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Article

Security interests and mortgages of goods

Steve Dukeson, Commercial Lawyer, Dukesons Business Law

Commercial lawyers will have had the occasion to consider whether certain types of security interests under the Personal Property Securities Act 1999 (PPSA) are mortgages of goods under the Property Law Act 2007 (PLA).[1] If you look for a detailed treatment of this issue in New Zealand, whether in text books, judgments, seminars, or legal writing, it would seem that you will be left largely wanting. The only consideration of the issue in any depth is found in an article by James Cooper.[2]

It is a hugely important issue. If a security interest is a mortgage of goods, the secured party may have to comply with some very onerous duties under the PLA. Failure to comply with some of these duties will amount to an offence and render the secured party, and any director (if the secured party is a company), liable to a fine of up to $10,000.

The key motivation for penning this article is the question of whether a common form of security interest, one arising where a lender has a security interest over goods to secure a loan, is a mortgage of goods (some diversions will take place along the way in dealing with that issue). For the purposes of this article, let's call that type of security interest a "loan security interest". It typically arises where a borrower wishes to buy goods with the loan or has goods against which to secure the loan.

A host of PLA provisions may apply if a security interest is a mortgage of goods under the PLA. Of particular importance in relation to a loan security interest, a secured party would have to give a notice that complies with s 128 of the PLA[3] before relying on an acceleration clause in the security agreement or on a power of sale, and should give notice under s 132 to covenantors (and former mortgagors) of intent to recover any deficiency after sale.[4]

By way of further example, if applicable, s 156 of the PLA imposes onerous notice obligations (including giving public notice) on a mortgagee of goods once they have entered into possession of goods.[5]

PPSA — s 114(4)

Section 114(4) of the PPSA states that if a security interest is a mortgage of goods, ss 128–136 of the PLA apply.[6]

The wording of s 114(4) is significant because it suggests some security interests may be a mortgage of goods and others may not. More on this later.

From s 114(1)(b), it would seem that where the security interest is a mortgage of goods, a s 114(1) notice must be given in the form required by regulations under the PLA. In that regard, it might be arguable that this only requires a pre-sale notice to be given and not any notice prior to relying on an acceleration clause (notice of which is required under s 128 of the PLA). However, s 114(a) states that where a security interest is a mortgage of goods, ss 128–136 of the PLA apply, so the better view would seem to be that where a security interest is a mortgage of goods:

- notice prior to reliance on an acceleration clause and prior to sale must be given as required by s 128 of the PLA; and
- the form of pre-sale notice to be given under s 114(1) of the PPSA must be as prescribed by regulations under the PLA.[7]

PLA — when is the PLA inconsistent with the PPSA?

The question arises as to what other provisions of the PLA may apply to a security interest that is a mortgage of goods. In that regard, there are two sections of the PLA that are critical starting points.

1. Note that neither the Personal Property Securities Act 1999 [PPSA] nor the Property Law Act 2007 [PLA] apply to taking possession of, or selling consumer goods, in relation to which Credit Contracts and Consumer Finance Act 2003pt 3A of the Credit Contracts and Consumer Finance Act 2003 applies.
2. James Cooper "Direct Enforcement of Security in Personal Property in New Zealand: Unhelpful Differences Between Acts" (2013) NZBLQ 44.
3. Unless an exception applies, such as under s 135 of the PLA.
4. Failure to serve a s 132 notice is only fatal to the extent to which the covenantor or former mortgagor can show prejudice caused by the failure.
5. There are some possible benefits of the PLA applying, for example, s 96 implies certain covenants into mortgages of goods, which might be of assistance where the secured party's documentation is lacking.
6. Personal Property Securities Act, s 114(5) states the term "mortgage" used in s 114(4) has the same meaning as in s 4 of the PLA
7. Where the mortgagee wants to rely on an acceleration clause, Form 2 as prescribed by the Property Law (Mortgagees' Sales Forms) Regulations 2007 provides for this, as well as for pre-sale notice.

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Section 8 states that if a provision of the PLA is inconsistent with a provision in another enactment, the provision in the other enactment prevails.

Section 78 provides that if a provision of pt 3 of the PLA (Mortgages) applies to a mortgage that creates or provides for a security interest to which the PPSA applies, the provision is supplementary to the PPSA but if the PLA provision is inconsistent with the PPSA provision, the PPSA provision prevails.

The elephant in the room in relation to these sections is the question of whether the PLA provisions that apply to mortgages over goods, where there is no equivalent under the PPSA, are to be treated as being inconsistent with the PPSA or merely as being supplementary to it.

For example, does s 156 of the PLA apply to a security interest that is a mortgage of goods? Where a mortgagee takes possession of mortgaged goods, s 156 requires the mortgagee to give notice to various persons, give public notice, and if the mortgagor is a company, give notice to the Registrar of Companies.[8] Against this, the PPSA does not require any notices to be given in relation to taking possession of goods, whether prior to, or after taking possession.

Roger Fenton took the view that s 156 may not apply, on the basis that it could be argued that s 156 is inconsistent with the PPSA — it would add obligations to those required by the PPSA.[9] Cooper argues that there is no inconsistency.[10] The issue does not seem to be clear cut because there clearly is an argument that if the PPSA does not expressly impose an obligation on a secured party, the PLA is inconsistent with the PPSA where the PLA does impose a duty, for example, in relation to taking possession of goods.[11] However, it is possible that Cooper's view will prevail, once fully tested in the courts.

Take another example, though this would only seem to be an apparent conflict, because the PPSA resolves it. Under s 107 of the PPSA, a debtor can contract out of the right to receive a pre-sale notice under s 114(1)(a). If there is a mortgage of goods, s 129 of the PLA requires a copy of the s 128 notice (notice by mortgagee of intent to sell) to be served on the current mortgagor. Given that s 114(4) of the PPSA says that ss 128–130 of the PLA apply where there is a mortgage of goods, it would seem to be more likely than not that despite contracting out of s 114(1)(a) of the PPSA, a debtor must be served with a s 128 notice under the PLA. The telling point is surely s 114(4)(b)(ii), which specifically states that in relation to a mortgage of goods, the persons to be served with a notice under s 114(1) are the persons referred to in ss 128 and 130 of the PLA instead of the persons referred to in s 114(1).

There seems to be a flavour that can be discerned from the few relevant cases that the courts are inclined to the view that if the PPSA does not expressly deal with a matter and the PLA does, the PLA will apply. For example, that in those circumstances, the PLA supplements what is in the PPSA. That is largely why it is probable Cooper will be proved right that s 156 of the PLA will apply to all mortgages of goods (above).

An example of that flavour can be seen in *Thorn v RDF*[12] where it was held that a mortgagor could redeem under either s 132 of the PPSA or s 97 of the PLA because these sections were seen to be to the same effect.[13]

The uncertainty as to when PLA provisions should be regarded as being inconsistent with provisions of the PPSA will only be cured by case law or legislation.

PLA — definition of mortgage

The starting point as to whether a PPSA security interest is a mortgage of goods is the definition of "mortgage" in s 4 of the PLA, which includes:

(a) any charge over property for securing the payment of amounts or the performance of obligations; and

(b) any registered mortgage; and

(c) any mortgage arising under a mortgage debenture.

In relation to (b), "registered" is defined so as to refer to instruments registered under various Acts relating to land or ships, and in relation to the PPSA, reads:

> (g) in relation to an instrument concerning personal property other than property referred to in paragraphs (c) to (f), means recorded in a financing statement registered in the personal property securities register kept under the Personal Property Securities Act 1999.

In relation to (c) above, "mortgage debenture" means: "an instrument creating a charge on property of a body corporate that comprises all, or substantially all, of the assets of the body corporate".

8. It is least a possibility that in some circumstances, a mortgagee may be able to exercise their power of sale without having to take possession. However, it is likely that in most circumstances, possession would be required or otherwise preferable.
9. Roger Fenton "Enforcement of Security Interests: A general guide to interpreting New Zealand's system of overlay Statutes" [2009] CSLB 15 at 18–19. See also, Fenton queried the application of ss 162–167 of the Property Law Act to security interests that are mortgages of goods at 17.
10. James Cooper, above n 2, at 53 and 55, as to the application of ss 162–167 of the PLA.
11. On the other hand, provisions of the PLA that do not add burdens where there are none under the PPSA can be seen to be truly supplementary, for example, covenants that are implied into mortgages of goods by virtue of s 96 of the PLA.
12. *Thorn v RDF Finance Ltd* [2012] NZHC 1959.
13. It can be questioned where s 97 of the PLA should have any application, given that s 132 of the PPSA expressly deals with redemption. At the very least, a mortgagor could not redeem under s 97 where, in terms of s 132(1), after default, they have agreed not to redeem. Gault assumes that any redemption should be under s 132 of the PPSA, see Thomas Gault (ed) *Gault on Commercial Law* (looseleaf ed, Brookers) vol 1.

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The definition of "mortgage" might be thought to be curiously drafted in some respects, though this is not the focus here. To pick just one possible curiosity, para (c) refers to registered mortgages — what of unregistered mortgages? The definition of mortgage in s 4 of the PLA is inclusionary, so there is scope to conclude that an unregistered mortgage is a mortgage under the PLA.

The PLA defines "mortgagor" as: "a person who is the owner of property that is subject to a mortgage".

That definition is a key pointer to the PLA being based on the traditional title concept of a mortgage being conferred by the owner of property. Conversely, the PPSA focuses squarely on the creation of a security interest.

It may be questioned why the PLA uses non PPSA terminology. Heath and Whale offer the following hypothesis:[14]

> ... it is probable that where legislation enacted after the Personal Property Securities Act, such as the Property Law Act 2007 or the voluntary administration provisions of the Companies Act, still uses terminology such as "mortgage" or "charge", rather than "security interest", this was done deliberately to ensure the relevant provisions applied only to mortgages or charges as traditionally conceived, rather than to the broader concept of a security interest.

Whatever the explanation, it seems clear enough that in determining whether there is a mortgage of goods under the PLA, the PLA focuses on traditional mortgage concepts. In *Conway v Mercedes-Benz Financial Services New Zealand Ltd*[15] and *Mercedes-Benz Financial Services New Zealand Ltd v Quadrant Wholesalers Ltd,*[16] the Court took the view that the PLA provisions are premised on the traditional concept of what constitutes a mortgage or charge.

Again, one thing that is clear is that not all security interests will be mortgages of goods.

In that regard, as will be seen later, the likely focus in relation to whether PPSA security interests are mortgages of goods will be primarily on whether they are "charges" over goods.

The key issue — what security interests are mortgages of goods under the PLA?

Reservation of title clause

It would be true to say that most lawyers never considered that a reservation of title would be a mortgage under the PLA.[17] There has been High Court authority to that effect for some time.

In *Conway v Mercedes-Benz Financial Services New Zealand Ltd*, the issue arose as to whether a reservation of title (in the context of a floor plan arrangement) was a mortgage of goods under the PLA. The Court of Appeal held there was not. The Court's reasoning can be summarised as follows:

- The PLA uses terminology that is consistent with an owner of property conferring rights, by mortgage or by charge, on another party over the property.
- On the other hand, as is made clear by s 24 of the PPSA, whether a party owns goods is irrelevant as to whether a security interest exists under the PPSA.
- A security interest may or may not be a mortgage or charge.
- A security interest deriving from a reservation of title is not a mortgage or charge — in traditional property law terms, it is not some form of right (mortgage or charge) conferred on another by the owner of the goods.[18] While a reservation of title was held to be a charge under the Companies Act 1993 in *Dunphy v Sleepyhead Manufacturing Co Ltd,*[19] that related to the definition of charge under the Companies Act, as interpreted in the light of the PPSA.[20]
- Section 114(4) of the PPSA distinguishes between security interests and mortgages in a way that only makes sense if the traditional, title based, approach is taken to the meaning of the term mortgage.

Many lawyers will not have an issue with *Conway* to the extent to which the Court concluded that a reservation of

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14. Michael Arthur *Heath and Whale on Insolvency* (loose-leaf ed, LexisNexis) at [25.5].
15. *Conway v Mercedes-Benz Financial Services New Zealand Ltd* [2017] NZCA 463.
16. *Mercedes-Benz Financial Services New Zealand Ltd v Quadrant Wholesalers Ltd* [2014] NZHC 1402 at [33].
17. Security interests under Conditional Purchase Agreements would be analogous.
18. This was the view taken in *Mercedes-Benz Financial Services New Zealand Ltd v Quadrant Wholesalers Ltd* [2014] NZHC 1402 at [30]–[34].
19. *Dunphy v Sleepyhead Manufacturing Co Ltd* [2007] NZCA 241, [2007] 3 NZLR 602.
20. James Cooper, above n 2, on the basis that a security interest under the PPSA may be a wider concept than a charge, Cooper considered the Court erred in stating that a reservation of title is a charge under the Companies Act 1993 at [48.50]. See also Michael Arthur *Heath and Whale on Insolvency* (looseleaf ed, LexisNexis) at [25.5], where it is stated:

    > If Parliament had intended the Personal Property Securities Act to alter the meaning of established concepts such as "charge" and "owned" in the Companies Act, it would have done so explicitly.

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title is not a mortgage of goods.[21] However, *Conway* goes no further than stating that a reservation of title (and any similar type of security interest) is not a mortgage over goods.

In passing, it should be noted that any argument that retention reservation of title have the same economic or "in substance" rationale as charges and mortgages so that they should be treated in much the same way (as is the case under the PPSA) would ignore the wording of the PLA, which seems to be predicated on encumbrances being conferred on goods by the owners of the goods.[22]

Further, in purely practical terms, the application of the PLA provisions to the typical supplier of goods subject to reservation of title could be a nightmare. Consider for example, the requirements under s 156 of the PLA. Suppliers of goods, many of whom would be small business operators, will not have the same systems and resources that secured lenders (as in banks and finance companies) would have to be able to deal with some of the more onerous obligations under the PLA in relation to mortgages of goods, and as a matter of both practicality and policy it can be questioned why trade suppliers should have to go through the same enforcement processes as secured lenders. Supply on the basis of the short-term provision of credit is a different ball game to secured lending.

Leases of goods

For much the same reason as reservation of titles, leases of goods would not give rise to a mortgage of goods under the PLA.[23]

Secured loan agreements

A common form of security interest is the loan security interest (arises where a lender provides finance on the security of goods, for example, where the borrower wishes to buy goods with the finance or has goods to secure the finance). These days, as would be expected, it is customary for a security agreement involving this type of financing to use PPSA terminology by stating that the secured party has a security interest over the goods — what else would be expected? Is this type of security interest a mortgage of goods? It is likely that this be held to be the case when considered by the courts (if necessary, at an appellate level) on the basis that a loan security interest is a "charge".

In that regard, while there does not seem to have been any detailed treatment of the issue in New Zealand, there are "scraps" of commentary here and there that suggest a loan security interest should be analysed as a charge.

For example, in relation to circulating assets, Michael Gedye wrote:[24]

> Although under the PPSA it is not necessary or desirable to conceptualise security interests in pre-Act terms, if this is done, the broadly based security interest over future circulating assets recognised by the Act is best viewed as a statutory fixed charge. It is statutory because it falls within the definition of security interest in s 17 and because its attributes are spelt out by ss 35 (except as otherwise provided, a security agreement is effective according to its terms), 40 (security interest attaches when statutory conditions met), 43 (security interest can cover after-acquired property) and 53 (security interest defeated by certain buyers and lessees), among others. It can be considered to be fixed rather than floating because it attaches in accordance with s 40 and not upon the happening of some later crystallising event.

Cooper wrote:

> What if a secured transaction is stated in a security agreement to be taken simply as a "security interest" under the PPSA, without any reference to the older forms of security? The Supreme Court of Canada has held that a transaction documented as a "security interest" is akin to the traditional charge, a view that has been endorsed in New Zealand. On that basis, a security under a security agreement that expressly creates a "security interest" would constitute a charge and thus a mortgage for the purposes of the PLA.

The Canadian Case to which Cooper referred to is *Bank of Montreal v Innovation Credit Union* where the Supreme Court said:[25]

> While the *PPSA* does not contain any provisions which identify the nature of a *PPSA* security interest in proprietary terms, the effect of the legislation is to create a statutory interest which is analogous to an inchoate property right. At the time the debtor gave the Bank its *Bank Act* security interest, Innovation Credit Union already held a valid security interest in the nature of a fixed charge.
>
> ...
>
> [47] After reviewing the relevant case law and academic commentaries, Gonthier J. concluded that the general security agreement taken under the Alberta PPSA could

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21. Such writing as there has been had accepted that reservation of titles are not mortgages of goods, for example, James Cooper "Direct Enforcement of Security in Personal Property in New Zealand: Unhelpful Differences Between Acts" (2013) NZBLQ 44; and Barry Allan *The Law of Secured Credit* (Thomson Reuters, NZ Ltd, Wellington 2016) at [14.5].
22. See James Cooper, above n 2, at 50, and 46–50 where Cooper muses over the reasons for the different terminology in the PLA when compared with the PPSA.
23. See Roger Fenton *Garrow & Fenton's Law of Personal Property in New Zealand* (7th ed, LexisNexis, 2010) at [21.22]; and Allan, above n 21, at [14.5].
24. Michael Gedye "The Structure of new Zealand's 'New' Priority Debts Regime" (2003) 9 NZBLQ 220.
25. *Bank of Montreal v Innovation Credit Union* [2010] SCC 47.

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> only be characterized as a fixed charge. (As we shall see in the companion appeal, the Court reached the same conclusion in respect of the Bank Act's security interest over both present and after-acquired property.) He found support in this conclusion from the fact that the academic literature was unanimous that PPSA legislation treats all charges, including floating securities, as fixed charges.

The following passage from *Stiassny v Commissioner of Inland Revenue* also offers some support for the view that the loan security interest should be considered to be a charge and therefore a mortgage of goods under the PLA:[26]

> [53] It was necessary to have [section 95] in the Act, along with s 94 (which applies to payments in money), so as to ensure that a person who has given a charge over their assets is able to carry on business and pay the creditors of the business. Sections 94 and 95 are, broadly speaking, intended as a replacement for the former position under a floating charge (before its crystallisation) now that there is a new regime where all security interests are treated as being at all times fixed in nature and there are no longer any securities which are recognised as operating as floating charges.

Though it is perhaps weak support in favour of loan security interests being mortgages under the PLA, there is also *Thorn v RFD Finance* where the High Court considered that a general security agreement (GSA) was a mortgage debenture and therefore a mortgage under the PLA.[27] It is likely that most corporate insolvency lawyers have assumed that GSA's are mortgage *debentures* under the PLA so that *Thorn v RFD Finance* would accord with that view.

The reason why *Thorn v RFD Finance* offers some support for loan security interests being mortgages of goods is because most GSA's, like secured loan agreements, simply refer to a security interest created over the property — the language of charging or mortgaging is not used (though it may be used in relation to other forms of property, for example, where the GSA creates a mortgage over interests in land). There does not seem to have been any requirement under the general law to use the term "charge" for a charge to be created. It follows that a security interest under the PPSA could be a charge even though the word "charge" is not used.

So much for sources that suggest that loan security interest is a charge. What is a charge? The term "charge" is not defined in the PLA. It has however been described in the Laws of New Zealand as: "a mere encumbrance providing the secured party, on the debtor's default, with a right to apply the charged personal property towards satisfaction of the debt or other obligation."[28]

That description is, more or less, relatively typical of various definitions of a charge that abound, and is compatible with a loan security interest that is conferred on a secured party by an owner of goods under the PPSA. Again, it can be noted that there does not seem to have ever been a requirement to use the word "mortgage" or "charge" to create a mortgage or charge.

As noted earlier, having regard to the definition of mortgage under the PLA and to the traditional difference between a mortgage and a charge, it seems likely that in determining whether a security interest is a mortgage as defined in the PLA, the focus would be on whether it is a charge.[29]

A brief comment about s 128 notices

Though it is a slight diversion from the main thrust of this article, it might be helpful to point out that there are cases on s 119 notices under the PLA, which would seem to be equally applicable to s 128 notices. This confirms that a mortgagee could use a s 128 notice to rely on an auto — acceleration clause or to call up money using an acceleration clause, but the mortgagee could not act on the acceleration until the notice expires. The mortgagee does not have to wait until the notice expires and then give a further notice or demand in exercise of the right to accelerate. See *Koroniadus v Bank of New Zealand,*[30] followed in *Debt Buyers Limited v Hancox.*[31]

This is an important "concession" because, in contrast to that time-saver, a COVID-19 inspired amendment to the PLA currently requires a mortgagee to give 30 working days' notice in the s 128 notice.[32] That is a very significant notice period, even more so where a default is not remediable.

As averted to earlier, s 135 sets out circumstances where there is no requirement to issue notices under ss 128

26. James Cooper, above n 2, at 49.
27. "Weak support" because while there may have been submissions by counsel on this issue, no reasons are given in the judgment for the Court's simple assertion that a GSA is a mortgage debenture and therefore a mortgage, for example, there was no discussion as to whether the security interest under the GSA was a charge. See also *Bank of New Zealand v Waewaepa Station 2002 Ltd* [2013] NZHC 3321 at [36]; and Michael Arthur *Heath and Whale on Insolvency* (looseleaf ed, LexisNexis) at [25.8(b)], where it is assumed that an all-assets security agreement (like a GSA) is a mortgage debenture.
28. Andrew Erueti *Laws of New Zealand* Personal Property Securities (online ed) at [3].
29. An exception would be where there is a GSA that secures goods. In that case, as noted previously, the assumption is that the GSA is a "mortgage debenture", though as defined, that in turn depends on the security interest being a charge.
30. *Koroniadus v Bank of New Zealand* [2015] NZCA 337.
31. *Debt Buyers Ltd v Hancox* [2015] NZHC 2484.
32. Property Law Act 2007, s 129B(2). The period would otherwise be a minimum 10 working days after the date of service of the notice under s 129(1)(c).

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or 132. A particularly important exception is where a mortgagee can rely on a mortgage debenture whether or not there is a collateral mortgage over those goods securing the same amounts.[33] Given that there is also an exception for inventory, ss 128 and 132 notices would only be required in relation to mortgages over goods that are equipment.

Impressions and suspicions

Most commercial lawyers, including their perhaps more specialised colleagues such as banking lawyers and corporate insolvency lawyers, take the view that the loan security interest is a mortgage of goods and that the typical GSA is a mortgage debenture.

On the other hand, it is possible there might be more than just a few secured parties who have not complied with their obligations under the PLA when enforcing their loan security interests. This may be out of ignorance, for example, they have never sought legal advice, or they may have been advised that the PLA does not apply when the better view may be that it does, or they may have chosen not to comply. In the latter regard, there may have been complete opting out or partial (for example, a secured party may have complied with ss 128–136 but not s 156). Cooper had noted that there was some evidence that secured parties may not be complying with the PLA.[34]

Headnotes

Alala International Ltd (in liq) v Chen

[2020] NZHC 2212

Companies Act 1993, ss 131, 135, 137, 194, 300, 301 — directors' duties — breach — reckless trading — failure to keep adequate accounting records — insolvency — liquidation — relief — full compensation

Fitzgerald J

Introduction

This case involved breach of directors' duties.

Alala International Ltd (in liq) (**the Company**) and the second plaintiffs (**the liquidators**) proceeded by way of formal proof against Mr Chen, the sole director and shareholder of the Company. The plaintiffs said that Mr Chen had breached duties owed by him to the Company and/or its creditors and had failed to keep adequate accounting records as required by s 194 of the Companies Act 1993 (**the Act**). The plaintiffs sought orders pursuant to s 301 of the Act that Mr Chen pay compensation to the Company.

At the heart of the plaintiffs' claim was the Company's purchase of a property in Queenstown (**the Property**) in November 2016 and its subsequent sale. After paying back a loan which had been taken out to part-finance the Property's purchase, the Company had received net proceeds of sale of approximately $1.8 million. The sale gave rise to a GST obligation on the part of the Company of around $330,000.

Despite the sale of the Property being profitable, the GST arising from it was not paid by the Company. Over the period October 2017 to April 2018, the net proceeds of sale were almost entirely disbursed to a range of parties, including to Mr Chen himself. This dispersal of the net proceeds of sale while the Company was incurring significant tax liabilities, which then could not be met, gave rise to the plaintiffs' claims.

Background

The Company was incorporated on 21 October 2011 with Mr Chen as the sole director. On 10 November 2016, Mr Chen entered into an agreement for sale and purchase of the Property. The purchase price was $2 million. Mr Chen subsequently nominated the Company as the purchaser.

The Company funded the purchase of the Property with an initial deposit payment of $200,000. The balance of the purchase price of the Property was funded by a bank cheque in the sum of $980,000, and a loan from Southern Cross Finance Ltd of $850,611, secured by a first ranking mortgage over the Property.

The Company sold the Property on 29 September 2017 for $2.8 million. Settlement occurred on 13 November 2017. On settlement, the Company received the net proceeds of sale of $1,810,246.01 (**the Net Proceeds**). This consisted of $190,300 from payment of the deposit, and $1,619,946.01 being the balance of funds received on settlement after repayment of the Southern Cross loan.

The Net Proceeds were deposited into the Company's bank account with Westpac Bank. Immediately prior to the deposit of those funds, the Company's bank account with Westpac had been in credit to the sum of $174,793.32 (**the Opening Balance**).

The sale of the Property gave rise to a GST obligation on the Company's part of approximately $330,000. Over the period 19 October 2017 to April 2018, the Opening Balance and Net Proceeds were gradually withdrawn from the Company's bank account. Amounts totalling approximately $915,000 (net) were withdrawn by Mr Chen and paid to himself. A number of other large withdrawals were also made in

33. Property Law Act 2007, s 135(1)(e).
34. James Cooper, above n 2, at 53–54.

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favour of other parties. At the end of March 2018, the Company's bank balance was $262.

In an interview with the liquidators, Mr Chen could not provide any clear reason for the payments out of the Company's bank account. He stated that he did not know what the payments related to, could not remember who the recipients of the funds were, or believed that they might be friends who had lent him money and he was paying them back.

In relation to the Company's tax liabilities, Mr Chen was unclear when asked about why the GST on the sale of the Property had not been paid when there ought to have been sufficient funds to do so. Compounding Mr Chen's lack of clarity, there were no proper accounting records in relation to the payments.

The Company ceased trading in August 2018. The Company was placed into liquidation on 3 May 2019 on the application of Inland Revenue. The second plaintiffs were appointed as liquidators. The Company had negligible assets at liquidation.

For the claims in the liquidation, Inland Revenue filed a claim for $503,398.99 plus petitioning the creditor's costs. The liquidators also received preferential claims from former employees of the Company totalling approximately $39,000, and other unsecured claims totalling approximately $35,250. All of the claims in the liquidation had been incurred after October 2017. Given the Net Proceeds, there ought to have been sufficient funds to pay back both these claims.

Issues

The Court had to decide whether:

- Mr Chen had breached his director's duties under ss 131, 135 and 137 of the Act;
- Mr Chen had failed to keep adequate accounting records; and
- relief should be awarded under s 300 or s 301 of the Act.

Court's findings

The Court started by considering whether the Company met the test for solvency. The plaintiffs submitted that the Company had been insolvent from 31 March 2012, and that there was "no question" that the Company was insolvent at the time the Opening Balance and Net Proceeds had been dispersed (at [32]). The Court agreed, although it said it was only necessary to reach a conclusion as to insolvency from the point at which the GST obligation had been incurred.

The Court then looked at the first cause of action, which was breach of director's duties. The plaintiffs argued that this was a case where there had clearly been no proper corporate governance applied to the Company for some time, and that Mr Chen had breached his duties in ss 131(1), 135 and 137 of the Act.

The plaintiffs' claims for the alleged breaches were brought under the mechanism provided by s 301 of the Act. Section 301's purpose was to compensate those who had suffered loss as a result of illegitimate trading. In *Mason v Lewis*, the Court of Appeal explained that claims brought pursuant to s 301 involved a two-stage evaluation. First, had there been a breach of a duty owed by a director to the company? Second, what was the appropriate relief, and should the director contribute to the company's losses?

The Court therefore looked at whether there had been a breach of any duties by Mr Chen. Starting with s 131, it was satisfied that there had been a breach. During the latter part of the Company's life, Mr Chen had effectively used the Company's monies as his own, including in the context of borrowing and repaying money from friends and other associates, and otherwise making significant payments to himself.

In addition, at a time when Mr Chen clearly knew of the Company's obligations to Inland Revenue, Mr Chen had diverted very significant resources to "projects" unconnected with the Company's business. There was no evidence that Mr Chen had conducted a proper analysis of whether such a significant proportion of the Company's funds should have been diverted in this way. It was difficult to see how such transactions could have been in the Company's best interests.

These actions were inconsistent with a director being cognisant of his obligations to a company and acting in its best interests. Indeed, it did not appear that Mr Chen was cognisant of his duties as a director, one of the first of his duties being "to actually come to grips with those duties" (at [43]). At the very least, there seemed to have been a blurring of the line between the Company's business and Mr Chen's own activities.

The plaintiffs submitted that Mr Chen had also breached s 135 of the Act, which concerned reckless trading. This occurred by dissipating the Opening Balance and the Net Proceeds at a time when the Company was insolvent, and by failing to cause the Company to be in a position to meet its tax obligations.

The Court was satisfied Mr Chen had breached s 135. The sheer inability of Mr Chen to explain or account for significant payments out of the Company's bank account gave rise to an inference that the funds were being used ultimately for his own personal benefit or for purposes unconnected with the Company's business.

Furthermore, dissipating the Opening Balance and the Net Proceeds in a relatively short time period meant that Mr Chen had caused the Company to be in a position where it was unable to meet its tax obligations, and he had thereby exposed it to further and ongoing liabilities by way of interest and penalties.

The plaintiffs also submitted that Mr Chen had breached s 137 of the Act, which was the director's duty of care. This was an objective test based on the standard of a reasonable director. The plaintiffs said that a reasonable director in the position of Mr Chen would not have caused or allowed the Company to trade in the manner that it had, incurring debts to creditors including Inland Revenue for unpaid pay as you earn income tax and GST without retaining sufficient funds to pay those debts, which then increased through penalties and interest.

A reasonable director would also not have allowed the withdrawal of the Opening Balance and Net Proceeds from

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the Company's bank account to or for the benefit of Mr Chen personally, when the Company was insolvent, without requiring security or any agreement to be signed.

The Court agreed that Mr Chen had breached s 137, particularly in more recent years, where he had not recognised the basic standards that would be expected of a company director. This included being "on top of" the quite significant payments out of the Company's accounts (at [53]); being able to account for and explain the substantial sums paid to himself; and ensuring that the Company was in a position to meet its tax and other liabilities as and when they fell due.

Mr Chen's ongoing mismanagement of the Company was against a backdrop of being warned by the Company's accountants in February 2014 that the Company was insolvent, and being made aware of the legal consequences of continuing to trade.

The Court then looked at the issue of what relief should be granted as a result of Mr Chen's breaches. In *Mason v Lewis*, the Court of Appeal had articulated a three-pronged approach to considering whether to grant relief under s 301. The first prong, causation, was concerned with the link between the carrying on of the company's business recklessly, to the knowledge of the impugned director, and the indebtedness of the company for which personal liability was sought. The second prong, culpability, reflected the deterrent purpose of the provision. In cases involving a high degree of culpability, punitive as well as compensatory orders could be accommodated. The third prong was the duration of the wrongful trading.

The plaintiffs focused on the period from 2017 onwards, when the Property had been bought and then on-sold, coupled with the ongoing dissipation of the Net Proceeds and Opening Balance. October 2017 was the "breach date", being one month after the sale of the Property and when the dispersal of the Net Proceeds and Opening Balance had begun. April 2018 was the "end date", being the point at which the Company's funds had been almost fully disbursed.

The Court accepted that the causation analysis in this case was straightforward, given Mr Chen's wholesale failure to take appropriate steps to ensure the Company met its GST obligations on the sale of the Property, which in turn had caused the majority of the Company's losses.

There was no satisfactory explanation from Mr Chen as to why steps had not been taken to ensure that the Company could meet its debts, or any suggestion that even had Mr Chen fulfilled his statutory duties, the loss would have been incurred in any event — particularly given that there ought to have been plenty of funds available to meet the claims in the liquidation.

Turning to culpability, the Court was not prepared to infer bad faith on Mr Chen's part. Instead, the situation had more likely arisen through Mr Chen failing to understand and implement his duties as a director of a company, and failing to recognise the separate corporate identity of the Company. However, his culpability was not at the level of "muddle-headedness" only (at [61]). The degree of culpability was at the moderately serious end of the spectrum.

There was a reasonably high degree of culpability because no steps had been taken by Mr Chen to rectify the Company's position. Mr Chen had been on notice from at least early 2014 of the Company's precarious finances. The situation had deteriorated significantly from 2017 onwards and there had been a choice to cause the Company to make the large payments. There was also a failure to keep proper accounting records of the suggested loan transactions and payments.

Turning to duration, the period in question was October 2017 to April 2018. It was not a particularly lengthy period, especially when measured against other authorities. But the relatively short period involved did not improve Mr Chen's position. The period was only short because Mr Chen had swiftly directed the dissipation of all of the Company's funds.

Drawing these threads together, the Court was satisfied that a compensatory award of damages pursuant to s 301 was appropriate. The question was the quantum of that award.

The Court said it was difficult to justify less than 100 per cent of recovery in circumstances where there had been a clear causative link between Mr Chen's mismanagement of the Company and the incurring of its losses, and a reasonably high degree of culpability. It was appropriate to award full compensation of the losses incurred by the Company, at least in relation to the claims in the liquidation.

The overall effect of this award was to shift the financial consequences of Mr Chen's breaches from the Company and its creditors to Mr Chen. This was fair in the circumstances. The Court ordered pursuant to s 301(1)(b)(ii) of the Act that Mr Chen pay compensation to the Company in the sum $580,248.24.

The Court then looked at the second cause of action, which was Mr Chen's failure to keep adequate accounting records.

Directors were obliged under s 194(1) of the Act to ensure a company's records correctly explained the company's transactions. Directors were also obliged to enable the company's financial position to be determined with reasonable accuracy at any time, and its financial statements to be readily and properly audited.

There was no doubt that Mr Chen had failed in his obligations to keep proper records of the Company. In particular, he had failed to record and explain the funding of the purchase of the Property, and correctly record and explain the dissipation of almost the entirety of the Opening Balance and Net Proceeds.

The plaintiffs sought orders requiring that Mr Chen pay the sum of $10,000 to the plaintiffs pursuant to s 300(1) of the Act. That amount was the liquidators' best estimate of the additional costs of the liquidation caused by Mr Chen's failure to keep proper accounting records. This was the cost of the liquidators having to reconstruct the accounts as much as could possibly be done.

The Court was satisfied that the elements required for a successful claim under s 300 were made out. In particular, Mr Chen's failure to comply with his duty to keep adequate accounting records had resulted in substantial uncertainty as to the financial position of the Company.

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The liquidation had also been substantially impeded, given the sheer lack of information about the Company's business and the transactions from October 2017 onwards. Given that the costs of the liquidation were higher than they would have been had proper accounting records been kept, it was appropriate that Mr Chen, who had caused that state of affairs to come about, meet the cost.

The Court made a declaration against Mr Chen pursuant to s 300 of the Act that he was personally liable for the sum of $10,000, payable to the Company.

Judgment

The plaintiffs succeeded on both causes of action. Mr Chen was ordered to pay compensation in the sum of $580,248.24 to the Company under s 301, and was also personally liable for the sum of $10,000 to the Company under s 300.

Cases cited in judgment

Boutique Tanneries Ltd (in liq) v Handley HC Auckland CIV-2006-404-2713, 24 July 2008;
Löwer v Traveller [2005] 3 NZLR 479 (CA);
Madsen-Ries v Twine [2015] NZHC 227;
Mason v Lewis [2006] 3 NZLR 225 (CA);
Morgenstern v Jeffreys (2014) 11 NZCLC 98-024, [2014] NZCA 449;
Nicholson v Permakraft (NZ) Ltd (in liq) [1985] 1 NZLR 242 (CA);
Sojourner v Robb [2007] NZCA 493, [2008] 1 NZLR 751; and
Thom Contractors Ltd (in liq) v Thom HC Auckland CIV-2008-404-6829, 28 April 2009.

Daniel Neighbour
Freelance Contributor

Re Metlifecare Ltd

[2020] NZHC 2752

Companies Act 1993, s 236 — scheme of arrangement — approval — material adverse change — opposition — honest and intelligent business person

Lang J

Introduction

This case involved opposition to a scheme of arrangement.

The applicant, Metlifecare Ltd (**Metlifecare**), was a publicly listed company. It sought an order under s 236 of the Companies Act 1993 (**the Act**) approving a scheme of arrangement. The scheme involved Asia Pacific Village Group Ltd (**Asia Pacific**) acquiring all shares in Metlifecare for $6 per share.

Asia Pacific supported the application. Until late in proceedings, the application had been opposed by one of Metlifecare's shareholders, ResIL Ltd (**ResIL**). ResIL had withdrawn its opposition to the scheme after the Takeovers Panel had announced that it proposed to issue a letter indicating that it had no objection to the orders being made under s 236 of the Act (**the "no-objection" statement**).

The Court had to decide whether to approve the scheme.

Background

Asia Pacific had previously tried to acquire Metlifecare's shares. On 29 December 2019, Metlifecare and Asia Pacific had entered into a scheme implementation agreement (**the earlier SIA**) under which Asia Pacific had agreed to acquire all of the shares in Metlifecare for $7 per share. No issues had arisen under the earlier SIA until New Zealand encountered the COVID-19 pandemic in March 2020.

The earlier SIA had permitted Asia Pacific to terminate the agreement if a Material Adverse Change or a Prescribed Occurrence occurred before the arrangement was implemented. On 28 April 2020, Asia Pacific had served Metlifecare with a notice terminating the earlier SIA.

Asia Pacific relied on two grounds. First, it alleged that the emergence and spread of COVID-19 in New Zealand constituted a Material Adverse Change under the earlier SIA because it had reduced, or was reasonably likely to reduce, Metlifecare's consolidated net tangible assets and underlying net profit. Second, it alleged that several acts by Metlifecare constituted Prescribed Occurrences under the earlier SIA.

Metlifecare did not accept that Asia Pacific had validly terminated the earlier SIA. It affirmed the agreement by issuing proceedings seeking a declaration that the earlier SIA remained in force, and orders requiring Asia Pacific and those standing behind it to perform their obligations under the earlier SIA.

In July 2020, while the litigation was still in its early stages, Asia Pacific approached Metlifecare with a new indicative non-binding offer under which it proposed to acquire the shares for the reduced price of $6 per share. Metlifecare's directors consulted institutional shareholders and concluded that the revised offer should be put to shareholders for their consideration.

Metlifecare's board then entered into an agreement (**the new SIA**) with Asia Pacific under which it agreed to place a new scheme of arrangement before shareholders involving the sale of all of Metlifecare's shares to Asia Pacific for the sum of $6 per share. As a condition of entering into the new SIA, Metlifecare agreed to settle the litigation relating to the earlier SIA.

In accordance with the Court's directions, Metlifecare convened a shareholders' meeting so that the shareholders could consider and vote on a resolution that the company should proceed with the new SIA. Prior to the meeting, the company had provided the shareholders with a Scheme Booklet containing information about the scheme. This included an Independent Advisors Report (**IAR**) prepared by Calibre Partners, a consultancy company. That firm had prepared a similar report in relation to the earlier SIA. As it had done with the earlier SIA, the IAR had placed the value of Metlifecare's shares as at 30 June 2020 in a range between $5.80 and $6.90 per share.

In order for the resolution to be carried a simple majority of shareholders present at the meeting needed to vote in favour of it. In addition, shareholders holding at least 75 per cent of all shares for which votes were cast needed to be in

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favour. A significant number of shareholders attended the meeting in person, by proxy and online. A clear majority of those attending the meeting voted in favour of the resolution. Of votes cast at the meeting based on shareholding, 90.70 per cent were in favour of the resolution and 9.14 per cent were opposed to it. The voting results prompted Metlifecare to seek the Court's approval of the scheme.

ResIL opposed the scheme. It owned 1,000 shares in Metlifecare and 7,000 retail bonds issued by Metlifecare. The sole shareholder and director of ResIL was Mr Priscott, a lawyer and accountant with experience in commercial investment. Mr Priscott initially acquired the shares and bonds after the proposed scheme had been announced and had then transferred them to ResIL on 3 September 2020.

ResIL objected to the scheme because Mr Priscott considered that the information Metlifecare provided to its shareholders in a Scheme Booklet was inadequate and/or misleading and incorrect. He therefore claimed that the shareholders had been unable to make an informed decision as to whether and how they should vote on a resolution proposing that the shareholders approve the scheme. He also contended that the scheme was not one that an intelligent and honest business person would agree to.

No other parties had raised objections like ResIL had done. All shareholders were in the same class, so no issues arose as to differential treatment between classes of shareholders. Furthermore, no objection had been taken to the manner in which Metlifecare had convened the meeting of shareholders or the manner in which votes were cast and/or counted. In addition, Asia Pacific had obtained consent to the transaction proceeding under the relevant provisions of the Overseas Investment Act 2005. Finally, the Takeovers Panel had issued a "no-objection" statement in relation to the scheme.

ResIL had ultimately withdrawn its opposition in light of the Takeovers Panel's statement. However, this did not alter the position so far as the Court was concerned. The Court proceeded to consider ResIL's objections and whether the scheme should be approved.

Issues

The Court had to decide whether the scheme:

- had been fairly put to shareholders; and
- was one that an honest and intelligent business person could support.

Court's findings

The Court first considered whether the scheme had been fairly put to shareholders.

Mr Priscott contended that the Scheme Booklet sent to shareholders before the meeting on 2 October 2020 was deficient in several respects. He relied on an observation from *Re HIH Casualty and General Insurance Ltd* in support.

The Court derived considerable comfort from the fact that the Takeovers Panel had issued its "no-objection" statement after considering the same material that was before the Court.

In a letter dated 19 October 2020 to Metlifecare, the Takeovers Panel had stated that it had given particular focus to the concerns raised by ResIL. It had decided that, whether considered individually or in aggregate, those concerns should not have prevented the Takeovers Panel from issuing a no-objection statement in respect of the proposed scheme. The Court said it was significant that the Takeovers Panel had independently concluded that Metlifecare had provided shareholders with sufficient material to satisfy the Takeovers Code requirements.

Mr Priscott submitted that a small number of institutional shareholders had placed inappropriate pressure on Metlifecare's directors to abandon the litigation against Asia Pacific and enter into the new SIA. This had arisen from events that occurred in the weeks following the announcement of the earlier SIA. During this period there had been significant changes in the composition of Metlifecare's institutional shareholder base. Once the scheme had been announced to the NZX and ASX, several sophisticated offshore financial institutions had acquired significant parcels of Metlifecare shares, principally from domestic institutions.

Mr Priscott said that it was relatively common for such entities to acquire shares in companies that were the subject of a takeover bid that was yet to be completed. Their objective was to earn short-term profits representing the difference between the prevailing share price and the final price shareholders would receive when the takeover was eventually completed.

The purported termination of the earlier scheme left these institutions in a difficult position. They had bought the shares in the expectation that Asia Pacific would acquire them within a short space of time for the sum of $7 per share. They had not anticipated that the scheme's implementation would be derailed due to events flowing from the COVID-19 pandemic. Once Asia Pacific had purported to terminate the earlier SIA, Metlifecare's share price had dropped significantly. It also became evident that the company would face a considerable period of uncertainty, possibly lasting two years, while the litigation ran its course.

Mr Priscott submitted that shareholders affected in this way had placed significant and inappropriate pressure on Metlifecare's directors to reopen negotiations with Asia Pacific. This had led to Asia Pacific making its revised offer on 20 July 2020 and the directors entering into the new SIA on behalf of the company.

Mr Priscott said that the Scheme Booklet had advised shareholders that the majority of shareholders who had been canvassed had informally supported the new scheme. These included the NZ Superannuation Fund, which owned 19.86 per cent of Metlifecare's shares. The Scheme Booklet did not, however, disclose the identity, character, interests or role played by those shareholders other than the NZ Superannuation Fund who had indicated early support for the scheme. Shareholders therefore did not know that many of those canvassed by the company's financial advisor were overseas hedge funds with highly strategic and short-term investment interests.

Mr Priscott argued that this meant that the shareholders could not make an informed decision as to whether to

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follow the lead of those shareholders and/or to place weight on the fact that a majority of directors had supported the scheme.

The Court said that the issue of whether Metlifecare's board ought to have entered into the new SIA and abandon the litigation against Asia Pacific was not relevant for the present purposes. That had already occurred by the time Metlifecare had sent out the Scheme Booklet to shareholders in anticipation of the meeting to be held on 2 October 2020. Mr Priscott's concern was based on his view that the Scheme Booklet should have identified the institutions who had already indicated support for the new offer, and also advised shareholders of their likely motivation for doing so.

The Court also did not accept that the Scheme Booklet should have contained this level of detail. It was for shareholders to decide whether to vote for or against the scheme based on their own circumstances and not those of other shareholders. In any publicly listed company, the aims and aspirations of shareholders differ. Some would acquire shares with a view to realising capital gains and/or dividends over time, whilst others would hope to sell within the short to medium term. The respective positions of these two groups may be irreconcilable where, as here, an offer was made for the acquisition of all the shares in a company for a cash consideration.
Metlifecare's shareholders therefore needed to consider their own positions when deciding whether to vote for or against the resolution. They did not need to know the identity of the institutional shareholders who had already indicated their support for the scheme or why those shareholders held that view. If individual shareholders were interested in those issues, they were free to attend the meeting and to ask questions about them.

Another argument raised was in relation to the methodology used in assessing the range of values for Metlifecare shares. ResIL produced a report prepared by Campbell MacPherson, a firm that provided advisory services including share valuations and advice on mergers and acquisitions. The report criticised numerous aspects of the methodology used by Calibre Partners in assessing the range of values within which Metlifecare's shares lay as at 30 June 2020. Calibre Partners responded to these criticisms in an affidavit.

The Court did not consider it helpful to analyse these issues for several reasons. First, any attempt to reach a firm view on the competing arguments without the benefit of cross-examination was futile. Second, it was clear that all of the issues were at least contestable and that any difference in ultimate outcome if the criticisms were valid was likely to be minor.

Third, some of the points raised by ResIL would have required the IAR to descend to a level of detail that would have hindered shareholders in making their decisions whether to vote in favour of the resolution. Fourth, given the number and breadth of the complaints made about Calibre Partners' methodology, one would have expected the Campbell MacPherson report to conclude that the Calibre Partners report had significantly undervalued Metlifecare's shares. But this was not the case and implicit within the conclusion was a concession that the share value as at 30 June 2020 may have been within the range identified by Calibre Partners in the IAR.

Finally, it was significant that the range of values identified in the second IAR was identical to that contained in the IAR prepared in relation to Asia Pacific's earlier offer to acquire the shares for the sum of $7 per share. By August 2020, the shareholders were acutely aware that Asia Pacific was offering to pay significantly less for their shares than had been the case just seven months earlier. This was despite the fact that, on Calibre Partners' analysis, the underlying value of the shares had not altered notwithstanding any issues created by the COVID-19 pandemic.

The Court said that the fact that more than 90 per cent of shares nevertheless voted in favour of the lower offer suggested that a slightly higher valuation was unlikely to have made any difference. Shareholders knew they were being offered a "take it or leave it" deal and they had elected to take it.

The Court therefore considered that the Scheme Booklet had fairly put the offer to shareholders and that any deficiencies in the IAR were unlikely to have affected the view that shareholders had taken of the scheme.

The next issue to consider was whether the scheme was one that an honest and intelligent business person could have supported. Where there were competing interests, the Court had to also consider whether the scheme was fair and equitable.

Mr Priscott said he would have preferred the directors to continue with the litigation against Asia Pacific, but that this option had no longer been available by the time of the shareholders meeting on 2 October 2020. Mr Priscott did not question the honesty of any of the shareholders who had voted in favour of the scheme, nor did he suggest that the directors and/or shareholders who had supported the scheme had acted inappropriately or in a coercive manner towards shareholders who either did not support the scheme or were undecided.

The institutional shareholders who had formed part of the majority had been motivated to sell their shares by the circumstances in which they had found themselves after Asia Pacific had purported to terminate the earlier SIA. The Court said that this did not call into question their right to act in what they perceived to be their own best interests. The institutional shareholders had the same rights as other shareholders. The test applied by the Court proceeded on the basis that all shareholders were entitled to vote in a manner that they considered to be in their own best interests.

Mr Priscott submitted that only 69.9 per cent of all shares in Metlifecare had ultimately voted in favour of the scheme. This was significantly lower than the threshold of 90 per cent that would have been required if Asia Pacific had wished to proceed to full acquisition of shares in the company under the Takeovers Code. The Court accepted this argument but did not see it as advancing ResIL's case materially because the procedure for schemes of arrangement under pt 15 of the Act prescribed its own thresholds.

ResIL's real complaint was that the price of $6 per share amounted to a "lowball offer" (at [51]) that no intelligent

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business person would have accepted. It also pointed out that the present scheme had attracted less support from shareholders than was the case in six other acquisition schemes between 2016 and 2019. In those other cases the votes cast in support of the proposed scheme had ranged between 99.3 per cent and 93.8 per cent.

The Court said that this submission needed to be viewed in light of the fact that the schemes to which ResIL had referred did not have the unfortunate background that this one possessed. By the time the shareholders had come to consider the current offer, they were in possession of several pieces of information that were likely to have affected their view of the scheme.

The most obvious of these was the fact that Asia Pacific had been prepared to pay $7 per share just a few months earlier. Shareholders would have been entitled to wonder why the current offer was at such a reduced price when the IAR indicated the value of the company's shares fell within the same range as it lay at the time of the earlier offer. It was therefore not surprising that some shareholders may have had reservations about the level of the current offer.

The Scheme Booklet also advised shareholders that it had only enjoyed the support of three of the five directors. Furthermore, those directors had not provided an unqualified recommendation in favour of the scheme.

In addition, the Shareholders Association had distributed a circular to its members on 17 September 2020 pointing out the shortcomings and disadvantages that it considered the scheme held for Metlifecare's shareholders. The circular advised members that the Shareholders Association proposed to vote the undirected proxies entrusted to it against the resolution.

The Court said that given all of this, the fact that more than 90 per cent of votes were cast in favour of the scheme was a strong endorsement by the shareholders. It clearly suggested that the scheme was broadly supported by the shareholders who had attended the meeting. It also needed to be borne in mind that many, if not all, of the institutional shareholders who voted in favour of the scheme were obviously sophisticated and intelligent investors. They would have been acutely aware of the background and nevertheless they voted in favour of the scheme.

Several other factors also suggested that the scheme was one that an intelligent business person could reasonably support. First, the offer of $6 per share was within the valuation range assessed by Calibre Partners in the IAR, albeit at the lower end of that range. Second, the offer represented a premium of 14.9 per cent over the price Metlifecare's shares were trading at immediately before Asia Pacific's new offer had been announced. This compared favourably with the premium of 13 per cent received by shareholders in *Re Fliway Group Ltd*.

An intelligent business person would also have been aware that rejection of the scheme would inevitably have caused the company's share price to fall sharply in the short to medium term. It was likely that it would have fallen at least to where it stood prior to the announcement of Asia Pacific's current offer. The price could easily have fallen lower than that because the institutions who had bought parcels of shares after the announcement in July 2020 may well have sold them immediately once it became clear that the new scheme was not going to proceed.

Finally, two factors suggested that ResIL and Mr Priscott did not speak for a significant proportion of Metlifecare's shareholders. ResIL was the owner of a very small parcel of shares that it had bought well after Asia Pacific's offer had already been announced. It was therefore fully aware that the shares were likely to be acquired by Asia Pacific. This meant that ResIL could not claim to represent the interests of long-term shareholders.

This led to the second point, which was that ResIL's opposition to the present application did not act as a catalyst for other shareholders who did not vote against the scheme at the meeting to voice their opposition to the scheme. There was no evidence that shareholders who had not attended or voted at the meeting on 2 October 2020 now supported ResIL's opposition to the scheme.

The Court said that the shareholders in Metlifecare were obviously entitled to feel disappointed that they were not going to realise the premium available under Asia Pacific's earlier offer. Some would also undoubtedly have shared Mr Priscott's view that the directors should have pursued the litigation against Asia Pacific notwithstanding the delay and continued uncertainty it involved.

Taking all relevant factors into account, the Court considered that the scheme was one that an intelligent business person could reasonably support. Those factors also meant that it was fair and equitable that the scheme be permitted to proceed.

Judgment

The Court made final orders in terms of the draft orders tendered by counsel for Metlifecare at the hearing. The orders were to take effect immediately.

Cases cited in judgment

Re CM Banks Ltd [1944] NZLR 248 (SC);
Re Fliway Group Ltd [2017] NZHC 3216;
Re HIH Casualty and General Insurance Ltd [2006] NSWSC 485, (2006) 57 ACSR 791;
Re Nuplex Industries Ltd [2016] NZHC 1677; and
Weatherston v Waltus Property Investments Ltd [2001] 2 NZLR 103 (CA).

Daniel Neighbour
Freelance Contributor

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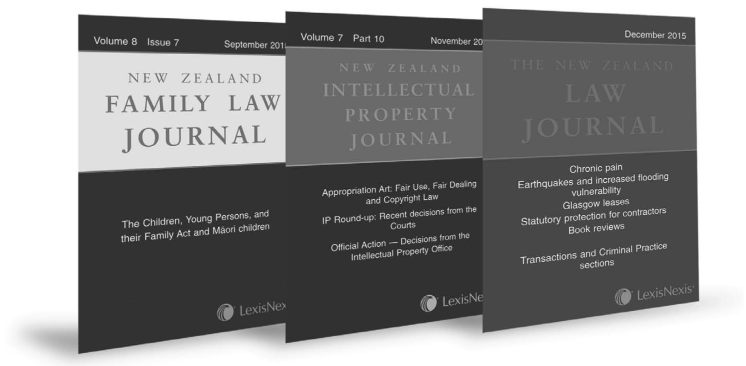

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