IN THE COURT OF APPEAL OF NEW ZEALAND

CA399/2013
[2014] NZCA 127

BETWEEN	DAMIEN GRANT AND STEVEN KHOV Appellants
AND	LOTUS GARDENS LIMITED Respondent

Hearing: 20 February 2014

Court: O'Regan P, Stevens and Asher JJ

Counsel: B J Norling and J K Boparoy for Appellants
S I Perese for Respondent

Judgment: 4 April 2014 at 2.15 pm

JUDGMENT OF THE COURT

A The appeal is allowed.

B The order dismissing the liquidation application is quashed.

C An order is made placing Lotus Gardens Ltd into liquidation.

D The appellants are entitled to costs for a standard appeal on a band B basis and usual disbursements.

E The costs order in favour of the respondent in the High Court is quashed, and in its place the appellants will have costs and reasonable disbursements calculated on a 2B basis. Any argument as to the quantum of costs is to be dealt with in the High Court.

REASONS OF THE COURT

(Given by Asher J)

Introduction

[1] The issues in this appeal are the nature of the debt that arises in favour of a company in liquidation when a transaction is set aside as an insolvent transaction under s 294 of the Companies Act 1993 (the 1993 Act) and if there was an insolvent transaction, the ability of the liquidators to liquidate the respondent company based on a statutory demand.

[2] The appellants, Damien Grant and Steven Khov, are liquidators of Quantum Grow Ltd (in liquidation) selling hydroponic equipment and nutrients. Lotus Gardens Ltd (Lotus Gardens), the respondent, is a grower of vegetables. Alan Canavan who has provided affidavits and evidence is a director of both Quantum Grow Ltd (Quantum Grow) and Lotus Gardens, and the shareholders of the two companies are the same.

[3] Prior to its liquidation between 3 March 2009 and 20 July 2010 Quantum Grow transferred $113,280.63 to Lotus Gardens. On 20 March 2012 Quantum Grow was put into liquidation by order of the High Court at Christchurch. By a letter dated 30 May 2012 the liquidators noted certain transfers made between 23 March 2010 and July 2010 and requested a statement of account from Lotus Gardens summarising the purpose of the payments. There was no response to that request.

[4] On 24 July 2012 the liquidators issued a formal request under s 261 of the 1993 Act for a statement of account summarising what the payments were for. Lotus Gardens did not respond to that notice.

[5] On 7 September 2012 another notice under s 261 was sent by the liquidators to Lotus Gardens. Again Lotus Gardens did not respond.

[6] On 15 October 2012 a notice to set aside a voidable transaction under s 294 of the 1993 Act was served on Lotus Gardens. The notice sought to set aside that portion of the payments of $113,280.63 that had been made within the two year

voidable transactions period before the date of commencement of the liquidation.[1] The weekly payments made within that two year period totalled $25,576.88. The statutory timeframe required Lotus Gardens to raise an objection within 20 working days failing which, the transaction was set aside.[2] There was no objection raised.

[7] On 15 November 2012 a demand letter for the voidable amount of $25,576.88 was sent to Lotus Gardens. The letter indicated that the transactions were automatically set aside pursuant to s 294(3) of the 1993 Act, and failure to make payment within five working days would result in proceedings being initiated in the High Court for an order to confirm the transactions were set aside. No response was received.

[8] On 23 November 2012 the liquidators served a statutory demand on Lotus Gardens under s 289 of the 1993 Act. The notice recorded an indebtedness of Lotus Gardens to the plaintiffs as liquidators of Quantum Grow Ltd (in liquidation) in the sum of $25,576.88 for non-payment of voided transactions. It required that sum to be paid within 15 working days of the service of the notice.

[9] The liquidators received no response to this notice, and there was no application to set aside the statutory demand made within 10 working days of the date of service, the prescribed time for such a notice.[3]

[10] The liquidators then filed a notice of proceeding and statement of claim to put the company into liquidation. The application was scheduled to be called on 11 February 2013. No statement of defence was filed within the prescribed 10 working days after the date of service.[4] Further, no appearance was filed before two working days before the date of the hearing.[5]

[11] However, on 8 February 2013, three days before the hearing, Lotus Gardens filed an application for leave to extend the time for filing a statement of defence and leave to appear. The liquidators opposed leave, but leave was given by the High

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1 Companies Act 1993, s 292(5).
2 Companies Act, s 294(3).
3 Companies Act, s 290(2).
4 High Court Rules, r 31.17.
5 High Court Rules, r 31.19.

Court. Lotus Gardens was directed to file and serve its statement of defence by 8 March 2013. Lotus Gardens proceeded to do this on 11 March 2013.

[12] The liquidation application was ultimately heard on 10 April 2013. Associate Judge Bell gave his decision on that application on 17 May 2013 declining to put the company into liquidation. That is the decision under appeal.[6]

The decision

[13] The Associate Judge concluded that the liquidators had taken the wrong procedure to recover the amounts paid under the allegedly voidable transactions. He refused to follow *McKinnon v Falla Holdings NZ Ltd (in liq)* (*McKinnon*),[7] a case which held that the precursor to a voidable transaction (the common law action for money had and received by way of a fraudulent preference) had survived the new provisions relating to voidable preferences in the 1993 Act. He took the view that the new procedures for setting aside a voidable transaction had the effect of pushing out the common law remedies. Section 295 has taken over the job formerly done by the common law. He considered that Lotus Gardens could not become indebted to the liquidators for the amounts of the alleged voidable transactions unless and until the Court made an order under s 295 of the 1993 Act.[8] In the absence of such orders the liquidators were not creditors of Lotus Gardens and did not have standing to seek a liquidation order.

[14] He also considered whether, if the liquidators could rely on the statutory demand procedure, Lotus Gardens could contest the debt on the grounds that there was no voidable transaction. Mr Canavan asserted that $25,576.88 was not paid for the benefit of Lotus Gardens, but those payments by Quantum Grow were payments to reduce indebtedness to the Bank of New Zealand and had simply passed through the accounts of Lotus Gardens as a conduit. The Associate Judge held that Lotus Gardens had done "just enough" on the facts to show that this assertion raised a genuine and substantial dispute as to whether there was a voidable transaction.[9] Lotus Gardens was entitled to raise that defence notwithstanding the automatic

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6 *Grant v Lotus Gardens Ltd* [2013] NZHC 1135.
7 *McKinnon v Falla Holdings NZ Ltd (in liq)* (1999) 8 NZCLC 262,034 (HC) [*McKinnon*].
8 At [98].
9 At [93].

setting aside that had occurred under s 294(3). Because there was a genuine and substantial dispute as to Lotus Gardens' liability, the Associate Judge declined to make a liquidation order.[10]

Setting aside voidable transactions

[15] Under s 309 of the Companies Act 1955 (the 1955 Act) a liquidator seeking to avoid a transaction known as a voidable preference had to establish that the company had entered into a transaction in favour of a creditor while it was insolvent, and with a view to giving that creditor a preference over other creditors. The 1993 Act abandoned the previous regime's focus on proving an intention to prefer in favour of proving that the effect of the transaction was that it was an insolvent transaction.[11] An "insolvent transaction" was defined as a transaction that was entered into when the company was unable to pay its debts,[12] and which enabled a person to receive more towards the satisfaction of a debt than that person would have otherwise received.[13] Where the transaction was entered into within the restricted period of 6 months before commencement of liquidation,[14] the company was presumed to be unable to pay its debts.[15]

[16] A new procedure was created for setting aside voidable transactions and charges by the 1993 Act, and this was amended further in 2006.[16] A liquidator who wishes to set aside a transaction or charge that is voidable under ss 292 or 293 must file a notice with the Court and serve that notice as soon as practicable upon the other party to the transaction or the charge holder, and any other party from whom the liquidator intends to recover.[17] The transaction or charge is "automatically set aside" as against the person served, if that person has not sent a written objection

10 At [99].
11 See *Insolvency Law Review: Tier One Discussion Documents* (Ministry of Economic Development, Wellington, 2001) at 58; *Law Commission: Company Law: Reform and Restatement Part 1* (NZLC R9, 1989) at [649] and [696].
12 Section 292(2)(a).
13 Section 292(2)(b).
14 Section 292(6).
15 Section 292(4A).
16 Companies Amendment Act 2006.
17 Section 294(1).

within 20 working days.[18] The need for a creditor to take steps to object to a notice, which was originally a requirement in the 1993 Act,[19] has been removed.

[17] Associate Judge Bell took the view that the 1993 Act had introduced a new process that displaced the previous regime:

> [74] A non-statutory rights-based remedy is incompatible with the statutory purpose. Such a remedy would allow liquidators to outflank the court's discretionary power to adapt relief so as to eliminate the preference but no more. The statutory remedy now fills the space once occupied by the common law. There is no room left for a common law remedy – it has been pushed out.
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> …
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> [78] The clear implication is that s 295 has taken over the job formerly done by the common law. From now on the common law decisions on relief for preferential transactions should be of antiquarian interest only, as common law relief is no longer available for insolvent transactions.

He did not agree with the decision of Chambers J in *McKinnon*, in which it was assumed that there had been no material change between the 1955 and 1993 Acts as they related to the recovery by a liquidator of monies paid under a transaction that had been set aside.

[18] Section 295 provides that if a transaction or charge is set aside under s 294 the Court may make one or more of the orders listed including an order that a person pay a sum of money to the company. Section 295(a) provides:

> **295 Other orders**
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> If a transaction or charge is set aside under section 294, the Court may make 1 or more of the following orders:
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> (a) an order that a person pay to the company an amount equal to some or all of the money that the company has paid under the transaction:
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> …

[19] Section 296 contains additional provisions, including at s 296(3) the circumstances in which the Court will not order the recovery of property:

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18 Section 294(3).

19 Section 294(2) (now repealed).

296 Additional provisions relating to setting aside transactions and charges

…

(3) A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or in equity, if the person from whom recovery is sought (**A**) proves that when A received the property—

(a) A acted in good faith; and

(b) a reasonable person in A's position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and

(c) A gave value for the property or altered A's position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

Section 311A of the 1955 Act.

[20] It is necessary to consider the relevant provisions of the 1955 Act, as the Associate Judge considered that the 1993 Act had effected a significant change in the liquidator's ability to recover monies paid under a set aside transaction.

[21] Under s 311A(1) of the 1955 Act the liquidator was required to file a notice in the Court stating a wish to set aside the allegedly fraudulent disposition, and serve that by notice on the person to whom the disposition was made. Unlike the present procedure where a challenge is by notice, a person who wished to contest the notice had to apply to the Court for an order that the disposition was not so voidable.[20] If no application was made for an order that the disposition was not voidable, or if no order was made to that effect, then the dispositions were set aside.[21]

[22] Thus, although under the 1955 Act the test was intention-based rather than effects-based, there was still a procedure in place whereby a liquidator could initiate a setting aside and, if after a certain date no steps had been taken, the disposition was set aside by operation of the statute.

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[20] Companies Act 1955, s 311A(2).
[21] Companies Act 1955, s 311A(3).

[23] These provisions were considered by this Court in *Westpac Banking Corporation Ltd v Nangeela Properties Ltd* (*Nangeela*).[22] That case concerned a payment made to Westpac by a company which subsequently went into liquidation. The payment was found to have been a voidable preference and the liquidators sought an order that Westpac pay the amount to the liquidator plus interest. Among the issues for determination was whether interest was payable, and if so from when. Ultimately the Court determined that the relevant statutory provision dealing with voidable preferences empowered the Court to make an order for repayment of the preference plus interest.

[24] Richardson J held that s 311A(4)(c) was worded sufficiently broadly to allow repayment of the voidable preference,[23] and in awarding interest applied the English decision *Re FP and CH Matthews Ltd* which determined that a claim following a transaction that had been set aside was a claim in debt.[24] He considered that decision was applicable even though the English provisions differed from the New Zealand provisions in some respects. This meant that the liquidator was entitled to interest from the date of winding up when his cause of action arose.[25] Importantly for present purposes, the other two Judges, McMullin and Somers JJ, went further and expressed the view that the liquidator could have recovered the amount of the voidable payment in an action for money had and received.[26] This entitled the Court to also award interest under s 87 of the Judicature Act 1908, which provides that a Court can award interest not exceeding the prescribed rate in any action "for the recovery of any debt or damages". Somers J held:[27]

> Had the company obtained no more than the order that it sought in its original application, namely that the disposition be set aside, the liquidator would then have had an independent action against the bank to recover the sum received by the bank as moneys had and received. Such a liability has the characteristics of a debt; it would be a sum payable in respect of a liquidated money demand and would be recoverable by action. In *Re F P & C H Matthews Ltd* [1982] Ch 257 the Court of Appeal held that a liquidator's claim in like circumstances to those in the present case was a claim for debt. That debt, it was held, arose not on the making of the order avoiding the transaction but upon the liquidation. With this I agree.

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22 *Westpac Banking Corporation v Nangeela Properties Ltd* [1986] 2 NZLR 1 (CA).
23 At 6.
24 At 7; *Re FP and CH Matthews Ltd* [1982] 1 Ch 257 (CA).
25 *Westpac Banking Corporation v Nangeela Properties Ltd* , above n 24, at 6–7.
26 At 9 per McMullin J and at 11 per Somers J.
27 At 11.

[25] McMullin J adopted the same approach as Somers J.[28] Their dicta were referred to and applied in *OPC Managed Rehab Ltd v Accident Compensation Corporation*,[29] which we discuss later in this judgment.[30]

Was the common law remedy pushed out?

[26] The remedies available on setting aside under the new 1993 Act were considered in *McKinnon*. As in this case, a setting aside notice had been served on a person under s 295 who did not respond. The transaction said to be set aside was a payment of $50,000 by the company to Mr McKinnon. The liquidator sued Mr McKinnon for $50,000 in the District Court and applied for summary judgment. Mr McKinnon claimed to have a defence on the merits. The liquidator was successful and Mr McKinnon appealed. Mr McKinnon argued that the District Court did not have jurisdiction to grant summary judgment under s 295 of the 1993 Act, as only the High Court had power to grant relief after the setting aside of a transaction. An issue arose as to whether the liquidator could proceed to seek summary judgment against Mr McKinnon in the District Court.

[27] Chambers J held that on the authority of *Nangeela*, where a company pays a sum of money to a recipient in circumstances which amount to a voidable preference, the liquidator of that company may, on or after the setting aside of that voidable preference, recover that sum as a debt.[31] He rejected a submission that s 295 imposed a code for orders following a setting aside, and that a liquidator can only proceed following the s 295 route.

[28] He also held that if a transaction was set aside the recipient could argue that the transaction was not voidable, because such an argument should have been raised through the course of the s 294 procedure.[32] However, Mr McKinnon was able to raise as a defence the fact that there was not a transaction at all. Section 296(3) conferred a wide discretion on the Court to deny recovery in certain circumstances.

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28 At 9.

29 *OPC Managed Rehab Ltd v Accident Compensation Corporation* [2006] 1 NZLR 778 (CA) at [48]–[49].

30 See [43] below.

31 At 262,037.

32 At 262,040.

While Mr McKinnon was precluded from contesting the voidability of the transaction, he was not precluded from advancing an allegation that the liquidators were estopped from recovering the debt. That could be argued by way of defence. Mr McKinnon could not be placed in a worse substantive position because the liquidator had chosen the summary judgment recovery route.[33] All remedies that would have been available under s 295 were available as an answer to the summary judgment application.[34]

Our analysis

[29] Under both the 1955 and 1993 Acts the process of setting aside a voidable transaction involved a notice to a creditor, and the obligation on the part of that creditor to respond. Under both, if there was no objection to that process by the creditor within the requisite time, the voidable transaction was set aside.[35] Both procedures involve the filing of a notice in Court,[36] service of the notice[37] and a requirement on the part of the creditor to file an application to the Court[38] or, in the case of the 1993 Act, to give a notice of objection to the liquidator.[39]

[30] Importantly, there is no significant difference between s 295 and the old s 311A(4) which provided:

> **311A Procedures relating to voidable preference and voidable securities**
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> …
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> (4) Subject to subsections (6) and (7) of this section, in any case where a disposition is set aside, the Court may—
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> (a) Order that the person to whom the disposition was made, or his personal representative, or any person claiming through him (not being a person claiming [[through him who received the property comprised]] in the disposition or any part of it or any interest in it, as the case may be, in good faith and for valuable consideration or who claims through such a person), shall transfer to the liquidator the property or any part of it or any interest in it retained by him:

33 At 262,042.
34 At 262,042.
35 Companies Act 1955, s 311A(3)(a), and Companies Act 1993, s 294(3).
36 Companies Act 1955, s 311A(1)(a), and Companies Act 1993, s 294(1)(a).
37 Companies Act 1955, s 311A(1)(b), and Companies Act 1993, s 294(1)(b).
38 Companies Act 1955, s 311A(2).
39 Companies Act 1993, s 294(3).

> (b) Order that the person to whom the disposition was made, or his personal representative, or any person claiming through him (not being a person claiming through him who received the property comprised in the disposition or any part of it or any interest in it, as the case may be, in good faith and for valuable consideration or who claims through such a person), shall pay to the liquidator such sum, not exceeding the value of the property when the disposition was set aside, as the Court thinks proper:
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> (c) For the purpose of giving effect to any setting aside or to any order under paragraph (a) or paragraph (b) of this subsection, make such orders as it thinks fit.

[31] Although s 311A incorporated the substantive defences now found in s 296, s 311A(4) gave the Court the same broad discretionary power as s 295 to direct transfers back or payments by the recipient of the payment.

[32] For the purposes of analysing the nature of any debt to the liquidator by the creditor following the voidable transaction procedure, we see no difference between the 1955 procedure and the 1993 procedure. In particular, both involve a default procedure in the event of the creditor taking no steps to contest a notice.

[33] Associate Judge Bell noted that s 311A(5) of the 1955 Act specifically saved other rights and remedies available to the liquidator.[40] It provided:

> ... the remedies given to the liquidator by subs (4) of this section are in addition to all other rights and remedies (if any) available to the liquidator, and nothing in the said subsection (4) shall restrict any such other rights and remedies.

[34] However, s 296(3) of the 1993 Act provides:

> A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, *any other enactment, or in law or in equity,* if the person from whom recovery is sought (**A**) proves that when A received the property ...
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> (Emphasis added).

[35] The Associate Judge considered that the removal of the provision in s 311A(5) supported the view that the ability of a liquidator to invoke common law and equitable remedies had gone.[41] However, we agree with the conclusion of

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40 At [45].
41 At [48](b).

Chambers J in *McKinnon* that s 311A(5) was not carried across because it was otiose.[42] The words in s 296(3) unambiguously contemplate the recovery of property in law or in equity in the context of setting aside transactions and charges. While the wording is not as explicit as in s 311A(5) in that it prevents any recovery using other rights and remedies, if s 296(3) applies, it unambiguously contemplates the continuation of those rights and remedies. The crucial point is that this provision is irreconcilable with the premise that the setting aside procedure in ss 294–296 is a code excluding other rights and remedies.

[36] We cannot agree with the Associate Judge's description of s 296(3) as "belts and braces",[43] or his view that Parliament was "... simply making sure that no matter how a liquidator might try to attack a preferential transaction, the creditor would be able to rely on the defences under s 296(3)".[44] If it was Parliament's intention to provide for a defence to claims in law or equity, it must have contemplated that such claims could be brought. The plain words cannot be brushed aside. Parliament was expressly contemplating a court ordering recovery of property the subject of a voidable transaction through processes other than those set out in the 1993 Act.

[37] Applying a purposive interpretation, we can see no reason why an order under s 295 should be treated as the exclusive method for a liquidator to obtain an order following a setting aside. The purpose of the 1993 Act as expressed in the long title is "to provide straightforward and fair procedures for realising and distributing the assets of insolvent companies". This does not require the abandonment of existing common law and equitable remedies. If the substantive defences are still available there is nothing complex or unfair in maintaining the existing remedies which have existed without giving rise to difficulties for a long time.

[38] Moreover, s 295 does not use exclusive or mandatory language. It states that the Court "may" make the orders set out in that section, and contains no words excluding any other remedy. There is no doubt that s 295 gives flexible discretionary powers to a liquidator.

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[42] *McKinnon v Falla Holdings NZ Ltd (in liq)*, above n 7, at 262,037.
[43] *Grant v Lotus Gardens Ltd*, above n 6, at [56].
[44] At [56].

[39] It follows that we do not agree with the Associate Judge's view that *Nangeela* should have been distinguished by Chambers J on the basis that it was stating the law under the 1955 Act, and that it does not follow that the same law applies to the 1993 Act.[45] In our view *McKinnon* remains good law as to the interpretation of the 1993 provisions, and the consequences of not responding to a notice. Mr Perese argued that *McKinnon* was distinguishable on the basis that it was a summary judgment application. That is a material difference in procedure to a statutory notice, but it not relevant to the issue of whether a debt arises.

[40] We have concluded that the s 295 procedure is not exclusive. The setting aside of a transaction gives the liquidator a basis for recovery. That will usually be under s 295, but a liquidator may seek to recover a debt by different means.

[41] The Associate Judge has assumed that the benefit of flexibility, to allow the Court to mould a relief to fit the circumstances of the case, could be outflanked by liquidators seeking rights-based remedies.[46] We do not agree. The Court is not precluded, when an alternative procedure to a s 295 application is adopted, from reacting in a manner that is fair to both sides. This is demonstrated by the statutory demand procedure adopted here, which we now consider.

A creditor's ability to contest a statutory demand

[42] The liquidators have sought to obtain payment, not by seeking an order under s 295, but by issuing a statutory demand under s 289 of the 1993 Act for the non-payment of the voided transactions. Under s 290(4) of the 1993 Act:

> The Court may grant an application to set aside a statutory demand if it is satisfied that—
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> (a) there is a substantial dispute whether or not the debt is owing or is due; or
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> (b) the company appears to have a counterclaim, set-off, or cross-demand and the amount specified in the demand less the amount of the counterclaim, set-off, or cross-demand is less than the prescribed amount; or

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45 At [53].
46 At [71].

(c) the demand ought to be set aside on other grounds.

[43] We see the case of *OPC Managed Rehab Ltd v Accident Compensation Corporation* as of importance.[47] OPC had provided case management services to ACC. Following the termination of the contract between ACC and OPC, ACC formed the view that it had overpaid OPC by $695,190 and sought to recover the overpayment by serving a statutory demand on OPC. The High Court ordered that $334,000 be paid by OPC to ACC on the basis that a settlement agreement had been reached for that amount. OPC appealed on the grounds that there was no debt due and that there was a substantial dispute as to whether ACC had overpaid OPC. The Court stated that debts may arise in a variety of ways.[48] An obligation to pay could arise regardless of a Court order. The Court considered and applied *Nangeela*, and the views of McMullin and Somers JJ, that the liquidator could have recovered the amount of the voidable payment in an action for money had and received, concluding:[49]

> ... If a *payment is received in circumstances where the recipient is obliged to repay it*, whether because of a contractual or *statutory* provision to that effect or because the circumstances give rise to an *obligation to repay on the basis of money had and received*, *the amount can be treated as a "debt due" for the purposes of s 289(2)(a)*. If the defence provided for in s 94B or the equitable defence of change of position may be available to the recipient, that may mean that there is a substantial dispute which would justify the setting aside of the statutory demand, but it would not disentitle the payer from using the statutory demand procedure on the basis that the recipient's obligation to repay is a "debt due".

[44] As this decision demonstrates, when monies are received and an obligation to repay those monies to a liquidator arises, the amount in question can be seen as a debt due and as recoverable under s 289. A liquidator can recover the amounts involved in transactions set aside by a statutory demand, based on a debt due for money had and received.[50] The Court's discretion is wide, and s 290(4)(c) is broadly worded. If the claim of the liquidators is outweighed by some factor making it plainly unjust for liquidation to ensue, no liquidation will be ordered.[51] If there was

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47 *OPC Managed Rehab Ltd v Accident Compensation Corporation*, above n 31.
48 At [38].
49 At [54] (emphasis added).
50 *OPC Managed Rehabilitation (in liq) v Accident Compensation Corporation*, above n 31, at [49] and [54].
51 *Commissioner of Inland Revenue v Chester Trustee Services Ltd* [2003] 1 NZLR 395 (CA) at [3].

a receipt of the property where the conditions of s 296(3) arguably could be made out, then the Court would refuse to make an order.

[45] We consider whether such an argument is made out on the facts of this case later in this judgment. If there were factors that might lead a Court to decline to make an order for the payment of the sum sought under s 295 of the 1993 Act, or in the alternative for some different order to be made, then that could also be a consideration that would persuade a Court to refuse to liquidate the company under s 290. We agree with the observation of Chambers J in *McKinnon* that a party who has not been proceeded against under s 295 cannot be placed in a worse substantive position because the liquidator has chosen an unorthodox recovery route.[52]

[46] We would not wish to be seen as encouraging the use of s 289 processes as a remedy for liquidators claiming recovery for set aside transactions. The s 295 procedure is designed to deal with remedies following setting aside, and it is good practice to utilise that section. We note that despite the decision of Chambers J in *McKinnon*, no common practice seems to have arisen of liquidators proceeding by way of summary judgment. Liquidators who use the s 289 procedure, as has been the case here, could well find that they have taken an unnecessary step and are faced with a Court refusing to make an order for liquidation, ordering costs, and having to apply under s 295, having wasted creditors' funds on an unnecessary step.

[47] It is not necessary for the purposes of this decision to discuss the matters that can be taken into account in determining the appropriate orders and considerations that arise under s 295, following a setting aside. There are a number of High Court decisions that consider this issue.[53] We accept that, if in essence Lotus Gardens had not received the funds at all, and was just a conduit to pay them to the bank in settlement of Quantum Grow's indebtedness, a Court would refuse to direct payment under s 295. Orders setting aside the statutory demand should be made.[54] We will

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52 *McKinnon v Falla Holdings NZ Ltd (in liq)*, above n 7, at 262,042.

53 *Re Huberg Distributors Ltd (in vol liq) (No 2)* (1987) 3 NZCLC 100,211 (HC); *Re Ashton Gregory Promotions Ltd (in liq)* (1991) 5 NZCLC 67,075 (HC); *Re BMH Pools Supplies Ltd (in liq)* (1999) 8 NZCLC 261,944 (HC).

54 The Associate Judge referred to *Rea v Russell* [2012] NZCA 536. That was a case where the party receiving the funds was a trustee, and the recipient was the Trust. It was not a conduit case.

now consider whether it is arguable that Lotus Gardens received the $25,576.88 as a conduit as distinct from a creditor. If so, no order should be made liquidating Lotus Gardens.

This voidable preference

[48] Mr Norling challenges the Associate Judge's finding that it was arguable that the payments were received as a conduit. Associate Judge Bell held:

> [93] In this case Lotus Gardens Ltd *has done just enough to show that there is a genuine and substantial dispute whether Quantum Grow Ltd made the payments to it in the context of a creditor/debtor relationship, or whether Lotus Gardens Ltd simply received the payments as a conduit to forward the payments on to the Bank of New Zealand in the discharge of the indebtedness of Quantum Grow Ltd to the bank.* The evidence for Lotus Gardens Ltd is in Mr Canavan's second affidavit: see paragraphs [9] and [10] above. *The liquidators have adduced no evidence to refute it.* Neither of the reply affidavits by the liquidators directly address the issue. Mr Canavan was cross-examined. Some of the cross-examination was about the payments by Quantum Grow Ltd to Lotus Gardens Ltd. The cross-examination made the point that by far the majority of the payments between 3 March 2009 and 20 July 2010 were automatic payments of $1,523 each. If anything, that might support the contention that these were regular instalments, such as those that are made to a creditor providing financial accommodation, such as a bank. *The cross-examination did not destroy this part of Mr Canavan's evidence in his second affidavit.*
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> (Emphasis added).

[49] In his very first interview about the payments before he filed any affidavits, Mr Canavan stated under oath that Quantum Grow and Lotus Gardens had no connection other than him being a common director and Lotus Trust being a shareholder. This was his first response.

[50] In his affidavit of 8 February 2013 Mr Canavan stated on oath that Lotus Gardens had lent funds to Quantum Grow and that the $113,280.63, which included the $25,576.88, constituted a repayment of that loan. He stated that Lotus Gardens was a creditor that should have made a claim against Quantum Grow. This was his second response.

[51] However, Mr Canavan in his affidavit of 11 March 2013 put the matter differently. He did not maintain there were actual advances by Lotus Gardens to Quantum Grow. Rather he claimed there had been loans from the Bank of New Zealand to the trustees of the Lotus Trust and the Lotus Trust in turn re-advanced the funds to Quantum Grow to repay the bank. Mr Canavan asserted that the liquidators had all the paperwork in relation to the loan. He stated that the payments should have been going to the Lotus Trust BNZ account rather than the Lotus Gardens Ltd BNZ account and that this was a mistake. He deposed "this was an error by the office staff for Quantum Grow, but it wasn't picked up and fixed as quickly as it should have been." This was his third response.

[52] There were therefore three different and incompatible stories told by Mr Canavan about the payments. As Associate Judge Bell noted, Mr Canavan "has not helped his cause" by not providing copies of any bank statements of Lotus Gardens showing that the payments made by Quantum Grow to Lotus Gardens were in turn paid to the Bank of New Zealand.[55]

[53] In *Gladding King Holdings Real Estate Ltd (in liq) v King* Blanchard J observed in the context of a contested application to set aside:[56]

> ... both [counsel] said, and I agree, that a liquidator should not fail merely because the recipient of a disposition chooses not to put forward material evidence and that appropriate inferences should be drawn from such a failure to adduce evidence.

[54] Lotus Gardens is not in liquidation and it is a company controlled by Mr Canavan. He has stated on oath that the payments made by Quantum Grow were payments destined for the Bank of New Zealand and that they were paid to the Bank of New Zealand by Lotus Gardens. It is entirely inconsistent with the truth of that assertion for him, without explanation, to proffer no bank statements that could support the proposition he puts forward. He has chosen not to put the bank statements forward, which should be under his control, and the appropriate inference to be drawn is that this is because they do not help the Lotus Gardens claim.

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[55] At [11].

[56] *Gladding King Holdings Real Estate Ltd (in liq) v King* HC Auckland M2122/91, 2 September 1992 at 21.

[55] Mr Canavan gave evidence and was cross-examined before the Associate Judge. He gave evidence consistent with his third and final response. The Associate Judge made no credibility finding in relation to his evidence, while making it clear that he did not feel able to regard it as utterly discredited. He went no further than to say that he had done enough to show a genuine and substantial dispute. In setting out his reasons for this he noted: "The liquidators have adduced no evidence to refute it."[57]

[56] We do not agree that the liquidators should have been expected to have adduced such evidence. They would have had no access to the Lotus Gardens bank accounts and no ability to extract evidence from Lotus Gardens or its bank records. But Lotus Gardens would have had that information which would have helped it, if true, but which it chose not to produce. The limited means available to a liquidator to undertake investigations in the face of an uncooperative creditor are not to be underestimated. It is not appropriate to impose upon a liquidator an unduly onerous duty to prove that the payments to Lotus Gardens were not destined for the Bank of New Zealand; particularly when the alleged debtor should, without cost or delay, be able to provide the information.[58]

[57] In summary:

(a) Mr Canavan gave three different explanations as to the arrangements between Quantum Grow and Lotus Gardens.

(b) He failed to produce bank records which should have been in his possession to demonstrate the correct position, if they showed receipt as a conduit.

(c) Lotus Gardens, without excuse, failed to provide formal responses to the liquidators despite statutory requests that this be done, and despite being served with a notice to set aside.

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57 *Grant v Lotus Gardens Ltd*, above n 6, at [93].
58 *Leven v Rastkar* [2011] NZCA 210 at [10].

(d) Mr Canavan's story is inherently implausible. If the payments to Lotus Gardens were an error, it was an obvious and significant error, with weekly payments of approximately $1,523 being made into the Lotus Gardens account for a period of 72 weeks. No explanation is offered as to why payments would have been made to Lotus Gardens rather than the Lotus Trust or to the bank. No explanation is offered as to why the error was not observed and corrected.

(e) Mr Canavan did not credibly explain at any stage what the real commercial relationship was between Quantum Grow and Lotus Gardens. Initially he maintained there was no connection.

[58] Given that the Associate Judge made no direct credibility finding, and the undisputed facts that are available, we feel able to differ from his assessment. We do not accept the explanation given before the Associate Judge. A Court in this context is not obliged to accept the unsubstantiated and inherently unlikely assertions of a party who could substantiate the assertions with corroborative material, but does not do so.

[59] In our view there was no arguable defence that these payments were to Lotus Gardens as a conduit. For that reason we do not consider the statutory demand should be set aside.

[60] We note that the Associate Judge was of the view that there was no defence available under s 296(3). He took the view that a reasonable person in Mr Canavan's position as a director of Lotus Gardens would have appreciated the insolvency of the company at the relevant time.[59] We agree. Mr Canavan stated that he was aware Quantum Grow was "an extremely shaky company". Lotus Gardens cannot therefore have received these payments that are not adequately explained in good faith, and he must have had reasonable suspicion of insolvency.

[61] We are satisfied that Lotus Gardens had no defence under s 296(3).

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[59] *Grant v Lotus Gardens Ltd*, above n 6, at [97].

Result

[62] The appeal is allowed.

[63] The order dismissing the liquidation application is quashed.

[64] An order is made placing Lotus Gardens Ltd into liquidation.

[65] The appellant is entitled to costs on the appeal for a standard appeal on a band B basis and usual disbursements.

[66] The costs order in favour of the respondent in the High Court is quashed. In its place the appellant will have costs and reasonable disbursements calculated on a 2B basis. Any argument as to the quantum of costs is to be dealt with in the High Court.

Solicitors:
Waterstone Insolvency, Auckland for Appellants
Teei & Associates, Auckland for Respondent