

**IN THE HIGH COURT OF NEW ZEALAND  
HAMILTON REGISTRY**

**I TE KŌTI MATUA O AOTEAROA  
KIRIKIROA ROHE**

**CIV-2022-419-239  
[2025] NZHC 974**

|               |                                                                                                                                                                                                                                                 |
|---------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| UNDER         | Part 18 of the High Court Rules 2016 and<br>the Companies Act 1993                                                                                                                                                                              |
| IN THE MATTER | of the liquidation of John. S. MacDonald<br>Builders Limited (in Liquidation)                                                                                                                                                                   |
| BETWEEN       | WARWICK BRUCE BATLEY and HELEN<br>WILHELMINA CATHARINA VAN GOCH<br>as trustees of the BATLEY FAMILY TRUST<br>First Plaintiffs<br><br>NIDHA SINGH and VED PRAKASH<br>SINGH as trustees of the V P & N SINGH<br>FAMILY TRUST<br>Second Plaintiffs |
| AND           | JOHN STEWART MACDONALD<br>Defendant                                                                                                                                                                                                             |

Hearing: 3 March 2025

Appearances: N Malarao and J Cordeiro for First and Second Plaintiffs  
No appearance for Defendant

Judgment: 28 April 2025

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**JUDGMENT OF WILKINSON-SMITH J**

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*This judgment was delivered by me on 28/04/2025 at 3 pm  
Pursuant to Rule 11.5 of the High Court Rules*

.....  
*Registrar/Deputy Registrar*

Solicitors:  
Norling Law Ltd, Auckland  
N Malarao, Auckland

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## **Introduction**

[1] The plaintiffs sue John Stewart MacDonald, for breach of director's duties following the liquidation of a construction company, John S. MacDonald Builders Ltd (in liq) (JSMB). Mr MacDonald placed JSMB into liquidation on 18 January 2021.

[2] Both plaintiffs are unsecured creditors in the liquidation of JSMB.

[3] The first plaintiff, the Batley Family Trust, entered into a construction contract with JSMB around 28 September 2020 for the construction of a house in Cambridge.

[4] The contract required the Batley Family Trust to pay a deposit of \$115,000, which it paid. Construction on the house ceased on 23 December 2020. Mr MacDonald placed JSMB into voluntary liquidation on 18 January 2021, owing the Batley Family Trust a total debt of \$116,777.55, comprising their deposit and a subcontractor invoice.

[5] The second plaintiff, the V P & N Singh Family Trust, entered into a construction contract with JSMB around 23 September 2020 for the construction of two residential units in Hamilton.

[6] The V P & N Singh Family Trust paid a deposit of \$172,500 to JSMB before JSMB went into liquidation. Construction on the V P & N Singh Family Trust property ceased on 18 December 2020.

[7] The plaintiffs' case is that Mr MacDonald, as the sole director, breached his director duties by causing JSMB to trade recklessly and by allowing JSMB to incur obligations that he knew it would not be able to meet.

[8] The plaintiffs seek compensation from Mr MacDonald for their losses under ss 135, 136 and 301 of the Companies Act 1993 (Act).

## **Background**

[9] JSMB was incorporated on 31 August 1998. Mr MacDonald is the sole director and shareholder.

[10] In 2020, Mr Batley and Ms van Goch, as trustees of the Batley Family Trust, had obtained building consent to build a house in Cambridge. Mr Batley approached Mr MacDonald as a prospective builder. Mr MacDonald reviewed the plans for the house and said that his company could undertake the build.

[11] On 25 September 2020, prior to an agreement being reached between the Batley Family Trust and JSMB, JSMB sent an invoice to the Batley Family Trust for the payment of a deposit in the sum of \$115,000 (including GST).

[12] On 28 September 2020 a registered Master Builders charge-up building contract was signed between the Batley Family Trust and JSMB. The contract provided that:

- (a) JSMB would construct the dwelling at the property in accordance with the drawings and specifications and estimate and tags dated 21 August 2020;
- (b) the contract was a charge-up contract, with the contract price being the total of all charge-up claims inclusive of GST, subject to adjustments provided for in the contract;
- (c) the start date for the construction works would be 12 October 2020;
- (d) the expected completion date for the works would be 20 December 2021;
- (e) the trust would pay a deposit to JSMB of \$115,000 (inclusive of GST);  
and

- (f) future payment claims by JSMB would be deducted from the deposit until those payment claims had been fully recovered.

[13] Mr MacDonald confirmed in an email to Mr Batley on 28 September 2020 that the deposit of \$115,000 would be used to settle payment claims from JSMB until the deposit had been fully used up.

[14] The deposit was paid on 29 September 2020.

[15] On 9 November 2020, JSMB's quantity surveyor, Blake Stevens, emailed Mr Batley asking whether the contract had been signed as he did not recall receiving a copy. Mr Batley replied by email to Mr Stevens attaching a copy of the contract signed by himself and Ms van Goch. Mr Stevens then advised that he would print an original hard copy of the contract for all parties to initial and sign at their next meeting.

[16] Ms van Goch and Mr Batley met with Mr MacDonald and Mr Stevens on 19 November 2020 at JSMB's offices. At this meeting Mr MacDonald and Mr Stevens produced a registered Master Builders' Association residential building contract and requested that Ms van Goch and Mr Batley sign the contract.

[17] Mr Batley deposes that the contract printed on 19 November 2020 appeared identical to the original contract that he and Ms van Goch had signed and provided by email. They nevertheless agreed to sign a further hard copy.

[18] In fact, the contract printed on 19 November 2020 did not include the clause which said that future payment claims by JSMB would be deducted from the deposit paid by the trust (Deposit Deduction Clause). The removal of the Deposit Deduction Clause was not drawn to Mr Batley or Ms van Goch's attention prior to them signing the hard copy contract on 19 November 2020. Mr Batley and Ms van Goch were under the impression that they were simply signing a copy of the original contract.

[19] The difference was significant because it allowed JSMB to apply the deposit paid by the Batley Family Trust to matters other than the construction of the

Batley Family Trust property. It is apparent from the financial records of JSMB that this had in fact already happened.

[20] On 28 September 2020 JSMB's bank account was overdrawn to the sum of \$446,030.80, which was \$3,969.20 from its overdraft limit. The first plaintiffs paid \$115,000 to JSMB's bank account on 29 September 2020. The payment of the deposit, together with a credit transfer from another account, allowed JSMB to make various direct debits from its bank account, including one coded "Wages" totalling \$154,761.07.

[21] On 3 November 2020 JSMB issued a payment claim for the sum of \$8,085.03 (including GST) to the Batley Family Trust. That claim was due for payment on 10 November 2020 but was not paid on that date because the first plaintiffs believed it would be deducted from the deposit in accordance with the original contract.

[22] On 24 November 2020 JSMB issued a second payment claim for the sum of \$13,089.97 (including GST). The payment claim indicated that it was due for payment on 1 December 2020.

[23] Between 25 and 26 November 2020, Mr Batley emailed Mr Stevens expressing his concerns that, in accordance with the contract, JSMB should have credited the deposit against the two payment claims and that JSMB's statements of account should have reflected that the Batley Family Trust was in credit with JSMB.

[24] Mr Stevens wrote that he did not recall explaining how the deposit functioned and that the deposit would be credited back against each payment claim until the deposit reached zero. He advised that as the payment claims had been relatively small, he had not started crediting the deposit against each payment claim. Mr Stevens then sent Mr Batley a revised statement of account reflecting the deposit credited against the account, but still indicating that an amount of \$21,184 was owing by the Batley Family Trust.

[25] On 26 November 2020, Mr Stevens asked if the Batley Family Trust would agree to start crediting back the deposit from January 2021, as it was close to

Christmas and JSMB's payment claims were comprised mostly of wages which impacted JSMB's cashflow. Mr Batley asked Mr Stevens if, under this arrangement, the Batley Family Trust would have to pay the amount showing on the statement of account. Mr Stevens confirmed that the Batley Family Trust should pay the amount claimed, and said that from January 2021, JSMB would start deducting the deposit from JSMB's payment claims.

[26] Although Mr Stevens' treatment of the deposit was contrary to Mr MacDonald's earlier indication, Mr Batley, on behalf of the Batley Family Trust, decided to pay the invoices in order to keep the construction moving forward.

[27] On 9 December 2020, JSMB issued a third payment claim for the sum of \$27,687.02 (including GST). This payment claim was due on 16 December 2020. The Batley Family Trust paid this payment claim on 16 December 2020.

[28] On 23 December 2020, JSMB stopped all construction work at the Batley Family Trust's property. Only the concrete footing for the main wing of the house had been poured.

[29] During December 2020, both the project manager for the Batley Family Trust's build, Lance Trumper, and the quantity surveyor Mr Stevens were made redundant by JSMB. Mr Batley was advised of this by telephone on 18 January 2021 by the site foreman for the build.

[30] On 18 January 2021 Mr MacDonald, by special resolution under s 241(2)(a) of the Act, placed JSMB into voluntary liquidation. On the same day, the site foreman advised Mr Batley by telephone that JSMB had been liquidated and would not be able to continue with the construction.

[31] It transpired that despite JSMB having claimed \$1,777.54 for work completed by Cogswell Surveys Ltd (Cogswell), the subcontractor had not been paid. In addition, JSMB had not paid \$22,942.50 for services provided by Waterproofing Systems Ltd (Waterproofing) in relation to the construction.

[32] On 22 January 2021 in an attempt to keep construction going at the property, the Batley Family Trust paid \$10,000 towards Waterproofing's outstanding invoice. The trust also agreed to pay the Cogswell invoice of \$1,777.54 in full.

[33] The second plaintiff, the V P & N Singh Family Trust, had a similar experience.

[34] In early 2020 Nidhi Singh and her husband, Ved Prakesh Singh, as trustees of the V P & N Singh Family Trust, decided to build two residential units (Unit A and Unit B). In May 2020, JSMB submitted a tender for the construction work. Mr MacDonald took Dr Singh and her husband on a tour of other houses that JSMB had built in the Hamilton area and submitted a tender proposal. On 7 September 2020, JSMB's tender proposal was accepted. On 23 September 2020, JSMB signed an NZIA standard construction contract (Initial Contract) and sent a copy of the signed Initial Contract to the architects engaged by the V P & N Singh Family Trust.

[35] The Initial Contract was a fixed price contract that did not require the payment of a deposit. Shortly after the signing of the Initial Contract, Mr MacDonald requested that the V P & N Singh Family Trust pay an increased contract price for the work to be performed under the Initial Contract. The V P & N Singh Family Trust was unable to pay an increased contract price and upon being advised of that, JSMB proposed that the V P & N Singh Family Trust agree to pay a deposit and to not withhold retentions throughout the contract.

[36] Dr Singh and her husband were unhappy about having to pay a deposit, however they trusted Mr MacDonald and understood that he had a good reputation as a reliable builder. They agreed that the V P & N Singh Family Trust would pay a deposit and would not withhold retentions. A further NZIA standard construction contract was prepared (Second Contract).

[37] The Second Contract was signed by Mr MacDonald on behalf of JSMB and by Dr Singh on behalf of the V P & N Singh Family Trust on 16 October 2020. The terms of the Second Contract provided in relation to the deposit that:



- (a) the V P & N Singh Family Trust would pay to JSMB a \$250,000 deposit, to be deducted from the overall price of the Second Contract;
- (b) the deposit would be paid in instalments as follows:
  - (i) \$50,000 on site possession.
  - (ii) \$100,000 after 10 days from site possession; and
  - (iii) \$100,000 in two instalments before 25 December 2020.
- (c) the deposit would be used against payment claims made by JSMB before the final payment claim.

[38] The V P & N Singh Family Trust made the following deposit payments to JSMB in accordance with the terms of the Second Contract:

- (a) \$50,000 plus GST was paid on 19 October 2020; and
- (b) \$100,000 plus GST was paid on 29 October 2020.

[39] Dr Singh became concerned that, despite payments of significant sums to JSMB, construction had not started.

[40] JSMB provided a construction programme in September 2020 which was not adhered to. By 27 October 2020 there was no set up work or construction work taking place at the property. When Dr Singh raised this with Mr MacDonald and the project manager, Mr Trumper, she was told that after contract signing JSMB generally needed a few weeks to notify its team and “get the ball rolling”.

[41] On 4 November 2020, Mr Trumper updated the architects and Dr Singh, confirming that JSMB had spent the last few weeks engaging JSMB subcontractors and getting them ready for the project.

[42] On 25 November 2020, JSMB issued its first payment claim to the trust. The claim covered various preliminary work and totalled \$10,112.24 (including GST) for Unit A and \$5,614.71 (including GST) for Unit B.

[43] Dr Singh's understanding of the terms of the Second Contract was that payment claims by JSMB were to be taken out of the deposit amount paid by the V P & N Singh Family Trust. That did not occur. Instead, the V P & N Singh Family Trust was asked to pay the JSMB payment claims. The trustees agreed to make the payments in order to keep work on the site progressing.

[44] On 25 November 2020, the architects acting for the V P & N Singh Family Trust asked JSMB to provide a revised construction programme based on possession of the property on 19 October 2020. It does not seem that any revised construction programme was ever provided.

[45] On 30 November 2020, JSMB submitted its second payment claim to the V P & N Singh Family Trust. This claim covered various excavation and piling work, totalling \$27,548.08 (including GST) for Unit B. The claim was not due for payment until 20 January 2021, and it was not paid.

[46] In early December 2020, Dr Singh visited the property. It was apparent that work was well behind schedule. On 9 December 2020, she wrote to Mr MacDonald expressing her concerns and asked if it was acceptable to pay the next deposit instalments totalling \$100,000 in January 2021 rather than by 25 December 2020. On 16 December 2020, JSMB quantity surveyor, Mr Stevens, accepted there had been delays for various reasons and agreed that it would be unfair to require that the deposit be paid by the end of the year. Instead, JSMB would invoice for the further deposit instalments when the reinforcing steel arrived on site. Mr Stevens also said that the payment dates could be discussed in the new year.

[47] In the week beginning 14 December 2020, Dr Singh happened to see Mr Trumper, who advised that JSMB would be stopping work at the site on 18 December 2020, and expected to resume on 11 January 2021.

[48] In fact, work never resumed. In January 2021, Dr Singh was notified that JSMB had gone into liquidation.

### **The pleadings**

[49] The plaintiffs plead that JSMB was balance sheet insolvent for at least four financial years prior to its liquidation and that Mr MacDonald chose to continue to trade JSMB causing it to incur obligations to the plaintiffs that it could never meet.

[50] The plaintiffs say Mr MacDonald used JSMB's funds, which contained the plaintiffs' deposits, to:

- (a) pay off older debts of JSMB;
- (b) pay for renovations at his personal home (held by a trust and his spouse);
- (c) pay interest on a loan to his other related entities; and
- (d) in general, prefer certain creditors over others.

[51] The plaintiffs plead as a first cause of action that Mr MacDonald engaged in reckless trading which gave rise to substantial risk of serious loss to JSMB's creditors (s 135 of the Act).

[52] As a second cause of action, the plaintiffs plead that Mr MacDonald incurred obligations without believing on reasonable grounds that JSMB would be able to perform those obligations (s 136 of the Act).

[53] Mr MacDonald filed a statement of defence in which he pleads:

- (a) following JSMB being placed into liquidation, he had no knowledge about, or access to, JSMB's financial statements or business records;
- (b) JSMB's financial difficulties were linked to the Covid-19 pandemic;

- (c) two alleged affirmative legal defences relating to:
  - (i) the plaintiffs' standing to bring this proceeding; and
  - (ii) whether any compensation awarded is payable to the liquidators/JSMB's account, or directly to the plaintiffs.

### **Procedural history**

[54] The plaintiffs filed their statement of claim on 30 August 2022.

[55] Mr MacDonald filed a statement of defence dated 27 October 2022.

[56] The plaintiffs filed a reply to the statement of defence dated 11 November 2022.

[57] Mr MacDonald filed an amended statement of defence dated 7 August 2023. The plaintiffs' reply was filed dated 22 August 2023.

[58] On 8 September 2023, the plaintiffs filed and served their affidavits of documents and provided documents in discovery to Mr MacDonald.

[59] Mr MacDonald filed and served his affidavit of documents on 28 September 2023 (there was a delay between the deadline for discovery in accordance with the Court timetable, and his eventual filing of his affidavit of documents). He provided his documents in discovery to the plaintiffs on or around 29 September 2023.

[60] After reviewing Mr MacDonald's discovery, the plaintiffs requested further documents they believed to be in Mr MacDonald's possession, particularly transactions between JSMB and Mr MacDonald's related entities.

[61] On 13 October 2023, Associate Judge Brittain issued a minute directing that the parties confer regarding discovery of further documents held by Mr MacDonald. It was further recorded that if the parties were unable to agree on the provision of further discovery, then the plaintiffs were to file a memorandum setting out the

documents/classes of documents sought. At this case management review, Mr MacDonald's counsel said that a five-day fixture was required.

[62] Following Associate Judge Brittain's minute, the plaintiffs' counsel wrote to Mr MacDonald's counsel to resolve the issues of discovery. Owing to illness on the part of counsel for the plaintiffs, the issue of discovery was delayed and revisited again in Associate Judge Brittain's minute of 27 November 2023, when the parties were again invited to confer.

[63] Correspondence followed with the plaintiffs requesting certain categories of documents for further discovery purposes. Mr MacDonald objected to providing some of these documents and claimed that the documents were in the liquidators' possession rather than in his.

[64] On 16 April 2024, Associate Judge Sussock issued a minute directing that any interlocutory applications and affidavits in support relating to discovery were to be filed by 16 May 2024.

[65] The plaintiffs filed a memorandum dated 30 May 2024, stating that there was a discrepancy between the financial accounts of JSMB and the accounts of JSM Construction Ltd (JSMC) for the financial year ending 31 March 2020. The intercompany balance between the two entities did not reconcile. This led the plaintiffs to request for further JSMC accounts, particularly for the period most relevant to the liquidation of JSMB.

[66] In the same memorandum the plaintiffs said that Mr MacDonald had not provided further documents requested, and his accountant had not advised as to whether any bank statements were requested from JSMB's former bank.

[67] Eventually the plaintiffs obtained further documents from the liquidators of JSMB in June 2024, albeit they say, through great effort and cost on their part. These documents comprised mainly invoices, which the liquidators consented to the plaintiffs inspecting and making copies of. The plaintiffs filed further affidavits of documents, primarily relating to documents uplifted from the liquidators. The

documents had already been provided to Mr MacDonald, by way of informal discovery on 2 August 2024, but given Mr MacDonald's failure to respond, the plaintiffs formalised this further discovery.

[68] A Court timetable was set, leading up to a five-day trial scheduled to commence on 3 March 2025.

[69] Mr MacDonald was originally required to serve his briefs of evidence, list of documents for inclusion in the common bundle, and response to the plaintiffs' draft chronology, by 30 August 2024.

[70] On 7 October 2024, the plaintiffs filed an amended statement of claim with a minor consented amendment required because of a change to the trustees of the V P & N Singh Family Trust. The plaintiffs also filed a memorandum updating the Court on the status of the proceeding and seeking an order compelling Mr MacDonald to serve his briefs of evidence, which were by then six weeks overdue.

[71] On 8 October 2024, Mr MacDonald filed a memorandum advising that he did not intend to serve any briefs of evidence.

[72] Van Bohemen J issued a minute on 11 October 2024, directing that Mr MacDonald serve his briefs of evidence within five days of the minute, and amending the Court timetable to account for Mr MacDonald's delay. It is unclear when the Court and the plaintiffs became aware of the memorandum filed by Mr MacDonald on 8 October 2024.

[73] After van Bohemen J's minute of 11 October 2024, the plaintiffs say they continuously followed up with Mr MacDonald's counsel regarding the status of Mr MacDonald's briefs of evidence.

[74] When Mr MacDonald's position became clear, the trial fixture was shortened, from five days to three days.

[75] On 3 February 2025, the plaintiffs filed their bundle of documents and chronology. Mr MacDonald did not submit any documents for inclusion in a common bundle, nor any points for inclusion in the chronology.

[76] On 17 February 2025, Mr MacDonald advised of his intention not to participate in the trial at all.

[77] On 19 February 2025, Robinson J granted leave for the plaintiffs to file affidavits attaching and verifying their briefs of evidence. Robinson J considered the trial Judge best placed to determine how best to proceed with this matter, in light of Mr MacDonald's inactivity.

[78] At the hearing Mr MacDonald did not appear and there was no appearance for him.

### **Issues**

[79] The issues are as follows:

- (a) The plaintiffs' standing to bring this proceeding.
- (b) In the event compensation is awarded in favour of the plaintiffs, is it payable to the liquidators/JSMB's account or directly to the plaintiffs?
- (c) Did Mr MacDonald engage in reckless trading:
  - (i) by agreeing to the business of the company being carried out in a manner likely to create a substantial risk of serious loss to the company's creditors; or
  - (ii) causing or allowing the business of the company to be carried out in a manner likely to create a substantial risk or loss to the company's creditors?

- (d) Did Mr MacDonald agree to the company incurring an obligation without believing at the time on reasonable grounds that the company would be able to perform the obligation when required to do so?

### **The Evidence**

[80] At the hearing affidavit evidence was provided, including from Mr Batley, Ms van Goch and Dr Singh.

[81] Accountant, Elizabeth Groenewegen, provided expert evidence for the plaintiffs.

#### *JSMB's financial position*

[82] Ms Groenewegen reviewed the signed financial statements for JSMB for the financial years ending March 2018, March 2019 and March 2020.

[83] In Ms Groenewegen's opinion, JSMB traded while insolvent for four years prior to its liquidation in January 2021. In addition, during the insolvent period JSMB owed, and was owed, significant debts from entities related to JSMB including:

- (a) Mr MacDonald;
- (b) JSMC;
- (c) J & J MacDonald (presumed to be a partnership);
- (d) J & J MacDonald Family Trust; and
- (e) J & J MacDonald Property Trust.

[84] The related entity balances were accounted for in the shareholder account schedule in the relevant financial statement for reporting purposes. Those entities are related to JSMB because:



- (a) JSMC's sole director and shareholder is Mr MacDonald (JSMC was removed from the New Zealand Companies Office register on 21 July 2022); and
- (b) Mr MacDonald is, or was, during the insolvent period, a trustee of the aforementioned trusts and a partner of the aforementioned partnership.

[85] The equity position arrived at by Ms Groenewegen was as follows:

- (a) for the year ending March 2017, JSMB had an equity deficit of \$533,072 and was balance sheet insolvent;
- (b) for the year ending March 2018, JSMB had an equity deficit of \$214,544 and was balance sheet insolvent;
- (c) for the year ending March 2019, JSMB had an equity deficit of \$148,398 and was balance sheet insolvent; and
- (d) for the year ending March 2020, JSMB had an equity deficit of \$693,715 and was balance sheet insolvent.

[86] Throughout the insolvent period, the defendant's shareholder current account was overdrawn. The defendant owed money to JSMB. Ms Groenewegen explained in her affidavit that technically the overdrawn shareholder balances are classified as assets of JSMB and are deemed collectible. However, including the shareholder current account balances as an asset can be misleading when determining a company's solvency.

[87] If the overdrawn shareholder current account balances are deducted from the net assets position, that results in a net assets position which is far weaker than the equity position set out above. If the overdrawn shareholder current accounts are not collectible, then the relevant financial statements show that:

- (a) for the year ending March 2017, JSMB had assets totalling \$956,476 and liabilities totalling \$2,440,786, resulting in a net assets deficit of \$1,448,310;
- (b) for the year ending March 2018, JSMB had assets totalling \$1,300,729 and liabilities totalling \$2,323,312, resulting in a net assets deficit of \$1,022,583;
- (c) for the year ending March 2019, JSMB had assets totalling \$992,405 and liabilities totalling \$1,863,731, resulting in a net assets deficit of \$871,326; and
- (d) for the year ending March 2020, JSMB had assets totalling \$903,423 and liabilities totalling \$1,799,194, resulting in a net assets deficit of \$895,771.

[88] During the insolvent period JSMB did not generate sufficient net profit after tax to remedy the serious equity deficit each year. The only exception to this was the year ending March 2018 when JSMB generated a net profit after tax of \$318,528. This was, however, insufficient profit to cover the deficit from previous years.

[89] Ms Groenewegen performed a short-term liquidity (acid) test on JSMB using information extracted from the relevant financial statements. The acid test is calculated by dividing the current realisable assets (such as bank funds, debtors, work in progress) by the current payables (such as the overdraft, payables, GST). The acid test revealed that:

- (a) for the financial year ending March 2017, and for every dollar due to creditors, JSMB had 39c to meet its creditor liabilities;
- (b) for the financial year ending March 2018, and for every dollar due to creditors, JSMB had 57c to meet its creditor liabilities;
- (c) for the financial year ending March 2019, and for every dollar due to creditors, JSMB had 51c to meet its creditor liabilities; and

- (d) for the financial year ending March 2020, and for every dollar due to creditors, JSMB had 45c to meet its creditor liabilities.

[90] Ms Groenewegen opines that JSMB was insolvent as of 31 March 2017. There was an equity deficit of \$533,072, and the shareholder current accounts were overdrawn by \$915,238.

[91] JSMB was profitable in 2018, which reduced the equity deficit to \$214,544. However, JSMB was still insolvent on 31 March 2018, assuming the overdrawn shareholder account balance of \$808,039 at that date was a realisable asset.

[92] JSMB remained insolvent at the end of the 2020 financial year and had an equity deficit of \$693,715, with the shareholder account overdrawn by \$895,771 as of that date.

[93] Ms Groenewegen also considered cashflow solvency between 1 April 2019 and 31 December 2020.

[94] At the close of business on 1 April 2019, JSMB's bank account was overdrawn to the sum of \$418,075.66.

[95] At the close of business on 30 September 2020, just before the first plaintiffs paid their deposit, JSMB's bank account was overdrawn to the sum of \$449,374.12. The overdraft limit was \$450,000.

[96] The overall assessment of the relevant bank statements is set out in Ms Groenewegen's affidavit as follows:

- (a) for the quarter ending June 2019, JSMB had a cashflow trading deficit of \$75,528;
- (b) for the quarter ending September 2019, JSMB had a cashflow trading deficit of \$16,902;

- (c) for the quarter ending December 2019, JSMB had a cashflow trading surplus of \$34,014;
- (d) for the quarter ending March 2020, JSMB had a cashflow trading surplus of \$122,467;
- (e) for the quarter ending June 2020, JSMB had a cashflow trading deficit of \$105,011;
- (f) for the quarter ending September 2020, JSMB had a cashflow trading deficit of \$52,387 (despite a deposit of \$115,000 by the first plaintiff); and
- (g) for the quarter ending December 2020, JSMB had a cashflow trading surplus of just \$17,608 (despite deposits from both plaintiffs totalling \$237,098).

[97] Ms Groenewegen opined that JSMB was cashflow insolvent for the entire period from the quarter ending December 2019 until the end of September 2020. Throughout the relevant period JSMB's creditors far exceeded its debtors. Without sufficient cashflow surplus, JSMB was never going to be able to pay its creditors as the creditors' bills became due.

[98] In conclusion, and in relation to the cash flow solvency of JSMB for the relevant period:

- (a) for the financial year ending 31 March 2020, JSMB had a cash deficit in trading of \$440,400 (excluding related party and shareholder deposits). The defendant appears to have deposited sufficient funds to generate a cashflow positive result of \$64,050 for the year, but this was insufficient to address the carry forward deficit or reduce the creditors;
- (b) in the six months of trading prior to the payment of deposit amounts by the plaintiffs, JSMB traded at a cashflow loss of \$157,398. If related party and shareholder transactions are excluded there was a cashflow

drain of \$283,898 (and a deficit of \$317,298 if the IRD loan of \$33,400 is also excluded);

- (c) the money owed by JSMB to its creditors far exceeded the money owed to JSMB by its debtors; and
- (d) JSMB was cashflow insolvent.

*Assessment on liquidation*

[99] The liquidator's reports show that, as of 17 January 2024:

- (a) the liquidators had been able to realise \$150,824.25 from JSMB's assets;
- (b) the liquidators had received preferential and secured creditor claims totalling \$580,301;
- (c) the liquidators had received unsecured creditor claims totalling \$1,236,664;
- (d) there was an estimated deficit in the liquidation, before considering unsecured creditors, of \$437,466; and
- (e) the liquidators had made a distribution to the ANZ Bank, the holder of a general security agreement, of \$70,203 representing 16.41 cents in the dollar.

[100] The liquidators' stated position is that they were advised that the reason for JSMB's insolvency was project cost overruns and slow or nonpayment of debtors that expended the cashflow of JSMB. This was disputed by Ms Groenewegen who said that the poor financial performance and insolvency of JSMB occurred before New Zealand entered the first Covid-19 pandemic lockdown on 25 March 2020 (Lockdown).

[101] Ms Groenewegen said that although it would appear that the pandemic and Lockdown were the “straw that broke the camel’s back”, the financial position of JSMB was not sustainable prior to the pandemic and Lockdown. JSMB owed significant sums to its creditors at the time of Lockdown, and Ms Groenewegen did not consider that the Lockdown was the cause of, or primarily contributed to, JSMB being liquidated.

[102] Ms Groenewegen says that immediately prior to the Lockdown, JSMB was in a poor financial position and was insolvent.

*JSMB’s dealings with the plaintiffs’ payments*

[103] On 28 September 2020, and immediately before the first plaintiff paid \$115,000 to JSMB, JSMB’s bank account was overdrawn to the sum of \$446,030.80, which was \$3,969.20 from its overdraft limit. JSMB invoices totalling \$110,425.44 were due for payment on 20 September 2020. Payment of outstanding invoices was made using the deposit paid by the first plaintiff.

[104] On 6 October 2020, after receiving some unrelated deposits into its bank account, JSMB’s bank account was overdrawn to the sum of \$430,599.74. On 8 October 2020, JSMB received a credit transfer from an ANZ account (First Unknown ANZ Account) in the sum of \$25,000, bringing JSMB’s overdraft to \$405,599.74. This enabled JSMB to pay \$31,392.78 to a creditor, Total Kitchens, whose invoice was due for payment on 30 September 2020. Total Kitchens was owed a further \$55,831.86 by JSMB, but there were insufficient funds available to pay anything further to Total Kitchens at that stage.

[105] On 12 October 2020, and after further direct debits and payments, JSMB’s bank account was overdrawn to the sum of \$444,472.14. On 14 October 2020, JSMB received credit transfers of \$6,500 from the First Unknown ANZ Account and \$7,500 from another ANZ account (the Second Unknown ANZ Account). These payments enabled JSMB to make a payment of \$18,094.93, coded as “Wages” on 14 October 2020.

[106] On 15 October 2020, JSMB received a significant payment of \$332,354.88 and a smaller payment of \$15,645.77, reducing its overdraft by \$350,000. However, further substantial payments by JSMB, including debit transfers of \$40,000 to the First Unknown ANZ Account and \$7,500 to the Second Unknown ANZ Account meant that at close of business on 16 October 2020, JSMB's bank account was overdrawn to the sum of \$376,302.78.

[107] On 19 October 2020, the second plaintiffs paid the sum of \$57,500 to JSMB. On that same date JSMB paid the sum of \$58,098.08 to its creditors, comprising of payments to:

(a) Carters, in the sum of \$57,695.58; and

(b) Karlene Henderson, in the sum of \$402.50.

[108] After further amounts were debited from JSMB's bank account, the bank account was overdrawn to the sum of \$423,003.11 at close of business on 27 October 2020.

[109] On 28 October 2020, JSMB's bank account received a credit transfer of \$10,000 from the First Unknown ANZ Account. The credit transfer allowed JSMB to make payments of \$26,424.01, coded as "Wages" and \$2,321.96, coded as "GST", on 28 October 2020. Without this credit transfer, and absent funds from another source, JSMB would not have been able to make these payments.

[110] At close of business on 29 October 2020, JSMB's bank account was overdrawn to the sum of \$445,487.57.

[111] On 29 October 2020, the second plaintiffs paid the sum of \$115,000 to JSMB. JSMB then made payments totalling \$91,569.29, including a payment of \$10,150 to The Shed Shop, in respect of a JSMB invoice due for payment in August 2020.

[112] After further amounts were deducted from JSMB's bank account by the ANZ Bank, JSMB's bank account was overdrawn to the sum of \$425,878.84 at close of business on 30 October 2020.

[113] JSMB's bank account remained significantly overdrawn for the first half of November 2020, until a substantial deposit of \$286,597.49 was received from Atlas Property on 13 November 2020. However, immediately following receipt of the payment from Atlas Property, JSMB made payments on 13 and 16 November 2020 totalling \$220,076.54.

[114] For the rest of November 2020, JSMB continued to make payments from its bank account until 25 November 2020, when its bank account was overdrawn to the sum of \$443,125.48. On 26 November 2020, the first plaintiffs paid the sum of \$21,184 to JSMB which then allowed JSMB to make payments on 27 November 2020 totalling \$26,686.74, bringing JSMB's overdraft to a total of \$448,628.22.

[115] During December 2020 and January 2021, leading up to the liquidation of JSMB, Ms Groenewegen did not note any concerning transactions, apart from a debit transfer of \$24,800 from JSMB to the First Unknown ANZ Account, after having received a payment of \$27,687.02 by the first plaintiffs on 16 December 2020.

[116] When the liquidators took control of JSMB's accounts, it was overdrawn to the sum of \$400,208.05.

### **Do the plaintiffs have standing?**

[117] Mr MacDonald's amended statement of defence raises the defence that the cause of action pleaded by the plaintiffs "vest[s] solely in the liquidator".

[118] Section 301 of the Act provides:

**301 Power of court to require persons to repay money or return property**

- (1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—



- (a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and
  - (b) order that person—
    - (i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or
    - (ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or
  - (c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.
- (2) This section has effect even though the conduct may constitute an offence.
- (3) An order for payment of money under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.
- (4) In making an order under subsection (1) against a past or present director, the court must, where relevant, take into account any action that person took for the appointment of an administrator to the company under Part 15A.

[119] Section 301(1) clearly permits a creditor to bring an application.

[120] In *Yan v Mainzeal Property and Construction Ltd (in liq) (Mainzeal)* the Supreme Court confirmed that creditors of a company in liquidation have standing to bring a claim against a director for breach of directors' duties.<sup>1</sup>

[121] This issue is easily disposed of in favour of the plaintiffs.

### **Plaintiffs' entitlement to relief**

[122] The second affirmative defence raised by Mr MacDonald is that the plaintiffs are not entitled to the relief sought because any compensatory award must be paid to the liquidator or to JSMB.

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<sup>1</sup> *Yan v Mainzeal Property and Construction Ltd (in liq)* [2023] NZSC 113, [2023] 1 NZLR 296 [Mainzeal].

[123] The Supreme Court in *Mainzeal* confirmed that a court can order compensation to be paid directly to plaintiff creditors:<sup>2</sup>

Either way, we are satisfied that s 301 allows for a direct claim by creditors for breaches of ss 135 and 136 for losses that they have suffered as a result of those breaches.

...

As will be obvious, our conclusion that the creditors may recover directly in relation to claims under ss 135 and 136 provides some support for the availability of new debt-based assessments of quantum in proceedings for breach of those sections.

[124] In *Boaden v Mahoney*, this Court found that the director, Mr Mahoney, breached ss 135 and 136 of the Act, and that Mr Boaden, the creditor, was entitled to recover directly.<sup>3</sup>

[125] Section 135 aims to protect creditors from substantial risk of serious loss arising from the manner in which a company's business is carried out.<sup>4</sup> It is not about preserving the shareholder's funds, but about acknowledging creditors' economic stake in an insolvent or near insolvent company.<sup>5</sup>

[126] Again, this issue is easily disposed of in favour of the plaintiffs.

### **Did Mr MacDonald breach his director duties under the Act?**

*Did Mr MacDonald breach the duty under s 135?*

[127] Section 135 sets out a director's duties in relation to reckless trading:

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<sup>2</sup> At [163] and [168].

<sup>3</sup> *Boaden v Mahoney* [2024] NZHC 2783.

<sup>4</sup> *Mainzeal*, above n 1.

<sup>5</sup> *Mainzeal*, above n 1, at [196].

### 135 Reckless trading

A director of a company must not—

- (a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
- (b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[128] In *Mainzeal*, the Supreme Court said in respect of s 135:<sup>6</sup>

[211] We conclude as follows:

- (a) An objective approach is to be taken in determining whether the business of the company was carried on in the prohibited manner (so that subjective awareness of the likelihood of substantial risk or serious loss is not necessary).
- (b) However, when assessing whether the actions of the directors in agreeing to or causing or allowing that trading were in breach of s 135, the courts will proceed on the basis of those facts and circumstances of which the directors were aware, or should have been aware, if exercising appropriate care, skill and diligence. The reference to “business judgment” in the long title of the 1993 Act is consistent with a focus on the reasonableness of the directors' actions on the basis of the material they had, or should have had, if exercising the required standard of skill, care and diligence.

...

[129] The test as to a director's conduct is an objective one. It focuses not on a director's subjective belief but on the manner in which a company's business is carried out and whether that creates a substantial risk of serious loss. The Court in *Mason v Lewis* considered that the question of whether there was a substantial risk of serious loss requires a “sober assessment' by the directors... as to the company's likely future income and prospects”.<sup>7</sup> The Court said:<sup>8</sup>

... where a company has little or no equity directors will need to consider very carefully whether continuing to trade has realistic prospects of generating cash

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<sup>6</sup> *Mainzeal*, above n 1.

<sup>7</sup> *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [51].

<sup>8</sup> At [51], citing *Fatupaito v Bates* [2001] 3 NZLR 386.

that will service both pre-existing debt and meet the commitments that such trading inevitably attracts.

[130] The Supreme Court in *Mainzeal* said that when it becomes apparent to a director that the company may be insolvent or near insolvent, they are entitled time to “take stock of the situation of the company” to determine whether there is a way that the company can continue trading without creating a “substantial risk of serious loss to creditors”.<sup>9</sup> This necessarily entails a business judgment. The taking stock period is what is reasonable in the particular circumstances, including the complexity of the company’s affairs and the urgency of the situation.<sup>10</sup>

[131] The question is what a reasonable director exercising “appropriate care, skill and diligence” would have done in the circumstances, based on the information available to the director at the time.<sup>11</sup>

[132] The High Court in *Re South Pacific Shipping Ltd (in liq)* noted:<sup>12</sup>

The cases, however, make it perfectly clear that there are limits to the extent to which directors can trade companies while they are insolvent (in the balance sheet sense to which I referred), in the hope that things will improve. In most of cases, the time allowance has been limited, a matter of months.

[133] In *Lower v Traveller*, an appeal decision of *South Pacific*, the Court of Appeal considered that where the director had put his extraneous interests ahead of the interests of the company’s unsecured creditors, the director’s level of culpability was of the most serious nature.<sup>13</sup>

[134] In the present case, the plaintiffs submit that Mr MacDonald’s conduct was of the most serious nature and certainly not reasonable. The plaintiffs say Mr MacDonald put his extraneous interests ahead of their interests despite being required to protect the interests of creditors in a situation where JSMB was balance sheet insolvent.

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<sup>9</sup> *Mainzeal*, above n 1, at [215].

<sup>10</sup> At [215].

<sup>11</sup> At [211].

<sup>12</sup> *Re South Pacific Shipping Ltd (in liq)* (2004) 2 NZCCLR 8 at [125] (footnotes omitted).

<sup>13</sup> *Lower v Traveller* [2005] 3 NZLR 479 at [85].

[135] It is apparent from the speed at which the deposit payments were disbursed to meet other debts, that JSMB was using new incoming funds to pay off older debts. It is also clear that Mr MacDonald allocated JSMB funds for extraneous personal interests including renovations on his own home, paying interest on personal loans and funding his racehorse interest.

[136] By asking the Batley Family Trust to pay the payment claims despite initially agreeing to credit the deposits and asking the V P & N Singh Family Trust to pay a deposit after initially not requiring one, Mr MacDonald evidenced his own understanding of the precarious financial situation of the company.

[137] In his statement of defence, Mr MacDonald claimed that he believed JSMB would be able to trade back to profit. There is no objective foundation for that belief, in fact, the evidence suggests the opposite.

[138] I find there was real dishonesty in the way that Mr MacDonald dealt with the deposit payments. The removal of the Deposit Deduction Clause from the first plaintiff's initial contract is particularly concerning. Almost as soon as the first plaintiff's deposit was paid into JSMB's bank account, it was used to meet existing debts. In treating the money in that way, JSMB was in breach of the contract that had already been signed. The removal of the Deposit Deduction Clause looks like a deliberate attempt to retrospectively legitimise the situation.

[139] Likewise, when the second plaintiff's deposit was paid, it was immediately used to meet existing debts.

[140] The precarious financial state of the company must have been apparent to Mr MacDonald when he entered into the contracts with the first and second plaintiffs. The company desperately needed money. At the time the deposits were paid, the company overdraft was very near its limit. It had multiple debtors and debts that had been overdue for months. The company used the deposit payments of the first and second plaintiffs to pay wages.

[141] Mr MacDonald, as the sole director, was required to make a sober assessment of JSMB's financial position. The contention that JSMB's financial woes were caused by Covid-19 is not tenable on the evidence. Mr MacDonald entered into the contracts with the first and second plaintiff only a few months before placing the company into voluntary liquidation, and those few months included the Christmas shutdown period. It is impossible that Mr MacDonald did not know that the company was in a dire financial position.

[142] I am satisfied that Mr MacDonald breached his duty under s 135 of the Act by causing or allowing the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

*Did Mr MacDonald breach the duty under s 136?*

[143] Section 136 sets out a director's duties in relation to incurring obligations.

### **136 Duty in relation to obligations**

A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

[144] Section 136 focuses on particular transactions rather than the general conduct of the company's business. In *Mainzeal*, the Supreme Court endorsed s 136 as reflecting a legislative choice to prioritise creditor protection over promoting risk taking in situations of doubtful solvency.<sup>14</sup>

[145] In *Madsen-Reis (as liquidators of Debut Homes Ltd (in Liq)) v Cooper (Debut Homes)*, the Supreme Court said:<sup>15</sup>

[91] Section 136 is directed to the incurring of obligations without a reasonable belief that the company will be able to perform the obligations when they fall due.

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<sup>14</sup> *Mainzeal*, above n 1, at [245]–[246].

<sup>15</sup> *Madsen-Reis v Cooper (as liquidators of Debut Homes Ltd (in Liq)) v Cooper* [2020] NZSC 100, [2021] 1 NZLR 43 [*Debut Homes*].

[146] The elements under s 136 were broken down by the Court of Appeal in *Peace and Glory Society (in liq) v Samsa* as follows:<sup>16</sup>

- (a) that the defendant was a director of the company;
- (b) that an obligation was incurred by the company; and
- (c) that at the time of incurring the obligation, the defendant did not honestly believe on reasonable grounds that the company would be able to perform the obligation when required to do so.

[147] In *Debut Homes*, the Supreme Court confirmed that “obligations” extend to “trade debts left outstanding at liquidation [that were] incurred at a time when it was clear those debts would not be paid”.<sup>17</sup> In that decision, the director used the GST component of sales, owing to the IRD, to pay off other creditors. When later sued by the liquidators under s 136, the director purported to argue that he did not breach s 136 because the overall debt position of the company had remained relatively stable. The Court did not accept this argument and confirmed that:<sup>18</sup>

[94] We also accept the submission of the liquidators and the Attorney-General that it is clear from the existence of s 136 that it is not legitimate to enter into a course of action to ensure some creditors have a higher return where this is at the expense of incurring new liabilities which will not be paid. In other words, it is not legitimate to “rob Peter to pay Paul”. This is also clear from the scheme of the Act, including the statutory priorities.

[148] In *Jordan v O’Sullivan* Clifford J said:<sup>19</sup>

[55] Section 136 therefore entails a mixed, objective-subjective approach. The director will breach the duty unless he or she subjectively believes, at the time the obligation was entered into, that the company will be able to meet the obligation incurred when it is required to do so. That subjective belief must, however, be based on objectively reasonable grounds (see, for example, *PC Company Ltd v Sanderson* HC HAM CP18/00 1 Nov 2001).

[56] The need for the director’s belief to be based on objectively reasonable grounds means the director must have sufficient knowledge of the company’s position and ability to meet the obligation so as to give rise to reasonable grounds. It is implicit that the director must take sufficient steps to obtain this knowledge – claiming ignorance will not be a defence.

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<sup>16</sup> *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396, [2010] 2 NZLR 57 at [45].

<sup>17</sup> *Debut Homes*, above n 15, at [96].

<sup>18</sup> *Debut Homes*, above n 15.

<sup>19</sup> *Jordan v O’Sullivan* HC Wellington CIV-2004-485-002611, 13 May 2008.

[149] The “rob Peter to pay Paul” concept discussed in *Debut Homes* confirms that a director cannot allow a company to incur obligations for the sake of paying off older debts or prioritising certain creditors over others. Rather, as discussed in *Mainzeal*, the director must prioritise creditor protection and must believe on reasonable grounds that any new obligations incurred can be performed.

[150] In the present case the deposits paid under the construction contracts were not used for their intended purposes. Instead, JSMB paid other creditors on the same dates as it received the plaintiff’s deposits. This included paying debts related to Mr MacDonald’s personal interests (including work on a property apparently owned by his trust).

[151] Throughout the period from September 2020 to the end of December 2020, JSMB’s bank account was frequently overdrawn near the overdraft limit. The plaintiffs’ deposits were essential to allow JSMB to meet its existing and overdue debts. This is a classic example of robbing Peter to pay Paul.

[152] JSMB incurred obligations under the respective construction contracts with the plaintiffs and those obligations were not fulfilled. By the time JSMB went into liquidation, only the concrete footings had been poured at the Batley Family Trust’s property, and that had been paid for separately by the Batley Family Trust without the use of the deposit.

[153] In respect of the V P & N Singh Family Trust property, construction was well behind schedule in December 2020, and by 18 December 2020, all construction work had ceased. All of the work completed at that date was paid for separately without the use of the deposit.

[154] Neither of the plaintiffs have had their deposits refunded.

[155] At the time JSMB entered into the construction contracts with the respective plaintiffs, Mr MacDonald could not have believed on reasonable grounds that JSMB would be able to either construct the buildings at the plaintiffs’ property or refund the plaintiffs their deposits. The deposits paid under the construction contracts were paid



out to meet other debts. JSMB incurred debts to subcontractors which at liquidation had not been paid.

[156] Mr MacDonald allowed JSMB to enter into the construction contracts with the hope of gaining income through the plaintiffs' deposits to pay off older debts, including extraneous interests. Although he may have hoped that JSMB could construct the buildings, there was no objective basis for him to hold a reasonable belief that this would in fact eventuate. Essentially, JSMB gambled, not with its own money but with the plaintiffs' money. Given the precarious situation of JSMB, Mr MacDonald should never have entered into the contracts with either of the plaintiffs and certainly should not have applied the deposit payments to other debts.

[157] As I have already said, it is striking how quickly after receiving the payments from the respective plaintiffs that money was disbursed for reasons quite outside that contemplated by the plaintiffs under their contracts with JSMB. I consider that Mr MacDonald's conduct was deliberately misleading in respect of both plaintiffs — first by removing the Deposit Deduction Clause from the first plaintiffs' contract, and secondly by requiring a deposit from the second plaintiffs, despite not requiring one initially. Those actions demonstrate Mr MacDonald's actual knowledge of the financial difficulties of the company.

[158] There was no reasonable basis for Mr MacDonald to assume that JSMB could meet its obligations under the contracts with the plaintiffs or trade its way out of debt. That is apparent in part by the speed at which Mr MacDonald placed the company into voluntary liquidation after incurring the obligations to the plaintiffs, and then spending the deposits they paid. There is no evidence of any material change in the circumstances of the company between September 2020 and mid-January 2021. The time frame is even more stark when considering that Mr McDonald entered into further contracts with both plaintiffs in November 2020, but by December 2020, staff were made redundant and work on the plaintiffs' projects had ceased. By January 2021 Mr MacDonald obviously knew that JSMB had to be placed into liquidation. He could not have believed just a few months earlier that JSMB could meet its obligations to the plaintiffs. If he did have that belief, it was not based on objectively reasonable grounds.

[159] I am satisfied that Mr MacDonald breached his duty under s 136 of the Act.

## **Relief**

[160] As a result of Mr MacDonald's breaches of his duties under ss 135 and 136 of the Act, the plaintiffs have lost their deposits paid to JSMB under the construction contracts. The plaintiffs incurred further loss by having to pay subcontractors' invoices that were supposed to have been paid from their deposit.

[161] The Court in *Debut Homes* considered that a restitutionary measure of relief was appropriate in relation to a combination of breaches, including under ss 135 and 136. The Court said that relief should operate to "reverse [the] harm and thus be restitutionary in nature",<sup>20</sup> particularly where "new obligations are incurred and used to pay other debts".<sup>21</sup>

[162] The plaintiffs' loss was caused by Mr MacDonald continuing to trade while JSMB was insolvent and entering into contracts at a time when JSMB had no real prospect of being able to meet its obligations under the contracts.

[163] Under the restitutionary approach, the plaintiffs should be returned to the same position they would have been in had the contracts not been entered into at all.

[164] I do not consider that a discount should be allowed for a "taking stock" period because I consider that Mr MacDonald was well aware of the precarious financial position of the company.

## **Result**

[165] For the reasons set out above, I find that Mr MacDonald has breached ss 135 and 136 of the Act, and the plaintiffs are entitled to recover the amounts claimed. I order under s 301 of the Act that the defendant pay:

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<sup>20</sup> *Debut Homes*, above n 15, at [165].

<sup>21</sup> At [166].

- (a) The first plaintiff the sum of \$116,777.55 (inclusive of GST) together with interest on the judgment debt pursuant to the Interest on Money Claims Act 2016, from the date of judgment to the date of payment in full.
- (b) The second plaintiff the sum of \$172,500 (inclusive of GST) together with interest on the judgment debt pursuant to the Interest on Money Claims Act 2016, from the date of judgment to the date of payment in full.

### **Costs**

[166] The plaintiffs seek costs on an indemnity basis.

[167] Rule 14.6(4) of the High Court Rules 2016 provides:

- (4) The court may order a party to pay indemnity costs if—
  - (a) the party has acted vexatiously, frivolously, improperly, or unnecessarily in commencing, continuing, or defending a proceeding or a step in a proceeding; or
  - (b) the party has ignored or disobeyed an order or direction of the court or breached an undertaking given to the court or another party; or
  - ...
  - (f) some other reason exists which justifies the court making an order for indemnity costs despite the principle that the determination of costs should be predictable and expeditious.

[168] Mr MacDonald increased the costs to the plaintiffs considerably by filing a statement of defence, failing to comply with timetable orders, and then two weeks before the scheduled trial date, advising that he did not intend to participate. The plaintiffs had to prepare for a trial that could have been dealt with by way of a formal proof hearing.

[169] The plaintiffs submit that it is in the interests of justice to award indemnity costs, as any judgment in their favour will otherwise be an “empty judgment”. Mr MacDonald will have simply delayed the inevitable and caused unnecessary cost by allowing the proceeding to continue on a defended basis when he did not actually intend to appear at the hearing to defend the matter.

[170] In *Mako Holdings Ltd (in Liq) v Crimp* the Court required the breaching directors to pay the costs of the litigation on the basis that:<sup>22</sup>

Unless full costs are awarded the creditors will not get paid and, unless judges take a firm line with those who choose to act in this way, we will wind up creating incentives for directors to strip their companies on the basis that they can argue about it later.

[171] It is also necessary to disincentivise parties from prolonging hopeless proceedings until litigation fatigue or cost forces an end to the matter.

[172] The actual amount claimed is relatively modest when compared to many matters involving commercial disputes that come before the Court. It is also modest compared to the cost of litigation. The plaintiffs’ case was always strong. Without an award of indemnity costs the result would be largely symbolic.

[173] There is a strong basis for an order that Mr MacDonald pay the actual and reasonable costs of the plaintiffs on an indemnity basis. I am mindful however that Mr MacDonald does have standing and I intend to give him an opportunity to provide a memorandum as to costs before making any final determination.

[174] The parties should attempt to agree costs.

[175] If they are unable to agree on the amount of costs to be paid, I make the following directions:

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<sup>22</sup> *Mako Holdings Ltd (in Liq) v Crimp* HC Invercargill CP23/00, 28 November 2000 at [75].

- (a) The plaintiffs are to file and serve material to support the actual and reasonable costs claimed within **20 working days** of the date of this judgment; and
- (b) any memorandum as to costs from the defendant is to be filed and served within a further **10 working days** following service of the plaintiffs' material.

[176] I will deal with the issue of costs on the papers unless the parties indicate that hearing time is required.

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Wilkinson-Smith J