Bikes International Ltd [2013] NZHC 1314 at [15]. For an earlier example, see Re Peter Austin Ltd [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).
company has occurred in this circumstance. In *Commissioner of Inland Revenue v Smith*, the Court of Appeal held that a set-off effected by the Commissioner under the provisions of s 46(6) of the Goods and Services Tax Act 1985 before a company is placed in liquidation falls outside the ambit of s 292 as “‘[i]t is not the payment of money by a company in the normal sense of that word and is not a voluntary payment made by the company’”. A statutory and automatic set-off arising under s 310(1) of the Companies Act 1993 is not a payment for the purposes of s 292(3)(e). Debts that are the subject of this form of set-off are automatically extinguished, rather than paid, so that the amount of the set-off is unavailable for use as a payment under s 292(3)(e).

There is 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 addressed by s 292(3)(a) as a transfer of property.

Whether a payment made by a third party to one of the company’s creditors is a payment by the company is a question of fact to be determined on the basis of the relationship between the third party and the company. 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 advanced to it 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. On the other hand, there is no payment of money by the company when a third party pays the debt of one

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27 *Commissioner of Inland Revenue v Smith* [2000] 2 NZLR 147 (CA) at [20]. See also the obiter comments in *Harlock v Commissioner of Inland Revenue* [2013] NZHC 3389 at [41].

28 See [28.14].

29 *Finnigan v He* [2010] 2 NZLR 668 (HC) at [53]; *Harlock v Commissioner of Inland Revenue* [2013] NZHC 3389 at [48].


32 *Cheng v McCallagh* HC Auckland CIV-2006-404-7843, 18 April 2007 at [37].

33 *Westpac Banking Corp v Nangela Properties Ltd* [1986] 2 NZLR 1 (CA).


of the company’s creditors out of its own money. This is so whether the third party makes the payment at the company’s request or pursuant to a contractual arrangement with the company.

Once a liquidator has proved that a payment has been made by the company, there is no additional requirement for the liquidator to show that the payment was made out of the company’s own property.

26.2.2 When a company is unable to pay its due debts

Under s 292(2)(a) of the Act, as originally enacted, the test for insolvency was whether a transaction was made “at a time when the company was unable to pay its due debts”. Now, pursuant to s 292(2)(a), as amended by s 27 of the Companies Amendment Act 2006, 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”. A company’s ability to have recourse to borrowed funds (both secured and unsecured) may be taken into account, so long as the borrowing is on deferred terms or “otherwise such that the lender itself is not a creditor whose debt can not be repaid as and when it becomes due and payable.”

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38 Anzani Investments Ltd v Official Assignee [2008] NZCA 144 at [23]. It would follow that this is also the case for the transactions specified in s 292(3)(c), (d) and (f) of the Companies Act 1993.
39 In our view, a policy choice has been made to defer any issues involving ownership of property transferred or money paid. That could be done on an application for relief under s 296(3) or resolved as part of the liquidator’s functions during the distribution phase of a liquidation.
The fact that a company’s total liabilities exceed its total assets is not conclusive evidence of its ability to pay its due debts. 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”.

A company’s failure to pay undisputed and overdue debts at the time a transaction, sought to be set aside, was incurred is evidence of its inability to pay its debts at that time.

A due debt is one that is legally due in the sense that the creditor is able to sue the debtor to judgment for payment. The fact that a creditor might not insist on payments strictly in accordance with the debtor’s obligations is not relevant to this assessment. On the other hand, if payment of a debt has been formally rescheduled, so that the creditor has relinquished its right to call for payment of the debt, the debt is not then due until the rescheduled date for its payment.

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, rather than the “moving picture”, or short period of time, that was taken into account under s 309 of the 1955 Act. 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, 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 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]”.

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 the solvency of a company is assessed; an approach that has been adopted in a number of decisions.

The liquidator bears 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. 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.

An “application” for this purpose includes an application to set aside a statutory demand under s 290 of the Act. 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 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 liquidation. In all other cases, the restricted period is the period of six 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.

The presumption of insolvency in s 292(3)(a), as originally enacted, 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

52 Re Northridge Properties Ltd (in lig) SC Auckland M46/75, 13 December 1977 at 29.
54 Companies Act 1993, s 292(4A). See, for example, Grant v Shears and Mac Ltd [2012] NZHC 1772, where the liquidators were unable to discharge the onus of showing that a payment was made at a time during the specified period when the company was unable to pay its due debts. See also Horton v Cowley [2012] NZHC 3089.
55 Companies Act 1993, s 292(6)(b).
57 Companies Act 1993, s 292(6)(c).
58 Companies Act 1993, s 292(6)(a).
restricted period than liquidators faced outside it. Section 27(2) of the Companies Amendment Act 2006 addressed 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”.

26.2.3 The 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. 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. The substitution of new plaintiffs in an application pursuant to the High Court Rules does not result in a new application being made to the court for the purposes of calculating the beginning of the specified period. 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. Otherwise, the specified period is the period of two 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.

26.2.4 Preferential effect

Under s 292(2)(b) of the Act, as substituted by s 27 of the Companies Amendment Act 2006, 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.”

The assessment of preferential effect as required by s 292(2)(b) is “purely objective”.

59 Companies Act 1993, s 292(1)(b).
60 Companies Act 1993, s 292(5)(b).
62 Companies Act 1993, s 292(5)(c).
63 Companies Act 1993, s 292(5)(a).
“Debt” in this context means an existing or antecedent debt. The company and “another person” (as referred to in s 292(2)(b)) must stand in a debtor/creditor relationship.

A “cash on delivery” supply to an insolvent company does not result in a preferential effect because, due to the contemporaneous exchange of value, the assets of the company are not reduced. To the extent that a creditor receives a payment partly to discharge existing indebtedness and partly as full payment for goods and services supplied contemporaneously with the payment, the part of the payment that relates to the new supply of goods or services is treated as a cash on delivery sale. Equally, a payment that is in the nature of a prepayment for goods and services does not have a preferential effect.

Section 292(2)(b), as originally enacted, provided that the liquidator bore 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. In Gray v Chilton Saint James School a company directed a third party which owed it funds to pay a debt of one 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.

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.”

“[T]he degree of any preferment is to be measured against what the creditors would receive in the actual liquidation”.  

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65 NZ Associated Refrigerated Food Distributors Ltd v Pierce (2000) 8 NZCLC 262,186 (HC) at [21].
70 Harte v Wood [2004] 1 NZLR 526 (CA).
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 is 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”.74 Courtney J also noted that the words “would receive or would be likely to receive” suggested “a threshold akin to the standard of the balance of probabilities”.75 Although it was not possible to put an exact value on the causes of action assigned, Courtney J concluded on the given facts that the company would have made 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*76 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*,77 an outstanding debt was cleared by a payment effected by a set-off. It was argued for the creditor that s 310(1) of the Act had not been regarded. This would have applied if liquidation had 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,”78 but, on the facts before it, found that the creditor fell within the

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74 *Managh v Morrison* HC Napier CIV-2009-441-522, 5 September 2011 at [15].
75 *Managh v Morrison* HC Napier CIV-2009-441-522, 5 September 2011 at [16].
76 *Pharmacy Wholesalers (Wellington) Ltd v Graham* HC Auckland CIV-2003-404-3312, 5 February 2004. This aspect of Master Lang’s judgment was not overturned on appeal: *Graham v Pharmacy Wholesalers (Wellington) Ltd* CA37/04, 17 December 2004.
78 *Re Washington Diamond Mining Co* [1893] 3 Ch 95 (CA) at 104, as cited in *Trans Otway Ltd v Shephard* [2005] NZSC 76, [2006] 2 NZLR 289 at [14].
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.  

(1) Payments made to secured creditors

The issue of whether a payment made to a secured creditor might constitute a preference was considered in *Grant v BB2 Holdings Ltd*. 

Associate Judge Bell drew a distinction between fully secured creditors and partly secured creditors. Fully secured creditors are those who have ensured that the sale proceeds of the asset over which they have security is of sufficient value to pay the amount they are owed in full, should enforcement steps be necessary. Partly secured creditors only have security for part of the debt they are owed. The Associate Judge adopted the position that a payment made to a fully secured creditor does not constitute a preference, adding:

“… so long as the value of the asset taken as security is worth more than the debt payable by the company there can be no element of preference. Payments made to a secured creditor will either reduce the debt or prevent the debt increasing on account of additional interest arising upon default. On payment made to a fully secured creditor, any equity left is available for unsecured creditors. Unsecured creditors benefit from the debt to the secured creditor being paid but they suffer if the debt is not paid because the equity available to them will be reduced by reason of the corresponding increase in the debt, the subject of the security.”

As far as partly secured creditors are concerned, the Associate Judge took the approach that payments received go first to reduce the unsecured part of the debt and only when that part of the debt is discharged do payments go to reduce the secured debt. 

Applying this statement of law to the facts, Associate Judge Bell held that payments received by a creditor during the specified period at a time when the company was insolvent and when the evidence showed it was partly secured were of preferential effect.

26.2.5 Transactions occurring as part of a continuing business relationship

Section 292 of the Act, as originally enacted, 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) into the Act, which mirrors s 588FA(3) of the Corporations Act

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79 See [28.14].  
80 *Grant v BB2 Holdings Ltd* [2014] NZHC 2504.  
81 *Grant v BB2 Holdings Ltd* [2014] NZHC 2504 at [40].  
82 *Grant v BB2 Holdings Ltd* [2014] NZHC 2504 at [41].  
83 Section 27(2) of the Companies Amendment Act 2006 came into force on 1 November 2007.
2001 (Cth). Section 588FA(3) of that Act, in turn, codified the running account principle developed by the Australian courts. 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.”

In Allied Concrete Ltd v Meltzer, the majority of the Supreme Court paraphrased the effect of s 292(4B) of the Act in the following terms:

“Under that provision, a series of transactions will be treated as a single transaction where the individual transactions are an integral part of a continuing business relationship between the parties (as where the parties operate a running account) and the level of the debtor company’s indebtedness fluctuates over time as a result of the various individual transactions. Under this approach, a liquidator will be entitled to claim the net difference of payments made and goods and services received from a creditor which has an ongoing business relationship with the debtor company.”

As the Court of Appeal explained in Timberworld Ltd v Levin:

84 Section 588FA(3) of the Corporations Act 2001 (Cth) codified many of the rules developed by the Australian courts: see, for example, Airservices Australia v Ferrier (1996) 185 CLR 483.

85 See Richardson v Commercial Banking Co of Sydney Ltd (1952) 85 CLR 110; Airservices Australia v Ferrier (1996) 185 CLR 483. See also the summary of the development of the law in Re Employ (No 96) Pty Ltd [in liq] (2013) NSWSC 61, (2013) 93 ACSR 48 at [37]–[41].


“To assess whether a preference arises, a comparison is made between the amount owed to the creditor at the point at which the assessment commences and the amount owed at the time of liquidation. A net increase in indebtedness to the creditor, for example, indicates no preference was received, despite the continued exchange of value for goods throughout the running account. A net decrease in indebtedness, however, indicates a permanent reduction in the balance owing to the creditor was achieved, and indicates that to such an extent the creditor has received a preference over others.”

The majority of the Supreme Court in *Allied Concrete Ltd v Meltzer* noted that the continuing business relationship test does not provide a defence, but “specifies what it is that a liquidator may challenge where there is a continuing business relationship between the creditor and the debtor company”. The majority also recognised that, although s 292(4B) did provide a measure of protection for those creditors who were able to bring themselves within its terms, the defence in s 296(3) remained as a source of relief for those that could not.

The rationale of s 292(4B) is to prevent the unfairness that could result if each 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 considered in isolation from the wider trading relationship between the creditor and the company.

Santow J, in *Sutherland v Eurolinx Pty Ltd*, commented on the issue of who bears the onus of proof under s 292(4B):

> “[T]he 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.”

(1) *The nature of a continuing business relationship*

The phrase, “continuing business relationship” is not defined in s 292(4B)(a) of the Act, although a “running account” is referred to as an example of such a relationship. The nature of a running account was explained by the majority of the High Court of Australia in *Airservices Australia v Ferrier*.

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89 *Allied Concrete Ltd v Meltzer* [2015] NZSC 7, (2015) 13 TCLR 833 at [98].
91 *Sutherland (as liquidator of Sydney Appliances Pty Ltd (in liq)) v Eurolinx Pty Ltd* [2001] NSWSC 230, (2001) 37 ACSR 477 at [167].
“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.”

In *Airservices Australia v Ferrier*, a case decided prior to the codification of the running account principle in the Corporations Act 2001 (Cth), the appellant supplied air navigation services to a company 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 six-month pre-liquidation period. In the same time period, the company’s indebtedness to the appellant increased by $8.18 million. All but the last of the payments were found to have no preferential effect, as the value of the services provided by the appellant exceeded the amount of payments it received from the company. The payments made to the appellant conferred on it no preference, priority or advantage over the general body of creditors. The majority noted that, on the contrary, the general body of creditors benefited from the revenues generated as the result of the services provided by the appellant. However, in respect of the last payment, which was...

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92 *Airservices Australia v Ferrier* (1996) 185 CLR 483 at 501–502 (footnotes omitted). This statement has been referred to with approval in a number of New Zealand cases: see, for example, *Rea v Russell* [2012] NZCA 536, [2015] NZAR 1368 at [57]; *Rea v Woglom* [2010] NZCCLR 6 (HC) at [32]; *Blanchett v McEstee Hire Holdings Ltd* (2010) 10 NZCLC 264,763 (HC) at [47]; *Jollands v Mitchell Communications Ltd* [2011] NZCCLR 20 (HC) at [13]–[14].

made the day before the company “folded” and following a demand made by the appellant, the majority held that notwithstanding the running account and the provision of further services by the appellant after receipt of this payment: “

“… the better view on the evidence is that in making its demand [the appellant] was looking backwards rather than forwards, looking to the partial payment of the old debt rather than the provision of continuing services.”

This last payment was held to constitute a preference.

In *Timberworld Ltd v Levin*, the Court of Appeal summarised the key features of a running account as determined by Australian case law:95

“(a) A payment is part of a running account where there is a business purpose common to both parties which so connects a payment to subsequent debits as to make it impossible, in a business sense, to pause at any payment and treat it as independent of what follows.

“(b) The amount owing to a creditor is likely to fluctuate over time, increasing and decreasing depending on the payment made and the goods or services provided.

“(c) The effect of a payment depends on whether it is paid (i) simply to discharge a debt then owing to the creditor (including the permanent reduction of the balance of an account that is then owing) or (ii) as part of a wider transaction which, if carried out to its intended conclusion, would include further dealings giving rise to further amounts owing at the time of payment.

“(d) A payment is part of a transaction that includes subsequent dealings even though it may reduce the amount of debt owing at the time of the payment, where it can be shown it is inextricably linked to further credits, and has the predominant purpose of inducing the provision of further supply and it is impossible to treat the immediate effect of the payment as the only effect.

“(e) The manner or form of keeping account of credits and debits does not determine the effect of the payments. Rather, whether the payments are in fact part of a transaction with an effect distinct from the mere reduction of debt owing to the creditor by the debtor company, drives whether the series of transactions constitute a running account. The courts are concerned with the

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95 *Timberworld Ltd v Levin* [2015] NZCA 111, [2015] 3 NZLR 365 at [34] (footnotes omitted).
‘business purpose’, the ‘business character’ and the ‘ultimate effect’ of the payments, in an objective sense.”

In Galvanising (HB) Ltd v Fisk, the Court of Appeal noted:96

“Whether or not a particular business relationship is characterised as involving a running account we think it is plain from the history and rationale of the provision [s 292(4B)] that the relevant relationship will share the key characteristics of such an account. In particular, the relationship must be one in which the payments made between company and creditor are for the purpose of securing more than the payment of a pre-existing debt. Without an extra dimension such as that, there could be no justification for treating the transaction as other than an insolvent transaction voidable under s 292(1).”

The balance of Australian authority holds that a continuing business relationship is not necessarily terminated when a creditor has knowledge or suspicion of the company’s insolvency.97 As noted above, the crucial issue is whether a payment has as its sole or predominant object the reduction of indebtedness.

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 that the creditor incurred in referring the company’s outstanding debt to a debt collection firm.98

Australian authority holds that liability of a taxpayer to pay sales tax to the Commissioner of Taxation does not involve a running account or a continuing business relationship for several reasons: there is no contractual relationship between the parties, no services are provided by the Commissioner and there is no fluctuating balance as a result of entries on both sides of the ledger.99 Progress payments under a building contract have also been held not to be payments made in the course of a continuing business relationship.100

96 Galvanising (HB) Ltd v Fisk [2015] NZCA 529 at [58].
(2) **The nature of “all the transactions” forming part of a continuing business relationship**

The reference to “all the transactions” in s 292(4B)(c) of the Act for the purposes of the single transaction calculation does not have a temporal connection in the sense that it refers to transactions occurring within the specified period, but refers instead to transactions going both ways between the debtor company and a creditor.101

(3) **Determining the start date for a single transaction under s 292(4B)**

The significance of the selection of the start date for the single transaction calculation under s 292(4B) of the Act was highlighted in *Farrell v Max Birt Sawmills Ltd*.102

“In a continuing business relationship, a company’s indebtedness to a supplier may fluctuate over time. It is necessary to establish a starting point from which all transactions (both supplies of goods and services and payments) are combined into a single transaction. Liquidators want to go for the point where the company’s indebtedness is at its highest. That means that even though there may be later transactions under which the creditor gives further value to the company, they will be exceeded in value by other transactions reducing the company’s indebtedness. Liquidators will therefore look to the net reduction in indebtedness as giving a preference. On the other hand, suppliers want to take an earlier date so that the hump in indebtedness is countered by earlier transactions in which the supplier gave value to the company.”

A number of Australian authorities, both before and after the enactment of s 588FA(3) of the Corporations Act 2001 (Cth), have applied a “peak indebtedness” rule that favours liquidators by determining when a “single transaction” begins and ends in the case of a continuing business relationship.103 Authority for the peak


indebtedness rule can be traced to the following obiter statement made by Barwick CJ in *Rees v Bank of New South Wales*:\(^{104}\)

“It was also said in argument for the bank that it was not permissible for the liquidator to choose a date within the period of six months and to make a comparison of the state of the overdrawn account at that date and its state at the date of the commencement of the winding up. It was submitted that the proper comparison was between the debit in the account at the commencement of the statutory period of six months and the debit at the commencement of the liquidation—a comparison which in this case would result in a materially lesser figure than that reached by taking the liquidator’s comparison. In my opinion the liquidator can choose any point during the statutory period in his endeavour to show that from that point on there was a preferential payment and I see no reason why he should not choose, as he did here, the point of the peak indebtedness of the account during the six months period.”

In *Timberworld Ltd v Levin*\(^{105}\) the Court of Appeal held, when determining the two appeals before it, that the peak indebtedness rule had no application in New Zealand. In so holding, the Court of Appeal affirmed the stance taken by the majority of High Court authorities on this issue.\(^{106}\)

Approaching the matter as one of statutory interpretation and, after having regard to the purpose of preference law in insolvency, the Court of Appeal turned to the legislative context and stated:\(^{107}\)

“[68] The legislature did not see fit to address the peak indebtedness rule, or to include it in the wording of s 292(4B). Section 292(4B)(c) provides that subsection (1) applies in relation to ‘all the transactions’ forming the continuing relationship and that they are to be treated as together constituting a ‘single notional transaction’. The effect of the section, taken on its face, is to require all payments and transactions within the continuing business relationship to be netted off against one another. This includes both payments to the creditor and the supply of goods to the debtor. Of course

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104 *Rees v Bank of New South Wales* (1964) 111 CLR 210 at 220–221.
where the business relationship began before the start of the two year period, only the transactions occurring within the period are taken into account. The statutory wording does not permit a liquidator to disregard some of those transactions. There is also no basis on which the liquidator can commence with only the first payment, and disregard the first supply of goods. The plain meaning of ‘all transactions’ is just that.

“[69] We consider the plain meaning of ‘all transactions’ is all transactions constituting an integral part of the continuous business relationship and therefore falling within the running account. On this approach, the assessment of these transactions will commence when the two-year specified period commences. Where, as with Z Energy, the running account starts only after the specified period has commenced, the starting point is the first transaction during the running account falling within the specified period. It follows from this position that to arrive at some artificial point during the course of all the relevant transactions and to select the date of peak indebtedness (resulting in the transactions prior to this point being disregarded), would be to ignore the express wording used by Parliament.”

In support of its contention that the plain meaning of s 292(4B) of the Companies Act 1993 should not be disregarded, the Court:

- rejected a submission that the adoption by the New Zealand legislature of s 588FA(3) of the Corporations Act 2001 (Cth) in similar language necessarily also required the importation of the peak indebtedness rule, noting that no reference to the peak indebtedness rule occurred during the legislative process leading to the enactment of s 292(4B) of the Companies Act 1993 and that, whilst the New Zealand legislature was plainly aware of the principles of Australian case law governing the running account provisions, it did not follow that the peak indebtedness rule must also be adopted;
- noted that the peak indebtedness rule was inconsistent with the Australian High Court decision in *Airservices Australia*, rejecting a policy argument that the peak indebtedness rule supported the pari passu principle of equal treatment of creditors of the same class; and

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noted that its interpretation was consistent with the position adopted by the Supreme Court in *Allied Concrete Ltd v Meltzer*<sup>109</sup> that the statutory defence in s 296(3) of the Act was a mechanism to balance the competing aims of promoting the collective realisation of assets for the benefit of all creditors and ensuring that fairness to individual creditors is achieved where necessary. The Court’s view was that:<sup>110</sup>

“The distinct treatment of trade creditors is, in our view, a similar mechanism. Parliament took the decision to set aside a particular group of creditors who continue to provide credit and goods on the assumption of future trade. That is seen as having distinct commercial benefits in the context of liquidation. It is a policy choice consistent with New Zealand’s insolvency scheme generally.”

In one of the appeals before the Court, *Levin v Timberworld Ltd*, the continuing business relationship was found to have begun prior to the beginning of the specified period and the Court upheld the finding at first instance that the company was insolvent before and during the specified period. Regarding the assessment of solvency for the purposes of s 292(4B), Associate Judge Abbott had noted at first instance:<sup>111</sup>

“[25] It would be unrealistic to impose a requirement that the liquidators have to prove insolvency specifically at the time of each payment. The interpretation that is most consistent with the purpose of s 292(4B) is that the liquidators should be required to prove insolvency at the start and finish of the continuing business relationship (or at least prior to the restricted period [where the presumption of inability to pay due debts in s 292(4A) applies]) and that there was no significant change in the company’s financial circumstances during the relationship to call into question its insolvency throughout the period. If there was such a change, the liquidators would need to go further and show that the changes did not change the overall conclusion of insolvency.

“[26] This approach aligns the assessment of insolvency under s 292(2)(a) with the assessment of preference in s 292(2)(b) in continuing business relationship cases, as in both cases the court is considering the question holistically from the perspective of net values (increase or decrease of indebtedness) and the state of solvency overall. It is also consistent with the approach taken

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<sup>110</sup> *Timberworld Ltd v Levin* [2015] NZCA 111, [2015] 3 NZLR 365 at [98].

<sup>111</sup> *Levin v Timberworld Ltd* [2013] NZHC 3180 (footnote omitted).
in Re Northbridge Properties Ltd (in liq) that inability to pay due debts is a ‘moving picture of [the] financial situation rather than a still shot’.”

In the other appeal before the Court, Levin v Z Energy Ltd, the High Court had held that an application of s 292(4B) resulted in there being no transaction having a preferential effect. As this meant that there could be no insolvent transaction, the Court did not have to consider whether the company was able to pay its due debts. The issue of solvency did not arise on appeal.

Thus, the Court of Appeal did not address how the issue of solvency affects the determination of the start date of the continuing business relationship because this issue did not arise on the facts before it. For example, given the two-year duration of the specified period, it is not unlikely that, in the case of a continuing business relationship beginning before the commencement of the specified period, a company may be solvent at the beginning of the specified period, but lapse into insolvency at a later time. In such a case, s 292(4B) of the Act can have no application until it is proved or presumed, whichever is applicable, that the company is unable to pay its due debts. In other words, until insolvency is established, there can be no insolvent transaction as defined in s 292(2) for the purposes of s 292(1)(a) as one element of the definition is lacking, that of inability to pay due debts as specified in s 292(2)(a).

If the above analysis is correct, then in the case of a continuing business relationship that begins before the commencement of the specified period, the single transaction calculation encompasses all transactions occurring whilst that relationship endures and which occur within the specified period if the company is unable to pay its due debts for that period. If the company is solvent at the start of the specified period, the start date is the date from which the company is unable to pay its due debts. In the case of a continuing business relationship beginning after the commencement of the specified period, the start date of the relationship for the purposes of s 292(4B) is the start date of the relationship (if the company is insolvent at that time) or otherwise when the company becomes insolvent.

(4) The significance of a running account prior to the enactment of s 292(4B)

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 of the Act as originally enacted. 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 significantly differed from s 292(2)(b) as originally enacted. 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) precluded any consideration of a company's intention to prefer a creditor (except as it otherwise provides), this only applied to a determination of whether a transaction is in the ordinary course of business, rather than to the enquiry as to preferential effect.

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, added:

113 Re Island Bay Masonry Ltd (in liq) (1998) 8 NZCLC 261,751 (HC).
116 Porter Hire Ltd v Blanchett (2006) 9 NZCLC 264,070 (HC) at [39].


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“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.”

26.2.6 The ordinary course of business

Pursuant to s 292(2) of the Act, as originally enacted, a transaction would not be set aside as a transaction having preferential effect if it took place in the ordinary course of business. This exception was removed by s 27 of the Companies Amendment Act 2006. An overview of the ordinary course of business test and the case law it has generated 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 were settled as follows:


121 See [26.2.3].

122 Thompson v ASB Bank Ltd (2004) 9 NZCLC 263,602 (HC). See also [26.2.2].

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

124 Waikato Freight and Storage (1988) Ltd v Meltzer [2001] 2 NZLR 541 (CA) at [17]–[18].

The transaction must be examined in the actual setting in which it took place.\textsuperscript{126} The transaction must be such that it would be viewed by an objective observer as having taken place in the ordinary course of business.\textsuperscript{127} The observer is the court which must look at the circumstances that are objectively apparent at the time of the transaction.\textsuperscript{128} Reference may be made 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 responses to abnormal financial difficulties.\textsuperscript{129} Reference may also be made to particular customs or practices within the field of commerce concerned.\textsuperscript{130} The prior dealings between the company and the particular creditor are relevant.\textsuperscript{131} Where the impugned transaction is made as part of an ongoing business relationship, as opposed to a one-off transaction, the main focus should be the company’s prior course of conduct towards the creditor and towards its creditors generally.\textsuperscript{132} The business context in which a transaction occurs includes its particular contractual context, so the question must be asked whether a payment made was in fulfilment of a company’s contractual obligation or in response to insolvency.\textsuperscript{133}

Although it has been accepted that 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{134} Certainly, as the summary of principles set out above makes clear, it is the particular factual situation in which a transaction occurs that determines 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:

\begin{itemize}
\item \textit{Countrywide Banking Corp Ltd v Dean} [1998] 1 NZLR 385 (PC) at 394.
\item \textit{Countrywide Banking Corp Ltd v Dean} [1998] 1 NZLR 385 (PC) at 394.
\item \textit{Waikato Freight and Storage (1988) Ltd v Meltzer} [2001] 2 NZLR 541 (CA) at [31].
\item \textit{Countrywide Banking Corp Ltd v Dean} [1998] 1 NZLR 385 (PC) at 394.
\item \textit{Waikato Freight and Storage (1988) Ltd v Meltzer} [2001] 2 NZLR 541 (CA) at [31].
\item \textit{Countrywide Banking Corp Ltd v Dean} [1998] 1 NZLR 385 (PC) at 394, citing \textit{Re Modern Terrazzo Ltd (in liq)} [1998] 1 NZLR 160 (HC) at 175.
\item \textit{Carter Holt Harvey Ltd v Fatupaito} (2003) 9 NZCLC 263,285 (CA) at [21].
\item \textit{Carter Holt Harvey Ltd v Fatupaito} (2003) 9 NZCLC 263,285 (CA) at [22].
\item See, for example, \textit{Re Wienk Industries Ltd (in liq)} HC Auckland CIV-2003-404-816, 17 September 2004 at [26].
\end{itemize}
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- lump sum payments that do not relate to any particular invoice, but which are commonplace in the industry in which the company and creditor trade and/or the trading relationship between the parties;\footnote{Waikato Freight and Storage (1988) Ltd v Meltzer [2001] 2 NZLR 541 (CA); Carter Holt Harvey Ltd v Fatupaito (2003) 9 NZCLC 263,285 (CA); Meltzer v Reidpaints Ltd (2001) 9 NZCLC 262,745 (HC); Re ABC Contractors Ltd (in liq) HC Auckland M303im01, 21 August 2002; Temperzone Ltd v Farrelly HC Auckland M237/1M-01, 2 October 2001.}
- a lump sum payment made late but in accordance with the past practices of the debtor company in relation to the creditor;\footnote{Re Terralink Ltd (in rec and in liq) HC Wellington M122-02, 13 November 2002; Porter Hire Ltd v Blanchett (2006) 9 NZCLC 264,070 (HC).}
- a payment in repayment of a debt on the due date of the debt.\footnote{Larsen v Mountford HC Auckland M562-IM01, 6 August 2002.}

Transactions held not to be made in the ordinary course of business include:

- a payment of a debt that was not due and owing;\footnote{Carter Holt Harvey Ltd v Fatupaito (2003) 9 NZCLC 263,285 (CA).}
- a lump sum payment clearing all outstanding arrears made at a time when the company was in the throes of disposing of its business;\footnote{Cobb & Co Restaurants Ltd v Thompson (2004) 9 NZCLC 263,638 (HC). See also Takapunui Rentors Ltd v Waikato Dive Centre Ltd (in liq) HC Hamilton CIV-2003-419-1637, 10 June 2004; Countrywide Banking Corp Ltd v Duan [1998] 1 NZLR 385 (PC) at 395.}
- a payment made outside the usually observed terms of trade between a company and a creditor;\footnote{Re Eastern Bay Forestry Contractors Ltd (in liq) HC Hamilton CIV-2004-419-165, 23 November 2004; Roofing Industries (Central) Ltd v Naylor HC Palmerston North CIV-2005-454-407, 27 October 2005.}
- payments made in response to a compromise made with a creditor and to avoid legal action;\footnote{Re Eastern Bay Forestry Contractors Ltd (in liq) HC Hamilton CIV-2004-419-165, 23 November 2004.}
- a payment made after the withdrawal of credit by a creditor in order to have that credit reinstated; and\footnote{Re Fieldway Services Ltd (in liq) HC Hamilton CIV-2003-419-301, 15 May 2003.}
- 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.\footnote{Oorschot v LJ Hooker Group Ltd HC Christchurch M445/00, 15 June 2001.}

Under s 292(4), as originally enacted,\footnote{Note that this subsection was repealed by s 27 of the Companies Amendment Act 2006.} when the court is 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.
Liquidation – Voidable Transactions

“(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 that 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, this points towards a transaction being outside the ordinary course of business, but is not determinative of the point.\(^{145}\) In *Graham v Pharmacy Wholesalers (Wellington) Ltd*,\(^ {146}\) the Court of Appeal regarded a creditor as being aware that 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; and
- the company was not meeting its obligations to a secured creditor; and
- if the company were 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.\(^ {147}\) The Ministry’s conclusion, adopted in s 27 of the Companies Amendment Act 2006, was that the flexibility offered by the ordinary course of business test was outweighed by the disadvantages associated with it.\(^ {148}\)

26.2.7 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:\(^ {149}\) s 32(1)(a) of the Receiverships Act 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

145 Waikato Freight and Storage (1988) Ltd v Meltzer [2001] 2 NZLR 541 (CA) at [32].
147 Voidable Transactions Discussion Document (Ministry of Economic Development, 2001) at [4.3].
Companies Amendment Act 2006 inserted a new s 292(4) codifying this rule.\textsuperscript{150} Section 292(4) provides:

“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.”

26.2.8 Administrators and transactions having a preferential effect

Section 239ACB of pt 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.

26.3 Voidable charges

26.3.1 The general rule

Pursuant to s 293(1) of the Act, 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.\textsuperscript{151} 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.\textsuperscript{152}

“Charge” is defined in s 2(1) of the Act to include:\textsuperscript{153}

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


\textsuperscript{150} The new s 292(4) of the Companies Act 1993 came into force on 1 November 2007.

\textsuperscript{151} Fisk v Mahoney HC Wellington CIV-2010-485-2518, 13 June 2011 at [20].

\textsuperscript{152} See [26.6.2].

\textsuperscript{153} See, for example, Mayo-Smith v Raynal [2010] NZCCLR 26 (HC).