It is not clear whether His Honour adverted to the presence in s.88(1) of paragraph (g) which adds to the scope of the subsection

> "Income derived from any other source whatsoever"

and if so, what effect he thought this had on the introductory words. But what is clear is that he adopted an approach to the interpretation of the subsection which is quite consistent with that enjoined by section 5(j), although he did not mention this latter expressly.

Cooke J's construction is clearly less strict than that of Turner P in the *International Importing Case* cited above. It is too soon to say whether it heralds a new approach to the interpretation of tax statutes in New Zealand but does seem to be a clear instance of the spirit of section 5(j) being applied to an area which has previously been thought to be immune from it.

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A DIRECTOR'S DUTY TO CREDITORS

Permakraft (N.Z.) Ltd (in liquidation) v *Nicholson*[1]

It is a basic principle of company law that directors owe fiduciary duties to an entity commonly described as "the company as a whole."[2] This means, broadly speaking, that they must exercise the powers which they are given as directors with regard only to the interests of shareholders both present and future as a general body. When the courts use the term "the company as a whole", they do not generally maintain a rigid division between the corporate entity and its shareholders, notwithstanding the theory as to separate legal personalities. Thus, it has been said in one case that the directors in fulfilling their duties, are not expected to look only to the interests of the "corporate entity", disregarding the interests of the members.[3] They must instead strike a balance between the short-term interests of the present members and the long-term interests of maintaining the company as a going concern for the benefit of future members. Furthermore, if the directors are themselves shareholders, they are entitled to have regard to their own interest as such and not to think only of others, in exercising their votes as members of general meetings.[4] However, limits are placed on this latter proposition, for obvious reasons. For instance,

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[1] (1982) NZCLC 98, 358.

[2] See, for example, *Re City Equitable Fire Insurance Co. Ltd* (1925) Ch. 407.

[3] Evershed MR in *Greenhalgh* v *Arderne Cinemas* (1951) Ch. 286, 291.

[4] *North-West Transportation* v *Beatty* (1887) 12 App Cas 589 *Mills* v *Mills* (1938) 60 CLR 150, 164.

while it may be acceptable for a director to sell his property to the company, and to use his vote as shareholder to ratify the sale,[5] it is not acceptable for a director to expropriate to himself property of the company, and to attempt to have that ratified by the general meeting.[6] Such latter course of action could never be for the benefit of the company as a whole.

However, what of the case where all of the shareholders agree together to bring about what amounts to an expropriation of the company's property, for their own personal benefit? In the case of a small private company, it is often highly artificial to speak of the company and its members as constituting two distinct entities. A layman might be forgiven for asking why could all the members not agree to give themselves a return of capital?

In various ways, however, the law has consistently shrunk from allowing such transactions to pass untouched. The justification for this refusal is the need to protect certain "outsider" interest groups, notably creditors. This note looks at how the courts have treated the notion of a duty owed by the directors of a company to that company's creditors.

The Companies Act 1955 contains a number of provisions which are designed, directly or indirectly, to protect the interests of company creditors: Section 309, which deals with fraudulent preferences, seeks to ensure that no one creditor is given better treatment than others; Section 311 prevents a company from removing its property from the reach of unsecured creditors by means of the giving of a security or charge over assets, except where a liquidation is not looming, or where the giving of the security or charge is part of a genuine attempt to resurrect the company's fortunes; Sections 311B and 311C seek to control transactions involving the giving of securities to "insiders",[7] or the entering into of transactions, for inadequate consideration;[8] Section 321 gives creditors locus standi to bring the directors to book for any "misfeasance"[9] which the latter may have committed.

These statutory provisions have a common feature, apart from that of protecting creditors, in that they come into operation upon liquidation. As such, they are clearly aimed at controlling transactions which might otherwise have the effect of disturbing the governing legal rules regarding allocation of company assets or the proceeds thereof to the various company creditors in the course of a liquidation. The most obvious of these rules is, of course, that which provides for pari passu ranking of unsecured creditors.

Apart from this group of liquidation-associated provisions, there are other rules which have as their sole, or substantial, justification the need to ensure fairness towards creditors. For instance, as a general principle it is

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[5] *Beatty's* case (supra).

[6] See e.g. *Cook* v *Deeks* (1916) 1 AC 554.

[7] The term is defined for the purposes of Section 311B, as including directors, or their nominees, trustees or relatives, or persons having control of the company, or related companies.

[8] Again, in relation to the same groups of persons or companies as are listed in Section 311B.

[9] . . ."negligence, default, breach of duty or trust". . .

accurate to say that the various rules which are concerned with the maintenance of the company's capital are based on a right of the creditors to rely on the capital remaining undiminished by any expenditure outside the limits of the authorised objects or by the return of any part of it to the shareholders.[10] Whether some of these rules are effective to attain this objective today is another matter entirely. The ultra vires principle, for example, is widely regarded as being all but a dead-letter, and in need of reform.[11]

Some of this second group are rules which exist because of a specific statutory initiative by the Legislature, often at the instance of a law reform body.[12] Thus, taking Section 62, we see that the liquidator of a company is thereby entitled to act to have certain transactions set aside, for the benefit, direct or indirect, of the creditors. Such statutory rules must still be regarded as being in one sense exceptional to the general law principles regarding the relation between directors and creditors, which will be touched upon below.

In other cases, rules which exist, at least partly, to benefit the creditors, may suffer from the defect of not giving a creditor the power to enforce them.[13]

What remains to be answered is the question whether the directors of a company owe anything in the nature of a general obligation, fiduciary or otherwise, to look after the interests of creditors. In other words, is there anything resembling the duty which they owe to the company? Should they act bona fide in the interests of the body of the creditors as a whole?

The courts have been most reluctant, to say the least, to concede anything like paramount importance to the interests of outsiders.[14] They have asserted time and again that attention may be given to the interests of others, but only to the extent that promotion of those interests is incidental to a bona fide discharge of the duties owed to sharehcolders.[15]

With specific regard to creditors, it was said in one case that:

> ". . .directors are trustees for the shareholders, that is, for the company. . .but directors are not trustees for the creditors of the company."[16]

However, an indication to the contrary appeared in the decision of the High Court of Australia in *Walker* v *Wimborne*.[17] In that case, the

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[10] See *Trevor* v *Whitworth* (1887) 12 App. Cas 409, and Section 62 of the Act, on which see M. W. Russell (1982) NZLJ 194.

[11] See Farrar (1978) NZULR 164.

[12] The forerunner to Section 62 was originally introduced in England, following a report of the Greene Committee in 1926.

[13] In the case of the ultra vires doctrine it has been held that a creditor has no standing to sue for a declaration to prevent the company from undertaking an ultra vires transaction: see *Lawrence* v *West Somerset Railway* (1918) 2 Ch. 250.

[14] See, for example, *Parke* v *Daily News Ltd* (1962) Ch. 927; *Re W. & M. Roith Ltd* (1967) 1 WLR 432. A statutory exception has been enacted in England in the Companies Act 1980.

[15] See, for example, *Ngurli* v *McCann* (1953) 90 CLR 425.

[16] *Re Wincham Shipbuilding Boiler and Salt Co.* (1878) 9 Ch. D 322 per Jessel MR; and *Re Dronfield Silkstone Coal Co.* (1881) 17 Ch. D 76, 97.

[17] (1976) 50 ALJR 446.

liquidator of "Asiatic" brought a summons under the Australian equivalent of our Section 321.[18] The summons was in respect of the making of certain payments, and the granting of certain securities, to other companies, the directors of which were identical to those of Asiatic. The High Court held that the directors were liable under the Section to compensate the company in respect of these various transactions. The judgment of Mason J, in particular, contained some interesting comments.

He firstly stated that:

> "The transactions offered no prospect of advantage to Asiatic, it exposed Asiatic to the probable prospect of substantial loss *and thereby prejudiced the unsecured creditors of Asiatic. . . . . .*"[19]

Then:

> "the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of a company. . .. must look at that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent."[20]

Now, if a company suffers a substantial loss of capital, then of course the creditors stand to be prejudiced, as Mason J rightly points out. However, was his Honour going further than this? He seems to be saying that directors owe duties to creditors which are comparable to those owed to the shareholders. On the other hand, it might be said that all that was intended to be said was that if the directors fail to discharge their admitted duty to the company, then in many cases this will result in a loss to the creditors as well. Indeed, care must be taken to remember that the proceedings were pursuant to a provision which expressly gave creditors standing to sue, but only in respect of breaches of duties owed to the company. The section looks to losses sustained by the company, and not the creditors, except in an indirect sense. It follows, therefore, that Mason J must have categorised a failure to have regard to creditors' interests as the breach of a duty owed to the company.

Nevertheless, the sweeping language employed by Mason J leads one to the conclusion that whether one categorises the duty as being owed to the company or not, the end result is still a de facto assertion of a general obligation to see to the interests of creditors.

The matter has now been touched upon in New Zealand in the recent case of ***Permakraft (N.Z.) Ltd (in liquidation)* v *Nicholson***'[20] The facts of the case are involved and complex, but essentially it concerned a "restructuring" of the company by the defendants, who were both directors and shareholders. A new company, Permakraft Holdings, was incorporated. Then, certain land and buildings belonging to Permakraft were substantially revalued, and a capital dividend paid to the shareholders as a result. The defendants then purchased shares in Permakraft Holdings

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[18] Section 367B of the Companies Act 1961.

[19] At 449.

[20] Ibid.

and simultaneously sold most of the shares in Permakraft to Permakraft Holdings. The end result was clear; money had passed to the defendants as shareholders, and the capital of Permakraft had been severely depleted. The company subsequently went into liquidation on a creditor's petition. It was found that there was a deficiency as regards payment of the company debts, which roughly corresponded to the amounts paid to the defendants. The liquidator sought to recover these moneys, under Section 321.

Although other points were in issue, the main question which fell to be decided was whether the transaction was carried out in good faith and for the benefit of the company. Senior counsel for the liquidator stressed that the claim was the liquidator's to recover the money for the company in liquidation and that the dispute was not between the directors and the principal creditor. Nevertheless, it was clear that in large part the decision in the case would turn on the nature of the duty, if any, which the directors owed to preserve a fund for the benefit of the creditors, since the directors had so benefited themselves qua shareholders as to diminish the chances of the creditors being paid in full.

While J held that the defendants were liable to refund the moneys. He referred to *Re Avon Chambers Ltd*[22] in which Casey J, found a director was liable under Section 321 for having deliberately attempted to put funds beyond the reach of creditors and to benefit shareholders at a time when it was obvious that the company could not afford such a payment.

In considering whether the transaction in the instant case was for the benefit of the company White J adopted the test stated by Pennycuick J in *Charterbridge Corporation Ltd* v *Lloyds Bank Ltd*[23] that is,

> ". . .whether an honest and intelligent man in the position of director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company."

He concluded[24] that the evidence gave rise to the reasonable inference that the directors in considering the two companies as a composite group did not consider the interests of Permakraft (N.Z.) Ltd. He expressly adopted the view of Mason J, that the interests of creditors had to be considered, since a failure to do so would have adverse consequences for the company as well as for them.

The case, therefore, does support the narrower interpretation of Mason J's views, in that the directors' liability was based on failure to have regard to the benefit of the company. While J plainly did not consider the creditor's interests in isolation from those of the company. The answer, then, to the main question raised in this note is — No. There is no independent duty owed by the directors to the company's creditors.

Nevertheless, however the duty of the directors is categorised the case shows clearly that the creditors may protect their interests, and ensure that the funds of the company are only to be dissipated pursuant to what are

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[21] (1982) NZCLC 98, 358.

[22] (1978) 2 NZLR 638.

[23] (1970) 1 Ch. 62, 74.

[24] At 98, 379.

seen as bona fide commercial operations. This is starkly shown when one remembers that all of the shareholders in Permakraft (N.Z.) Ltd agreed to the transaction. Therefore, no "insiders" were prejudiced. Indeed, they were substantially benefited. In the case of a relatively small, private company, it does not always make sense to speak of there being a benefit to the company, as distinct from a benefit to its members. The only real potential losers here were the company's creditors.

The future of the "Mason" school of thought will be interesting. If his remarks are seen to have a wider relevance, then it could be said that some inconvenience and uncertainty will follow if directors of a company are always under an abstract duty to "take account of the interests of its shareholders and its creditors", since there will often be insoluble problems of reconciling the conflicting interests of these two groups.

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LAMB v *LONDON BOROUGH OF CAMDEN: A CASE OF SHIFTING FOUNDATIONS*

What is the proper test of causation when a defendant's breach of duty does not by itself cause damage to a plaintiff but provides the opportunity for a deliberate and harmful intervention by a third-party? According to Lord Sumner in a much-quoted passage from *Weld-Blundell* v *Stephens*:[1]

> "In general . . . even though A is in fault he is not responsible for injury to C, which B, a stranger to him, deliberately chooses to do. Though A may have given the occasion for B's mischievous activity, B then becomes a new and independent cause. . . . It is hard to steer clear of metaphors. Perhaps one may be forgiven for saying that B snaps the chain of causation; he is no mere conduit pipe, through which consequences flow from A to C, no mere moving part in a transmission gear set in motion by A; in a word, he insulates A from C."

The above dictum is, perhaps, too widely stated. The original wrongdoing is at least one of the causes of the damage and certainly there are many decisions in which damage has been attributed to a defendant notwithstanding a deliberate intervening act by a third party. The difficulty comes in seeking to define the principle which allows recovery in such circumstances. The English Court of Appeal has recently considered this issue in some detail in *Lamb* v *London Borough of Camden*[2] but whether the law has thereby been clarified must, unfortunately, be regarded as doubtful.

The facts of *Lamb's* case were as follows. The plaintiff was the owner of a house near Hampstead Heath. In 1972 she went to New York and let

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[1] [1920] AC 956 at p.986.

[2] [1981] QB 625.