NOT RECOMMENDED

IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CP 108/97

BETWEEN SUMITOMO CORPORATION (UK) PLC

Plaintiff

AND ALAN RAYMOND ISAAC and JOHN STEWART DRAGE

Defendants

Hearing: 15 October 1997

Counsel: B J C Tidswell for Plaintiff
C Taylor for Defendants

Judgment: 22 OCT 1997

JUDGMENT OF MASTER J.C.A. THOMSON

Solicitors:
Bell Gully Buddle Weir, Wellington
Simpson Grierson, Wellington

The defendants are the liquidators of W M Scollay & Co Limited (in liquidation). They are seeking to set aside three payments made by Scollay to the plaintiff as voidable transactions. Sumitomo have issued proceedings seeking an order that the transactions not to be set aside. The defendant liquidators have provided discovery and seek an order for general discovery against Sumitomo. That is opposed.

The plaintiff's position is that discovery of documents should properly be achieved through a limited focused order and that an order for general discovery is unnecessary. It says general discovery will only serve to create uncertainty and costs, delay matters and prolong the hearing. The plaintiff says that it should only need to provide discovery of -

a Transaction documents evidencing the historical transactions between the plaintiff and the company between September 1994 and February 1996 including the order documents for the three transactions in question to establish authority of the agent.

b The circumstances in which it is said the plaintiff has changed in position in reliance on the payments.

It is submitted for the plaintiff that apart from such documents there are no others which are or might be in the plaintiff's possession or power which are relevant to the proceedings. In particular it is submitted that the defendants pleading of knowledge by the plaintiff of any financial difficulty of the company or lack of knowledge on the part of the company of certain transactions is entirely

irrelevant and no documents evidencing that (if they exist) are discoverable. The proper test to be applied in the case the plaintiff says does not allow for consideration of those matters and documents which might evidence them are irrelevant.

If such documents exist it did not appear there would be any great difficulty for the plaintiff in making them available. An affidavit has been sworn by Mr Isaac in support of the defendants' application for discovery. In paragraph 17 of his affidavit Mr Isaac sets out the documents the defendants wish to have discovered. I set out paragraph 17:

"**Ordinary course of business**

17 The payments which are the subject of this proceeding are three payments out of ten payments made from 28 November 1995 to 23 January 1996 to the plaintiff which appear to John Drage and I to have been made outside the ordinary course of business of the Company. I make the following points (amplified in paragraph 9 of the Amended Statement of Defence):

(a) *Authority*

MSS requested the plaintiff to arrange for the delivery of bunker oil to nominated vessels at nominated ports without authority from the Company.

(b) *Security deposit*

The Company used a security deposit to make the payments which are the subject of this proceeding.

(c) *Ordinary course of business between the plaintiff and the Company*

Late payments

(i) the pattern of payments by the Company to the plaintiff altered significantly after mid November 1995 in that the majority of payments were made later than usual or not at all;

Pressure

(ii) the plaintiff repeatedly placed pressure on the Company in order to obtain payment of a number of invoices issued by the plaintiff to the Company from November 1995, including the three invoices which relate to the payments which are the subject of this proceeding; copies of the relevant telexes and facsimile referred to in paragraph 9 of the Amended Statement of Defence are annexed marked **"A"** to **"K"** respectively.

Other factual circumstances

(iii) the Company received the plaintiff's invoices which relate to the payments which are the subject of this proceeding at a time when those invoices were either almost due or overdue;

(iv) prior to receipt of the invoices the Company had no knowledge of two of the three transactions to which the invoices referred;

(v) usual procedures for the conduct of bunkering transactions were not followed;

(vi) it appears that the plaintiff knew or should have known:

- that the Company was in financial difficulty; and
- of the Company's lack of knowledge of certain transactions for which invoices had been sent to the Company by the plaintiff.

(vii) the transactions detailed in the schedule to the Amended Statement of Defence were accounted for by the Company in the books of its related company, WM Scollay & Co Pty Limited."

I do not understand the plaintiff to resist producing documentation relating to each of the above headings except those sought regarding the plaintiff's knowledge of the company's financial difficulties. Paragraph 17(vii). It is the

plaintiff's strong submission that because of the Court of Appeal judgment in ***Countrywide Banking Corporation Limited v. Dean*** CA 13/96, 12 December 1996, the plaintiff's knowledge of the company's financial position prior to or at the time of the transactions is not relevant. That is, the plaintiff says, because the Court of Appeal, citing from ***Downs Distributing Co Pty Ltd v. Associated Blue Star Stores Pty Ltd (in liquidation)*** (1948) 76 CLR 463 476 - 477 held that the test to be applied to s.266 transactions is an objective one. I set out that passage of the judgment:

> "In a range of such situations the New Zealand courts in giving content to the expression "the ordinary course of business" have often turned to the test stated by Rich J in the High Court of Australia. He was interpreting the phrase as it appeared in Federal Bankruptcy Act:
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> > this last expression it was said "does not require an investigation of the course pursued in any particular trade or vocation and it does not refer to what is normal or usual in the business of the debtor, or that of the creditor." It is an additional requirement and is cumulative upon good faith and valuable consideration. It is, therefore, not so much a question of fairness and absence of symptoms of bankruptcy as of the everyday usual or normal character of the transaction. The provision does not require that the transaction shall be in the course of any particular trade, vocation or business. It speaks of the course of business in general. But it does suppose that according to the ordinary and common flow of transactions in affairs of business there is a course, an ordinary course. It means that the transaction must fall into place as part of the undistinguished common flow of business done, that it should form part of the ordinary course of business as carried on, calling for no remark and arising out of no special or particular situation. *Downs Distributing Co Pty Ltd v Associated Blue Star Stores Pty Ltd* (In Liquidation) (1948) 76 CLR 463, 476-477.
>
> While "the transaction" is to be made in "the ordinary course of business" it does not follow that the particular transaction must be "ordinary". That adjective qualifies the expression, "course of business", rather than the noun "transaction". Mahoney JA in the New South Wales Court of Appeal has elaborated the point. In discussing a transaction which he agreed was extraordinary he ruled that,

> within this principle, "ordinary" is not to be confined to what is in fact ordinarily done in the course of the particular business of the company. Transactions will be within this principle, even though they be, in relation to the company, exceptional or unprecedented. *Reynolds Bros (Motors) Pty Ltd v Esanda Ltd* (1983) 8 ACLR 422, 428.

The test stated by Rich J was applied by this Court in *Julius Harper Ltd v F W Hagedorn & Sons Ltd* [1991] 1 NZLR 530, although in a different context; and in the present context by the High Court in a number of cases, including *Chilton St James School v Gray and Traveller* (Wellington CP 304/95, judgment of 19 March 1996), *Re NZ Spraybooths Ltd* (In Liquidation) (1996) 7 NZCLC 261, 075, as well as this one.

We see no reason to depart from the guidance provided by Rich J and Mahoney JA."

To persuade the Master that knowledge was not relevant to a s.266 Companies Act 1955 transaction, Mr Tidswell for plaintiff relied on an article by Andrew Keay, which is to be found in Volume 5 March 1997 of the Insolvency Law Journal at page 41, where the author examines a number of Australian decisions concerning similar Australian legislation. He contrasts the 'undistinguished common flow of business' approach as expounded by Rich J in ***Downs Distributing Co. Pty Limited***, with what the author says is a second and older view that a transaction 'cannot be said to be in the ordinary course of business if the creditor apprehended the debtor's insolvency'. The second approach is exemplified the author says in the judgment of Williams J again in ***Downs Distributing Co. Pty Limited*** where that Judge said:

> "It seems to me therefore that the expression refers to a transaction into which it would be usual for a creditor and debtor to enter as a matter of business in the circumstances of the particular case uninfluenced by any belief on the part of the creditor that the debtor might be insolvent."

Mr Tidswell submitted that if there are two different tests as identified by Mr Keay then they are mutually exclusive and it is implicit in the Court of Appeal judgment in ***Countrywide Banking Corporation Ltd*** that Rich J's judgment in ***Downs Distributing Co. Pty Limited*** is to be applied in New Zealand. Accordingly Mr Tidswell says if an objective is to be applied then knowledge of the state of the debtor's financial situation is irrelevant for the purposes of s.266. It follows he argues that on discovery documents going to show knowledge are not relevant and production of them is not necessary in order to resolve the dispute between the parties. However Mr Tidswell's submission I think is much too simplistic and anyway in my view is not supported by Mr Keay's article. At page 45 the author referring to the Australian decisions says:

> "Some decisions have referred to both views and linked them so that they are regarded almost as two tests which must be fulfilled."

In a footnote to that statement Mr Keay refers to ***Downs Distributing Co. Pty Limited*** to ***Taylor & White*** (1964) 110 CLR 129 and to ***Taylor v. ANZ Banking Group Ltd*** (1988) 6 ACLC 808 where McGarvie J after citing the well known passage from of Rich J's judgment in ***Downs*** says at page 823:

> "It is appropriate to read with that statement of the test the statement of *Williams* J in the same case. He said of the expression "in the ordinary course of business":
>
> > "that the expression refers to a transaction into which it would be usual for a creditor and debtor to enter as a matter of business in the circumstances of the particular case uninfluenced by any belief on the part of the creditor that the debtor might be insolvent." (P.480)

> The case which provides authority as to the practical application of the test is *Taylor & Anor v. White & Anor* (1964) 110 C.L.R. 129."

And at page 825 McGarvie J says:

> "Under the test of *Rich* J a payment is not made in the ordinary course of business if it arises from a "special or particular situation". It follows from *Taylor v. White* that a payment which originates from and is accounted for by the presence or fear of insolvency arises from a special or particular situation and not from ordinary business considerations.
>
> Whether a payment is made in the ordinary course of business is basically a question of fact, determined by applying the test to the facts disclosed by the evidence (*Re E.J. Taylor & Sons Pty. Ltd. (in vol. Liq.) (supra)* at p.296). The existence or fear of insolvency may be regarded in a particular case as having induced the making of a payment where it led the debtor to choose to make the particular payment or the creditor to procure its making. *Kyra Nominees Pty. Ltd. (In liq.) v. National Australia Bank Ltd.* (1986) 4 ACLC 402 and *Taylor v. White* (1964) 110 C.L.R. 129 are examples of the first situation. *Re Dunemann; Ex parte the Trustee* (1935) 8 A.V.C. 148 is an instance of the second. The circumstances which may lead to the making of a payment other than in the ordinary course of business are infinite."

It seemms to me such issues have yet to be addressed by our High Court and Court of Appeal, and when they are our Courts will have to wrestle with the same problems the Australian Courts have encountered, and which are referred to Mr Keay at pages 50 and 51 where the author says :

> "Undoubtedly the "in the ordinary course of business" element has produced some confusion because of a number of factors. First the difficulty of understanding its meaning has been exacerbated by the divergent approaches adopted by the Courts. Secondly the law has been complicated by the fact that some Courts have held that the intention of the debtor (and perhaps even the creditor) at the time of the impugned transaction is relevant. This is anti-thetical to Australian preference law. Thirdly it is not easy to gauge how the element ties in with the question of good faith another element in s.122(2)(a). (I interpolate that good faith is not part of our section). To ascertain the principles which are to be applied in determining whether a particular transaction is or is not in the

> ordinary course of business is impossible without extensive research and even if the necessary research is undertaken the task is still arduous. Simply some views are just unable to be reconciled. Parties to actual or potential preference litigation do not know what view will be taken by a Judge because as Pincus J stated in ***Re Cummins*** Judges are able to adopt whatever view they like."

Given the problems identified by the Australian Courts the author notes that it is ironical that New Zealand has introduced the ordinary course of business protection in respect of preferences only quite recently.

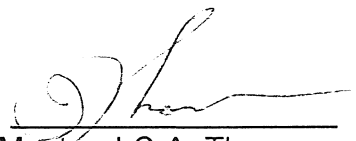
That our avoidance sections are likely to cause difficulty is also alluded to in an article by Lynne Taylor in the 1997 New Zealand Law Journal for May 1997 at page 168 where the author says at page 170:

> "In New Zealand any intention on the part of the company to confer a preference is only relevant if the person receiving the benefit of the transaction is aware of it (s.292)(4) Companies Act 1993 and s.266(4) Companies Act 1955). It does, however, remain open for a finding such as that in *Australian and Overseas Telecommunications Corporation Ltd v Russell Kumar & Sons Pty Ltd* (1993) 11 ACLC 281 to be made. In that case pressure applied to a company for payment of an outstanding account in circumstances where the creditor was aware of the company's insolvency was held to take the company's payment outside the ordinary course of business." (Emphasis added)

She concludes on page 170 by saying:

> "There remain, however, other aspects of the test that require clarification. It has yet to be resolved, for instance, whether the test for assessing whether a company is insolvent at the time of a transaction differs in a material way from that in s.309(1) Companies Act 1955. Further, it has yet to be seen if when determining whether or not a transaction has a preferential effect the New Zealand Courts adopt the continuing business relationship principle recently restated by the High Court of Australia in *Airservices Australia Ltd v Ferrier* (1996) 137 ALR 609. Future developments in these areas are awaited with interest."

Clearly the law is not yet as certain as the plaintiff contends for so as to make it unnecessary for the documents sought to be discovered from the plaintiff, by the defendants, in order that they can conduct a proper defence. As to the merits, the fax's exhibited by Mr Isaac I think gave some support to the defendants view that the discovery they seek should be made. There will be an order that the plaintiff discover the documents sought by the defendants as set out in paragraph 17 of Mr Isaac's affidavit. I understood such documents should be able to be agreed but leave is reserved to apply further if any difficulty as to compliance arises. Costs are reserved.



Master J.C.A. Thomson