IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2008-404-007696

UNDER	the Companies Act 1993
BETWEEN	AUCKLAND CITY COUNCIL Plaintiff
AND	CENTRO CONSTRUCTION LIMITED Defendants

CIV2008-404-007697

AND BETWEEN	AUCKLAND CITY COUNCIL Plaintiff
AND	KITCHENER RENTALS LIMITED Defendant

CIV 2008-404-007698

AND BETWEEN	AUCKLAND CITY COUNCIL Plaintiff
AND	SHED 21 INVESTMENTS LIMITED Defendant

Counsel: S C Margetts for plaintiff
D W Grove for defendants

Judgment: 25 March 2009 at 2:30pm

JUDGMENT OF ASSOCIATE JUDGE ABBOTT

This judgment was delivered by me on 25 March 2009 at 2:30pm, pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Solicitors:
Simpson Grierson, Private Bag 92518, Auckland 1141
Ellis Law, PO Box 4516, Auckland 1140

[1] The plaintiff, Auckland City Council (Auckland City), has applied for orders placing the three defendant companies into liquidation. The three proceedings have been called together by consent. The defendants are related companies.

[2] The defendants did not file statements of defence prior to the first hearing of the applications. Counsel appeared for the defendants at that hearing (by leave of the Court) to seek an adjournment to allow them time to attempt to settle the underlying debts. He did not seek an extension of time for filing a defence. A one month adjournment was granted. The parties could not reach agreement on terms for settlement of the debts. On the day before the applications were to be recalled the defendants purported to file statements of defence, contending they were solvent.

[3] When the application was recalled, counsel for the defendants was given leave to address the Court in relation to the late filing of the statements of defence. He made an oral application for extension of time for filing of the defences. Counsel for Auckland City opposed the application on the grounds that they could not satisfy the criteria for granting an extension of time, in particular that there was an arguable basis for the proposed defence.

[4] The issue for the Court is whether it should exercise its discretion to extend time for filing a defence and, if not, whether it should proceed to determine the substantive application or allow the defendants further time to pay.

Background

[5] The defendant companies, Centro Construction Limited (Centro), Kitchener Rentals Limited (Kitchener) and Shed 21 Investments Limited (Shed 21) are part of the Kitchener Group of companies. They each own properties in central Auckland on which varying amounts are due and payable to Auckland City for rates.

[6] On 29 August 2008 Auckland City issued statutory demands for rates arrears and penalties due by:

a) Centro totalling $14,134.98;

b) Kitchener totalling $34,350.36; and

c) Shed 21 totalling $20,160.27.

[7] The demands were served on 30 September 2008. Because there was no public access to the defendants' registered office (an apartment at Level 8 of the building known as Shed 21, Princes Wharf, within the Hilton Hotel complex) they were served by leaving them with the concierge of the Hilton Hotel under an arrangement made with an employee of the defendants. The defendants failed to meet the demands.

[8] On 18 November 2008, Auckland City filed these applications. It had difficulty serving the applications. An arrangement similar to that for the statutory demands could not be reached, notwithstanding that Auckland City's solicitors and counsel for the defendants were in contact by telephone and in correspondence regarding details of the rates arrears.

[9] The application for liquidation was eventually served pursuant to an order for substituted service, both on the concierge of the Hilton Hotel, and on counsel for the defendants. Service took place on 19 December 2008.

[10] The applications were listed for hearing at 10:00am on 4 February 2009. Under former r 700Q of the High Court Rules (now r 31.17) the defendants were required to file their statements of defence by 26 January 2009. They did not do so.

[11] Counsel appeared for the defendants at the hearing on 4 February 2009 and sought an adjournment. The applications were adjourned to 6 March 2009. The Court's minute of the February hearing merely records the appearance of counsel and the notation:

> May settle. Adj 06/03/09 10:45

[12] Counsel for the defendants does not contend that the defendants sought an extension of time for filing their statements of defence at the hearing on 4 February 2009.

[13] On 5 March 2009 the defendants presented statements of defence to the Court for filing together with an affidavit by Ms S Prenter, office manager for the Kitchener Group of companies. Ms Prenter annexed a letter from Auckland City's solicitors dated 20 February 2009 setting out the terms on which it would withdraw its applications, her analysis of the amount outstanding, and a letter written by Kitchener Group's accountant summarising the income/outgoings and asset/liability positions of the company.

[14] Counsel for the defendants did not dispute a submission by counsel for Auckland City that the letter from Auckland City's solicitors was the last in a without prejudice exchange of correspondence, including several proposals by the defendants that had been rejected by Auckland City because they were inadequate.

[15] When the applications were called on 6 March 2009 counsel for Auckland City opposed an extension of time and sought leave to proceed with Auckland City's application. Counsel for the defendants was given leave to address the Court on the issue of extension of time. The matter was argued as an oral application by the defendants for extension of time.

Principles

[16] The High Court Rules contain express provisions for the time by which any statement of defence is to be filed, and the effect of failure to file within that time. As new High Court Rules came into force after the time by which the defendants were to have filed their defences it is necessary to consider both the previous rule and the present rules:

a) Previous r 700Q stipulated that a defendant "shall file a statement of defence within 14 days [of service of the statement of claim]";

b) R 700Q has been replaced by r 31.17 of the High Court Rules which came into force on 1 February 2009. However, under the transitional provisions of s 9(4) of the Judicature (High Court Rules) Amendment Act 2008, the period for filing a statement of defence is determined by r 700Q as the time for taking that step had passed by 1 February 2009.

c) Rule 31.20 provides that a defendant who fails to file a statement of defence within the prescribed time must not be allowed to appear at the hearing of the proceeding:

> … without an order for extension of time granted on application made under r 31.22 or the special leave of the court.

d) Rule 31.22 permits an application for extension of time as one of a limited number of interlocutory applications that can be brought ahead of the first hearing of an application for liquidation.

[17] Rule 31.20 does not contain any guidance as to when an application should be made (as distinct from allowing an appearance by special leave). Authorities referred to in *McGechan on Procedure*, HR 31.20.01 suggest that special leave is more likely to be granted to a person entitled to enter an appearance under r 31.18 (such as another creditor) than for the defendant company. A rationale for that could be that defendant company is likely to have had more notice and therefore greater opportunity to apply for extension of time. Having said that, by providing for the possibility of special leave being granted to a defendant company (as a "person … entitled to file a statement of defence") the rule clearly contemplates that there could be circumstances where it is not possible, or perhaps not appropriate, for a defendant company to apply for extension of time.

[18] As may be expected, applications by defendant companies for leave to file a statement of defence have come before the Court in liquidation proceedings on several occasions: *McGechan on Procedure,* HR 31.20.01; *Mosaed v Roy Turner Ski Shop Limited* (HC WANG M63/92 10 December 1992 Master Williams QC); and *Orme v Parkway Investments Limited* (HC HAM M149/00, 7 May 2001, Master Faire). These cases are authority for the propositions that an applicant must

demonstrate an arguable defence on the papers, and that the test is similar to that for an application to set aside a statutory demand.

[19] The above authorities were approved in *Fresh Cut Flower Wholesalers Ltd v The Living and Giving Gift Company Ltd* (2001) 16 PRNZ 173, in which the Court was asked to determine an application for leave to file a statement of defence out of time under the former r 700T (which is essentially the same as r 31.20). The Court apparently saw no difference in principle between an application for extension of time and special leave. It referred to the application as one for "special leave to file a statement of defence out of time", and stated the applicable principles as follows (at para [9]):

> [9] Neither counsel made submissions on the law applicable to an application for special leave. There are several helpful decisions of Masters referred to para HR700T.04 of *McGechan on Procedure*. With respect, I adopt the principles applied by the Masters. First, leave should not be granted unless the applicant can show on the papers an arguable basis upon which it is not liable for the amount claimed. Further, in my view, even if there is an arguable defence, leave should not be granted if the applicant is insolvent.

[20] Given the close similarity between previous r 700T and r 31.20, these principles are equally applicable to applications under r 31.20. Additionally, the Court will also consider what the justice of the case requires, which should include consideration of the reason for the delay: refer *Orme v Parkway Investments Limited* at para [16].

Consideration of factors for exercise of discretion

[21] The first matter that the Court must consider on an application for extension of time is whether the defendants have shown an arguable basis that they are not liable for the sums demanded: *Fresh Cut Flower Wholesalers Limited*. It is quite clear that the defendants have not shown an arguable basis. To the contrary, Ms Prenter acknowledges in paragraph 3 of her affidavit that the rates claimed are due and payable. In paragraph 6 of her affidavit, and an attached schedule, she accepts that the amount outstanding at that time was $109,433.35, of which Centro owed $33,972.50, Kitchener owed $54,138.31, and Shed 21 owed $21,322.54. there is no suggestion that any of the defendants have a set-off or counterclaim.

[22] The second consideration identified in *Fresh Cut Flower Wholesalers Limited* (that leave should not be granted if the applicant is insolvent) was said to arise only if it was arguable that the defendant is not liable for the debt. I have just rejected that proposition.

[23] The last consideration (arising out of *Orme*) is whether the justice of the case requires extension of time. I will address under this heading the submission that the defendants are solvent and two further matters raised by counsel for the defendants.

[24] The only evidence supporting the defendants' solvency is the letter from the defendants' accountants which Ms Prenter produced in her affidavit. In that letter the accountants state (without providing any detail) that Centro and Kitchener have net monthly incomes of $1,772.25 and $3,701.12 respectively, and that Shed 21 has no monthly income but its monthly outgoings of approximately $50,000.00 are paid from another source. They also state (again without providing any supporting detail) that Kitchener and Shed 21 have substantial equity in their properties and Centro has some equity in its properties.

[25] The applicable test for solvency is the "cash flow" test, namely whether a company is able to pay its debts when due and owing: *Re Tweeds Garage Limited* [1962] 2 WLR 68. The defendants' evidence does not satisfy the "cash flow" test. Ms Prenter has acknowledged that the defendants for many months have been unable to pay their rates as they became due. She contends, without giving any support for this, that they will be able to clear the arrears within six months. This is evidence that they cannot meet the "cash flow" test. Ms Prenter candidly acknowledges the defendants' inability to obtain further mortgage funding (despite the alleged equity). She gives no detail of the source of the funds to be used to clear the arrears. The alleged income of Centro and Kitchener is patently insufficient. The debt due by Centro and Kitchener has increased substantially since the demands were issued, notwithstanding that they are the two companies with an alleged income stream. The position of Shed 21 has improved slightly (before legal costs are added). However, even if it is being supported by an external funding source, that support has clearly been insufficient to meet its debt.

[26] I also take into account that the defendants did not raise the solvency defence until the day before the resumed hearing. They failed to provide verified accounts (a factor for the Court in *Concept Manufacturing Limited v Concept Lighting Limited* (HC AK M896-im00, 6 July 2000, Master Kennedy-Grant)). The letter from their accountants falls well short of cogent evidence of solvency. It is significant that the accountants do not state that in their view the companies are (or any of them is) solvent. Ms Prenter comments that the defendants "also have other outgoings that need to be serviced" without identifying them or relating that statement to the general statement of income and outgoing given by the accountants.

[27] The first of the further matters raised by counsel for the defendants was a complaint that the plaintiffs had been inflexible in its negotiations on terms for settlement. Counsel for the defendants referred to what he described as an unreasonable requirement by Auckland City to include debts by other companies (including one already in liquidation) to any repayment arrangement. I reject this as a matter going to the justice of the case. Auckland City was under no obligation to allow further time to pay. That was a commercial position that Auckland City was entitled to take. It was always open to the defendants to settle by payment in full if they did not like Auckland City's terms. There was no suggestion that anything had been said or done by Auckland City which led the defendants to believe that they need not comply with their obligation to file defences.

[28] The second of the further matters was that the defendants had an available argument that there had been compliance with the statutory demand. This was based on s 59 of the Local Government (Rating) Act 2002 under which rates are made a charge against the rated property. Counsel argued that that statutory requirement was "a charge over [the defendants'] property to secure payment of the debt" for the purposes of s 289(2)(d) of the Companies Act 1993. I do not accept this submission. Section 289(2)(d) requires "the company … to … give a charge … to the reasonable satisfaction of the creditor". I read that as requiring the defendant to provide a security which is satisfactory to the creditor, rather than simply relying on a charge imposed by statute. I see no reason to limit Auckland City to the procedure for recovery of rates under the Local Government (Rating) Act 2002 where there is no dispute over the rates being due and there are at least serious questions as to the

defendant companies' solvency. I also take into account that the defendants did not attempt to have the statutory demand set aside on this ground, and have not referred to it in the statement of defence that they seek leave to file.

[29] Weighing all of these factors, I find that the defendants have not made out sufficient grounds for exercise of the discretion to extend time.

Should further time be granted

[30] Auckland City seeks an order for liquidation based on the acknowledged debts and the presumption of insolvency arising out of the defendants' failure to meet the statutory demand.

[31] The real thrust of the defendants' "defence", in my view, was a plea for an extended adjournment to enable the defendants to try to repay the debts by instalments. In the alternative, if the defendants were not granted an extension of time, counsel for the defendants sought time to pay.

[32] The Court does not allow liquidation proceedings to be protracted, for good reasons. A creditor which has proved its debt and that the debtor company is unable to pay it promptly is prima facie entitled to a liquidation order. Where there is concern as to insolvency, the Court has to have regard to the possible risk to other creditors as well.

[33] The defendants are all property investment companies. Liability for rates is a fundamental aspect of their business. The fact that they have been unable to clear arrears of rates over a substantial period coupled, with the fact that arrears are increasing (at least in the cases of Centro and Kitchener) suggest that Auckland City (and indirectly its rate payers) will be prejudiced by further delay. Even the defendants' best case scenario of at least six months to clear them constitutes prejudice to Auckland City. The proposed repayments do not appear to allow for any further penalties. In the meantime further rates will be payable and presumably will have to be paid out of the same limited income streams. If the improvement in financial circumstances anticipated by the defendants does not eventuate, the

deterioration in the arrears position ($68,645.61 as at 29 August 2008 to $109,435.35 as at 5 March 2009 or perhaps earlier) seems likely to continue.

[34] The defendants assert (without providing any support for it) that Kitchener and Shed 21 have substantial equity in their properties. Even if that proves to be the case, there is no telling how much of that equity will in fact be available to creditors after secured liabilities have been discharged. Their inability to refinance independently using this allegedly substantial equity suggest that there may be other obligations affecting that equity.

[35] Nevertheless I will allow a further short adjournment to allow the defendants an opportunity to put their houses in order, but bearing in mind that they have already had some 2½ weeks since the hearing and several months before that.

Decision

[36] The defendants' oral applications for extension of time to file a statement of defence are dismissed.

[37] All three applications for liquidation are adjourned to the liquidation list at 10:45am on 1 April 2009. Auckland City will be entitled to proceed that day if the debts have not been cleared.

[38] Auckland City is entitled to costs of and incidental to the application for extension of time on a 2B basis together with disbursements as fixed by the Registrar.

_____

Associate Judge Abbott