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NZLR

LOW PRIORITY

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

M. NO. 1631/98

IN THE MATTER of the Companies Act 1993

A N D

IN THE MATTER of PARKWAY PRINTERS LIMITED (IN LIQUIDATION)

BETWEEN ESTES INTERNATIONAL LIMITED

Applicant

A N D GJ HULST

Respondent

Hearing: August 10, 1999

Counsel: E St John for Applicant
V Clyne for Respondent

Judgment: September 2, 1999

JUIDGMENT OF MASTER ANNE GAMBRILL

Solicitors for Applicant

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The application herein is made between Parkway Printers Limited (in liquidation) and Estes International Limited, a trade supplier of paper, for orders that transactions not be set aside pursuant to ss 292, 294 and 296 of the Companies Act 1993.

Parkway Printers Limited (hereinafter referred to as "Parkway") was placed in liquidation by order of this Court on the petition of the Inland Revenue Department on 4 September 1997 with debts of $149,752.00 to the Inland Revenue Department. Parkway was a paper supply merchant operating in Auckland. On 16 September 1998, that is more than 12 months after the liquidation, the liquidator filed and issued a notice to set aside transactions which had taken place between 25 May 1996 and 21 November 1996. All transactions fall within the two year period but not in the first six month period. The transactions relate to various sums totalling $24,027.49 for paper supplied between 25 May 1996 and 21 November 1996. These goods were supplied at the Respondent's request, a paper user from a paper supplier, and were properly invoiced.

The liquidator seeks to set aside these transactions arguing they were made at a time when Parkway was unable to pay its debts, they were outside the ordinary course of business and therefore Estes International Limited has received more than it would otherwise have received in the liquidation of Parkway. It is significant that neither party called evidence. Mrs Muhr put the matter in issue in her affidavit evidence as to the lack of firsthand evidence of

her dealings with Parkway, vis a vis the implications Mr Hulst appears to have deduced from the papers only and of which he has no personal knowledge. I say at the outset that I accept her evidence that she was not aware of the financial difficulties of the company nor was there any unusual pressure exerted to obtain repayment and I accept that the letter on which Mr Hulst refers to hereinafter and appears to rely, was not referred to Parkways.

Unlike the majority of applications which have recently been before the Court, this case is an application by the liquidator outside the six month period and the responsibility moves to the liquidator.

The first issue the Court must address is under s 292 of the Companies Act 1993 where the payments were made in the ordinary course of business under subs (2)(a) and (2)(b). It was accepted by both Counsel that pursuant to subs (5) of the said section, that the payments fell within the two year period and not within the six month restricted period prior to liquidation and the onus of satisfying the Court that these payments fell outside the ordinary course of the company's business is the responsibility of the liquidator. There was compliance with s 294 and the Applicant also relies on s 296(3) which I set out:

> **"296. Additional provisions relating to setting aside transactions and charges –**
>
> (1) .....
>
> (2) .....
>
> (3) Recovery by the liquidator of property or its equivalent value, whether under section 295 of this Act or any other section of this Act, or

under any other enactment, or in equity or otherwise, may be denied wholly or in part if –

(a) The person from whom recovery is sought received the property in good faith and has altered his or her position in the reasonably held belief that the transfer to that person was validly made and would not be set aside; and
(b) In the opinion of the Court, it is inequitable or order recovery or recovery in full....."

Counsel for the Applicant, Estes International Limited (hereinafter referred to as "Estes"), says the company is a small paper supply company which has been in business since 1992. It employs four people, has a substantial turnover and runs its business as a commission agent on which there are fairly minimal returns. It sources and obtains this paper from overseas and receives a margin for supply.

A decision herein will have to be made taking into account the factual basis which cannot be disputed as to the dates of payment and the dates of the dockets. In these cases the Court must rely on the material the Applicant can produce and the liquidator can ascertain and produce from the liquidated company's files.

Neither party sought to cross-examine on the affidavit evidence and I therefore accept the evidence of the parties as put forward in the affidavits filed.

The Applicant's case is that these transactions (a) took place within the ordinary course of business; (b) Estes have received the moneys in good faith and has altered its position in the reasonably held belief that the payments were validly made and could not be set aside. The affidavit evidence is that

the Director has no knowledge of the possibility of the company's insolvency. Estes says it would be inequitable to order recovery in full. Furthermore, this company could not survive a repayment of this nature.

On receipt of the notice Estes' solicitors wrote two letters, one stating the payments had been received in the ordinary course of business and in good faith. Secondly, detailing the account with the date of opening and in the second letter, identifying that all payments were outside the restrictive period.

Mr Hulst's evidence shows that the company in liquidation was clearly unable to pay its debts from 30 April 1991 through until 4 September 1997. Effectively, the Inland Revenue Department, the only major claimant as far as the Court was aware, allowed this company to remain in debt for GST from 1991 onwards, starting with a debt of $38,000. At that time the evidence is that the company was accruing further tax debts over the period.

I turn to the liquidator's evidence. Mr Hulst produces the ledgers. He describes Parkway's payments as a fire-fighting approach. In support of the contention he produces a copy of a letter dated 24 September 1996. It shows as "Faxed". It shows handwritten on the top "Parry Ganda". It has in square brackets "[Estes International Ltd Letterhead]". It is a letter addressed to Parkway Printers Limited. It finishes "Yours faithfully [etc]". It confirms the "May, June and July accounts amounting to $15,546.32 are overdue at today's date". It confirms the "advice on the 23rd September 1996 that you will be reducing your account on a monthly basis by a minimum of $2,000.00

(exclusive of any monies received from you in relation to purchases subsequent to this letter)". It confirms "18%.....is applicable to your account.....if the account is not in credit by the 15th October 1996". It says "We wish to maintain our business relationship with you and allow payment terms of 60 days from date of invoice.....". In view of the form of the letter, which was found in the Applicant's discoverable list, and the format of the letter as it stands on file, I accept the Applicant's evidence that this letter was never sent. Mr Hulst says by the terms payments were altered. He suggests there was a cheque not honoured by the bank but the evidence on this issue is clouded I do not believe I can rely on his deposition taking into account Estes' Director, Mrs Muhr's deposition that she did not notice anything out of the ordinary in relation to this cheque.

He then says the payments on 5 August, 2 October, 17 October, 7 November 15 November and 21 November did not relate to particular invoices. He says also the cheques 17, 24 and 31 October (not honoured) were sequential payments and were given as post-dated cheques. He says the Applicant did not supply further goods after 21 June 1996. His evidence in affidavit form is the invoices he has found from Estes International, copies of the cheque books showing Parkway's monthly payments, copies of offers for paper and circular copies of offers for discount supply of paper. The creditors' records of the company for February and March 1996, unsecured creditor's claim and details of the statements of account as faxes. Further evidence he adduced was a completed statement of account showing the on-going six year accruing debt with the Inland Revenue Department.

Upon liquidation the tax in respect of the company amounted to $149,752 and although it is impossible in this hearing to identify the extent of the company's unpaid debts, GST and PAYE as preferred tax or just general income tax, Mr Hulst says it would be inequitable for other creditors of the company to be disadvantaged by providing the Applicant relief in the circumstances. The liquidator has produced no evidence that any non-preferential creditor has proved except the IRD. It is impossible to ascertain correctly whether the notices are issued to enable recovery of funds to assist the payment of the IRD and for the professional services necessary to liquidate and conduct an investigation of the company. The Court is not aware of the other unsecured creditors.

Counsel for the Applicant pointed out that there is no evidence either direct or by inference that any one known preferential creditor would benefit from the transaction being set aside other than the Inland Revenue Department being the preferential creditor and its professional advisers.

The evidence filed by Estes in support of its application was deposed to by Mrs Muhr, the Director of the company. She details the introduction to Parkway in February 1996, she details the fact the industry is very competitive and she deposes that the majority of her customers pay within 60 to 120 days. She produces the trial balances for March 1996, August 1996, February 1997, and October 1998. These show respectively that debtors in 60 to120 days were 84%, 76% and 66%. She produces the invoices and dates of payment. She says every payment was made within 120 days of due date. She says this

information was furnished to the liquidator. She says the payments were received in good faith and without knowledge of any financial difficulties of Parkway. She filed a subsequent affidavit. She says Mr Hulst has taken isolated records from Parkway. She says there is no evidence from Parkway's accountants or the company's principals who Mr Hulst had the power to question. She analyses the evidence relating to payments. She produces the details provided by Mr Hulst of the status of liquidation and the amounts recovered from other creditors on probably voidable preference notices. She says that no creditor can benefit under this recovery except the Inland Revenue Department. She says there were no demands made on the Applicant for payment. She says lump sum payments are not unusual. She does not recall the cheque being dishonoured. She says some of the evidence is speculative and has no knowledge of the difficulties of Parkway. She gives evidence as to the effect of recovery on the company. She says the company takes a commission of 3% – 5% on sale process, the margins are small and the turnover is healthy. She says that if she has to repay $28,849 as claimed, which is greater than the sum actually owing and which was finally accepted in the Courtroom, then it is unlikely the Applicant, which is a small business, will survive.

Counsel for the Applicant analysed the facts and referred to the various authorities identifying the grounds which the Court must consider in reaching a conclusion whether the transaction should be set aside. He relied on the decision of Salmon, J in ***Vague v Chubb Building Services Ltd*** M.2174/98 (Auckland Registry) 22 June 1999 (unreported) at pages 8 – 11 where there is

a useful summary of the authorities applicable and of assistance to the Court in reaching a conclusion. The starting point is (a) were these transactions in the "ordinary course of business". He noted thereunder the history of the debtor company is irrelevant in assessing whether the transactions were within the "ordinary course of business" and the act in this case of the debtor company making a number of payments late, is not relevant to assessing the "ordinary course of business". He also accepted that the Court relying on ***Countrywide Banking Corporation Ltd v Dean*** [1998] 1 NZLR 385, must make this decision by an actual examination of the transaction in its factual setting. See ***Anntastic Marketing Limited*** M.468/97 (Auckland Registry) 8 September 1998 (unreported) at pages 8 and 9. His Honour Justice Baragwanath noted at page 15:

> "If one were considering the issue of 'ordinary course' in the abstract it might well open to a Court to treat the evidence as showing an amber light signalling that the case was not ordinary. But decisions of this Court such as ***Re Hawkes Bay Promotions*** and ***Woodbine*** decide that an honest trader is to have reasonable scope for giving or extending credit without being held to account, unless there is more specific evidence that the company was under such financial pressure that the trader must have known or closed its eyes to a real prospect of insolvency."

Counsel noted the liquidator relied on a number of factors. He said these factors could be dealt with individually but, in considering the matter it is noteworthy that in ***Meltzer v The Attorney General*** CA.216/98 (unreported), Doogue, J, in delivering a unanimous decision of the Court of Appeal at page 6, pointed out that such an analysis is not helpful when dealing with the factual circumstances of each case. Counsel then outlined the evidence and assertions made by the liquidator:

(a) Payments were not made in accordance with the terms of trade.

The Applicant's answer is there is nothing unusual about this. In fact the commercial reality of the world we live in is that the converse is true. See ***Chatfield v Woodbine*** M.696/97 (Auckland Registry) 25 March 1998 (unreported) at pages 9 and 10; ***Excel Freight Limited v Meltzer*** M.451/98, 26 November 1998 (unreported) page 7 and ***J Scott & Co Ltd v Oorschot & Ors*** CP.153/98, 30 September 1998 (unreported).

(b) The liquidator says the majority of payments were made only after a a number of demands from the Applicant.

Counsel says there is a bald and careless assertion. The liquidator only relies upon Exhibit G to his affidavit, which was a draft letter which the Applicant says was not sent. It was properly disclosed in the list of documents as being on the company's file. The liquidator has not challenged the evidence and there is no independent evidence of any other demands. I have considered this letter and clearly, as produced, it is a letter not sent and probably sent to Estes' solicitors for advice.

(c) There was an alteration to terms of trade.

Counsel said in response to the allegation the terms of trade were altered. The Applicant merely afforded Parkway more time to pay. He says there is no

evidence as to why this is unusual in a commercial context. In fact it is in accordance with terms actually extended by the Applicant to other purchases and this evidence is before the Court.

(d) Course of payment of cheque.

The liquidator says one cheque was dishonoured but the Applicant says it did not take much notice of this as it immediately received a cheque in replacement and this evidence is not challenged. He said the Manager did not speak to Parkway about this dishonoured cheque.

(e) Rounding off of payments

The liquidator says some payments do not specifically relate to a particular invoice. The Applicant says there is nothing unusual about this. Likewise, some payments were rounded off. He refers to two post-dated cheques and says this is nothing unusual about this when it is remembered that Parkway was not under pressure to pay at the time it wrote out these cheques or that the Applicant appreciated the significance of receiving a post-dated cheque. Likewise, this evidence is not challenged. He notes the confusion over the payment of cheques and I think it is accepted by Counsel that there is a duplication in the notice.

The Applicant's evidence given by Mrs Estrella Muhr, has stated the Applicant did not consider the late payments in itself extraordinary. It had no personal

knowledge of Parkway's financial position and payments fell within the ordinary course of business. There has been no cross-examination and Counsel's case is there is nothing unusual about these payments.

He says the liquidator bears the onus of proof to establish the payments should be set aside. He has not established the Applicant would receive more in the liquidation. He relies on statements that the payments were outside the "ordinary course of business". Counsel's submission is that scales should be tipped in favour of the Applicant.

The Respondent's Counsel's submission is that these transactions took place at a time when Parkway was unable to pay its debts and while its indebtedness was accruing. The liquidator or investigator of the records has formed a view that "the company was paying those creditors whom it deemed most necessary to pay whilst never being able to meet the company's due debts in full". There is no evidence of the events in 1996 or given by the Pathway's representative that can refute the evidence of Estes' Manager/Director.

It is noted Counsel for the Respondent says that the Applicant has not attempted to demonstrate Parkway could pay its debts. That is not the obligation. The obligation is fairly squarely in this case on the liquidator. Counsel for the Respondent in submissions acknowledges the fact which was adverted to but not clear from the evidence, that the IRD is an unsecured creditor and she suggests the liquidator may benefit from the setting aside. Counsel said any argument based on priority between preferential and non-

preferential unsecured creditors has little merit in this case and I accept this to be the case.

Counsel analysed the legal principles applicable to determine whether the payments were made in the ordinary course of business. Counsel analysed the law relating thereto adopting the statements made by His Honour Justice Fisher in ***Re Modern Terrazzo Limited (In Liquidation) Bowden v MacDonald*** [1988] 1 NZLR 160 where the Court held at 180 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 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……the focus of the enquiry must still be the ordinary operational activities of businesses as going concerns, not responses to abnormal financial difficulties."

Counsel also relied on ***Countrywide Banking Corporation Limited v Dean*** [1998] 1 NZLR 385. She acknowledged there was no particular formula but she submitted the ordinary course of business test would be satisfied so long as it can be said the transaction is one which might reasonably take place in some business setting. She suggested the surrounding circumstances of the transactions must be examined in order to determine whether the transactions objectively meet the ordinary course of business standard. I note the Court has the evidence of the Applicant which is available to be verified (Mrs Muhr was at the hearing), but the Court has no evidence of the representative of Parkway. The critical evidence is the evidence of those parties of the events in 1996, not the evidence of a liquidator perusing a company's works post liquidation, particularly bearing in mind a company in financial difficulties,

failing to pay tax will often fail to keep its books in order because it is slipping into a financial mire.

She analysed a number of the recent cases and she then made submissions in relation to the application of the facts to these cases. She said that the payments were significantly overdue although payments were normally due 20th of the month and this was the terms of trade. Some of these payments ran up to 5 or 6 months late she suggests on Parkway's own evidence. In fact I find they were four months overdue. She says that there was demand made in May, June and July but there is no real evidence supporting this. The evidence of Mr Hulst is challenged. It has not been corroborated and I accept that it is unclear whether demand was or was not made particularly in the face of Estes' clear denial that the letter (which it says was a draft) was not sent. Mr Hulst relies upon the lump sum payment, post-dated cheques and says that overall the evidence of Mrs Muhr is not relevant in determining whether or not the payments were made in the ordinary course of business. Knowledge that Parkway was unable to meet its debts could be imputed by the Applicant, Counsel submitted, because of lateness in paying the invoices issued, secondly, by a repayment programme, thirdly, by the alteration of the terms of trade, fourthly by a dishonoured cheque and fifthly, by the letter which is disputed whether it was sent. Imputation when the responsibility rests on the liquidator has not been accepted by this Court as far as I aware in this context.

Counsel then considered the liquidation evidence and made submissions over the issue of good faith and alteration of position. She says that the elements of

s296(3) are cumulative and must each be satisfied before the Court will deny in whole or in part the liquidator's claim to set the transaction aside. The Respondent's case is that none of the four elements have been satisfied. She submitted that (a) the Applicant did not receive the payments in good faith; (b) the Applicant must have been aware Parkway was unable to meet it debts because of a bounced cheque; (c) the delay between invoicing and payment; (d) the letter which it challenged; (e) the repayment programme and the lack of adherence; (f) finally, the use of post-dated cheques.

Secondly, she questions whether the evidence is sufficient to show the Applicant altered its position in reliance on the receipt of the payments in question. She says the Parkway did not receive further goods and therefore it did not change its position. She says if the Court considers it is inequitable to order recovery in whole or in part, then in continuing to trade with the Respondent in these circumstances, the Applicant acted for its own benefit and to the detriment of the other creditors. She said it would be inequitable for other creditors to be disadvantaged by providing the Applicant relief in these circumstances.

I turn to the just and equitable ground which arises in my view an interesting point. The liquidator relies on the insolvency of the company because of its debts to the Inland Revenue Department which had existed since 1991 and continue to exist except for some amelioration of the position in 1996. The Court has no evidence who would really benefit from the recovery of these payments and I gather from submissions from the Bar that it is the only

application still outstanding relating to the notices issued by the liquidator in this company liquidation. The liquidator has recovered $39,166.67, paid $9,928.70 in legal fees and his fee to date is $345.89. I question, although it will not necessarily be finally determined by the matters herein, whether the Inland Revenue Department as the agency of Government can and should allow a clear insolvent company to continue to trade from 1991 and then seek to recover from an independent party a sum of money only paid in the last year of that trading.

The starting point herein must be the creditor's evidence that it was unaware of the company's financial position and its outstanding tax obligations, and that evidence is not challenged adequately. This means that the Court finds there is no intention of the creditors to prefer. The Court must then consider whether the parties' acts rather than knowledge, intentions and purposes, meant that the payments were outside the ordinary course of business. It has been said in ***Burns v MacFarlane*** [1946] CLC 108,125:

> "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."

The Privy Council in ***Countrywide Banking Corporation v Dean*** (supra) has said that the transaction must be examined in the actual setting in which it takes place which defines the circumstances in which it is to be determined whether it was in the ordinary course of business. The determination therein is

to be made objectively by reference to the standard of what amounts to the ordinary course of business

> "……the focus must still be the ordinary operational activities of businesses as going concerns, not responses to abnormal financial difficulties."

The Privy Council included the statements by Fisher, J in ***Re Modern Terrazzo Limited (In Liquidation)*** (supra) at 175:

> "……so that at a policy level or something to be said for the view that relevant considerations should extend to the prior practices of the particular company."

I note the comments by the Respondent's Counsel about the faxed letter produced to the Court dated 25 September which was a reminder that the May, June and July accounts were overdue. I have already made a finding that I accept that that letter was not sent to Parkway and Parkway, through the liquidator, has produced no independent evidence to satisfy the Court as to whether these payments were outside the ordinary course of business. The evidence is insufficient to satisfy me that any demand was made for payment which was an unusual or an excessive demand outside the ordinary course of business. I am satisfied that Estes must have the benefit of any question whether or not the payments were made in accordance with the terms of trade because of its deposition made by its Director and not challenged. I am not satisfied that there was an alteration of terms of trade because I do not accept the letter on which this submission is based was sent. I accept that there is an irregular course of payment of cheques and these were rounded off, but I must

accept Estes' Director's deposition that she had no knowledge and indeed nothing points to her having knowledge, that this company was in financial difficulties and insolvent when it was trading. Estes has produced evidence as to the operation of its business, the lateness of payment often made by its purchasers and the fact that it accorded credit to Parkway on much the same basis as other purchasers. There is nothing to indicate that Estes refused to continue to supply to Parkway, in fact there is evidence produced by the liquidator of flyers to cut price paper being sent to Parkway after the date the indebtedness had accrued. There is nothing from Parkway to indicate it was in difficulties, likely to be unable to pay its account and/or contemplating any cessation of trading and indeed it continued to trade for a further twelve months after these payments were completed. Estes had no further trade with Parkway and therefore had no reason to believe moneys it had received in payment of its normal trading accounts could be subject to Court proceedings and clawed back three years later.

In my view there can be no argument about the first two payments made on 27 May and 5 August as they fall within the trading pattern of any company. As to the latter payments on 21 October, 24 October, 7 November 15 November and 21 November, it may be possible to argue that they were not necessarily in the ordinary course of business. However, as set out above, there is no satisfactory evidence that satisfies me that Estes could have acknowledged it was receiving payments from a company which was not solvent and thus likely to gain advantage over other unpaid creditors. In fact, if one considers the payments, they occurred 11 months before the liquidation. It is also likely that

the substantial supplies made during June would not have occurred if the first payment had not been made. I therefore find the payments were made in the ordinary course of business and should not be set aside.

If, however, this finding is challenged, I turn to the provisions of relief under the Companies Act. The question whether the payment has been received in good faith, whether there was a reasonably held belief in its validity and retention, the consent to alteration of position and the inequitableness of setting aside. In applying this test I am satisfied that the payments were received in good faith and there was little to indicate the company was insolvent. Although the Applicant did not supply further, there is no evidence of refusal to supply and there is still the possibility Parkway could have still purchased. The act of not supplying further does not deprive Estes of the right to collect the payments due. Secondly, the creditor's evidence which is not challenged and upon which the Director has not been cross-examined, was that she had a reasonably held belief in the right to receive and hold these payments. Thirdly, the Director deposes she has altered her position to the extent that she had obligations to suppliers and she has continued to meet the obligations and has not believed she has to account for or cover a loss. I have already held payments were received in good faith and Estes was unaware of insolvency of the company. I believe that Estes also would be entitled to relief under s 296 of the Companies Act 1993. Mrs Muhr has said she has reasonably held belief in the right to receive these payments, the company has continued to trade and if the payment is recovered, this company Estes will not be able to stay in business. She has therefore satisfied the Court that she has altered her

position. Fourthly, the inequitableness of setting aside. Finally, I turn to the important issue of the inequitableness of setting aside and I am prepared to find in this case there would be inequity. The creditor, the Inland Revenue Department, who could benefit from the setting aside, has continued since 1991 with GST debts owing to allow this company to trade. The company has substantial debts, far more than the sums outstanding for GST in 1991. The moneys the company has not paid are moneys which do not even belong to it. They include GST, a tax or share on the moneys which have passed through the company's hands and for which it has failed to account. The Inland Revenue Department has let that situation continue to arise and it would seem to me that it would be inequitable to allow the Department who has the knowledge of this company's insolvency in 1991 when GST was not paid, to continue to allow it to operate and to recover at the benefit of a small trading company which has no such privileged position and no such access to knowledge. If a company cannot account for GST, which it is legally bound to within six months of receipt thereof, then in my experience it is a prime and important indicator of the insolvency of the company which should not be allowed to continue to operate and deal with the public while it is effectively misappropriating moneys to which it is not entitled. The Inland Revenue Department has the particular knowledge of failure to file and pay GST (in this case) and often PAYE. I believe the Inland Revenue Department will have to take a stocktaking and balance whether companies with substantial unpaid GST and PAYE should continue to carry on business over a lengthy period when the Inland Revenue Department has the privileged position of being able, each six months, to identify these debts which are owing to Government and

which are not profits but moneys paid by or withheld from ordinary independent taxpayers.

For the reasons set out herein I would not set the transactions aside. The Applicant is entitled to its costs of $2,000 plus disbursements.

I thank Counsel for their carefully prepared submissions, cases and bundles on a developing area of law affecting particularly small traders and businesses whose profits are lean.

Anne Gambrill

MASTER ANNE GAMBRILL