

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

**CIV-2015-404-000213
[2015] NZHC 2480**

UNDER the Companies Act 1993
IN THE MATTER OF the liquidation of O's Construction
Limited (In Liquidation)
BETWEEN DAMIEN GRANT AND STEVEN KHOV
AS LIQUIDATORS OF O'S
CONSTRUCTION LIMITED (IN
LIQUIDATION)
Plaintiffs
AND TIANJIAO GUO
Defendant

Hearing: 1 October 2015

Appearances: A Cherkashina and B J Norling for Plaintiffs
Defendant in person

Judgment: 9 October 2015

JUDGMENT OF WOOLFORD J

This judgment was delivered by me on Friday, 9 October 2015 at 3:00 p.m.
pursuant to r 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Solicitors/Counsel: A Cherkashina, Waterstone Insolvency, Auckland
B J Norling, Waterstone Insolvency, Auckland

Copy to: A Guo

Summary

[1] The applicants, Messrs Grant and Khov, are the liquidators of O's Construction Limited (OCL or the company). The defendant, Tianjiao Guo, is the sole director of the company. OCL traded as a construction company from incorporation on 27 April 2010, until it was put into liquidation on 8 February 2013. OCL currently has five creditors who are owed \$60,872.38.

[2] The liquidators claim that Ms Guo has breached the requirements of s 194 of the Companies Act 1993, and s 10 of the Financial Reporting Act 1993 by failing to keep proper accounting records for OCL. They seek an order pursuant to s 300(1)(b)(i) and (ii) of the Companies Act that Ms Guo is personally liable for the debts and liabilities of the company, and an order that Ms Guo pay the net liquidator fees and disbursements in liquidating the company of \$12,992.18.

[3] No defence was filed within the requisite time limit after receiving the statement of claim. The claim has therefore proceeded as a formal proof hearing under High Court Rule 15.9.

[4] When the case was first called in Court on 1 October 2015, Ms Guo appeared in person and sought to defend the claim. When I asked her why she had not taken any steps earlier to defend the claim, she said that she did not have a lawyer and did not read the documents with which she was served. She then told me that she had paid some creditors already and complained that the liquidators had taken some personal assets when they had seized the company's assets.

[5] Rule 15.9(3) provides that after a proceeding is listed for a formal proof hearing no statement of defence may be filed without the leave of a judge, granted on the ground that there will or may be a miscarriage of justice if judgment by default is entered. I therefore outlined the nature of the liquidators' case to Ms Guo and asked her whether she had any defence to the claim brought by them. Ms Guo said no. In those circumstances, I advised her that she was not able to defend the claim. I invited her to stay and listen the case, but she chose to leave the Court at that stage.

Formal proof

[6] Rule 15.9(1) states that r 15.9 for a formal proof hearing applies if the defendant does not file a statement of defence within the number of working days required by the notice of proceeding, and the judgment sought is other than for a liquidated demand.

[7] Under r 15.9(4), the plaintiff must file affidavit evidence which establishes, to the Judge's satisfaction, each cause of action relied on. The liquidators have filed an affidavit of Prashika Chand in support of their claim.

Applicant's submissions

[8] The liquidators say that following their appointment, they spent time trying to locate and obtain OCL's accounting records. They say that this proved difficult because Ms Guo has not co-operated and has no accounting records. Limited accounting and financial records have been obtained from Ms Guo and Michael Zhou, a friend who assisted in the preparation of financial statements for the year end 31 March 2012.

[9] On 13 October 2013, the liquidators interviewed Ms Guo, using their powers under s 261 of the Companies Act. Ms Guo confirmed that on occasions she allowed some third parties to order supplies, which were paid for through OCL's trading account. However, no documentation was provided to show which payments those were, despite the liquidators issuing requests under s 261 of the Act, and obtaining a court order requiring the production of the relevant documentation under s 266 of the Act.

[10] The liquidators say that, on reviewing the limited financial documentation of OCL, it "became apparent" that Ms Guo failed to keep proper accounting records. In particular, they say that:

- (a) OCL never prepared any end of year financial statements which would comply with statutory requirements; and

- (b) OCL never kept any ledgers, registers and supporting documents which would correctly record and explain the transactions, assets and liabilities of OCL at any given time.

[11] The liquidators say that the failure to keep proper records has adversely affected the liquidation, particularly as it has resulted in uncertainty as to OCL's assets and liabilities. The liquidators therefore could not secure OCL's physical assets, or collect receivables that were owing to OCL as at the date of liquidation. They also have been unable to consider taking legal action against OCL's suppliers under the voidable transactions regime or Ms Guo for recovery of her overdrawn current account with OCL.

[12] Further, the liquidators say that they were owed \$12,992.19 in the liquidation of OCL as at 29 January 2015.

[13] They submit that they should be able to recover from Ms Guo their fees, and that Ms Guo should be found personally responsible for all the outstanding debts of OCL.

Law

[14] The allegations against Ms Guo stem from her behaviour as a director during the period from the company's incorporation on 27 April 2010, until liquidation on 8 February 2013. The law that was in force in relation to financial reporting at that time has now been updated.¹ I apply the law that was at force at the time of the relevant breaches, as is appropriate.

[15] Section 194 of the Companies Act as applicable provides that accounting records must be kept at all times, according to the strict terms of that section. The records must achieve the following objectives:

- (a) Correctly record and explain the transactions of the company; and

¹ In the case of the Companies Act, s 194 was repealed and replaced with a substantially similar provision as of 1 April 2014 by the Financial Reporting (Amendments to Other Enactments) Act 2013. The Financial Reporting Act 1993 was repealed by the Financial Reporting Act 2013, which came into force on 1 April 2014.

- (b) Will at any time enable the financial position of the company to be determined with reasonable accuracy; and
- (c) Will enable the directors to ensure that the financial statements of the company comply with section 10 of the Financial Reporting Act and any group financial statements comply with section 13 of that Act; and
- (d) Will enable the financial statements of the company to be readily and properly audited.

[16] Section 194(4) provides that if the board of the company does not comply with the requirements, every director of the company has committed an offence and is liable on conviction to the penalty set out in s 374. Section 374 provides for directors to face a fine of up to \$50,000.

[17] In *Maloc Construction Ltd (in liq) v Chadwick*, the Court held that the records must be such that they will, at any time, enable the financial position of the company to be determined without requiring explanation or reconstruction.² The Court stated that a company must keep the records necessary to achieve the objectives listed above. This duty is an ongoing duty, as evidenced by the words “at any time” in s 194(1)(b) of the Act.

[18] These duties were applicable to Ms Guo and OCL at all relevant times.

[19] Section 10 of the Financial Reporting Act as applicable, provides:

10 Obligation to prepare financial statements

- (1) The directors of every reporting entity must ensure that, within 5 months after the balance date of the entity or, where the entity is required by any other Act to prepare financial statements or accounts within a shorter period after the end of its financial year or balance date, within that period, financial statements that comply with section 11 of this Act are—
 - (a) Completed in relation to the entity and that balance date; and
 - (b) Dated and signed on behalf of the directors by 2 directors of the entity, or, if the entity has only 1 director, by that director.

² *Maloc Construction (in liq) v Chadwick* (1986) 3 NZCLC 99,794 (HC), cited with approval recently by *Mizeen Painters Ltd (in liq) v Tapuosa* [2015] NZHC 826.

- (2) The directors of every exempt company must ensure that within 5 months after the balance date of the company or, if all the members or shareholders of the company agree, within 9 months after the balance date of the company, financial statements that comply with section 12 of this Act are—
- (a) Completed in relation to the company and that balance date; and
 - (b) Dated and signed on behalf of the directors by 2 directors of the company, or, if the company has only 1 director, by that director.

[20] The liquidators say that, under s 10, OCL was an “exempt entity”. An exempt entity is defined under s 6 of the Act as a company with at least two of the following:

- (a) Assets of less than \$1,000,000 as at the balance date;
- (b) Turnover of less than \$2,000,000 in the accounting period for which the financial statements are required; or
- (c) Five or fewer employees.

[21] The liquidators say that OCL was an exempt entity because the draft financial statements of OCL for the year ended 31 March 2012 showed less than \$1,000,000 of assets, and less than \$2,000,000 of turnover for any relevant financial period.

[22] Although under s 10A of the Financial Reporting Act, a possible defence for OCL would be that it was a non-active entity (which does not have to prepare financial statements) the liquidators submit that OCL was never non-active. OCL issued invoices, earned profit and incurred creditor debts up until the date of liquidation. It never issued a declaration that it was a non-active entity.

[23] On the evidence, it appears that s 10(2) of the Financial Reporting Act did apply to Ms Guo and OCL, as an exempt company.

Were these duties breached?

[24] The liquidators submit that Mr Guo failed to comply with her obligations to keep proper accounting records, pursuant to s 194 of the Companies Act and s 10 of the Financial Reporting Act. First, OCL never prepared any end of year financial statement that would comply with the Financial Reporting Act. While some end of year financial statements were prepared for the year ended 31 March 2012, they were not signed by Mr Guo as required by s 10 of that Act.

[25] Further, it does not appear that the financial statements were properly completed as they do not provide a true view of OCL's financial position at the time. Specifically:

- (a) The debts to the Inland Revenue Department and Porter Hire Limited were not recorded correctly on the balance sheet of OCL; and
- (b) The financial statements do not correctly record the assets of OCL. In particular, there was no record of the 2012 Volkswagen Amarok on the balance sheet of OCL.

[26] It does not appear that OCL provided any financial statements for the year ended 31 March 2011 and 2013.

[27] Secondly, OCL never kept any ledgers or registers, together with supporting documents that would correctly record and explain the transactions, assets and liabilities of OCL. In particular, to achieve the objective set out in s 194(1) of the Companies Act, Ms Chand has identified the following accounting records that had to be kept by OCL:

- (a) Legible list of debtors and creditors of OCL;
- (b) Records that account for cash transactions of OCL;
- (c) Contracts and building plans recording the construction work that OCL undertook on various residential houses;

- (d) Records detailing employees/contractors of OCL and its PAYE obligations to the Inland Revenue Department;
- (e) A complete asset register and depreciation schedule that records all of the assets of OCL and their market values; and
- (f) Accurate records that separate the transactions paid to suppliers on behalf of third parties and those transactions paid to the suppliers by OCL.

[28] It does not appear to the liquidators that Ms Guo kept documentation which would record the above information. While Ms Guo prepared limited excel spreadsheets for her personal record keeping, the spreadsheets are short of information which would enable a clear determination of OCL's financial position. In addition, the records contained within the spreadsheets do not "speak for themselves" as described in *Maloc Construction Ltd (In liq) v Chadwick*.³

[29] Further, the bank statements of OCL obtained by the liquidators have proven to be unhelpful in determining OCL's financial position. In particular, Ms Chand deposes that the bank statements omitted key information relating to OCL's assets and liabilities and transactions that were not banked.

[30] The evidence of the liquidators, which appears to be accurate, is that Ms Guo did not keep accounting records of the type required under s 194 of the Companies Act. Nor did she prepare any financial records for the financial years ending 2011, 2012 or 2013, as required by s 10 of the Financial Reporting Act.

Liability

[31] Section 300 of the Companies Act, as applicable at the date of Ms Guo's alleged breaches, states:

- (1) Subject to subsection (2) of this section, if—

³ *Maloc Construction Ltd (in liq)*, above n 2, at [22] and [23].

- (a) a company that is in liquidation and is unable to pay all its debts has failed to comply with—
 - (i) Section 194 of this Act (which relates to the keeping of accounting records); or
 - (ii) Section 10 of the Financial Reporting Act 1993 (which relates to the preparation of financial statements); and
- (b) The Court considers that—
 - (i) The failure to comply has **contributed to the company's inability to pay all its debts**, or has resulted in **substantial uncertainty** as to the assets and liabilities of the company, or has **substantially impeded** the orderly liquidation; or
 - (ii) For any other reason it is proper to make a declaration under this section,-

the Court, on the application of the liquidator, may, if it thinks it proper to do so, declare that any one or more of the directors and former directors of the company is, or are, personally responsible, without limitation of liability, for all or any part of the debts and other liabilities of the company as the Court may direct.

- (2) The Court must not make a declaration under subsection (1) of this section in relation to a person if the Court considers that the person—
 - (a) Took all reasonable steps to secure compliance by the company with the applicable provision referred to in paragraph (a) of that subsection; or
 - (b) Had reasonable grounds to believe and did believe that a competent and reliable person was charged with the duty of seeing that that provision was complied with and was in a position to discharge that duty.
- (3) The Court may give any direction it thinks fit for the purpose of giving effect to the declaration.

...

[32] The inability to pay debts must be determined at the date of the commencement of the liquidation, and must relate to all debts.⁴ The fact that OCL is in liquidation and has been unable to pay all its debts is clearly evidenced by Ms Chand's affidavit. Further, as analysed above, the evidence shows that Ms Guo

⁴ *Re Bennett Keane & White Ltd (in liq) (No 2)* (1988) 4 NZCLC 64,317.

was not complying with her duties under s 194 of the Companies Act or s 10 of the Financial Reporting Act.

[33] The failure must also have affected the company's ability to pay its debts, created substantial uncertainty as to the assets and liabilities of the company or substantially impeded the orderly liquidation of the company.

Impeded liquidation?

[34] The liquidators say that they were compelled to undertake additional investigations to get clarity on OCL's financial position, and that a considerable amount of time was spent on trying to determine what records should be available and trying to obtain them from the various parties. This impeded the orderly winding up of the business. The liquidators say that they have still been unable to obtain sufficient information to reconstruct OCL's accounts and financial positions.

[35] This has meant that the liquidators have not been able to say whether OCL was insolvent at any given time within two years of being put into liquidation. The liquidators have not been able to distinguish between payments made to suppliers by or on behalf of OCL, or to third parties. The liquidators have therefore not been able to pursue any remedies against OCL's suppliers under the Act, including the voidable transactions regime. They also have not been able to identify whether Ms Guo's use of the OCL account for personal spending has given rise to any liabilities.

[36] These all appear to demonstrate that the liquidation has been impeded by the lack of records.

[37] Similarly, it appears that there is resulting uncertainty as to OCL's assets and liabilities. There are inadequate records in the fixed asset register, and various pieces of equipment cannot be located. There is also no account payable register. Similarly, ongoing contracts with OCL appear to have been finished (following liquidation) by companies associated with Ms Guo. The liquidators cannot account for what proportion of the contract prices are payable to OCL.

[38] These matters all appear to demonstrate that the lack of record keeping had resulted in substantial uncertainty as to OCL's assets and liabilities.

Possible defences

[39] There is no evidence that Ms Guo could fall within the exception for liability provided under s 300(2). The liquidators say that there is no evidence that Ms Guo took any reasonable steps to secure compliance. Although Mr Zhou helped Ms Guo prepare some financial statements for the year ended 31 March 2012 he has confirmed that he was not formally engaged by OCL. Further, he did not have access to source documents to confirm whether the Excel spreadsheets which Ms Guo provided were accurate.

[40] In *Re Cellar House (in liq)*, France J clarified that the defendant must actually prove that the defence applies.⁵ Section 300(2) is not a default to be disproved by the applicants.

[41] Without further evidence from Ms Guo, there is no evidence that she has done anything which would satisfy s 300(2). The investigations of the liquidators, including an oral examination of Ms Guo, do not appear to provide any basis for the suggestion that Ms Guo took any particular steps to secure compliance with her duties or that she was reasonably relying on anyone else to complete her duties.

Quantum

[42] Having found that the grounds contained in s 300(1) have been made out, and that there is no available defence, I must still exercise my discretion as to the extent of Ms Guo's liability. Section 300 provides the Court with a broad discretion to make a declaration that Ms Guo is personally responsible for all or any part of the debts and other liabilities of the company.

[43] The recommended factors to consider in making such an award were discussed in *Mason v Lewis*.⁶ The Court of Appeal highlighted three factors:

⁵ *Re Cellar House Ltd (in liq)* HC Nelson CP13/00, 18 March 2004 at [157].

⁶ *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [110].

causation, culpability and the duration of trading. These have been summarised in commentary as entailing:⁷

- (a) Causation: Whether the action or inaction of a director or a former director has contributed to a failure to comply and to the financial position of the company.
- (b) Culpability: The extent to which the failure to comply results from the actions or inactions of a director or former director. A punitive element is involved so as to deter laxity on the part of directors in the keeping of proper accounting records.
- (c) Duration: The period over which the director or former director was responsible for the keeping of proper accounting records especially over the periods in which the debts were incurred which directly or indirectly led to the company's insolvency.

[44] In *Mizeen Painters Ltd (in liq) v Tapuosa*, Muir J allowed recovery of a contribution towards the liquidators' accounting costs, reflecting a fair apportionment for the time spent in reconstructing the company's affairs.⁸ In *Blanchett v Keshvara*, Venning J noted that the claim was discretionary, and took into account that there were directors other than the defendant at the time.⁹ His Honour also considered that a significant part of the claim related to advances that post-dated the defendant's involvement as a director. He therefore awarded one-third of the legal costs claimed, and one-third of the liquidator's extra costs incurred in assessing the correct position.

[45] In other cases, such as *Grant v Johnston*, a director has been found personally liable for the full sum of the company's indebtedness.¹⁰ This demonstrates that the scope of the discretion available. The Court of Appeal in *Mason v Lewis* also acknowledged this, saying "claims of this character necessarily have to be approached in a relatively broad-brush way. The jurisdiction to order recompense is of an "equitable" character."¹¹

[46] In this case, the liquidators say that the relevant "duration" is the entire period over which OCL traded. All outstanding debts of OCL were accrued during the duration of Ms Guo's directorship. It appears from their other submissions that

⁷ *Company Law* (online looseleaf edition, Westlaw) at [CA300.03]

⁸ *Mizeen Painters Ltd (in liq) v Tapuosa*, above n 2, at [52].

⁹ *Blanchett v Keshvara* [2011] NZCCLR 34 (HC) at [90].

¹⁰ *Grant v Johnston* [2015] NZHC 611.

¹¹ *Mason v Lewis*, above n 6, at [118].

her negligence as to financial reporting and accounting was ongoing throughout this period.

[47] The liquidators also say that there is a direct link between the lack of financial reporting and the impeded liquidation, the inability of OCL to pay all its debts, and the substantial uncertainty as to OCL's assets, as set out in s 300(1)(b)(i). This is also evidenced in their submissions summarised earlier.

[48] Finally, they say that Ms Guo should be culpable for the whole debt. Ms Guo was involved in the day to day management of OCL, including its finances. She was the sole director, and there is no evidence that she was relying on the statements of others in a way which could shift the culpability partially onto others. The liquidators therefore say that the whole debt should be found to be owed by Ms Guo.

[49] I agree that there appear to be no mitigating factors in Ms Guo's decision not to complete financial records or to maintain any accounting practices. As a sole director, she cannot seek to shift some blame onto anyone else with responsibility. Similarly, although it appears that she at one stage engaged Mr Zhou to do some basic accounting, she did not engage him in a formal capacity. Nor did she provide him with the information necessary to fully complete those accounts.

[50] On the information provided, I therefore allow the liquidator's claim for the full debt.

[51] In support of their claim that the costs that they incurred during the liquidation should also be paid, the liquidators point to a recent case in which the Court held that a director breaching their duties should pay compensation for the amount of the costs and disbursements incurred in the liquidation.¹² In that case, Brown J allowed the recovery of the liquidators' costs, excluding costs related to the litigation.¹³ In the few other cases that I highlighted above which dealt with ss 194 and 300, the liquidators' costs which were awarded were the extra costs associated with attempting to account for the lack of financial records.

¹² *Richard Geewiz Consultants Limited (in liq) v Gee* [2014] NZHC 1483.

¹³ *Richard Geewiz Consultants Limited (in liq) v Gee*, above n 12, at [12].

[52] This point was dealt with very recently in *Madsen-Ries v Petera*.¹⁴ Lang J did not see that a director should be liable to meet the general costs of the liquidation “unless there is a link between the incurring of those costs and the director’s conduct.”¹⁵ The case also involved directors whose poor record keeping had required the liquidators to incur expense in reconstructing books of account. Lang J quoted from *Madsen-Ries v Twine*, in which Gilbert J said:¹⁶

[10] The question of whether compensation should also be ordered in relation to the liquidators’ costs in undertaking the liquidation is less straightforward. Such costs may well be recoverable in a case where, for example, liquidators have been required to incur expense in reconstructing books of account because the directors failed to keep proper records in breach of their duty to do so. However, that is not the situation here. In this case, the directors ought to have ceased trading by early 2008, if not earlier. But it is not clear from the evidence that the costs incurred by the liquidators in carrying out the liquidation would have been any less if they had been appointed earlier. The liquidators would still have had to realise the company’s assets for the benefit of creditors and take all other steps required in any liquidation. It appears that a significant part of the liquidators’ costs were incurred in preparing the present proceeding. Such costs are not normally recoverable. For these reasons, I am not persuaded that an order requiring the directors to meet the costs of the liquidation is appropriate in this case.

[53] Following this approach, Lang J said that in some cases it would be appropriate for a director to meet some or all of the liquidation costs. As well as cases where poor records have been kept, it might also be appropriate where the actions that give rise to liability under s 300 or s 301 render an otherwise healthy company insolvent. His Honour did not require the errant directors to meet the general costs of the liquidation, as they had not caused an otherwise healthy company to fail. Elsewhere in the judgment, his Honour noted that the liquidators had not adduced evidence regarding the costs attributable to the reconstruction of the company’s affairs, which may explain why no partial award was made.¹⁷

[54] I am of the view, following Lang J and Gilbert J’s approach, that all of the liquidation costs should be awarded in this case. Not only were substantial costs incurred by Ms Guo’s poor record-keeping and failure to co-operate with the liquidators, but liquidation may not have occurred at all if Ms Guo knew of the

¹⁴ *Madsen-Ries v Petera* [2015] NZHC 538.

¹⁵ At [112].

¹⁶ *Madsen-Ries v Twine* [2015] NZHC 227.

¹⁷ *Madsen-Ries v Petera*, above n 14, at [107].

company's actual financial position earlier. The total sum owing to creditors who have proved in the liquidation amounts to \$60,872.38, yet the sum realised in the liquidation amounts to \$76,655.72. This sum has been applied to the liquidators' costs rather than being paid to the creditors. Ms Guo could have avoided liquidation by paying the creditors, using the company's assets, if the company's financial position had been accurately recorded by her.

Conclusion

[55] I make a declaration under s 300(1)(b) of the Companies Act that Ms Guo is personally responsible without limitation of liability for all the debts of OCL. I therefore enter judgment in favour of the plaintiffs against Ms Guo in the sum of \$60,872.38. In addition, I order that Ms Guo pay the plaintiffs the net liquidator fees and disbursements in the liquidator of the company, being \$12,992.18.

[56] Finally, the plaintiffs are entitled to costs of this proceeding on a 2B basis.

.....
Woolford J