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IN THE HIGH COURT OF NEW ZEALAND A NO 101/82

WELLINGTON REGISTRY

341

IN THE MATTER of The Companies Act 1955

AND

IN THE MATTER of LABEL HOUSE (1980) LTD a duly incorporated company having its registered office at Upper Hutt, Garment Label Printers

AND

IN THE MATTER of an application by the Receivers of LABEL HOUSE (1980) LTD for orders under s 345 of the Companies Act 1955 and/or orders pursuant to Rule 154 of the Code of Civil Procedure

Applicants

Hearing: 23-24 May 1983, 16 December 1983

Counsel: G S Tuohy for Receivers of Label House (1980) Ltd and Textile Era Ltd
T J Castle for Parkbel Properties Ltd and Unsecured Creditors of Label House (1980) Ltd
Mrs G J Goodwin for U.D.C. Finance Ltd (Withdrew)
J A Young for Directors of Label House (1980) Ltd (withdrew)
A J MacCuish for B.N.Z. Finance Ltd and S H Lock Ltd (Withdrew)

Judgment: 12 April 1984

JUDGMENT OF JEFFRIES J

The motion before the court, subject to changes which will be reached in due course, is that of Label

House (1980) Limited (hereafter called "Label House") which is in receivership, and therefore the requests to the court are those of that company's receivers. The motion is pursuant to s 345 of the Companies Act 1955 for orders:-

(a) Giving directions to the receivers as to the application of the anticipated surplus available on the realisation of the assets of Label House (1980) Limited after payment of all preferential creditors debenture holders and expenses to the receivers.

(b) Declaring the rights of Label House (1980) Limited and Textile Era Limited in respect of a claim by Textile Era Limited, a creditor of Label House (1980) Limited, to set off the debt owing to it by Label House (1980) Limited against moneys paid and to be paid by the Receivers of Label House Limited to Bank of New Zealand on account of Textile Era Limited under joint and several guarantees given by Textile Era Limited and Label House (1980) Limited to the bank.

As can be observed from the wording of the motion the narrower issues to be decided by the court concern Label House and Textile Era but those issues are preliminary, in reality, to broader issues which will arise through three separate actions by another company, Parkbel Properties Limited (hereafter called "Parkbel") which is a creditor of Label House. Parkbel has an

unregistered debenture and one of the sets of proceedings is to obtain the leave of court for extension of time which, if granted, would make it a secured creditor. There is another group of unsecured creditors of Label House whose interests in this proceeding are similar to Parkbel, and they appeared and were represented by Parkbel's counsel. The details of the foregoing will be outlined by refernce to the agreed statement of facts placed before the court by counsel who presented argument.

However before doing that it is convenient to mention counsel who entered appearances but took no part in the argument and left the court. They were Mrs G. Goodwin for U.D.C. and Mr McCuish for B.N.Z. Finance Limited, creditors of Label House, and S.H. Lock Limited, creditor of Textile Era. Also Mr J. Young appeared by Label House's directors but indicated he did not wish to present argument on the receivers' motion. Mr T J Castle, who appeared for Parkbel and unsecured creditors, informed the court the Registrar of Companies abided the decision of the court on all questions.

Now to the agreed facts. There are three parties actually involved in this application. The first, Label House (1980) Ltd, is a company which was incorporated on 4 March 1980. Its shareholders are Mr and Mrs D.L. Kincaid, each as to $6,000, and Textile Era Ltd as to $48,000. Textile Era Ltd is an associate company of Label House, and has the same directors, (Mr and Mrs Kincaid), as Label House. The third party, Parkbel Properties Ltd is a creditor of Label House, its debt at this point being unsecured, because its debenture over the assets of Label

House is unregistered. Parkbel for this application has identical interests with other unsecured creditors of Label House.

Ten days after Label House was incorporated (i.e. 14 March 1980), it executed a debenture over its undertaking in favour of the Bank of New Zealand (hereafter called "the bank") to secure loans, advances, discounts, to be made to the company solely, or together with any other person. On the same day, Label House also executed a guarantee in favour of the bank guaranteeing payment to the bank on demand all sums of money at any time owing to the bank by Textile Era. Not surprisingly, the bank already had by that time, a debenture over the undertakings of Textile Era on the same terms as above, the charge being executed by Textile Era on 21 May 1979. Similarly on 14 March 1980 Textile Era executed a guarantee to the bank to pay any sums of money owed by Label House to the bank if demand were made.

Thus the situation from 14 March 1980 until the receivership of both companies was that each company had given the bank a debenture over its respective undertakings, and each had guaranteed the other's debts to the same bank. On 18 December 1981 the bank made simultaneous demands to both companies under their guarantees, and payment not being made, the bank appointed receivers under the debentures executed by the companies on 21 December 1981. At that date, Label House owed the bank $42,304 and Textile Era $88,759. These figures are subject to some variations apparently which do not affect the principles involved.

Since the appointment of the receivers on 21 December 1981 the assets of Label House have been realised and all preferential creditors, debenture holders, and expenses of the receivership in respect of Label House have been paid. In addition, Label House has managed to honour part of its guarantee to the bank to pay Textile Era's debts, and $42,410 has been thus utilised to reduce the $88,759 that Textile Era owed the bank as at 21 December 1981. The receivers of Label House (who are also the receivers of Textile Era) estimate that a further sum of $37,197 will be available from the realisation of the assets of Label House to further reduce Textile Era's indebtedness to the bank and they propose to put that sum of money to such effect. Both amounts add up to $79,607 so there would still be $9,152 outstanding in Textile Era's debt to the bank (excluding interest). The receivers of Textile Era meanwhile have kept Textile Era trading in its business and anticipate that the balance of its debt to the bank will be repaid in due course. In the event of that happening, it is anticipated that Label House may be entitled to an assignment of the bank's debenture over the undertaking of Textile Era because Label House has made payment, and will make further payment to the bank under its guarantee. Those payments will substantially reduce Textile Era's debt to the bank. If Textile Era pays the balance then there could well be an assignment of the debenture to Label House. However, before the companies went into receivership, Label House owed Textile Era $204,028. This sum was the total of debts incurred in the normal course of trade between the two companies.

As a result the receivers of Textile Era and Label House (in reality of Textile Era only but it is in fact Label House's motion) by (b) of the motion come to court requesting in effect that the court sanction a set off by Textile Era against its debt to Label House, in the event that the debenture now held by the bank is assigned to Label House, using the $204,028 that Label House owes Textile Era under their pre-receivership trading arrangements. Since the receivers of Label House have not paid the $37,197 which they estimate will be available when all the assets of Label House are finally realised, the court was originally also asked by (a) of the motion to give directions as to what should be done with that sum of money. In effect, the receivers wish their scheme, or arrangement for the two companies to bear the stamp of approval from the court.

The aforesaid might be said to represent the requests to the court when the motion of the receivers was first argued. I foresaw difficulties and conferred with counsel which I will refer to again hereafter. I have now been advised in writing that all parties involved in the proceedings accept the legality of the receivers' actions in regard to the receivership of Label House and the payments made and intended to be made by the receivers to the bank pursuant to the guarantee by Label House of the obligations of Textile Era. The receivers of Textile Era need to know however if that company will have the benefit of the moneys paid to the Bank of New Zealand from Label House or whether on repayment in full of Textile Era's liability to the bank that company will be liable to repay

such moneys to Label House. That is the question the court is now asked to answer.

This application would not present any difficulties (as both companies and presumably the bank are agreed as to the course of action proposed by the receivers) if it were not for the presence of the third company and respondent to this application, Parkbel, which is also acting in concert with other unsecured creditors of Label House. The plain fact is that Parkbel will stand to lose, and lose quite substantially, if the set off is allowed, for counsel have agreed in their statement of facts that there will be no funds available after the realisation of all the assets of Label House to make any payments to Parkbel, even if it establishes its claim to be a secured creditor of Label House. Needless to say, the chances of other unsecured creditors being paid by Label House if the set off went ahead are non-existent as well.

Conversely, the future of Parkbel in its dealings with Label House will be considerably brightened if the set off is not allowed for the former can then proceed with its action to extend the time for the registration of its debenture over the assets of Label House (or what is left of them after the first and second debenture holders have been paid off). If that application succeeds, then Parkbel will have a valid charge over Label House, and any debts in favour of Label House, including that of Textile Era, will be assigned to them if and when its debenture crystallizes.

The motive apparently behind the arrangement proposed by the receivers is the desire to keep Textile Era trading. Its viability as a trading concern will be undermined if it had to make allowances for the sums of money that Label House paid and intends to pay to the bank to help extinguish the former's debts. It would appear that Textile Era is in no dire need for the repayment of the debt owed to it by Label House, for even if the set off is allowed, Label House will remain indebted to Textile Era for something in the vicinity of $120,000.

It is against the foregoing fact pattern that the question of the set off falls to be decided. It must be borne in mind that the set off, if it is allowed, would take place in the future, for as at today, the debenture executed by Textile Era in favour of the bank has not been satisfied. It is only if Label House uses its assets to make further payments under its guarantee, and if Textile Era is able to make up for the shortfall from its own funds, that its liability to the bank will dissolve. Only then will Label House be in a position to enjoy the rights embodied in the debenture by way of subrogation. The set off will be brought into play by Textile Era in the event of Label House asserting its claim under the assigned debenture to the $79,607 owing to it by Textile Era which it has or will pay to the bank.

The short point is that arising out of both companies giving debentures and cross guarantees to the bank when the bank acted in December 1981 over default by the companies it was able to appoint two receivers who were the same for each company. Clearly enough the two

companies were interlocked by their shareholders, directors, trading patterns with each other and third persons, and cross guarantees. The first duties of the receivers were to the debenture holders who appointed them. Pursuant to that primary duty the receivers examined the affairs of the two companies and resolved to conduct their receivership of the two companies to the best overall advantage of their appointer, the bank. It would appear therefore they decided to continue trading through Textile Era and to better effect that course they set about applying Label House's assets to Textile Era's needs which more particularly comprised the part discharge of Textile Era's debts to the bank. To that end the sum of $42,410 was taken from Label House and paid to the bank in satisfaction of Textile Era's liability to the bank. This was done pursuant to Label House's guarantee of Textile Era's liability. It should be recalled before doing this Label House had satisfied all its preferential creditors, debenture holders and expenses of receivership. The receivers of Label House anticipate another $37,197 will be available from its assets and it is now agreed by all parties this may be done. The court is not required to examine that action. Plainly enough Label House's assets are being exhausted by its receivers to the ultimate benefit of another company and its secured creditors of which company they are also receivers. Standing in the wings watching are a group comprising a potential secured creditor (Parkbel) and unsecured creditors of Label House, all of whom will get nothing if the aforesaid actions are approved and set off allowed to operate.

The actions thus far, and those proposed by the receivers of both companies are for the benefit of the future of Textile Era at the cost of Label House's other creditors. The directors of Label House appeared through counsel and in effect abide the decision of the court. One assumes Label House's shareholders expect nothing whatever course is followed. Are the receivers in the foregoing circumstances entitled as a matter of law to effect set off?

The judgment of this court is to decline to answer the single question left in the motion basically because on the present state of the litigation it is speculative. The court now says why and a convenient point to start is with the memorandum I sent to all counsel after the first two days of argument. I said this:-

> "The motion before the court is in the alternative but my note of Mr Tuohy's argument commenced with reference to s 345 and that the receivers were seeking this direction as it will determine their future action. He mentioned Rule 154 as being placed in the motion ex abundante.
>
> Counsel will recall that at the commencement of the argument I showed considerable unease that the court could satisfactorily dispose of the points advanced for decision. Nevertheless I could see advantages if events proved to be as counsel assured me and therefore continued to hear the whole argument. However it was on the

basis conveyed to counsel before the argument proper began that I reserved the position not to give judgment once the whole argument and case could be surveyed. Unfortunately I have reached the view judgment cannot be given as matters currently stand. The reasons are as follows.

Before the court is a motion first requesting "directions to the Receivers as to the application of the anticipated surplus available on the realisation of the assets of Label House (1980) Limited after payment of all preferential creditors debenture holders and expenses to the Receivers". There was placed before the court a written agreed statement of facts signed by both counsel which I assume was an extrapolation of the facts contained in the affidavits and other pleadings. That document is not without its difficulties. For example I find paragraph 8 opaque. In his argument Mr Tuohy, for the receivers, took the court through that statement and then I have a note he said "For the purposes of argument proceeding on basis can call on bank to pass security. Can assert its right to be subrogated". It is assumed this refers to Label House after approximately $80,000 of Label's assets have been paid to the bank by the receivers.

The note I have then of Mr Tuohy's argument is that he proceeded to address the second question in the receiver's motion seeking an order

declaring the rights of Label House (1980) Limited and Textile Era Limited in respect of a claim by Textile Era Limited, a creditor of Label House (1980) Limited, to set off the debt owing to it by Label House (1980) Limited against moneys paid and to be paid by the Receivers of Label House Limited to Bank of New Zealand on account of Textile Era Limited under joint and several guarantees given by Textile Era Limited and Label House (1980) Limited to the Bank.

I then have a note that at the conclusion of that argument on (b) of the motion, which was quite extensive and detailed with references to very many authorities, Mr Tuohy said:-

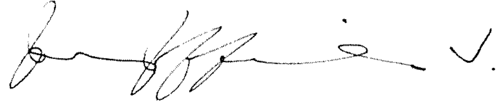
> "Lastly turn to duties of receivers in this particular situation.
>
> Label paid $42,000 to bank pursuant to obligation as guarantor of Textile. But not any more payments pending court's decision. 37,000 available to meet 54,000 still owing under guarantee of Textile. Equity situation between Label and Textile and not the consequences in relation to unsecured creditors."

The foregoing represents the only notes I have of receivers' counsel's argument on (a) of the motion."

I might add that most of the memorandum is really still relevant. The result of that memorandum was that all counsel returned to court, as stated above, and took away from the court the necessity of dealing with (a) of the motion leaving only the issue of set off. It must be remembered that set off is only reached if Textile Era's debts to the bank are entirely discharged and Label House seeks subrogation. Label House has to this point not formally indicated it will seek subrogation and issue proceedings against Textile Era thereby laying the foundation for set off. The court is simply asked to assume it will. That may be a question to be decided when and if the receivers vacate Label House and hand the company back. Moreover Textile Era could sue Label House for the full trade debt of $204,028. Now it is also clear that a court decision on set off <u>ahead</u> of those basic ones on subrogation and issue of proceedings could be very helpful to Parkbel's advisers and unsecured creditors, as well as to the receivers of both companies, but particularly Textile Era. However this court has reached the conclusion it would be a most unwise step to take into the dense thicket of legal and equitable set off with the litigation in the aforesaid state. In reality the motion seeks from the court a legal opinion.

These proceedings are between Label House and Parkbel and other creditors and no matter how convenient it might be in fact behind the scenes out of the courtroom the decision is rightly made when and if Label House and Textile Era become the parties, and in what capacities.

The motion is dismissed. Costs are reserved.



Solicitors for Receivers of Label House (1980) Ltd and Textile Era Ltd	Buddle Findlay
Solicitors for Parkbel Properties Ltd and Unsecured Creditors of Label House (1980) Ltd	Castle Pope Prosser & Lynn
Solicitors for U.D.C. Finance Ltd	Watts & Patterson
Solicitors for Directors of Label House (1980) Ltd	Gillespie Young & Co.
Solicitors for B.N.Z. Finance Ltd and S H Lock Ltd	Findlay Hoggard Richmond & Co.