

IN THE MATTER of the Companies Act  
1955 and its amendments

A N D

IN THE MATTER of ELECTRONIC BUSINESS  
SYSTEMS LIMITED (in  
Liquidation)

BETWEEN

A W GUZZWELL

Applicant

A N D

A J BURR

First Respondent

A N D

D J WOLLAND

Second Respondent

Hearing : 29 June 1989

Counsel : D J King for applicant

Judgment : 8 May 1990

Judgement Delivered 8 May 1990

R J Wolland

OR

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JUDGMENT OF ONGLEY J

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The applicant in this proceeding is the Liquidator of the company named Electronic Business Systems Limited (in liquidation) which is in the process of Voluntary Winding-up. Application was initially made under sections 319, 320 and 321 of the Companies Act 1955 seeking an order that the first and second respondents be made personally liable for the indebtedness of the company as having been directors and/or officers of the company at material times.

The proceeding has been compromised by the Liquidator against the respondent, Burr, and is continued now against the respondent, Wolland, alone. Wolland has not taken any step in the proceedings which are, therefore, unopposed. It remains for the applicant to satisfy the Court that it is proper to grant the relief sought.

On 1 December 1982 the shareholders of the company unanimously resolved that the company be wound up. On 13 December 1982 Westpac Bank appointed Derek Newall Quickfall and Ormond Arthur Maling Grensill both of New Plymouth, chartered accountants, as Receivers and Managers of the company's property under the powers contained in a debenture given by the company to the Bank on 4 March 1981.

A preliminary statement of affairs presented to a meeting of creditors held on 13 December 1982 by the first respondent, then secretary of the company, disclosed an estimated deficiency of funds of an amount of \$194,225.15 made up as follows :

Gross assets (less bad debts)	\$176,025.39
Less : Specific charges	\$48,910.47
Debenture holders	\$183,623.56
Unsecured creditors	<u>\$137,716.51</u>

Deficiency	\$194,225.15
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The receivers realised all the assets of the company and after deducting the costs and disbursements of the receivership were left with a balance of \$121,190.22 which was applied in part satisfaction of the first debenture. The second and third debenture holders received nothing nor did the unsecured creditors. The receivership terminated on 26 October 1983 and on the following day a meeting of creditors appointed the present applicant as Liquidator of the company.

The final indebtedness of the company is \$246,306.91 comprising the following categories :

<u>Deficiency on secured claims.</u>	
(i) Final deficiency on 1st debenture to Westpac Banking Corporation	\$55,000.00
(ii) Final deficiency on 2nd debenture to Apex Enterprises Limited	\$44,440.00
<u>Deficiency on unsecured claims.</u>	
(iii) Final balance on 3rd debenture to Ian Cedric Crysell	\$13,304.21
(iv) Deficiency on claims partly secured	\$4,205.39
(v) Trade creditors who submitted proofs of debt	\$70,189.94
(vi) Trade creditors who did not submit proofs of debt	\$59,167.37
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	246,306.91

The Liquidator does not now pursue a claim in respect of debts owing to unsecured creditors who did not submit proofs of debt. The total deficiency therefore for present purposes consists of -

Deficiency on 1st and 2nd debentures	\$99,440.00
Trade creditors who have submitted proofs of debt	<u>70,189.94</u>
	\$169,629.94

It is necessary to examine the history of the company in order to understand fully the relationship of the respondents to it at the time the receivers were appointed by Westpac at which time it ceased to trade. The following information is relevant :

The company was registered as a private company in 1977 under the name "Spotswood Dairy Limited" with a paid up capital of 4000 shares of \$1 each. It operated a dairy business until December 1980. On 4 December 1980 the first respondent acquired 2666 shares in the company and the balance were transferred to a man named Morse. They became the directors and the first respondent was appointed secretary. The shares in the first respondent's name were held by him in trust for the second respondent.

On 23 December 1980 the company entered into an agency contract with a number of persons calling themselves "Electronic Business Systems Partnership", the partners being Wolland and his wife and Morse and his wife. They appointed the company to operate the office equipment and supplies business of the partnership as their agent which it did from 1 January 1981.

On 28 January 1981 the company changed its name to "Electronic Business Systems Limited".

As a result of developments which are detailed hereunder the business formerly operated by the company as agent was transferred to the company on 5 September 1981 and was subsequently operated by the company as principal.

The developments to which I refer commenced in late August 1981 when a set of accounts for the company was produced for the period ended 31 July 1981 showing a loss of \$69,828.39 which all but extinguished the partnership capital of \$74,896. A meeting of the company held on 28 August 1981 considered immediate liquidation but deferred a decision until a meeting held on 2 September 1981 when proposals by the second respondent for the scaling down of the business were considered and Mr B Busing a chartered accountant, was instructed to prepare a forecast based on these proposals. On 4 September Mr Busing wrote to the directors of the company warning that to continue trading at losses would result in exposing directors to personal liability for those losses and expressing the opinion that the most optimistic outcome of receivership at that time would be 25 cents in the dollar but would vary considerably depending on the realisation of stock.

On 5 September 1981 the partnership was dissolved and its business vested in the company. A balance sheet for the

company when it commenced trading as a principal on 6 September 1981 shows that its starting equity on a book value basis was nil with its assets and liabilities each totalling \$337,550.00. Mr Busing forecast to the directors on 7 September 1981 that sales of \$45,000 per month would be necessary for the scaled-down business to break even. That volume of sales was not achieved during the next four months during which period the company operated at a loss totalling \$23,961 for the period 6 September 1981 to 31 December 1981. Although it had been decided by the directors that the accounts should be monitored on a weekly basis their resolution was not implemented and a reconstruction of the company's accounts from available material shows that the loss must have been substantially greater than that upon which the directors were basing their administration of the company's affairs.

At the end of October P D Morse agreed to transfer all his shares to the first respondent to be held by him in trust for the second respondent thereby making the latter the sole beneficial owner of all the shares in the company. On 5 November 1981 P D Morse resigned as a director leaving the first respondent as sole director until 8 February 1982 when the second respondent was appointed a director. Thereafter the respondents continued to hold office as directors until the liquidation. The only subsequent change in the structure of the company occurred on 30 September 1982 when the company resolved to increase its share capital to \$10,000 by creating 6000 ordinary shares of \$1 each which were allotted as to 5000

shares to the first respondent and as to 1000 shares to the second respondent so that they each then owned 5000 shares.

The company continued to trade during the first half of 1982 and a set of accounts prepared by the first respondent for the period 1 January 1982 to 30 June 1982 purported to show a net profit of \$46,876 for that period. It is the opinion of several experienced chartered accountants who have filed affidavits in this proceeding that this apparent change of fortunes compared with the losses incurred during the latter part of the 1981 year should have alerted the directors to the possible inaccuracy of the company's accounts. The reasons for that are explored in detail in their affidavits. It is not necessary for me to traverse their reasoning except to say that they conclude that the company had in fact operated at a loss during that period and that a major factor in the production of erroneous accounts was the over-valuation of stock on hand. A further set of accounts for nine months to 30 September disclosing a loss of over \$10,000 caused the first respondent to have an independent check made on the stock figures which showed that the June and October stock-takes were over-valued by \$50,000 - \$60,000 and \$80,000 respectively. As well, it was discovered that trade creditors had been understated by about \$20,000 in the accounts for the first half of 1982. The result was that the company's liabilities were shown to exceed its assets by approximately \$183,000.00. On receipt of that information and following a series of meetings with interested parties the shareholders passed the winding-up resolution of 1 December 1982.

The affidavits filed herein show that the first respondent assumed the direction of the company's day to day financial affairs from the time it commenced business on its own account in September 1981 but in relation to stock figures was dependent upon information supplied to him by the second respondent. The second respondent professed to have considerable experience in the business of retailing office equipment and managed the trading activities of the company. In effect he controlled the marketing side of the business and personally attended to the company's stock-takes and personally made the stock valuations. He would have been well aware of the significance of stock valuations as related to profitability. In the opinion of several chartered accountants expressed in affidavits filed herein the second respondent failed to meet the standard of a competent manager in relation to stock valuations. In particular he valued stock at retail instead of at cost, he did not write down obsolete stock and did not value trade-in equipment at its true value but at its traded value. The result was a vastly inflated stock figure which when incorporated in the accounts gave an entirely erroneous picture of the company's asset position and the profitability of its trading. In the opinion of Mr Busing a chartered accountant specialising in the field of commercial accounting the company should have been placed in liquidation in early November 1981 at the latest and subsequent trading involved an unjustifiably high risk that the company's creditors would suffer significant loss.



Turning to the specific relief sought under the various sections of the Companies Act 1955 it may be noted that counsel for the applicant accepts that in the circumstances of this case the cause of action under s 321 is co-extensive with the causes of action under sections 319 and 320 and an award of damages under the former section in addition to relief under the latter two sections is not now sought.

As to the other two sections it is my view that the case under s 319 of failing to comply with s 151 of the Act, so far as it relates to Wolland, is subsumed in the allegations of carrying on the business of the company in a reckless manner in contravention of s 320 (1) (b). It is preferable in my view to deal with the matter under that provision rather than in respect of the contracting of a specific debt under s 320 (1) (a) on the carrying on of the business with intent to defraud creditors of the company under s 320 (1) (c).

I find that the stocktaking as carried out by the second respondent was not in accordance with the practice or standards to be expected of a reasonably competent retail manager engaged in a business such as the retail selling of office equipment. I find that the second respondent knew or should have known that the system of stocktaking adopted by him would result in a false position as to profitability of trading and of the company's asset position as shown in its accounts. I find further that during the year 1982 the second respondent

was aware or by the exercise of reasonable care would have become aware that the company was trading at a loss and that to continue trading would involve the company's creditors in the risk of financial loss. From the beginning of the year 1982 he was knowingly a party to the carrying on of the business of the company in a reckless manner.

The Court therefore has a discretion to declare that the second respondent shall be personally responsible for all or any part of the debts of the company. What part of company's liabilities may be attributed to the second respondent's recklessness depends in part as to when the company should reasonably have been wound-up which at the very latest I believe to have been at the end of the year 1981. It is not possible to say exactly what part of the company's indebtedness had accrued by that date but I believe it may reasonably be inferred that its assets had been diminished by the amount of its accumulated trading losses incurred after 6 September 1981, namely \$23,961. By far the greater part of the final indebtedness was accumulated in 1982 while the second respondent was a director. He was not appointed a director until 8 February 1982 but I do not think that is of any consequence because he was aware when he became a director of the part which his faulty stock-taking played in giving the company's trading a false appearance of profitability which on the face of it justified the company continuing to carry on business.

I take the additional net deficiency attributable to the reckless carrying on of the business to have been the final figure of \$169,629.94 mentioned above, less the amount of accumulated losses at the end of 1981 namely, \$23,961.00 resulting in a figure of \$145,668.94.

The first respondent has paid a sum of \$59,876.32 in settlement of the liquidator's claim against him. I do not know how that figure was computed but assuming that it was a fair estimate of the first respondent's responsibility under one or other of the relevant sections of the Companies Act, it may be excluded from any sum in respect of which the second respondent may be considered to be liable. That would reduce the indebtedness for which the first respondent may be made liable under the present proceedings to a sum of \$85,792.60.

There may be adjustments to be made between the two respondents in respect of amounts paid in connection with the winding-up of the company but it is not the function of the Court to determine those matters in this proceeding.

There will be a declaration under s 320 (1) (b) of the Companies Act 1955 that the second respondent shall be personally responsible for the debts of Electronic Business Systems Limited (In Liquidation) to the amount of \$85,792.60. There will be a direction that the said amount shall constitute a debt due by him to the liquidator payable forthwith. It is

not appropriate to enter judgment against the second respondent at this time as he has not had notice of the debt.

Should it prove necessary to seek a judgment against the second respondent for the amount of the debt, counsel should give consideration to the question whether such judgment can be obtained in this proceeding or whether a separate action should be commenced.

Leave is reserved to apply for further directions as to any question incidental to this judgment.

The applicant is allowed costs in the sum of \$1,000.00 plus disbursements.

A handwritten signature in cursive script, appearing to read "J. C. Anderson". The signature is written in dark ink on a light-colored background.

Solicitors :

Till, Henderson, King & Co (New Plymouth) for applicant