

# **Reconsidering Directors' Reckless Trading Duty Under Section 135 of the Companies Act 1993**

**Bianca Hawkins**

A dissertation submitted in partial fulfilment of the degree of Bachelor of Laws (Honours) at  
the University of Otago, Dunedin, New Zealand – Te Whare Wānanga o Ōtākou

October 2021

## **Acknowledgements**

Thank you to my wonderful supervisor Shelley Griffiths. Your encouragement and advice over the past two years has been invaluable. Thank you for always having time during a busy year, reading my long drafts and pushing me to improve. I am forever grateful. I will miss our catch-ups!

Thank you to my second marker Barry Allan for always having your door open for a chat and advice.

Thank you to my family for your support. I appreciate everything you all do for me. I wouldn't be where I am today without you all!

Thank you to Michael Harper for your invaluable guidance and insights.

Lastly, thank you to all the friends and lecturers who have helped me through university.

# Table of Contents

<b>Introduction</b> .....	<b>3</b>
<b>Chapter One: Company Law Principles and Theory</b> .....	<b>5</b>
I    Important Company Law Principles .....	5
II   The Influence of the Corporate Objective .....	8
A    Shareholder Primacy .....	9
B    Stakeholder Theory .....	11
C    Entity Theory.....	12
<b>Chapter Two: The Reckless Trading Duty – Purpose and Pitfalls</b> .....	<b>15</b>
<b>Chapter Three: The Reckless Trading Duty’s Development and Disappointment</b> .....	<b>19</b>
I    Section 135’s Development – Increasing Breadth and Burdens.....	19
II   Extensive Criticism of Section 135.....	22
<b>Chapter Four: Section 135 and the Judiciary – From Pragmatic to Problematic</b> .....	<b>27</b>
I    The Early Cases – Emergence of a Dominant Pragmatic Approach .....	27
II   Debut and Mainzeal: The Pragmatic Approach Abandoned (But Not Forgotten) .....	30
A    Debut Homes .....	30
1    The Decisions .....	31
2    Considerable Criticism of the Supreme Court's Decision .....	33
B    Mainzeal .....	38
C    Debut’s Frosty Reception in the High Court .....	43
D    Overarching Criticisms of the Modern Judgments and Judiciary .....	44
<b>Chapter Five: Overlapping Directors Duties – Superfluous Section 135</b> .....	<b>50</b>
I    Delaware and Canada .....	50
II   Overlapping Director’s Duties – No Gap to Fill?.....	51
A    Section 136 .....	51
B    Section 131(1) .....	54
C    Section 137 .....	56
<b>Chapter Six: A Safe Harbour Solution</b> .....	<b>58</b>
I    Utility of COVID-19 Safe Harbours.....	58
II   Lessons from Australia’s Safe Harbour .....	60
III  Harmonisation .....	62
<b>Conclusion</b> .....	<b>63</b>

## Abbreviations

Companies Act 1993 - CA  
Shareholder primacy - SP  
Entity theory - ET  
Stakeholder theory - ST  
Small and medium enterprise - SME  
Inland Revenue - IR  
Directors’ and officers’ insurance - D&O insurance

## Introduction

Directors' duties have always been a hotly debated topic, none more so than insolvent trading duties. New Zealand's Companies Act 1993 (CA) contains two of these duties, ss 136 (duty not to incur obligations) and 135 (duty not to trade recklessly). The focus of this dissertation is s 135. Section 135 is the more problematic provision, it has been extensively criticised and is New Zealand's most litigated directors' duty.<sup>1</sup> Debate surrounding the provision came to a head with two major recent cases, *Debut Homes v Cooper (Debut)* and *Yan v Mainzeal (Mainzeal)*.<sup>2</sup> Both cases have made their way to the Supreme Court. Despite the plentiful litigation, s 135 remains as fraught with issues as when it was introduced. The judgments show a divided judiciary, some straying into concerningly draconian territory. The extensive litigation and academic discourse indicate s 135 is deficient and needs reconsideration.

Chapter one discusses company law principles and theory which shape directors' duties. Theory and principle underpin the law, meaning they are relevant for considering what is currently wrong with s 135 and guiding how it could be improved. It is difficult to balance principles and the tension is evident in s 135 decisions, as is the court's straying from an entity focus.

Chapter two considers the purpose of these duties to prevent directors destroying value in companies through improper conduct and providing protection/redress to creditors and the company. Whilst there are valid reasons for reckless trading duties, they are generally inefficient and uncertain.

Chapter three outlines the development of New Zealand's reckless trading duty and issues with the statutory provision. The courts have been left the burden of 'fixing' s 135.

---

<sup>1</sup> Lynne Taylor "Directors' Duties on Insolvency in New Zealand: an Empirical Study" (2019) 28 NZULR 171 at 185-186.

<sup>2</sup> *Debut Homes Limited (in liquidation) v Cooper* [2020] NZSC 100; and *Yan v Mainzeal Property and Construction Limited (in liquidation)* [2021] NZCA 99.

Three main solutions are canvassed – amending/rewriting the provision, removing the provision and/or adding a safe harbour.<sup>3</sup>

Chapter four outlines the early case law which became defined by the *Mason v Lewis* (*Mason*) pragmatic approach.<sup>4</sup> It struck an appropriate balance between efficiency and protecting stakeholders by interpreting s 135 with reference to the CA's purpose. This kept commentators concerns at bay. However, there was still uncertainty in this approach and the inherent broad nature of s 135. This left room to stray from pragmatism. The issues with *Debut*, *Mainzeal* and the modern judiciaries approach generally are discussed.

Chapters three and four show the major issues with s 135 are the lack of entity focus and failure to balance the CA's dual-purpose of protection and efficiency. The analysis in these chapters leads to the conclusion s 135 requires amendment.

Chapter five considers if s 135 is needed to address directors destroying value during financial difficulty. Reference to Delaware's and Canada's lack of insolvent trading duty assists this analysis. Section 135's significant overlap with ss 131, 136 and 137 shows the duty may be an unnecessary duplication.

Chapter six discusses whether a safe harbour could help address s 135's issues. COVID-19 saw safe harbours implemented globally, including for ss 135 and 136.<sup>5</sup> This showed they can be useful. Australia's permanent safe harbour for its wrongful trading duty provides helpful lessons for New Zealand.

This dissertation focuses on the company and largely stays within the bounds of company law, particularly directors' duties. However, it is important to note s 135 spans other areas of law that must be considered when amending the provision. This dissertation will also not consider if s 135 actually modifies director conduct.

---

<sup>3</sup> There are other options like compulsory D&O insurance, for more discussion see Helen Anderson *Corporate Directors' Liability to Creditors* (Lawbook Co, Pyrmont, 2006); and Taylor, above n 1.

<sup>4</sup> *Mason v Lewis* [2006] 3 NZLR 225.

<sup>5</sup> Companies Act 1993, s 138B and sch 12.

## Chapter One: Company Law Principles and Theory

It is important to consider company law theory and principles because they underpin the law.<sup>6</sup>

The corporate objective informs how and for what end directors manage the company and company law principles show the ideals the legislation and courts should include.<sup>7</sup>

### *I Important Company Law Principles*

The company is important to the New Zealand economy. It is a vehicle for economic progression.<sup>8</sup> The company and company law have this effect due to core doctrines.<sup>9</sup>

The modern company's core features are perpetual life, separate legal identity, limited liability, transferability of shares, shared ownership by contributors of capital and centralised/specialised management (separation of ownership and control).<sup>10</sup> Separate legal identity is a long-established principle integral to the success of the company.<sup>11</sup> It is clearly affirmed in s 15 of the CA. Separate legal identity means companies are separate from all associated with it and have legal standing and personality – a juridical person.<sup>12</sup> Assets belong

---

<sup>6</sup> Helen Anderson “Creditors’ Rights of Recovery: Economic Theory, Corporate Jurisprudence and the Role of Fairness” (2006) 30 *Melb. U. L. Rev.* 1 at 1.

<sup>7</sup> Kristin Van Zwieten “Disciplining the Directors of Insolvent Companies: Essay in Honour of Gabriel Moss QC” (2020) 33 *I.I.J.* 2 at 2.

<sup>8</sup> Law Commission *Company Law, a Discussion Paper* (NZLC PP5, 1987) at [33]-[35]; and Len Sealy “Directors’ ‘Wider’ Responsibilities – Problems Conceptual, Practical and Procedural” (1987) 13 *MonashULawRw* 164 at 181; John Farrar, Sian Elias, Peter Watts and others *Contemporary Issues in Company Law* (Commerce Clearing House, Auckland, 1987) at 3; and Anderson, above n 3, at 1-2.

<sup>9</sup> Law Commission *Company Law Reform and Restatement* (NZLC R9, 1989) at [22].

<sup>10</sup> At 22; Law Commission, above n 8, at [31]-[33]; Reinier Kraakman, John Armour, Paul Davies and others *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed, Oxford University Press, Oxford, 2017) at 5; and Susan Watson and Lynne Taylor *Corporate Law in New Zealand* (1st ed, Thomson Reuters New Zealand, Auckland, 2018) at 4 and 15.

<sup>11</sup> For more information on the development of separate legal identity and its’ impact on the company’s success see Watson and Taylor, above n 10, at 64-95; Ross Grantham and Charles Rickett *Corporate Personality in the 20<sup>th</sup> Century* (1st ed, Hart Publishing, Oxford, 1998) at 1-10; *Salomon v A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22 (HL); *Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL); *Lee v Lee’s Air Farming Ltd* [1961] NZLR 325 (PC); Sneha Mohanty and Vrinda Bhandari “The Evolution of the Separate Legal Personality Doctrine and Its Exceptions: A Comparative Analysis” (2011) 32 *Comp.Law.* 194; Susan Watson “The Corporate Legal Person” (2019) 19 *J. Corp. Law Stud.* 137; and Susan Watson “How the Company Became an Entity: A New Understanding of Corporate Law” (2015) 120 *J. Bus. Law. I.*; and Phillip Lipton “The Introduction of Limited Liability into the English and Australian Colonial Companies Acts: Inevitable Progression or Chaotic History?” (2018) 41 *Melb Univ Law Rev* 127.

<sup>12</sup> Grantham and Rickett, above n 11, at 4-9; *Salomon v A Salomon & Co Ltd*, above n 11, at 30, 31, 33, 45, 51, 53, 54; *Lee v Lee’s Air Farming Ltd*, above n 11, at 426-429; Lynn Buckley “The Foundations of Governance: Implications of Entity Theory for Directors’ Duties and Corporate Sustainability” (2021) 25 *J. Manag. Gov.* 1385 at 1390; and Watson and Taylor, above n 10, at 16.

to the company, not shareholders nor creditors.<sup>13</sup> This separation means directors, as the company's agent, are not personally liable for commitments incurred by the company.<sup>14</sup> The limitation of directors' personal liability enables them to take risks beneficial to the company and economic development.<sup>15</sup> Separate legal identity is therefore a crucial principle to uphold.

However, the corporate form is open to abuse.<sup>16</sup> At the heart of commercial law is balancing efficiency and substantive fairness (fair allocation of responsibility).<sup>17</sup> These are both objectives valued in the CA long title.<sup>18</sup> This means the CA should provide checks on director behaviour to protect stakeholders from impropriety without reducing the utility of the company form for legitimate risk-taking (which separate legal identity encourages).<sup>19</sup> Directors' duties which hold directors personally liable for breaching their obligations are one of the major checks in the CA preventing improper behaviour. Duties are also a major inroad into separate legal identity. Directors' duties should only include actions that go beyond legitimate risk-taking to avoid dissuading expert businesspeople taking directorships and risks.<sup>20</sup> A directors' duties purpose provision reaffirming the relevance of the CA's dual-purpose to directors' duties would assist the courts.

The solvency test is another core provision in the CA.<sup>21</sup> It replaced the capital maintenance rule in the Companies Act 1955 as the tool preventing undercapitalisation (coupled with

---

<sup>13</sup> Kraakman, Armour, Davies and others, above n 10, at 5; and *Ten Pin Properties Ltd v Bowlarama (NZ) Ltd* HC Christchurch M655/89, 18 December 1989 at 2–3.

<sup>14</sup> Kraakman, Armour, Davies and others, above n 10, at 12; Jason Harris "Director Liability for Insolvent Trading: Is the Cure Worse than the Disease?" (2009) 23 AJCL 1 at 2; and Susan Watson and Chris Noonan "The corporate shield: What happens to directors when companies fail?" (2005) Auckl.Univ.Law.Rev.1 27 at 27-28.

<sup>15</sup> Law Commission, above n 9, at [22]; Helen Anderson "Directors' Personal Liability to Creditors: Theory versus Tradition" (2003) 8 DeakinLawRw 209 at 217; Mohanty and Bhandari, above n 11, at 206; Harris, above n 14, at 2; and Grantham and Rickett, above n 11, at 25.

<sup>16</sup> Special Committee to Review the Companies Act *Final Report of the Special Committee to Review the Companies Act* (1973) at 187; and Andrew Keay "Wrongful Trading and the Liability of Company Directors: Theoretical Perspective" (2006) 25 Leg Stud 431 at 457.

<sup>17</sup> Michael Bos and Martin Wiseman "Directors' liabilities to creditors" (2003) NZLJ 262 at 262-263; Anderson, above n 3, at 8 and 56; and Anderson, above n 6, at 2-3.

<sup>18</sup> Companies Act, long title; Farrar, Elias, Watts and others, above n 8, at 6; (15 December 1992) 532 NZPD 13111; Law Commission, above n 9, at [21], [23] and [69]; and Neil Campbell, Peter Watts, Kim Francis and others *Morison's Company and Securities Law* (loose-leaf ed, LexisNexis) at [1.3].

<sup>19</sup> Law Commission, above n 8, at [35]-[38].

<sup>20</sup> Farrar, Elias, Watts and others, above n 8, at 71; *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [198]; Sealy, above n 8, at 180; Law Commission *Company Law Reform: Transition and Revision* (NZLC, R16, 1990) at 14-15; and Anderson, above n 6, at 2-3.

<sup>21</sup> Companies Act, s 4; John Farrar and Doug Tennent "The Unfitness of Directors, Insolvency and the Consequences – Some Comparisons" (2005) 11 CanterLawRw 239 at 239; Watson and Taylor, above n 10, at 136; and Law Commission, above n 20, at 17-18.

directors' duties) for the protection of the company, shareholders and creditors, particularly creditors as they rank ahead of shareholders for repayment on liquidation.<sup>22</sup> The solvency test requires directors to be satisfied the company will pass the solvency test after all distributions of wealth from the company.<sup>23</sup> The test has two limbs, cash flow (paying debts in the normal course of business) and balance sheet solvency (assets being greater than liabilities).<sup>24</sup>

In addition to the solvency test, the CA contains formal mechanisms to address the company's position during financial strife.<sup>25</sup> New Zealand (legislation) was part of the global movement towards valuing and focusing on a rescue culture.<sup>26</sup> Rescue promotes economic growth beneficial for wider society.<sup>27</sup> Parts 14 (compromises with creditors), 15 (Court approved arrangements, amalgamations or compromises) and 15A (voluntary administration) provide statutory procedures for rehabilitating companies in the vicinity of insolvency.<sup>28</sup> Another option is informal restructuring – a contractually based arrangement which may include professional help, asset sales and compromises.<sup>29</sup> If rescue efforts succeed and the company survives all stakeholders benefit. For example, creditors are paid and employees have jobs.<sup>30</sup> A going concern company with goodwill, works in progress, ability to collect

---

<sup>22</sup> Law Commission, above n 9, at [223]-[228] and [330]-[332]; Watson and Taylor, above n 10, at 952-953 and 955-958; Paul Heath and Michael Whale ed *Heath and Whale on Insolvency* (loose-leaf ed, LexisNexis) at [32.2.1]; Peter Fitzsimons "Australia and New Zealand on Different Corporate Paths" (1994) 8 *OtagoLawRev* 267 at 284-285; and (23 February 1993) 533 *NZPD* 13350.

<sup>23</sup> Christopher Haynes "The Solvency Test: A New Era in Directorial Responsibility" (1996) 8 *Auckland U. L. Rev.* 125 at 126-128; Watson and Taylor, above n 10, at 955-958; and Law Commission, above n 9, at [330]-[332].

<sup>24</sup> Companies Act, s 4; for more detail on the solvency test in s 4 see Mike Ross *Corporate Reconstructions: Strategies for Directors* (CCH New Zealand, Auckland, 1999) at ch 7; Haynes, above n 23; and Seppo Villa "Creditor Protection and the Application of the Solvency and Balance Sheet Tests under the Company Laws of Finland and New Zealand" (2008) 1.

<sup>25</sup> Companies Act, pts 14, 15, 15A, 16; and Lynne Taylor and Grant Slevin *The Law of Insolvency in New Zealand* (Thomson Reuters, Wellington, 2016) at 14-16.

<sup>26</sup> Law Commission *Insolvency Law Reform: Promoting Trust and Confidence – An Advisory Report to the Ministry of Economic Development* (NZLC, SP11, 2001) at 74-76; Sebastian Ellice "Is Voluntary Administration Failing Companies? An Investigation Into the Operation of Voluntary Administration in New Zealand from Inception To 2019" (2021) 52 *VUWLR* 29 at 8; Vanessa Finch *Corporate Insolvency Law Perspectives and Principles* (2nd ed, Cambridge University Press, Cambridge, 2009) at 253-254; Jan Adriaanse "The Uneasy Case for Bankruptcy Legislation and Business Rescue" (2014) 2 *NIBLeJ* 119 at 119-120; and Andrew Keay "Financially Distressed Companies, Restructuring and Creditors' interests: what is a Director to do?" (2019) *LMCLQ* 297 at 228-230.

<sup>27</sup> Harris, above n 14, at 6.

<sup>28</sup> For more information see Companies Act, pts 14, 15 and 15A; Campbell, Watts, Francis and others, above n 18, at [47.2], [48.1] and [47.11]; Heath and Whale, above n 22, at ch 16 and 17; Ellice, above n 26, at 30-32; and Taylor and Slevin, above n 25, at 14.

<sup>29</sup> Ross, above n 24, at 95; and Finch, above n 26, at 251-253.

<sup>30</sup> Sealy, above n 8, at 186.

debts owed, and better asset sale values is more valuable than the assets which constitute the business.<sup>31</sup> Whilst the CA supports rescue, this also depends on the judiciary's decisions.<sup>32</sup>

The principles of certainty, whilst retaining flexibility to meet diverse situations are also important in company law.<sup>33</sup> The CA was meant to make company law accessible and usable. But company law is not a field where finality is common due to the complex and unique situations meaning breadth is required to avoid lacunas.<sup>34</sup> However, too much flexibility creates uncertainty, leading to procedural unfairness. Procedural unfairness exists where the law is unsettled by inconsistent legislation and unpredictable common law decisions based on intuition and fairness. Without coherence, a body of law becomes technical and relies on arbitrary distinctions to justify disparate outcomes. This means directors, creditors and shareholders do not know what to do.<sup>35</sup> Certainty is vital to justice.

These are all important principles that should be present in company law. However, the balance between the oft-competing ideas is difficult to strike. It is questionable whether the current reckless trading duty upholds these doctrines.

## ***II The Influence of the Corporate Objective***

The corporate objective influences the interpretation of legal rules, how legislation is reformed and provides guidance impacting real-world governance.<sup>36</sup> Theory on the corporate objective impacts whose interests' directors consider when performing their duties and how.<sup>37</sup> Given the ambiguity surrounding s 135 and calls for reform, such discussion is imperative.

---

<sup>31</sup> Harris, above n 14, at 6.

<sup>32</sup> Muir Hunter "The Nature and Functions of a Rescue Culture" (1999) 104 Com. L.J. 426 at 458

<sup>33</sup> Farrar, Elias, Watts and others, above n 8, at 1; and Ross Grantham and Charles Rickett *Company and Securities Law* (Brookers, Wellington, 2002) at 40.

<sup>34</sup> Law Commission, above n 8, at [15], [16], [19] [20], [26], [33], [47] and [121]-[126]; (15 December 1992) 532 NZPD, above n 18, at 13110; and Special Committee to Review the Companies Act, above n 16, at 121; and Farrar, Elias, Watts and others, above n 8, at 4.

<sup>35</sup> Anderson, above n 3, at 4-6; and Anderson, above n 6, at 4 and 13.

<sup>36</sup> Buckley, above n 12, at 1385; and Andrew Keay "Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model" (2008) 71 Mod. L. Rev. 663 at 665-666.

<sup>37</sup> PM Vasudev and Susan Watson *Corporate Governance After the Financial Crisis* (Cheltenham, United Kingdom, Northampton, 2012) at 5-6; and Edward Rock "For Whom is the Corporation Managed in 2020?: The Debate over Corporate Purpose" (2020) 515 ECGI 1 at 1.

One of the oldest unsolved debates in company law is the corporate objective.<sup>38</sup> Shareholder primacy (SP), stakeholder theory (ST) and entity theory (ET) are the main competing paradigms.<sup>39</sup>

### **A Shareholder Primacy**

SP is a traditional interpretation of the corporate objective.<sup>40</sup> It grew from contrarianism and emphasises a private property-focused view of the company.<sup>41</sup> SP views the corporate purpose (director's responsibility) as maximising shareholder interests.<sup>42</sup> The company is merely a nexus of contracts, a convenient legal fiction.<sup>43</sup> This is justified by shareholders' provision of capital making them owners, and their position as the last claimants making them residual risk-bearers. Thus, shareholders have the greatest interest in the company's fortunes meaning they are incentivised to maximise profits. This leads to increased social wealth beneficial to all stakeholders.<sup>44</sup> SP views directors as the shareholders' agents<sup>45</sup> – allocating ownership and control to shareholders.<sup>46</sup> Monitoring and remuneration costs are incurred by shareholders to keep directors' interests aligned with shareholders.<sup>47</sup>

However, SP is heavily criticised. Firstly, shareholders do not own the company, only shares in the company.<sup>48</sup> Separate legal identity of the company is well-established (as

---

<sup>38</sup> Law Commission, above n 8, at [206].

<sup>39</sup> Vasudev and Watson, above n 37, at 5-6; and *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [28]-[31].

<sup>40</sup> Henry Hansmann and Reinier Kraakman "The End of History for Corporate Law" (2001) 89 *Geo.L.J.* 439 at 440-441; Thomas Clarke "Deconstructing the Mythology of Shareholder Value: A Comment on Lynn Stout's "The Shareholder Value Myth"" (2013) 3 *Account. Econ. Law* 15 at 27; and Andrew Keay and Rodoula Adamopoulou "Shareholder Value and UK Companies: A Positivist Inquiry" (2012) 13 *Eur. Bus. Organ. Law Rev.* 1 at 2.

<sup>41</sup> Clarke, above n 40, at 31; John Farrar and Pamela Hanrahan *Corporate Governance* (1st ed, Lexis Nexis Australia, Australia, 2016) at 32-33.

<sup>42</sup> Hansmann and Kraakman, above n 40, at 441, Watson and Taylor above n 10, at 50-51; and Peter Watts *Directors' Powers and Duties* (2nd ed, LexisNexis New Zealand, Wellington, 2015) At 10.

<sup>43</sup> Stephen Bainbridge "Twilight in the Zone of Insolvency: Fiduciary Duty and Creditors of Troubled Companies - Presentation of Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency" (2007) 1 *J. Bus. & Tech. L.* 281At 283.

<sup>44</sup> John Quinn "The Duty to Act in the Interests of the Company: Simply a Duty to Increase Shareholder Wealth?" (2015) 7 *UCD Working Papers* 1 at 1-3 and 6; Keay and Adamopoulou, above n 40, at 7-10; Keay, above n 36, at 667-669; and Watson and Taylor, above n 10, at 53.

<sup>45</sup> Watson and Taylor above n 10, at 50; Anderson, above n 15, at 211; and Grantham and Rickett, above n 40, at 73.

<sup>46</sup> Buckley, above n 12, at 1388.

<sup>47</sup> Hansmann and Kraakman, above n 40, at 455-456; Quinn, above n 44, at 6; Companies Act, ss 104-109 and 165; Watson and Taylor above n 10, at 50; and Anderson, above n 15, at 211.

<sup>48</sup> *Macaura v Northern Assurance Co Ltd*, above n 11, at 628; *Ten Pin Properties Ltd v Bowllarama (NZ) Ltd*, above n 13, at 2-3; Watson and Taylor, above n 12, at 535.

abovementioned). This also negates directors being the shareholders' agents, they are the company's agents with powers conferred by statute.<sup>49</sup> Nor are shareholders ultimate controllers, their powers are limited.<sup>50</sup> Directors are the true controllers.<sup>51</sup> Shareholders vulnerable position as residual claimants is overstated, liquidation negatively impacts many stakeholders<sup>52</sup> and shareholders have special protections.<sup>53</sup> SP also fails to recognise the diversity in shareholder constituencies. It does not provide any mechanism to balance shareholders' diverging interests.<sup>54</sup>

SP's focus has also been met with growing disapproval. Private shareholder centric governance is no longer acceptable given the power some companies possess.<sup>55</sup> SP is also known for short-termism and excessive risk because it measures success by short-term targets like quarterly earnings, share value and dividends.<sup>56</sup> As a result, it is closely linked to corporate collapses.<sup>57</sup>

The United Kingdom takes an enlightened shareholder value approach, a legal manifestation of SP. This tries to improve upon SP by including other stakeholders and focusing on long-term value.<sup>58</sup> However, the goal of promoting shareholders over all others remains.<sup>59</sup>

Most SPs accept limited consideration of creditors. Under SP directors' duties shift from being directly owed to shareholders to creditors during insolvency. This is because companies function on capital contributed by shareholders and creditors.<sup>60</sup> During insolvency

---

<sup>49</sup> Chris Noonan and Susan Watson "The Foundations of Corporate Governance in New Zealand: A Post-Contractualist View of the Role of Company Directors" (2007) 22 NZULR 649 at 5-6.

<sup>50</sup> Noonan and Watson, above n 49, at 2; and Len Sealy "Director's Duties Revisited" (2001) 22 Comp.Law 79 at 79; and Law Commission, above n 9, at [153]-[154].

<sup>51</sup> Companies Act, ss 128 and 126; Watson and Taylor, above n 10, at 35, 533 and 282-284; and Noonan and Watson, above n 49, at 3, 5-7.

<sup>52</sup> Keay, above n 36, at 671; and Watson and Taylor, above n 10, at 51.

<sup>53</sup> Law Commission, above n 9, at [196]-[199]; Quinn, above n 44, at 7; Watson and Taylor, above n 10, at 51; and Companies Act, pts 7, 11 and 12, and ss 90, 140, 153, 156, 180, 164, and 165.

<sup>54</sup> Law Commission, above n 8, at [250]; and Keay, above n 36, at 672.

<sup>55</sup> Sealy, above n 8, at 169 -170; and Quinn, above n 44, at 21.

<sup>56</sup> J. William Callison "Why a Fiduciary Duty Shift to Creditors of Insolvent Business Entities is Incorrect as a Matter of Theory and Practice" (2007) 1 J. Bus. & Tech. L. 431 at 435, 436 and 450.

<sup>57</sup> Watson and Taylor, above n 10, at 51 and 54; Keay, above n 36, at 670-672; Keay and Adamopoulou, above n 40, at 6-7 and 21; and Quinn, above n 44, at 8.

<sup>58</sup> Buckley, above n 12, at 1395-1397; and Companies Act 2006 (UK), s 172.

<sup>59</sup> At 1397 and 13401; and Andrew Keay "Risk, Shareholder Pressure and Short-Termism in Financial Institutions: Does Enlightened Shareholder Value Offer a Panacea?" (2011) 5 Law Financial Mark. Rev. 435 at 440-444.

<sup>60</sup> Callison, above n 56, at 431; Anderson, above n 15, at 219; *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [31]; Farrar and Hanrahan, above n 41, at 533-534; and for more discussion see Simone Sepe

creditors take shareholders' place as the party with an equitable interest in the corporate assets because the company is trading with creditor money.<sup>61</sup> There are two issues with this risk-shifting formulation. Firstly, the shift is based on creditors having a proprietary interest in the company, but no stakeholders own company assets as the company is a separate legal person.<sup>62</sup> Secondly, shifting the duty upon financial conditions creates uncertainty on when it arises.<sup>63</sup> It also means situations outside insolvency where director opportunism can arise, like where a company has outstanding debt, creditors are ignored.<sup>64</sup>

SP theory is flawed. SP has never been mandated in New Zealand and it does not reflect New Zealand company law.<sup>65</sup>

## ***B Stakeholder Theory***

The traditional competing model to SP is ST which holds the corporate objective should create value for all stakeholders.<sup>66</sup> Whilst the wider socially conscious view of the corporate objective is more acceptable to society than SP, it is difficult to implement. 'Stakeholder' is too broad, directors must constantly balance competing interests, there is no framework for directors to make decisions, directors are given too much discretion and there is no accountability mechanism.<sup>67</sup> Lastly, ST is unnecessary because stakeholders' interests are protected elsewhere.<sup>68</sup> Whilst the theory's inclusive approach is attractive, it is unworkable.<sup>69</sup>

---

"Directors' Duty to Creditors and the Debt Contract" (2007) 1 J. Bus. & Tech. L. 553; Andrew Keay "Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors" (2003) 66 Mod. L. Rev. 665 at 667 and 687-698.

<sup>61</sup> Keay, above n 60, at 667-668; and Kenneth Hayne "Directors' Duties and a Company's Creditors" (2014) 38 MelbULawRw 795 at 802-803.

<sup>62</sup> Anderson, above n 14, at 214; Hayne, above n 61, at 803; and Heath and Whale, above n 22, at [32.2.4].

<sup>63</sup> Callison, above n 56, at 449-450; and Andrew Keay "Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach" (2005) 64 Cambridge L.J. 614 at 615.

<sup>64</sup> Sepe, above n 60, at 577.

<sup>65</sup> Lynn Stout "On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)" (2013) 36 Seattle Univ. Law Rev. 1169 at 1184.

<sup>66</sup> Watson and Taylor, above n 10, at 54; and Watts, above n 42, at 132.

<sup>67</sup> Keay, above n 36, at 675-678; Quinn, above n 44, at 7-8; and Stephen Bainbridge "Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency" (2007) 1 J. Bus. & Tech. L. 335 at 354-355.

<sup>68</sup> Law Commission, above n 9, at [194] and [286].

<sup>69</sup> Keay, above n 36, at 675.

## *C Entity Theory*

ET is a paradigm gaining traction.<sup>70</sup> It has been endorsed in multiple jurisdictions,<sup>71</sup> including Canada – a well-known entity orientated jurisdiction.<sup>72</sup>

Managerialism laid the foundations for this conception of the corporate objective which views the company as a separate juridical person with wider responsibilities to society.<sup>73</sup> ET holds the corporate objective is to further the interests of the entity itself, protecting the company from abuse.<sup>74</sup> Directors as the company’s agents must maximise the long-term value of the company and ensure its survival.<sup>75</sup> Value maximisation is wide, it includes minimising and repaying debts, investing in the community and more. The second objective relates to financial sustainability. This involves avoiding insolvency, developing financial strength and creating strategies to address change.<sup>76</sup> Risky actions are not legitimate if they endanger the company (unlike SP).<sup>77</sup> But this would not prohibit legitimate risk-taking. An entity maximisation approach is attractive as it provides a happy medium between excessive risk and excessive caution. Furthermore, ET includes greater social responsibility without the drawbacks of balancing interests like ST as directors focus on the company’s interest.<sup>78</sup> However, other groups are not disregarded, they are valued and considered when ascertaining the company’s interests and where they align with the company’s interests.<sup>79</sup> This makes express reference to stakeholders in directors’ duties unnecessary as all stakeholders will be considered at a point in the company’s life.<sup>80</sup> Therefore, ET benefits everyone.

---

<sup>70</sup> Buckley, above n 12, at 1388-1389.

<sup>71</sup> Anderson, above n 15, at 211-213; Hayne, above n 61, at 797-799; Keay, above n 36, at 682; *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239; *Walker v Wimborne* [1976] HCA 7; and *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communs. Corp.*, 215 A.3d 12150 (Del.Ch. 1991).

<sup>72</sup> Watts, above n 42, at 264; Buckley, above n 12, at 1398-1401; *Peoples Department Stores Inc. (trustee of) v Wise* [2003] SCCA 133; and *BCE Inc v 1976 Debentureholders* [2008] SCCA 202.

<sup>73</sup> Clarke, above n 40, at 29-30; Grantham and Rickett, above n 33, at 58-59; Quinn, above n 44, at 1-2; and Watson and Taylor, above n 10, at 546, 59, 60 and 67.

<sup>74</sup> Watson, above n 11, at 1 and 20; Watson and Taylor, above n 10, at 80 and 144; Keay, above n 36, at 663 and 6664; Anderson, above n 15, at 16; and Buckley, above n 12, at 1386 and 1389.

<sup>75</sup> Keay, above n 36, at 678, 679 and 685-694; Buckley, above n 12, at 1387 and 1404; and Andrew Keay “Board Accountability and the Entity Maximization and Sustainability Approach” in Barnali Choudhury and Martin Petrin *Understanding the Company – Corporate Governance and Theory* (Cambridge University Press, Cambridge, 2017) 271 at 272-276.

<sup>76</sup> Keay, above n 36, 685-694; Keay, above n 63, at 634; and Buckley, above n 12, at 1387 and 1404.

<sup>77</sup> Callison, above n 56, at 435, 436 and 450.

<sup>78</sup> Vasudev and Watson, above n 37, at 129-130; Keay, above n 63, at 638-640; and Watson and Taylor, above n 10, at 545-546.

<sup>79</sup> Watson and Taylor, above n 10, at 545-546; for more discussion and examples of how ET decision-making looks, is different from SP and is beneficial for all stakeholders see Keay, above n 36, at 670 and 658-686.

<sup>80</sup> Buckley, above n 12, at 1400.

This reasoning applies to creditors.<sup>81</sup> The company's and creditors' interests overlap when considering actions during financial difficulties. ET means excessive risk-taking is impermissible as it would jeopardise the company. This matches creditor interests. When the company is insolvent there is also congruence. This is because for the company to continue it must be able to pay debts, which creditors want too.<sup>82</sup> This view was enunciated in New Zealand by Cooke J in *Nicholson v Permakraft* when he stated directors' duties are owed to the company which includes creditors in the vicinity of insolvency.<sup>83</sup>

However, there are criticisms of ET.<sup>84</sup> Firstly, that ET gives directors too much discretion. However, discretion is unavoidable in any paradigm as company law (as abovementioned) requires flexibility.<sup>85</sup> Furthermore, ET's objectives are clear which provides guidelines for directors.<sup>86</sup> It is also suggested ET provides no accountability mechanism. But, under ET directors are deterred by potential discipline, loss of income and reputation, performance-based remuneration mechanisms and monitoring each other.<sup>87</sup> Secondly, directors are answerable to shareholders who still perform an accountability function.<sup>88</sup> But, under ET shareholders act for the company.<sup>89</sup> The criticisms of ET are minor.

New Zealand can be explained as an ET jurisdiction.<sup>90</sup> It strongly affirms separate legal identity and related concepts like director control, the company's immortality, the company's ownership of its own assets and room for a wider long-term focus.<sup>91</sup> Furthermore, Māori corporate governance and Tikanga concepts align with ET's long-term focus and rescue

---

<sup>81</sup> Anderson, above n 15, at 219; and Watts, above n 42, at 264.

<sup>82</sup> Keay, above n 63, at 636-637.

<sup>83</sup> *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) at 249; and Hayne, above n 61, at 797-798.

<sup>84</sup> For more criticisms on ET being a 'dangerous' form of reification, incoherent and leaving directors owing duties to themselves see Bainbridge, above n 43, at 283; and Bainbridge, above n 67, at 352-353.

<sup>85</sup> Keay, above n 63, at 645-646.

<sup>86</sup> Quinn, above n 44, at 8-9.

<sup>87</sup> Keay, above n 36, at 694 and 697-698.

<sup>88</sup> Keay, above n 75, at 276 and 285-292; Law Commission, above n 8, at [153]-[154]; and Companies Act, pts 7, 11 and 12, and ss 90, 140, 153, 156, 180, 164, and 165.

<sup>89</sup> Keay, above n 75, at 284.

<sup>90</sup> Helen Winkelmann, Susan Glazebrook, and Ellen France, judges of the Supreme Court of New Zealand "Climate Change and the Law" (paper presented to the Asia Pacific Judicial Colloquium, Singapore, 2019) at [114]; further support is found in Te Urewera Act 2014 s 11; and Te Awa Tupua (Whanganui River Claims Settlement) Act 2017, s 12.

<sup>91</sup> Grantham and Rickett, above n 33, at 56; Companies Act, ss 128 and 126; Watson and Taylor, above n 10, at 2-3, 35, 533 and 282-284; Noonan and Watson, above n 49, at 3, 5-7; *Macaura v Northern Assurance Co Ltd*, above n 11, at 628; and *Ten Pin Properties Ltd v Bowlarama (NZ) Ltd*, above n 13, at 2-3.

culture, supporting ET's place in New Zealand.<sup>92</sup> Acknowledgement of corporate personality concedes there is more to the company than contracting, meaning SP cannot theoretically stand (even if it may be applied in practice).<sup>93</sup> Section 169 reinforces that shareholders are separate from the company by outlining different (direct) duties owed to shareholders and the company. Shareholders are owed direct duties because they are the accountability body, not because they are paramount.<sup>94</sup> ST theorists have a stronger claim than SP theorists as the CA directors' duties refer to the company, employees, shareholders and creditors.<sup>95</sup> However, the Law Commission did not plan to include stakeholders in the company or company law, they had an entity primacy type approach in mind. These additional constituencies were intended to be subordinate and external to the company. The mention of creditors is only an indirect duty as it is ultimately owed to the company.<sup>96</sup> Rather, the CA's mention of other groups reflects the ET understanding that the company's interests change over its life and the CA is providing guidance on when stakeholder interests overlap with the company's.<sup>97</sup> ET has the most explanatory power and promotes the best outcomes for companies in practice as it is fair and efficient.<sup>98</sup>

SP and ST have significant shortcomings. SP is unfair to stakeholders and encourages excessive risk-taking. ST is impractical and inefficient. ET resolves these issues as it is fair and efficient. ET also fits best with the CA. So, when discussing any amendments or interpretations of s 135, ET should be considered.

---

<sup>92</sup> For more discussion on the intergenerational focus of Māori corporate governance, the growing Māori economy and tikanga concepts such as mauri, kaitiakitanga, rangatiratanga, manaakitanga, and whanaungatanga see Joseph Williams "Lex Aotearoa: An Heroic Attempt to Map the Māori Dimension in Modern New Zealand Law" (2013) 21 Wai.L.Rev. 1; *Stakeholder Governance – A Call to Review Directors' Duties* (New Zealand Institute of Directors and MinterEllisonRuddWatts, 2021); Linda Te Aho "Corporate Governance: Balancing Tikanaga Māori with Commercial Objectives" (2005) 8 Yearb.N.Z.jurisprudence 300; Rachel Jones, Erin Matariki Carr and Liam Stoneley *Te Ao Māori Trends and Insights* (Chapman Tripp, June 2017); Valmaine Toki *Culture – the Foundation of Māori Governance* (Chartered Secretaries New Zealand, 2013); Watson and Taylor, above n 10, at ch 7; and Mark Story "Māori Governance: Meeting the Cultural Challenge" (2005) 25 NZM 7.

<sup>93</sup> Watson and Taylor, above n 10, at 533-535.

<sup>94</sup> Companies Act, s 169(3); John Bovaird Brennan "The Companies Act 1993 and Common Law Directors' Duties to Creditors: The Demise of Redundant Judicial Sympathies" (LLM Research Paper, University of Victoria, 1995) at 28; Ross Grantham "New Zealand – Reforming the Duties of Company Directors" (1991) 12 Comp.Law 27 at 28; and Law Commission, above n 8, at [149], [153]-[154].

<sup>95</sup> Companies Act, s 90 132, 135, 136, 140 and 148.

<sup>96</sup> Taylor, above n 1, at 171-172; Watts, above n 42, at 262; Vasudev and Watson, above n 37, at 130; and Law Commission, above n 9, at [192]-[195] and [284]-[286]; and Grantham, above n 94, at 27-28.

<sup>97</sup> Watson and Taylor, above n 10, at 531 and 545-546. Grantham, above n 94, at 27-28; and Law Commission, above n 9, at [188]-[194].

<sup>98</sup> Keay, above n 36, at 687; Winkelmann, Glazebrook, and France, above n 90, at [114].

## Chapter Two: The Reckless Trading Duty – Purpose and Pitfalls

Most jurisdictions have implemented directors' duties as one of the legal strategies that prevent directors taking improper risks which destroy the company's financial position - harming the company and (existing and future)<sup>99</sup> creditors.<sup>100</sup> The duty can be implemented in multiple ways. Amongst the suite of possibilities is the reckless trading duty (known as a wrongful or insolvent trading duty in other jurisdictions).<sup>101</sup> It is often coupled with other duties.<sup>102</sup>

The rationale behind these duties is directors and/or shareholders during financial distress face perverse incentives to take excessive risks.<sup>103</sup> When a company enters the vicinity of insolvency, shareholders are predicted to favour high-risk high-reward strategies. This opportunistic conduct arises because once the company enters the zone of insolvency shareholders will only receive further financial benefit if the company returns to solvency because on liquidation, there is unlikely to be sufficient funds to cover shareholder claims who are last in the order of priorities.<sup>104</sup> Limited liability emboldens shareholders to pursue risky projects because if ventures fail their personal assets are protected.<sup>105</sup> The downside of large gambles (insolvency and insufficient funds to meet claims) falls on the company and creditors.<sup>106</sup> However, in modern companies the concern of shareholder risk-taking only has

---

<sup>99</sup> Watson and Taylor, above n 10, at 609; and *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [233].

<sup>100</sup> Andrew Keay "The Shifting of Directors' Duties in the Vicinity of Insolvency" (2015) 24 *Int.Insol.v.Rev* 140 at 2-3; Aurelio Gurrea-Martínez "Towards an Optimal Model of Directors' Duties in the Zone of Insolvency: An Economic and Comparative Approach" (2020) 22 *SMU* 1 at 4; and Anderson, above n 3, at 2-3; Taylor, above n 1, at 711-172; Brennan, above n 94, at 76-77; and *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [235].

<sup>101</sup> For more discussion on other variations of director's duties targeting value destructive conduct during financial difficulty see Oscar Couwenberg and Stephen J. Lubben "Solving creditor problems in the twilight zone: Superfluous law and inadequate private solutions" (2013) 34 *Int.Rev.LawEcon.* 61 at 61-65; Gurrea-Martínez, above n 100, at 11-30; Keay, above n 100, at 1-2; Helen Anderson "Directors' Liability for Corporate Faults and Defaults – An International Comparison" (2009) 18 *Pac.Rim.L&Pol'y.J.* 1 at 22-230; and Amir Licht "My Creditor's Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency" (2021) *ECGI* 1 at 27-31; and London School of Economics *Study on Directors' Duties and Liability* (European Commission, April 2013).

<sup>102</sup> Licht, above n 101, at 27-28; Lubben, above n 101, at 63; and Gurrea-Martínez, above n 100, at 23-24.

<sup>103</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [231]; and Callison, above n 56, at 431-433.

<sup>104</sup> Kristin Van Zwieten "Director Liability in Insolvency and its Vicinity" (2018) 38 *Oxf. J. Leg. Stud.* 382 at 2, 5, 7-11; Gurrea-Martínez, above n 100, at 7-10; and Grantham and Rickett, above n 11, at 25.

<sup>105</sup> Bos and Wiseman, above n 17, at 262-263; Kraakman, Armour, Davies and others, above n 40, at 111; and Bainbridge, above n 67, at 356-357.

<sup>106</sup> Grantham and Rickett, above n 11, at 25; and Grantham and Rickett, above n 33, at 582.

traction where shareholders can influence directors who control the company.<sup>107</sup> Shareholder and director interests align in closely held corporations where there is a controlling shareholder, a shareholder-director or directors have equity-based incentives. In these instances, a reckless trading duty on directors would impede shareholder opportunism.<sup>108</sup> This concern is particularly relevant in New Zealand where small and medium enterprises (SMEs) comprise 97% of companies.<sup>109</sup> This danger with SMEs has been illustrated in New Zealand where 80% of claims for directors' breaching duties on insolvency were from SMEs.<sup>110</sup>

Directors are expected to engage in excessive risk-taking independent of shareholder influence during financial difficulty. Whilst managers are more risk-averse than shareholders as reputational and monetary incentives deter misbehaviour, when business deteriorates, directors have little to lose and are influenced by a 'gambler' strategy.<sup>111</sup> Furthermore, separate legal identity creates a moral hazard as directors are not personally liable for debts and actions within their role.<sup>112</sup> Directors may act to the company's and creditors' detriment by diluting assets, keeping non-viable companies alive, increasing the company's liabilities by taking on more debt and substituting assets used in low-risk activities to pay for high-risk projects.<sup>113</sup> This behaviour also stems from escalation of commitment. Escalation of commitment is where directors remain committed to their original choices even when it is no longer rational as the project is failing. Directors do this as they value perseverance, want to avoid failure, consider non-recoupable past expenditure, are influenced by family pride in closely held SMEs, have sentimental attachment, and/or are blinded by the herding mentality of the 'ingroup' (the board).<sup>114</sup> As shareholders have already lost their investment, they are unlikely to stop directors' risk-taking.<sup>115</sup>

---

<sup>107</sup> Bainbridge, above n 67, at 358; Watson and Taylor, above n 10, at 607; and Kraakman, Armour, Davies and others, above n 40, at 112.

<sup>108</sup> Anderson, above n 3, at 48, 50 and 51; Sepe, above n 60, at 564-565; and Licht, above n 101, at 2-3.

<sup>109</sup> "Small Business" Ministry of Business, Innovation and Employment <[www.mbie.govt.nz](http://www.mbie.govt.nz)>.

<sup>110</sup> Taylor, above n 1, at 185.

<sup>111</sup> Sepe, above n 60, at 575-577; Keay, above n 60, at 668-669 and 693; and Keay, above n 100, at 6-7.

<sup>112</sup> Anderson, above n 3, at 2; and Mike Ross *Directors' Liability and Company Solvency: the New Companies Act* (Commerce Clearing House, Auckland, 1994) at 77.

<sup>113</sup> Licht, above n 101, at 3-4; Anderson, above n 6, at 6; Sealy, above n 8, at 171-172; Grantham and Rickett, above n 33, at 588; and Kraakman, Armour, Davies and others, above n 10, at 111-113.

<sup>114</sup> Licht, above n 101, at 6-12; Farrar and Hanrahan, above n 41, at 336, 444 and 445; and Andrew Keay "Wrongful Trading: Problems and Proposals" (2014) 65 NILQ 63 at 18.

<sup>115</sup> Watson and Taylor, above n 10, at 607; and Anderson, above n 15, at 17.

The sanction of a reckless trading duty discourages controllers from taking advantage of separate legal personality and ‘betting the house’ in the hopes of avoiding insolvency by imposing personal liability on directors for losses.<sup>116</sup> The duty also provides a remedy for those harmed (particularly the company and creditors).<sup>117</sup>

Affording this protection to the company is met with little controversy. However, it is argued (mainly by some SP theorists) that creditors should not receive extra protection.<sup>118</sup> Creditors are not vulnerable, the relationship is a voluntary business bargain and all bargains involve risks, incomplete information and inefficiencies. Creditors should protect themselves through contractual terms like high-interest rates, security or guarantees.<sup>119</sup> Reckless trading duties give creditors a windfall, encouraging foolishness rather than pre-emptive protection.<sup>120</sup>

Whilst these criticisms hold weight with well-resourced, powerful and expert sophisticated creditors, many creditors cannot protect themselves.<sup>121</sup> Disparities in bargaining power and information asymmetries prevent some creditors obtaining effective protection.<sup>122</sup> For example, trade creditors have little choice over whether to deal with companies, they lack bargaining power to obtain contractual concessions and monitoring companies for a security or guarantee is unprofitable.<sup>123</sup> Furthermore, contracts do not stop directors acting improperly.<sup>124</sup> As a result, it is generally accepted creditors should be considered in directors’ duties.

---

<sup>116</sup> Anderson, above n 15, at 17; Harris, above n 14, at 3; Van Zwieten, above n 104, at 2 and 9; Watts, above n 42, at 268; Keay, above n 16, at 456; Sefan HC Lo “Proposals for Insolvent Trading Laws in Hong Kong: A Comparative Analysis” (2020) *J.Int’l&Comp.L.* 229 at 231-234; and Watson and Taylor, above n 10, at 606-607.

<sup>117</sup> Heath and Whale, above n 22, at [32.2.2]; and Roderick S Deane “Besieged by Duties – Will the New Companies Act Work for Directors” (paper presented to the Company Law Conference, 1994) at 1; and Keay, above n 100, at 6.

<sup>118</sup> Anderson, above n 7, at 4-5.

<sup>119</sup> Deane, above n 117, at 2; Hayne, above n 61, at 805-810; Anili Hargovan and Timothy Todd “Financial Twilight Re-Appraisal: Ending the Judicially Created Quagmire of Fiduciary Duties to Creditors” (2016) 78 *U. Pitt. L. Rev.* 135, 150-51 at 163-179; and Keay, above n 60, at 15 and 28-30; Christopher Cowton *Putting Creditors in Their Rightful Place: Corporate Governance and Business Ethics in the Light of Limited Liability* (University of Huddersfield Business School) at 15-16.

<sup>120</sup> Anderson, above n 6, at 4; and Bainbridge, above n 43, at 282.

<sup>121</sup> Grantham and Rickett, above n 33, at 590 and 592; Law Commission, above n 8, at [309]; and Keay, above n 60, at 679-680.

<sup>122</sup> Anderson, above n 6, at 5-6; and Keay, above n 60, at 698-699.

<sup>123</sup> Keay, above n 16, at 451-453; Watson and Taylor, above n 10, at 608; and Grantham and Rickett, above n 11, at 32.

<sup>124</sup> Anderson, above n 6, at 7; and Keay, above n 63, at 699.

Whilst reckless trading duties serve a valuable purpose, they suffer drawbacks so significant the duties are despised globally.<sup>125</sup> Firstly reckless trading duties produce inefficiencies.<sup>126</sup> Reckless trading duties diminish separate legal identity by holding directors personally liable, meaning directors are less likely to take risks or restructure.<sup>127</sup> Instead directors may become risk-averse, decline directorships, resign at the first sign of trouble or prematurely liquidate.<sup>128</sup> This limits benefits to society from business risk-taking and contributes to recessionary conditions.<sup>129</sup> Company resources are also used inefficiently to meet the increased costs of insurance and director remuneration which rise with growing risks.<sup>130</sup> This shows reckless trading duties have significant drawbacks.

Another drawback of reckless trading duties is they are unpredictable. Legislation is broad to allow flexibility, and courts do not often provide guideposts as breaches are fact-dependent.<sup>131</sup> The uncertainty leads to risk-averse behaviour as directors do not know if their conduct will comply with the law.<sup>132</sup>

### ***Conclusion***

Whilst there are valid reasons for imposing reckless trading duties, a fair balance between creditors', the company's and directors' interests is essential. It is important to avoid imposing uncertain and draconian liability on honest directors and ensure truly reckless and dishonest directors do not harm the company or creditors.<sup>133</sup>

---

<sup>125</sup> Licht, above n 101, at 31.

<sup>126</sup> Anderson, above n 15, at 216-217.

<sup>127</sup> Sealy, above n 8, at 186; Grantham and Rickett, above n 33, at 589; and Harris, above n 14, at 7.

<sup>128</sup> Watson and Taylor, above n 10, at 608; and Keay, above n 16, at 435-437 and 445-446.

<sup>129</sup> Harris, above n 14, at 2.

<sup>130</sup> Grantham and Rickett, above n 33, at 589; Anderson, above n 3, at 95; Hargovan and Todd, above n 119, at 159-160; and Andrew Keay "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" (2001) 25 MelbULawRw 315 at 325.

<sup>131</sup> Licht, above n 101, at 1 and 25; and Keay, above n 63, at 615.

<sup>132</sup> Hargovan and Todd, above n 119, at 139 and 140; Keay, above n 130, at 806; Licht, above n 101, at 6, 33 and 34; Couwenberg and Lubben, above n 101, at 70-71; Keay, above n 26, at 305-311; Gurrea-Martínez, above n 100, at 17; and Keay, above n 63, at 615.

<sup>133</sup> Grantham and Rickett, above n 33, at 588 and 590; and Keay, above n 16, at 447-449 and 460.

## Chapter Three: The Reckless Trading Duty's Development and Disappointment

### *I Section 135's Development – Increasing Breadth and Burdens*

A provision prohibiting fraudulent trading (committing the company to contracts the director knew could not be met) was enacted in New Zealand in 1933 and was retained in the 1955 Act.<sup>134</sup> It required directors directly compensate creditors.<sup>135</sup> The provision mirrored s 275 of the 1929 United Kingdom Act, enacted following the 1926 Greene Report.<sup>136</sup> In 1962 the United Kingdom's Jenkins Committee noted the provision was too narrow and therefore did not effectively deter directors continuing hopelessly insolvent companies. The Committee recommended including reckless trading. This was taken up by Australia in 1971 and 1981 in New Zealand through revising s 320.<sup>137</sup>

The 1981 amendment preserved the fraudulent trading prohibition and added two limbs.<sup>138</sup> The first limb was a negligence type obligation. It made directors liable for knowingly incurring company debts they did not honestly believe the company could meet. This first limb is largely repeated in s 136 of the CA.<sup>139</sup> The second limb prohibited knowingly causing reckless trading (based on an objective standard). The wording is not repeated in s 135 of the CA but shares the same purpose.<sup>140</sup> Section 320 only caught directors who had active roles and actual knowledge and applied to all business activity.<sup>141</sup> Section 321 was a special enforcement provision, only a liquidator could bring the action.<sup>142</sup> Compensation was held for

---

<sup>134</sup> Companies Act 1955, s 320; Companies Act 1933, s 268; Watts, above n 42, at 269; Watson and Taylor, above n 10, at 605; and Law Commission, above n 9, at [515]; and *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [239].

<sup>135</sup> Heath and Whale, above n 22, at [32.3].

<sup>136</sup> Hugh Rennie and Peter Watts "Directors' Duties and Shareholders' Rights" (paper presented to the New Zealand Law Society, 1996) at 33; Watson and Taylor, above n 10, at 605; and Heath and Whale, above n 22, at [32.3]; and *Re South Pacific Shipping Ltd (in liq)* HC Christchurch CIV-1998-409-000069, 12 February 2004 at [117].

<sup>137</sup> Grantham and Rickett, above n 33, at 592; Special Committee to Review the Companies Act, above n 16, at 181; and *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [243]; Watson and Taylor, above n 10, at 606; and Watts, above n 42, at 270.

<sup>138</sup> Companies Act 1933, s 320(1)(a)-(c) and s 461D; and Michael Arthur "Reckless Trading Damages" (2013) NZLJ 51 at 52.

<sup>139</sup> Watts, above n 42, at 270; and Grantham and Rickett, above n 33, at 592.

<sup>140</sup> Watts, above n 42, at 271; and *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [113]-[115].

<sup>141</sup> Grantham and Rickett, above n 33, at 593; and Brennan, above n 94, at 27-31.

<sup>142</sup> Arthur, above n 138, at 52; and Heath and Whale, above n 22, at [32.3].

creditors<sup>143</sup> and quantum was determined by considering causation, culpability and duration of trade.<sup>144</sup>

Meanwhile, decisions across the Commonwealth on directors' duties reflected growing recognition of the vulnerability of the company and creditors during financial uncertainty. These cases recognised it was likely in such circumstances the company included creditors.<sup>145</sup>

In 1986 the Law Commission began reviewing company law culminating in the CA. The Law Commission departed from the Europeanised United Kingdom law and dense/outdated Australian law for the deregulatory North American approach.<sup>146</sup> They were to recommend accessible legislation fit for present and future New Zealand that prevented abuse and encouraged efficiency. This included compiling and clarifying general directors' duties.<sup>147</sup> The Law Commission stated s 320 undermined the position of the company as a vehicle for business risk.<sup>148</sup> They proposed cl 105, a general duty to the company owed throughout its life which prohibited directors transacting unless they believed actions would not involve unreasonable risk to the company failing the solvency test; and prohibited directors incurring obligations they did not believe the company could perform. Only after the company's interests were met could directors consider creditor interests which were *consistent* with the company's.<sup>149</sup> In acknowledgement of risk-taking being a legitimate/beneficial activity cl 105 only imposed liability where directors "unreasonably" risked insolvency.<sup>150</sup> This allowed

---

<sup>143</sup> There is some disagreement on whether compensation was held for creditors generally or unsecured creditors specifically. For more discussion on this point see Grantham and Rickett, above n 33, at 592; Watson and Taylor, above n 10, at 605; and Heath and Whale, above n 22, at [32.3].

<sup>144</sup> Watts, above n 42, at 287; Farrar and Tennent, above n 21, at 244; and *Löwer v Traveller and Waller* [1988] NZCA 36/04 at [78].

<sup>145</sup> These judgments were directed at directors' duty of good faith, discussed in chapter five. For more on the early cases recognising a shift in duty to creditors see the Law Commission, above n 8, at [210]; Hayne, above n 61, at 797-799; Heath and Whale, above n 22, at [32.2.3]; Keay, above n 100, at 5-10 and 14-20; Licht, above n 101, at 27-30; *Walker v Wimborne*, above n 71; *Nicholson v Permakraft (NZ) Ltd*, above n 83; *Peoples Department Stores Inc. (trustee of) v Wise*, above n 72; *Credit Lyonnais Bank Nederland, N.V. v Pathe Communs. Corp.*, above n 71; *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA); and *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722 (NSWCA).

<sup>146</sup> Law Commission, above n 9, at [29]-[33] and [36]-[42]; and John Farrar *Corporate Governance – Theories, Principles and Practice* (3rd ed, Oxford University Press, Victoria, 2008) at 16-17.

<sup>147</sup> Special Committee to Review the Companies Act, above n 16, at 10-11; Law Commission, above n 9, at ii and [184]-[187]; (23 February 1993) 533 NZPD, above n 27, at 13351-13352; and Watson and Taylor, above n 10, at 132-133.

<sup>148</sup> Law Commission, above n 9, at [516].

<sup>149</sup> At [515]-[518] and 241-242; and Watts, above n 42, at 264-265.

<sup>150</sup> Law Commission, above n 9, at [516]; and Watson and Taylor, above n 10, at 615.

reasonable risks, and trading whilst insolvent was not wrong.<sup>151</sup> It captured the dual-purpose of protection and efficiency in the CA's long title.

Clause 105 was not enacted. For the Companies Bill the Justice Department instead included cl 113 which prohibited directors agreeing, causing or allowing the business of a company being carried on recklessly (indifference and gross negligence causing undesirable outcomes).<sup>152</sup> This provision had potential as it comes close to what the law should be aiming at – grossly improper trading after insolvency.<sup>153</sup> The reckless trading duty was changed for the final time by the Justice and Law Reform Select Committee to clarify 'reckless trading'. Rather than defining the term, 'recklessly' was replaced with "in a manner likely to create a substantial risk of serious loss to the creditors". The Committee believed the words reflected judicial interpretation as it is a modified version of Bisson J's judgment in *Thompson v Innes*.<sup>154</sup> They felt this was "easy to interpret and...logical".<sup>155</sup> The Committee still viewed the provision as prohibiting reckless trading, applying throughout the company's life and owed to the company. It is also not a fiduciary duty and is an objective standard.<sup>156</sup> Notable differences from the old provision are the shift from what directors know to what directors "agree to", "cause or allow" and focusing on the company rather than creditors. Knowledge was omitted to include ignorant directors.<sup>157</sup>

Provisions related to s 135 in the CA are ss 131 (duty to act in good faith in the company's best interests) 136 (duty not to incur obligations the company cannot meet), 380 (criminal fraudulent trading), 138 (general defence for relying on information from others), and 301 (procedural shortcut for a liquidator, creditor or shareholder bringing a s 135 breach

---

<sup>151</sup> Watts, above n 42, at 271; Rennie and Watts, above n 136, at 32; and David Tompkins "Directing the Directors: the Duties of Directors under the Companies Act 1993" (1994) 2 WkoLawRw 13 at 21.

<sup>152</sup> Companies Bill 1900 (50-1), cl 113; and Tompkins, above n 151, at 14-15.

<sup>153</sup> Rennie and Watts, above n 136, at 32.

<sup>154</sup> Companies Bill 1900 (50-1) (Select Committee Report) at 6; *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [118]; and *Thompson v Innes* (1985) 2 NZCLC 99,463 (HC) at 99,472; and Watson and Taylor, above n 10, at 612-613 and 615.

<sup>155</sup> (15 December 1992) 532 NZPD, above n 18, at 13112; and (23 February 1993) 533 NZPD, above n 22, at 13364-13366.

<sup>156</sup> Companies Bill 1900 (50-1) (Select Committee Report), above n 154, at 6; *Madsen-Ries and Vance v Petera* [2015] NZHC 538 at [25]; Companies Act, s 169(3); Grantham and Rickett, above n 42, at 3; Taylor, above n 1, at 171-172.

<sup>157</sup> For more in-depth discussion on the differences between s 320 Companies Act 1955 and s 135 Companies Act 1993 see Grantham and Rickett, above n 33, at 615; Paul Davies "Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency" (2006) 7 Eur. Bus. Organ. Law Rev. 301 at 333-334; Brennan, above n 94, at 41-43; Watts, above n 42, at 276; and Heath and Whale, above n 22, at [32.3.3].

claim/inquiry to the High Court).<sup>158</sup> Under s 301 courts also have broad discretion to order directors contribute sums as they think just.<sup>159</sup> Any compensation under s 301 falls into the pool of company assets.<sup>160</sup> Importantly, sch 7 cl 1(1)(e) gives unsecured creditors preferential right to repayment of costs and their unsecured debt if they provide funding for a claim.<sup>161</sup> This helps s 135 achieve the aspect of the reckless trading duty rationale of protecting unsecured creditors. Section 135 claims can also be brought as ordinary actions for breach of statutory duties, an injunction or derivative action by the company, liquidator and shareholders respectively.<sup>162</sup>

Whilst the CA is a hybrid between the Law Commission's deregulatory law and economics approach and the Department of Justice's regulatory approach, s 135's high objective standard is a compromise in favour of the conservative approach.<sup>163</sup>

## ***II Extensive Criticism of Section 135***

No other provision in the CA has attracted the degree of criticism directed at s 135.<sup>164</sup> It suffers typical reckless trading duty shortfalls.<sup>165</sup> The phrase "substantial risk of serious loss" has been the primary concern.<sup>166</sup>

There has been significant criticism of the legislative process and confusing drafting.<sup>167</sup> Section 135's incoherence stems from the Law Commission's and Justice Department's

---

<sup>158</sup> Chapter five discusses ss 131, 136 and 137 of the Companies Act 1993; Companies Act, ss 380, 138 and 301; Bos and Wiseman, above n 17, at 264; Harris, above n 14, at 10-11; and Watson and Taylor, above n 10, 650-651.

<sup>159</sup> Watson and Taylor, above n 10, at 146, 609-610, and 747-749; and *Goatlands Ltd (in liq) v Borrell* HC Hamilton CIV-2005-419-1643, 14 December 2010 at [119]-[121]; *Mason v Lewis*, above n 4, at [18].

<sup>160</sup> Grantham and Rickett, above n 33, at 593; Watts, above n 42, at 286; and Arthur, above n 138, at 51.

<sup>161</sup> Companies Act, sch 7 cl 1(1)(e); and Taylor, above n 1, at 179.

<sup>162</sup> Companies Act, ss 164 and 165; Heath and Whale, above n 22, at [32.3.6]; Watts, above n 42, at 286; and Farrar and Tennent, above n 21, at 244-245. Other relevant provisions are Companies Act, s 383 under which the Court has power to disqualify a director, including for breach of s 135 and Financial Markets Authority Act 2011, s 34 under which the Financial Markets Authority has been able to exercise a right of civil action a listed company has against its directors for breach of duty

<sup>163</sup> Grantham and Rickett, above n 33, at 38-40; Tompkins, above n 151, at 14; Sealy, above n 50, at 82-83; Watson and Taylor, above n 10, at 132; *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [252]; and (15 December 1992) 532 NZPD, above n 18, at 13108.

<sup>164</sup> Watson and Taylor, above n 10, at 611; Deane, above n 117, at 1; Rennie and Watts, above n 136, at 31; and *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [128].

<sup>165</sup> Discussed in chapter two.

<sup>166</sup> Campbell, Watts, Francis and others, above n 18, at [24.17].

<sup>167</sup> John Farrar "Directors' Duties and Corporate Governance in Troubled Companies" (2001) 8 *CanterLawRw* 99 at 110-113; and *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [128].

opposing approaches and various changes.<sup>168</sup> For example, s 135 refers to loss to creditors but s 169(3) says the duty is owed to the company, s 135 does not mention recklessness in its body but is called “reckless trading”, later changes increased directors’ liability under s 135 meaning it may not strike the balance in the long title, it applies before insolvency but it is not clear how or why a creditor (the stakeholder stated in the provision) would enforce s 135 if they are being paid.<sup>169</sup> Commentators felt later changes were based on “feelgood intuition” by a legislature disinterested in commercial law.<sup>170</sup> It is not easy to understand why a carefully crafted reform from the expert and independent Law Commission would be re-examined by the Justice Department.<sup>171</sup> As a result of the process and drafting, s 135 is incoherent.<sup>172</sup>

Commentators have been particularly critical of the provision including Bisson J’s test.<sup>173</sup> The test was based on Diplock LJ’s objective test for recklessness in criminal law, which included inadvertence to risk of harm and equated recklessness with ordinary negligence.<sup>174</sup> The test was disowned in New Zealand and by English courts who preferred a subjective standard and gross negligence.<sup>175</sup> It is unfair that a widely criticised and disregarded criminal law test provides the standard of civil liability for directors’ duties.<sup>176</sup> Furthermore, the strict test in s 135 does not capture the tone of Bisson J’s judgment and common law. Section 320 case law shows consideration of commercial reality and business judgment.<sup>177</sup> Bisson J required a higher degree of blameworthiness than the excerpt, as a company being “unable to pay...debts...does not...prove recklessness...it is attempting this course, without a reasonable prospect of success”.<sup>178</sup> In addition, the old case law focused on insolvency and

---

<sup>168</sup> Tompkins, above n 151, at 14-15.

<sup>169</sup> Companies Act, ss 169(3) and 135; Heath and Whale, above n 22, at [32.2] and [32.3]; and Brennan, above n 94, at 41-42.

<sup>170</sup> Deane, above n 117, at 8-9.

<sup>171</sup> Tompkins, above n 151, at 14-15.

<sup>172</sup> Farrar, above n 167, at 111-112.

<sup>173</sup> *Thompson v Innes*, above n 154, at 99,470-99,472.

<sup>174</sup> Watson and Taylor, above n 10, at 612; Rennie and Watts, above n 136, at 33; and *R v Lawrence (Stephen)* [1982] AC 510 (HL) at 526.

<sup>175</sup> Watts, above n 42, at 271; Heath and Whale, above n 22, at [32.3.3]; and *R v Harney* [1987] 2 NZLR 576 (CA) at 579.

<sup>176</sup> Heath and Whale, above n 22, at [32.3.3]; and *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [119].

<sup>177</sup> Rennie and Watts, above n 136, at 33; Deane, above n 117, at 2; Watson and Taylor, above n 10, at 613; *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [13]-[126]; and *Re Lake Tekapo Motor Inn Ltd (in liq)* (1987) 3 NZCLC 100,156 (HC) at 100,171-100,172; *Re Petherick Exclusive Fashions Ltd (in liq)* (1987) 3 NZCLC 99,946 (HC) at 99,959; and *Re Bennett, Keane & White Ltd (in liq) (No 2)* (1988) 4 NZCLC 64,317 (HC) at p 64,333.

<sup>178</sup> *Thompson v Innes*, above n 154, at 99,468.

creditors, whereas s 135 is a general duty owed to the company throughout its life. Therefore, the haphazard drafting does not reflect the tenor of judicial opinion as hoped.

As a result, s 135 is very strict.<sup>179</sup> The broad literal wording, “likely to create a substantial risk of serious loss to the company’s creditors” prima facie imposes strict liability resembling mere negligence, not true recklessness (fraudulent improper conduct).<sup>180</sup> This does not allow balancing risk and reward, nor consideration of important subjective factors. This subverts the distinction between legitimate and non-legitimate risk-taking that is part of normal business.<sup>181</sup> Thus, s 135 is almost a warranty of solvency.<sup>182</sup> This means s 135’s plain wording does not achieve the CA’s purpose of balancing shareholder/creditor protection with encouraging beneficial risks.<sup>183</sup> As a result, New Zealand’s reckless trading duty is seen as one of the most draconian approaches.<sup>184</sup>

However, commentators argued other interpretations are available. This ties into another major criticism of s 135, the clumsy and elusive language.<sup>185</sup> “Substantial” is a variable expression implying a 10-30% chance of occurrence.<sup>186</sup> It is unclear if “loss” should be considered regarding particular creditors, as part of the overall debt against the group or something else.<sup>187</sup> Some commentators believe the long title and vagueness enables an interpretation which allows risk of loss commensurate to gain. Thereby only capturing truly reckless behaviour.<sup>188</sup> Ross supported this interpretation and further stated it requires a sober assessment of the company's future income based on reasonable assumptions. He considered serious loss to creditors meant inability to pay debts.<sup>189</sup> However, Watts questions whether the long title justifies this pragmatic gloss as nothing indicates the risk-taking purpose outweighs the purpose of protecting creditors/shareholders. The wording is plain, the

---

<sup>179</sup> Grantham and Rickett, above n 33, at 592.

<sup>180</sup> Heath and Whale, above n 22, at [32.3]; Watts, above n 42, at 272; and Davies, above n 157, at 333-334.

<sup>181</sup> Deane, above n 117, at 2; Grantham and Rickett, above n 33, at 614; Bos and Wiseman, above n 17, at 262 and 267; Farrar and Tennent, above n 21, at 3-4; and Watson and Taylor, above n 10, at 612.

<sup>182</sup> Rennie and Watts, above n 136, at 35.

<sup>183</sup> Taylor and Watson, above n 10, at 608; Grantham and Rickett, above n 33, at 59; and Michael Arthur and Jacque Lethbridge “In short: Debut Homes Ltd – Implications for Directors” (paper presented to New Zealand Law Society Council of Legal Education, Auckland, December 2020) at 19.

<sup>184</sup> Farrar, above n 167, at 99 and 111.

<sup>185</sup> Deane, above n 117, at 1; and Bos and Wiseman, above n 17, at 264 and 266.

<sup>186</sup> Ross, above n 24, at 39.

<sup>187</sup> Heath and Whale, above n 22, at [32.3].

<sup>188</sup> Brian Gould “Director’s Personal Liability – Assesses the Likely Impact of s 135 Companies Act 1993” (1996) NZLJ 437 at 437-438; and Farrar, above n 167, at 99 and 176; and Tompkins, above n 151, at 22.

<sup>189</sup> Ross, above n 24, at 40.

meaning is simply unjust.<sup>190</sup> However, the Law Commission stated those concerned directors' duties were too onerous must note the importance of references to business judgement and risk in the long title. This shows the Law Commission intended the long title to be used as context for interpreting (down) directors' duties.<sup>191</sup> The vague terms mean directors may struggle to know what to do ex post.<sup>192</sup>

Section 135 also does not outline how to resolve creditors' diverging interests.<sup>193</sup> Creditors have different preferences in the zone of insolvency. For example, preferential creditors may prefer conservative decisions minimising the risk of asset dilution but unsecured creditors may prefer risky actions which may increase the funds available to repay them.<sup>194</sup> Section 135 provides no direction on what directors should do if actions mean some creditors suffer but others benefit.<sup>195</sup> Owing a duty to different persons with opposing interests fragments the duty so it ultimately amounts to a vague obligation to be fair.<sup>196</sup> Section 135 is further fragmented because the company's interests must also be considered.<sup>197</sup> "Loss to creditors" conflicts with and diminishes the responsibility to the company as the ultimate beneficiary.

The uncertainty surrounding s 135 means the courts are relied upon for guidance. This means the goal of the CA being a source of first recourse was ineffective for s 135.<sup>198</sup> Directors hoped judges could 'make it work'.<sup>199</sup> However, the judiciary's ability to 'fix' the misconceived section is not limitless.<sup>200</sup> Commentators at the time of enactment and today remain concerned the section's breadth means it is susceptible to misapplication by commercially inexperienced judges.<sup>201</sup> There is also concern judges may apply hindsight bias, attributing an erroneously high likelihood to failure because it occurred.<sup>202</sup> But it is difficult

---

<sup>190</sup> Watts, above n 42, at 273-274; and Grantham and Rickett, above n 33, at 614.

<sup>191</sup> Law Commission, above n 20, at 15.

<sup>192</sup> Bos and Wiseman, above n 17, at 264 and 266.

<sup>193</sup> Watts, above n 42, at 278; and Callison, above n 56, at 450.

<sup>194</sup> Keay, above n 63, at 629-633.

<sup>195</sup> Watts, above n 42, at 278; and Sealy, above n 8, at 178.

<sup>196</sup> Keay, above n 63, at 615.

<sup>197</sup> Companies Act, s 169(3).

<sup>198</sup> Grantham and Rickett, above n 33, at 613; Deane, above n 117, at 2; and Tompkins, above n 151, at 21.

<sup>199</sup> Deane, above n 117, at 1 and 10.

<sup>200</sup> Farrar and Hanrahan, above n 41, at 568 and 571-572.

<sup>201</sup> At 567; Watson and Taylor, above n 10, at 608; and Andrew Keay, Joan Loughrey and others "Reviewing Directors' Business Judgements: Views from the Field" (2020) 47 J.L. & Soc. 639 at 642-645.

<sup>202</sup> Keay, above n 16, at 439-442; Keay, Loughrey and others, above n 201, at 656-661; and Bos and Wiseman, above n 17, at 268.

for directors to make decisions in the moment, especially regarding the company's financial state.<sup>203</sup>

### ***Conclusion***

Section 135's wording is uncertain and potentially draconian, leading to the efficiency stifling concerns discussed in chapter two.<sup>204</sup> Honest business judgment that balances risk and return should not be inhibited.<sup>205</sup>

---

<sup>203</sup> For further discussion on the difficulty of identifying insolvency, the zone of insolvency and the different types of insolvency see Hargovan and Todd, above n 119, at 151-157; and Andrew Keay "Directors Taking into Account Creditors' Interests" (2003) 24 Comp.Law 300 at 303-306; and Keay, above n 26, at 300-301.

<sup>204</sup> Deane, above n 117, at 2; and Grantham and Rickett, above n 33, at 614; and Bos and Wiseman, above n 17, at 262 and 267.

<sup>205</sup> Farrar, above n 167, at 111-112.

## Chapter Four: Section 135 and the Judiciary – From Pragmatic to Problematic

What a director must do to comply with s 135 can only be determined by referring to case law.<sup>206</sup> Most s 135 breach claims are brought by liquidators under s 301.<sup>207</sup>

There are some things generally agreed upon by the courts. The duty is owed to the company, it is not a fiduciary duty, the test is objective<sup>208</sup> and ignorant directors fall within s 135.<sup>209</sup> Furthermore, s 138 is very narrow.<sup>210</sup>

However, there is substantial judicial disagreement over the key term of the provision, “substantial risk of serious loss”.<sup>211</sup> Case law has oscillated between a stringent and pragmatic approach to s 135.<sup>212</sup> The approach to compensation also remains uncertain.

### *I The Early Cases – Emergence of a Dominant Pragmatic Approach*

During the early period after the CA’s enactment judicial disagreement on s 135’s interpretation was clear.<sup>213</sup> The literal approach realised commentators’ concerns on s 135.<sup>214</sup> O’Regan J in *Fatupaito v Bates (Fatupaito)* recognised the strict liability import of the provision’s plain wording. He also held ‘substantial risk’ is where a company with little or no equity carelessly trades with no prospects of salvage.<sup>215</sup> William Young J’s judgment in *Re South Pacific* is a well-recognised pragmatic approach.<sup>216</sup> William Young J recognised the

---

<sup>206</sup> Watson and Taylor, above n 10, at 616.

<sup>207</sup> Arthur, above n 138, at 51.

<sup>208</sup> Examples of this consensus can be found in *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [218] and [262]; *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [159]; *Fatupaito v Bates* [2001] 3 NZLR 386 at [67]; *Mason v Lewis*, above n 4, at [50]-[51]; and Linda Howes, Stephen Revill and Kath Clark *Company Law* (loose-leaf ed, Thomson Reuters) at [CA135.03].

<sup>209</sup> Examples of this consensus can be found in *Grant v Johnston* [2016] NZCA 157 at [38]; *Mason v Lewis*, above n 4, at [53]-[55] and [83] and [115]; and Howes, Revill and Clark, above n 208, at [CA135.05].

<sup>210</sup> *Mason v Lewis*, above n 4, at [77]; *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [120]-[122] and [126]-[127]; and Howes, Revill and Clark, above n 208, at [CA135.03].

<sup>211</sup> Heath and Whale, above n 22, at [32.1].

<sup>212</sup> Farrar, above n 146, at 171.

<sup>213</sup> Watson and Taylor, above n 10, at 616; and *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [127]-[129].

<sup>214</sup> Discussed in chapter three.

<sup>215</sup> *Fatupaito v Bates*, above n 208, at [67] and [70]; Watts, above n 42, at 273; and Heath and Whale, above n 22, at [32.3.3] and [32.3.4].

<sup>216</sup> Watson and Taylor, above n 10, at 614.

strict interpretation was problematic, as risk is implicit in business and failure is rarely negligible.<sup>217</sup> William Young J instead suggested “substantial risk” and “serious loss” were met if trading risks were ‘illegitimate’, supported by the long title.<sup>218</sup> He also outlined considerations for determining legitimacy. These included creditor knowledge, corrective strategies used and that a company does not need to cease the moment it becomes balance sheet insolvent, trade may continue for a few months whilst implementing corrective measures.<sup>219</sup> This recognises directors cannot predict the future (regarding salvage). William Young J’s approach mitigated the harsh plain wording and moved the test towards true recklessness.<sup>220</sup> Uncertainty followed on which approach to take.

*Mason* was the next significant case. It became the orthodox approach.<sup>221</sup> Rather than a close textual analysis, the Court summarised s 135’s “essential pillars” in light of the long title and s 135 criticisms. The duty is owed to the *company*, is objective, focuses on whether the *manner* of business as a whole creates substantial risk of serious loss (“substantial risk” as defined in *Fatupaito* above), requires a sober assessment of the company’s prospects on troubled waters and practicing minimum care, skill and diligence by understanding relevant information and acting on it as a reasonable director would.<sup>222</sup> The Court also affirmed the *Re South Pacific* distinction between legitimate and illegitimate business risks and noted this distinction and s 301 remedial discretion mitigates s 135’s strictness.<sup>223</sup> But, ss 135 and 301 should not be conflated.<sup>224</sup> This pragmatic approach appears to take inspiration from the Law Commission’s cl 105. The subsequent courts favoured *Mason*’s pragmatic test.<sup>225</sup> Downs J summarised the judiciary’s position “Business is...risky...directors must be entitled to some

---

<sup>217</sup> *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [120].

<sup>218</sup> At, [123]-[124]; and Watts, above n 42, at 273.

<sup>219</sup> *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [125].

<sup>220</sup> Howes, Revill and Clark, above n 208, at [CA135.01].

<sup>221</sup> *Mason v Lewis*, above n 4; Watson and Taylor, above n 10, at 622-623; and Heath and Whale, above n 22, at [32.3.4].

<sup>222</sup> *Mason v Lewis*, above n 4, at [45]-[51]; and Watson and Taylor, above n 10, at 619.

<sup>223</sup> Companies Act, s 301; and *Mason v Lewis*, above n 4, at [45]-[49] and [55].

<sup>224</sup> At [51].

<sup>225</sup> Some examples of courts taking the pragmatic approach, including the legitimate-illegitimate distinction are *Grant v Johnston*, above n 209, at [36]-[37] and [166]-[169]; *Mountfort v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104 (HC) at [25] and [31]; *Delegat v Norman* [2012] NZHC 2358 at [77] and [105]; *Goatlands Ltd (in liq) v Borrell*, above n 159, at [31]-[47]; *Rowmata Holdings Ltd (in liq) v Hildred* [2013] NZHC 2435 at [81]-[83] and [88]; Allan McRae “Reckless Trading” (2019) NZLJ 349 at 349; and Howes, Revill and Clark, above n 208, at [CA135.01].

margin of appreciation in the way a company's affairs are managed. Ex post...analysis is...easy – making corporate decisions...is not. However, there is risk and *risk*.”<sup>226</sup>

Compensation under s 301(1) was also settled in the early period.<sup>227</sup> Section 301 is compensatory.<sup>228</sup> In extreme cases, compensation was for all losses.<sup>229</sup> However, the orthodox net deterioration approach compensates creditors for loss suffered from the point the director breached their duty to the date of liquidation. The courts considered causation, culpability and duration of breaches.<sup>230</sup> Generally, different successful claims could be subject to additional award.<sup>231</sup>

The sober assessment requirement and damages calculation meant the financial position of the company (onset of (a type of) insolvency and when a company should have ceased) became integral to assessing liability.<sup>232</sup>

Typical successful claims were where directors allowed continued trade knowing the company was hopelessly insolvent making loss to creditors inevitable,<sup>233</sup> self-dealing which risked solvency,<sup>234</sup> director's entering obligations without sufficient finances<sup>235</sup> and failure to repay tax debts, as tax payments are only meant to be held for a short period so failing to pay

---

<sup>226</sup> Tim Conder and David Fraundorfer “Trade Better” (2019) NZLJ 148 at 148; and *Madsen-Ries v Greenhill* [2016] NZHC 3188 at [70].

<sup>227</sup> Watson and Taylor, above n 10, 629-630 and 631-635; Watts, above n 42, at 287-289; Mike Ross “Assessing Damages for Reckless Trading” (2002) NZLJ 178 at 178-179; and Heath and Whale, above n 22, at [32.3.6].

<sup>228</sup> Conder and Fraundorfer, above n 226, at 149 and 151; and *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [172].

<sup>229</sup> *Goatlands ltd (in liq) v Borrell*, above n 159 at [120]; and Ross, above n 227 at 178.

<sup>230</sup> *Mason v Lewis*, above n 4, at [109]-[118]; *Löwer v Traveller and Waller*, above n 144, at [78]-[79]; Conder and Fraundorfer, above n 226, at 151-152; Arthur, above n 138, at 51; and Watson and Taylor, above n 10, at 630-631.

<sup>231</sup> Watson and Taylor, above n 10, at 632.

<sup>232</sup> Harris, above n 14, at 10; Taylor, above n 1, at 176; and *Mason v Lewis*, above n 4, at [109]-[110]; McRae, above n 225, at 350-351; and Watson and Taylor, above n 10, at 604.

<sup>233</sup> Examples include *Nippon Express (New Zealand) Ltd v Woodward* (1998) 8 NZCLC 261,765 (HC) at 261,773-261,774; *Re Hilltop Group Ltd (in liq)* (2001) 9 NZCLC 262,477 (HC) at [46]; and *Benchmark Building Supplies Ltd v Jackson* (2001) 9 NZCLC 262,612 (HC) at [40] and [51]-[52]. This ‘category’ is discussed in Watson and Taylor, above n 10, at 617-618; and Conder and Fraundorfer, above n 226, at 150.

<sup>234</sup> Examples include *Kings Wharf Coldstore Ltd (in rec and in liq) v Wilson* (2005) 2 NZCCLR 1042 (HC), at [67] and [68]; *Re Gellert Developments Ltd (in liq)* (2002) 9 NZCLC 262,942 (HC) at [18]-[19] and [43]; and *Madsen-Ries and Vance v Petera*, above n 156, at [51]-[71].

<sup>235</sup> Examples include *Cool Cars (Wholesale) Ltd (in liq) v Sharma* [2014] NZHC 256 at [20]-[23]; and *Goatlands ltd (in liq) v Borrell*, above n 159, at [77]-[89]; and *Ocean Boulevard Properties Ltd v Everest* (2000) 8 NZCLC 262,289 at 262,291. This ‘category’ is discussed in Allan McRae “Reckless Trading” (2020) NZLJ 30 at 31-32; and Farrar and Tennent, above n 21, at 243-244.

indicates trouble.<sup>236</sup> These cases held directors liable in instances where one would expect liability to arise for truly reckless behaviour – finding the proper target of s 135.

The courts' pragmatic interpretation of the provision abated commentators' fears.<sup>237</sup> The CA's dual-purpose was considered, and the entity focus met. Whilst the early position seemed satisfactory, uncertainty and room for manoeuvre still followed *Mason* due to citing the conflicting *Re South Pacific Shipping* and *Fatupaito* judgments with approval, the broad provision, lack of close textual analysis, and fact-dependent nature of the approach.<sup>238</sup>

## ***II Debut and Mainzeal: The Pragmatic Approach Abandoned (But Not Forgotten)***

The precarity of relying on the goodwill of the judiciary to read down the drafting through reference to the long title, and understand commercial reality was shown by *Debut* and *Mainzeal*.<sup>239</sup>

### ***A Debut Homes***

Debut was a property development company. Cooper was the sole director and a shareholder (with his wife). Debut had two financiers, BNZ and JT Jamieson. The loans were secured by mortgages Cooper personally guaranteed. His family trust was also a lender. So, Cooper had conflicting interests. From 2009 Debut was balance sheet insolvent but paid debts through shareholder advances. However, by October 2012 Debut failed to pay debts.<sup>240</sup> On 6 November 2012, Cooper discussed options with Debut's accountant. Cooper did not consider Debut was "salvageable" and decided Debut would cease after completing and selling the remaining properties, rather than liquidate immediately. This was projected to create a \$170,000 surplus for paying financiers. But, excluded GST/interest, Cooper knew trading would lead to a GST shortfall.<sup>241</sup> After the projects were completed the Inland Revenue (IR)

---

<sup>236</sup> Examples include *Rowmata Holdings Ltd (in liq) v Hildred*, above n 225, at [96]; *Goatlands ltd (in liq) v Borrell*, above n 159, at [77]-[89]; and *Syntax Holdings (Auckland) Ltd (in liq) v Bishop* [2013] NZHC 2171 at [21]. This 'category' is discussed in Howes, Revill and Clark, above n 208, at [CA135.04].

<sup>237</sup> Discussed in chapter three; and Davies, above n 157, at 334.

<sup>238</sup> Taylor, above n 1, at 175; and Watts, above n 42, at at 275.

<sup>239</sup> Peter Watts "Debut Homes in the Supreme Court—a Product of the Vicarage?" (2020) CSLB 107 at 4; and Heath and Whale, above n 22, at [32.3.3].

<sup>240</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [8]-[9], [18], [20], [22] and [117].

<sup>241</sup> At [12]-[13], [15]-[17], [19], [22]-[23] and [70].

placed Debut in liquidation with approximately \$450,000 GST owing.<sup>242</sup> If the houses had been sold partially completed, claims on liquidation would have been higher.<sup>243</sup> The liquidators brought a claim under s 301, alleging breaches of ss 131, 135 and 136.<sup>244</sup>

## **1 The Decisions**

In the High Court Hinton J found Cooper breached s 135 as continuing trade was an illegitimate substantial risk as it increased debt to the IR, which Debut was unable to pay.<sup>245</sup> Cooper could not rely on the accountant's advice as a defence under s 138, if it was reasonable there would be no breach of duty.<sup>246</sup> Hinton J applied the net deterioration approach to compensation arriving at \$280,000.<sup>247</sup> Hinton J's judgment was harsh on the director.<sup>248</sup>

The Court of Appeal overturned the High Court's decision. They followed (and embellished) the orthodox pragmatic approach.<sup>249</sup> The Court analysed the provision in light of the long title.<sup>250</sup> They emphasised directors have wide discretion in matters of business judgment, judges must avoid hindsight bias and risk is legitimate where commensurate to potential advantage.<sup>251</sup> The Court also reinforced liability does not arise simply from continued trading after insolvency – it is fact dependent.<sup>252</sup> The Court of Appeal held Debut's continued trade was based on a sober assessment, was a sensible business decision, and likely to improve return rather than cause loss.<sup>253</sup> Whilst the Court recognised the IR was most at risk, they were not yet a preferred creditor (GST must be payable), Cooper believed GST was resolvable and it was unclear the IR's net position was worse-off.<sup>254</sup> The Court of Appeal

---

<sup>242</sup> At [26].

<sup>243</sup> *Cooper v Debut Homes Ltd (in liq)* [2019] NZCA 39 at [47] and [51].

<sup>244</sup> *Debut Homes Ltd (in liq) v Cooper* [2018] NZHC 453 at [1]-[4] and [32]. Sections 131 and 136 are addressed in chapter 6.

<sup>245</sup> *Debut Homes Ltd (in liq) v Cooper*, above n 244, at [53]-[56].

<sup>246</sup> At [58].

<sup>247</sup> At [63].

<sup>248</sup> Howes, Revill and Clark, above n 208, at [CA135.04]. For example, the approach to s 131 was too objective *Debut Homes Ltd (in liq) v Cooper*, above n 244 at [43]-[50], the creditor focus, little weight was given to mitigating factors and a very high amount awarded in compensation *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [63] and [95], and factual findings – discussed below.

<sup>249</sup> Wolters Kluwer "What's New, March 2020" (case updates, March 2020); Sean Gamble *Construction's Insolvency Predicament: Cooper, Mainzeal and Reckless Trading* (Hesketh Henry) at 1; and *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [21], [22] and [33].

<sup>250</sup> *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [21]-[22].

<sup>251</sup> At [33].

<sup>252</sup> At [31].

<sup>253</sup> At [64]-[65].

<sup>254</sup> At [38] and [61]-[63].

agreed with the High Court that s 138 was not available because there were no “reports, statements...financial data and other information”.<sup>255</sup> Given its’ findings on liability the Court did not comprehensively address s 301.<sup>256</sup> The Court of Appeal’s judgment clarified s 135, emphasised the section must be interpreted in the light of the long title and acknowledged the place of business judgement and pragmatism.<sup>257</sup>

An important distinction between the High Court and Court of Appeal was their focus. The Court of Appeal focused on the company and body of creditors. Whereas the High Court focused on risk from the IR’s perspective, excluding consideration of benefits.<sup>258</sup> The Courts also emphasised different facts. Hinton J painted Cooper in a negative light as opposed to the Court of Appeal’s favourable interpretation.<sup>259</sup> Nor did the High Court share the Court of Appeal’s affinity of commercial reality.<sup>260</sup>

The case then reached the Supreme Court who held Cooper breached s 135.<sup>261</sup> This was the Court’s first judgment on s 135, “it sent shockwaves through the director community”.<sup>262</sup> The Court first analysed the CA’s scheme.<sup>263</sup> They emphasised the importance of solvency, following statutory insolvency priorities and using formal mechanisms in the vicinity of insolvency – particularly because they take decision-making away from director’s and involve creditors.<sup>264</sup> Informal mechanisms, must align with formal mechanisms.<sup>265</sup> The judgment then considered directors’ duties. The pattern of not undertaking a close textual analysis continued – but a different gloss was applied.<sup>266</sup> The Supreme Court’s key finding on s 135 was if a company reaches the point trading will result in a shortfall and the company is not salvageable, then trading breaches s 135.<sup>267</sup> Risk and reward cannot be balanced and creditors cannot be compartmentalised.<sup>268</sup> It is also not an answer to s 135 that an action was a sensible business decision. The Supreme Court stated creditors must be consulted and

---

<sup>255</sup> At [77].

<sup>256</sup> At [94].

<sup>257</sup> At [33]; and McRae, above n 225, at 349; and Gamble, above n 249, at 1 and 4-5.

<sup>258</sup> At [63]; and Arthur and Lethbridge, above n 183, at 4.

<sup>259</sup> At [40], [41], [47]-[49], [56], [60] and [82]

<sup>260</sup> At [33], [57], [58], [61] and [65].

<sup>261</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [185]-[187].

<sup>262</sup> *Litigation Forecast 2021* (MinterEllisonRuddWatts, February 2021) at 4.

<sup>263</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [27].

<sup>264</sup> At [32]-[35], [42]-[49], [73], [76], [176] and [178]-[181].

<sup>265</sup> At [47]-[48] and [180].

<sup>266</sup> Example of the lack of close textual analysis at [70].

<sup>267</sup> At [174], [176] and [181].

<sup>268</sup> At [32], [72] and [174]

directors must investigate formal options or liquidate.<sup>269</sup> The Court did not consider s 135 controversies arose for unsalvageable companies.<sup>270</sup> This approach meant Cooper traded recklessly. He should have consulted the IR, transacted in line with statutory priorities explored other options (namely formal mechanisms) and liquidated when his strategy failed.<sup>271</sup> Cooper could not rely on s 138 because the accountant's advice was generalised.<sup>272</sup>

The Court described relief under s 301(1)(b)(i) as restitutionary, and compensatory under s 301(1)(b)(ii).<sup>273</sup> The Court confirmed the orthodox net deterioration approach to s 135, but, left open an alternative starting point where multiple duties are breached. Multiple breaches requires tailored redress under s 301. The Court considered a restitutionary measure responded to breaching ss 131, 135 and 136.<sup>274</sup> The starting point was November 2012 when Cooper knew the company was insolvent. The appropriate comparison was if Debut had been liquidated. If Debut was liquidated, the liquidator would have been liable to pay GST on selling the properties.<sup>275</sup> Deductions were made for Cooper working without pay and believing his actions were in some creditor's interests. The amount added for GST interest in penalties was confirmed. This resulted in the Supreme Court affirming the High Court's order.<sup>276</sup>

## **2 Considerable Criticism of the Supreme Court's Decision<sup>277</sup>**

Whilst the imposition of liability was unsurprising due to finding the company was unsalvageable with an intentional shortfall,<sup>278</sup> the statements of law are concerning.<sup>279</sup> The reasoning is draconian, detached from commercial reality, does not support a rescue culture

---

<sup>269</sup> At [72]-[76] and [180].

<sup>270</sup> At [69].

<sup>271</sup> At [73]-[77] and [180].

<sup>272</sup> At [126]-[127].

<sup>273</sup> At [156].

<sup>274</sup> At [162], [164] and [167].

<sup>275</sup> At [168]-[170].

<sup>276</sup> At [171]-[173].

<sup>277</sup> There are other criticisms but not all can be discussed in the constraints of this dissertation. For more criticisms of the Supreme Court's approach see Arthur and Lethbridge, above n 183; Watts, above n 239; Peter Watts "Directors' Duties after *Debut Homes* – A Return to the Scene" (2021) 6 CSLB 55; and McRae, above n 235.

<sup>278</sup> As abovementioned, this was a typical category of liability under the pragmatic approach.

<sup>279</sup> Watts, above n 239 at 1; and Watts, above n 277, at 55-56.

and increases uncertainty for situations between clear un-salvageability and salvageability. It may “encourage a new batch of life-destroying litigation”.<sup>280</sup>

Firstly, the Court strayed from past decisions in the way it interpreted s 135. The Courts’ role is to interpret broad wording in general provisions in light of the scheme and purpose of the relevant Act.<sup>281</sup> The Supreme Court did not consider the CA’s dual-purpose in the long title, nor the rationale of s 135.<sup>282</sup> This failure resulted in a stringent approach that ignores business sense.<sup>283</sup> In light of the CA’s purpose, it is imperative to balance risk and business judgement with protecting stakeholders.<sup>284</sup> The Court of Appeal<sup>285</sup> past leading decisions<sup>286</sup> and subsequent cases<sup>287</sup> which consider the long title and s 135’s rationale are more pragmatic, showing the impact of the missed step.<sup>288</sup>

The decision that every creditor must be treated equally and better off from trade, rather than considering creditors as a whole (like the Court of Appeal) has been criticised. This creditor driven decision making is impractical and has no place in modern company law – this has been accepted across the commonwealth.<sup>289</sup> The CA and case law has long recognised s 135 is a duty to the company, not creditors.<sup>290</sup> The focus should be on the company. If an entity approach is taken, a shortfall or one creditor being worse off is acceptable if actions benefit the company’s success and sustainability. Nor do the formal mechanisms mandate equal treatment. Parts 14, 15, and 15A only apply once a company is wound up or enters the arrangements.<sup>291</sup>

---

<sup>280</sup> Watts, above n 239 at 3; Arthur and Lethbridge, above n 183, at 18-19; and Paul Dalkie “Insolvent Trading and Directors’ Duties” (2021) NZLJ 64 at 67.

<sup>281</sup> Interpretation Act 1999, s 5; and Susan Glazebrook, judge of the Supreme Court of New Zealand “Statutory interpretation, tax avoidance and the Supreme Court: reconciling the specific and the general” (paper presented to the New Zealand Institute of Chartered Accountants Tax Conference, Auckland, 2013) at 53.

<sup>282</sup> See chapter one and chapter two.

<sup>283</sup> Arthur and Lethbridge, above n 183, at 15-16.

<sup>284</sup> Companies Act, long title.

<sup>285</sup> *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [33].

<sup>286</sup> Some examples referred to above *Grant v Johnston*, above n 209; *Mountfort v Tasman Pacific Airlines of NZ Ltd*, above n 256; *Delegat v Norman*, above n 225; *Mason v Lewis*, above n 4; and *Re South Pacific Shipping Ltd (in liq)*, above n 136; and *Goatlands ltd (in liq) v Borrell*, above n 159.

<sup>287</sup> *Banks v Farmer & Others* [2021] NZHC 1922; and *Watts & Hughes Construction Ltd v Biala* [2020] NZHC 3041.

<sup>288</sup> McRae, above n 235, at 32.

<sup>289</sup> Watts, above n 239, at 2.

<sup>290</sup> Companies Act, s 169(3); *Mason v Lewis*, above n 4, at [51]; Law Commission, above n 9, at [192]-[195] and [284]-[286].

<sup>291</sup> Dalkie, above n 280, at 68.

It also goes too far to say directors are not the appropriate decision-makers in the vicinity of insolvency. The policy is to encourage directors to make good decisions, not remove directors.<sup>292</sup> There would be no need for duties if directors were not meant to be making decisions.

The Court's approach is worryingly similar to a capital maintenance type rule by requiring companies maintain solvency or enter formal mechanisms.<sup>293</sup> This means directors essentially guarantee solvency.<sup>294</sup> This departs from case law which consistently acknowledged companies are not required to immediately cease trading, as insolvent trading is not itself bad and directors will not immediately know the prospects of salvage.<sup>295</sup> The provision's purpose is to warn directors to trade carefully, not mandate solvency or liquidation on insolvency.<sup>296</sup> The important context of the provision's title "*Reckless Trading*" cannot be forgotten.<sup>297</sup> Whilst there is no doubt the solvency test is critical it is not absolute.<sup>298</sup> This is because mandating solvency impinges on business activity and separate legal identity.<sup>299</sup> Nor does solvency work in the binary manner the Court believes, there is a large turbid zone between solvency and insolvency. It is difficult to make decisions in this zone.<sup>300</sup> Nor does the CA support this strict approach. Section 135 was intentionally separated from the insolvency regime (indicating it mandates care not formal mechanisms)<sup>301</sup> and if the legislature wanted the provision to mean companies must enter formal mechanisms upon insolvency, they would have said this, like other jurisdictions.<sup>302</sup> The Supreme Court's approach is prescriptive and does not align with the CA nor support the rescue culture the CA tries to achieve.

---

<sup>292</sup> See discussion in chapter two.

<sup>293</sup> Dalkie, above n 280, at 67.

<sup>294</sup> Arthur and Lethbridge, above n 183, at 20.

<sup>295</sup> Dalkie, above n 280, at 65; Watts, above n 239, at 2; *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [125]; and even the stricter *Fatupaito v Bates*, above n 208, at [67] and [70] did not mandate immediate liquidation.

<sup>296</sup> See discussion in chapter three.

<sup>297</sup> Davies, above n 157, at 334.

<sup>298</sup> See chapter one discussion; Watson and Taylor, above n 10, at 956; and Dalkie, above n 280, at 65

<sup>299</sup> Dalkie, above n 280, at 68

<sup>300</sup> Dalkie, above n 280, at 64-65; *Madsen-Reis v Cooper* [2019] NZSC Trans 23 at 37.

<sup>301</sup> Law Commission, above n 9, at [516]; and Companies Bill 1900 (50-1) (Select Committee Report), above n 154, at 6.

<sup>302</sup> For more discussion on jurisdictions with insolvent trading duties which compel initiation of formal proceedings see Davies, above n 157, at 314; Keay, above n 100, at 2-3; Harris, above n 14, at 11-12; and Couwenberg and Lubben, above n 101, at 63-64 and 75.

Furthermore, requiring formal mechanisms to avoid personal liability is unwise as they are not always the best solution. Formal mechanisms are expensive, reduce employee morale and cause reputational harm leading to loss of value to a going concern business.<sup>303</sup> They are also often unsuccessful, for example, 83% of companies who used voluntary administration between 2014-2019 were deregistered.<sup>304</sup> Whereas informal workouts are cheaper, flexible and limit publicity. However, informality means arrangements lack the legal status of formal arrangements, may disadvantage non-parties and director's actions are not investigated.<sup>305</sup> Watts notes this aspect of the judgment especially shows the Court introducing their moral standards.<sup>306</sup> This is because entering formal mechanisms isn't mandated in legislation, but the Court thinks it is desirable practice.

The wrong the Court focused on was informal liquidations that ignore statutory priorities for director's personal interests.<sup>307</sup> The Court was influenced by the IR's statutory priority on liquidation.<sup>308</sup> The policy behind the point makes sense – a director should not be able to defeat priorities by trading a company it knows is unsalvageable for self-interest.<sup>309</sup> Whether s 135 is the most appropriate section to capture this behaviour is questionable. The Court targeting this activity rather than approach it under an existing 'category'<sup>310</sup> (as it could have come under them) may have been inspired by English law.<sup>311</sup> One of the categories under s 172 in the United Kingdom is informal liquidations. However, s 172 is a fiduciary duty analogous to New Zealand's s 131. Section 172 is also subjective and on insolvency the duty shifts to creditors.<sup>312</sup> The more comparable provision to s 135 is s 214 of the Insolvency Act which provides no solution for informal liquidations.<sup>313</sup> Section 135 is not a fiduciary duty, is

---

<sup>303</sup> Arthur and Lethbridge, above n 183, at 10 and 20; Ellice, above n 26, at 29, 40-58; Watts, above n 239, at 2; and Finch, above n 26, at 251-252.

<sup>304</sup> Ellice, above n 26, at 42; and Farrar and Hanrahan, above n 41, at 530.

<sup>305</sup> At 530; and Finch, above n 26, at 251-252; and Taylor and Slevin, above n 25, at 10.

<sup>306</sup> Watts, above n 239, at 2.

<sup>307</sup> Arthur and Lethbridge, above n 183, at 7; Watts, above n 277, at 56 and 58; and *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [49].

<sup>308</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [118]; and Dalkie, above n 280, at 64-65.

<sup>309</sup> Keay, above n 26, at 300-301. There is disagreement on this point, for a contrasting view see Dalkie, above n 280, at 64-65.

<sup>310</sup> Outlined at the start of the chapter.

<sup>311</sup> The Supreme Court makes two references to English law suggesting this is possible. *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [112] and [166]. The reference in [166] to 'net deficiency' is the English term – 'net deterioration' is the New Zealand term - Arthur and Lethbridge, above n 183, at 7; and *Madsen-Reis v Cooper*, above n 300, at 42-44.

<sup>312</sup> Companies Act (UK), s 172; Keay, above n 26 at 300-301; and Van Zwieten, above n 104.

<sup>313</sup> Insolvency Act 1986 (UK), s 214; Farrar and Tennent, above n 21, at 246-247; and Van Zwieten, above n 7, at 9.

objective, is owed to the company and departed from English influence - so care must be taken when referring to English law. The activity is more appropriately captured under s 131 or the voidable preference regime made for this purpose.<sup>314</sup> It is inappropriate to find liability for an informal liquidation outside the voidable preference period as this gives creditors rights the legislature did not intend.<sup>315</sup>

It is important to analyse the restitutionary aspect of the remedy even though it focused on s 136, as it may apply to s 135 where there are multiple breaches. The Court interpreted “repay” in s 301(1)(b)(i) as implying directors can be ordered to return money; and “restore” suggests returning the company to the position it would have been absent the breach, this includes company debt that should not have been incurred.<sup>316</sup> Watts instead sensibly considers that “repay” refers to returning money, and “restore” refers to returning property. Furthermore, s 301(1)(b)(i) does not capture the wrong in ss 135 or 136, only the reference to “negligence, default, or breach of duty” does and this correlates to s 301(1)(b)(ii).

Restitutionary remedies reverse the precise inappropriate transfer of property received by someone and consider counter-receipts.<sup>317</sup> The Supreme Court erroneously focused on loss to the creditors rather than the company as s 301 requires, they did not state the benefit Cooper obtained nor base repayment on this, did not give weight to counter-receipts nor to the activities being ordinary business.<sup>318</sup> From an entity perspective the transactions did not worsen or increase survival but did decrease debt owed – affecting its financial position, arguably improving the net position.<sup>319</sup>

The law remains in an uncertain state. The Supreme Court largely did not discuss past case law leaving its’ place unclear.<sup>320</sup> Furthermore, the Supreme Court does not appear to have found its draconian approach/gloss in the literal wording as there was minimal close textual analysis. Leaving the exact words of the provision still in question. For example, the Court failed to fully address the phrase ‘serious loss’.<sup>321</sup> \$300,000 is not a ‘serious loss’ to a

---

<sup>314</sup> Campbell, Watts, Francis and others, above n 18, at [63.2].

<sup>315</sup> Companies Act, s 292(4C); Watts, above n 277, at 60-61; and Heath and Whale, above n 22, at [24.1].

<sup>316</sup> Companies Act, s 301; and *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [157].

<sup>317</sup> Watts, above n 239, at 3; and Arthur and Lethbridge, above n 183, at 11-13.

<sup>318</sup> Companies Act, ss 301 and 169(3); Watts, above n 277, at 56-57; Arthur and Lethbridge, above n 183, at 11-14; and Watts, above n 239, at 3.

<sup>319</sup> *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [61]; and Arthur and Lethbridge, above n 183, at 13.

<sup>320</sup> *Watts & Hughes Construction Ltd v Biala*, above n 287, at [22] and [26]; and *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [70] and fn 83.

<sup>321</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [70].

sophisticated creditor like the IR.<sup>322</sup> The phrase was important to consider as a key part of s 135's application, and for potentially skewing the provision towards vulnerable creditors and balancing creditors' and directors' interests.

The negative implications of the decision will depend on how widely it is applied.<sup>323</sup> The Supreme Court noted in multiple instances they were only dealing with unsalvageable businesses.<sup>324</sup> This may confine the ratio to unsalvageable companies.<sup>325</sup> This ratio would mean wider statements in the judgment are obiter.<sup>326</sup> If these statements are applied widely, *Debut* will significantly impact commercial transactions, especially for companies who closely walk the line of solvency.<sup>327</sup> Directors will personally guarantee the company debts, are not able to take actions which benefit the entire company unless every creditor benefits, must shift their focus in financial difficulty from sustaining the company to every creditor, cannot take normal business risks which balance risk and reward, upon insolvency formal actions should be taken and when transacting directors must uphold insolvent priorities (even outside the voidable preference period). As a result, the purpose of incorporation – separate personality for risk-taking – is lost.<sup>328</sup> This judgment does not balance legitimate business risks and protecting stakeholders.<sup>329</sup> The chapter one principles of the CA have not been given effect. The case shows s 135 needs amendment.

## ***B Mainzeal***

*Mainzeal* has run alongside *Debut*.<sup>330</sup> *Mainzeal*, was a construction company. For eight to ten years before liquidation, *Mainzeal* relied on informal support from Richina, majority shareholder and previous parent company.<sup>331</sup> By 2011, advice showed *Mainzeal* was balance sheet insolvent and reliance on group support was problematic and unreasonable.

---

<sup>322</sup> Watts, above n 239, at 2; for further comment on the finding \$300,000 was a 'serious loss' see Heath and Whale, above n 22, at [32.3.3].

<sup>323</sup> Arthur and Lethbridge, above n 183, at 16; and Watts, above n 277, at 55-56.

<sup>324</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [69] and fns 198, 208 and 83

<sup>325</sup> Watts, above n 277, at 55.

<sup>326</sup> At 55-56.

<sup>327</sup> Grantham and Rickett, above n 33, at 592; Watts, above n 42; Watts, above n 239, at 3; Dalkie, above n 280, at 64 and 68; and Deane, above n 117, at 2.

<sup>328</sup> Dalkie, above n 280, at 67.

<sup>329</sup> Watts, above n 239, at 3.

<sup>330</sup> The Supreme Court has granted leave to appeal. *Yan v Mainzeal Property and Construction Limited (in liq)* [2021] NZSC 109 at [1].

<sup>331</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [1], [73], [84] [88] [107][108] [127] [150] [361] and [443] [445].

Nevertheless, the directors continued trading normally.<sup>332</sup> In 2012 Mainzeal experienced cash flow difficulties. Advice in December 2012 identified significant concerns.<sup>333</sup> In 2013 Mainzeal went into liquidation owing \$110million to unsecured creditors.<sup>334</sup> The liquidator brought a claim under s 301 for breach of ss 135 and 136.<sup>335</sup>

Both courts found the directors breached s 135 as Mainzeal had been trading balance sheet insolvent for a protracted period without improvement, had long-standing poor performance and the directors were inactive. By early 2011 there was no reason to think solvency could be restored.<sup>336</sup> Again, imposition of liability was unsurprising based on these factual findings (likely breaching the pragmatic test too), it is some of the statements of law which are concerning.<sup>337</sup>

The High Court took a novel approach and was critical of early case law.<sup>338</sup> Notably, Cooke J said s 135 is not limited to considering either liquidation or continued trade and can encompass other modes of business.<sup>339</sup> The alternative strategies Cooke J identified were recapitalising, formalising informal funding arrangements and the directors resigning.<sup>340</sup> He also took a strict approach to solvency – accepting ss 135 and 136 replaced the capital maintenance rule, meaning directors were responsible for adequately capitalising the company.<sup>341</sup> The approach applied to the facts meant Mainzeal breached s 135.<sup>342</sup> Cooke J set aside the traditional net deterioration compensation measure on the basis that if the directors had threatened to resign a better result would have eventuated.<sup>343</sup> His approach centred on culpability rather than causation.<sup>344</sup> The starting point was the full debt, but the culpability of

---

<sup>332</sup> [133]-[138] [145][189] [432][443] [445]-[448]

<sup>333</sup> At [475]-[476] [151]-[173].

<sup>334</sup> At [1]

<sup>335</sup> *Mainzeal Property and Construction Ltd (in liq) v Yan* [2019] NZHC 255 at [3].

<sup>336</sup> At 187; and *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [445]-[448] and [452].

<sup>337</sup> At [446]-[447]; *Re South Pacific Shipping Ltd (in liq)*, above n 136, at [125]; and even the stricter *Fatupaito v Bates*, above n 208, at [67] and [70] did not mandate immediate liquidation.

<sup>338</sup> For example Cooke J was sceptical of the distinction between legitimate and illegitimate risk-taking and the capital and revenue account distinction between ss 135 and 136 (discussed in chapter five); *Mainzeal Property and Construction Ltd (in liq) v Yan*, above n 335, at [163]-[164] and [300]-[301]; and Richard Gordon “Directors’ duties and the case for vulnerable trading?” (17 July 2019) MinterEllisonRuddWatts <[www.minterellison.co.nz](http://www.minterellison.co.nz)>.

<sup>339</sup> *Mainzeal Property and Construction Ltd (in liq) v Yan*, above n 335, at [168].

<sup>340</sup> At [232]-[233], [293], [417]-[419], [423] [417].

<sup>341</sup> At [544] and [169]-[174].

<sup>342</sup> At [187].

<sup>343</sup> At [416]-[419].

<sup>344</sup> *Conder and Fraundorfer*, above n 226, at 152 and 179.

the directors justified reduction, meaning \$36,000,000 was appropriate.<sup>345</sup> Cooke J justified the decision by stating Mainzeal’s circumstances were exceptional.<sup>346</sup> This is not the case. Commercially experienced commentators noted intergroup transactions, shareholder support, and trading during difficult times are commonplace. The High Court’s approach adds unnecessary complexity into the law as it could have been decided under traditional measures.<sup>347</sup>

The Court of Appeal’s decision in *Mainzeal* restores some orthodoxy and clarity following Cooke J’s judgment and the Supreme Court’s *Debut* decision.<sup>348</sup> The Court of Appeal rejected the High Court’s stance (and the Supreme Court’s strict approach to an extent) on solvency, stating “directors do not have a duty to capitalise a company adequately”.<sup>349</sup> The Court analysed s 135 in light of the text and dual-purpose.<sup>350</sup> The Court of Appeal also endorsed the orthodox pragmatic approach from *Mason*.<sup>351</sup> However, with some differences that stem from affirming aspects of the Supreme Court’s *Debut* decision. Namely, the Court did not accept there was room for a business judgement approach in the objective provision (despite the long title),<sup>352</sup> affirmed the requirement to consider all alternatives,<sup>353</sup> ensure actions benefit all creditors,<sup>354</sup> and that recourse to formal mechanisms is essential.<sup>355</sup> To avoid liability directors should not continue business as usual, be cautious, seek advice, liquidate if returning to solvency seems unlikely after considering alternatives and attempt to address issues.<sup>356</sup> The guidance helps directors navigate the law.<sup>357</sup> Mainzeal’s directors did the one thing not open to them – continue normally.<sup>358</sup> The alternative courses available to the directors were pressing for repayment of the debts owed to Mainzeal, seeking written assurances of support,

---

<sup>345</sup> *Mainzeal Property and Construction Ltd (in liq) v Yan*, above n 335, at [430]-[436] and [445]-[460].

<sup>346</sup> At [284]-[285].

<sup>347</sup> *McRae*, above n 225, at 349; and *Gamble*, above n 249, at 7-8.

<sup>348</sup> Matt Kersey, Jeremy Upson, Nathaniel Walker and Gordon Lamb “Mainzeal Judgement: Court of Appeal Finds Directors Liable with Quantum Still to be Clarified” (6 April 2021) Russell McVeagh <[www.russellmcveagh.com](http://www.russellmcveagh.com)>.

<sup>349</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [256]; and see chapter one for discussion on solvency and capital maintenance in the Companies Act 1993.

<sup>350</sup> At [195].

<sup>351</sup> At [253], [266]-[268] and [441]; and *Heath and Whale*, above n 22, at [32.3.2].

<sup>352</sup> At [262].

<sup>353</sup> At [442] and [446]-[452].

<sup>354</sup> At [264].

<sup>355</sup> At [270].

<sup>356</sup> At [445]-[452].

<sup>357</sup> Sean Gollin “Court of Appeal Confirms Liability of Mainzeal Directors” (31 March 2021) MinterEllisonRuddWatts <[www.minterellison.co.nz](http://www.minterellison.co.nz)>.

<sup>358</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [446] and [452].

reviewing the appropriateness of trading, ring-fencing new projects, threatening to wind down the business or resign.<sup>359</sup> Whilst this is less extreme than the High Court's judgment and Supreme Court in *Debut*, the Court of Appeal still imposed their own judgement with hindsight, not fully appreciating the directors' predicament – like being hampered by the wider group.<sup>360</sup>

The Court of Appeal overturned the High Court's entire deficiency approach as the breaches did not cause the company to become insolvent.<sup>361</sup> They also rejected the new debt approach for s 135 which protects "new creditors" who extended credit after the company should have ceased.<sup>362</sup> This approach was formulated by Moss on the basis "it is a disgrace... a director can get away with wrongful trading as long as... net deficiency... does not increase". Such change was pertinent for the United Kingdom as there was no gap filler for these situations.<sup>363</sup> However, New Zealand has other coverage.<sup>364</sup> Furthermore, the new damages approach was "necessary to fulfil the intention of the statute, to create justice to creditors".<sup>365</sup> This shows the approach is inappropriate for New Zealand's focus on the company.<sup>366</sup> Whilst the net deterioration approach may sometimes mean no compensation is awarded, this occurs where there has been no loss to the company, making it the appropriate measure under an entity regime. So, the Court decided the net deterioration approach was appropriate for s 135. However, no compensation was recoverable because there was no net deterioration in Mainzeal's position.<sup>367</sup> the Court of Appeal was divided over the extent of their discretion under s 301. Kós P and Miller J favoured the current broad discretion. Whereas Goddard J, felt broad discretion was inappropriate given s 301 is only one way of bringing proceedings against directors. Liquidators could avoid the court's s 301 discretion by bringing an ordinary action where judges have less discretion.<sup>368</sup> However, the court's discretion is important as it can ameliorate the harsh duty.<sup>369</sup> The Court did not have

---

<sup>359</sup> At [447]-[450].

<sup>360</sup> Gollin, above n 357.

<sup>361</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [484]-[491] and [503]-[509].

<sup>362</sup> At [525]-[531].

<sup>363</sup> Arthur, above n 138, at 53-54; Gabriel Moss "No Compensation for Wrongful Trading – Where Did it All Go Wrong?" (2017) 30 *Insolvent Int.* 49, 50-51 at 56.

<sup>364</sup> *Mainzeal Property and Construction Ltd (in liq) v Yan*, above n 335, at [385]; and discussed in chapter five.

<sup>365</sup> Moss, above n 363, at 56.

<sup>366</sup> *Mainzeal Property and Construction Ltd (in liq) v Yan*, above n 335, at [386].

<sup>367</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [513]-[518].

<sup>368</sup> At [303]-[307].

<sup>369</sup> Heath and Whale, above n 22, at [32.3.6].

to rule on the point, because the issue of damages was sent back to the High Court. Creditors claiming (instead of a liquidator) under s 301(1)(c) was also left open for future determination.<sup>370</sup> So, compensation remains uncertain.<sup>371</sup>

Importantly the Court of Appeal called for these provisions to be reviewed to ensure the laws is coherent and workable.<sup>372</sup>

Despite the Court of Appeal improving upon the High Court's decision, they share common shortfalls. Firstly, condemning intergroup transactions and shareholder support mechanisms without realising they are commonplace in commerce has wide implications on business activity.<sup>373</sup> Especially because the Court did not provide realistic alternatives for directors.<sup>374</sup> For example, getting a legally enforceable guarantee is unlikely because it defeats the purpose of separate legal identity limiting liability. Furthermore, the alternatives proposed largely lay outside the directors control and may be harmful.<sup>375</sup> For example, supporting resignation is unwise as directors know companies the best and their absence leaves the company looking for someone to make critical decisions, creating disarray.<sup>376</sup> This shows the judiciary's deficient commercial knowledge and struggle to avoid hindsight bias.<sup>377</sup> Hypothetical alternatives expose directors to wider liability,<sup>378</sup> inviting "courts into the boardroom to substitute their own judgment for...duly appointed directors...Such an approach creates...substantial risks for directors".<sup>379</sup>

---

<sup>370</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [307] and [308]-[309].

<sup>371</sup> "Court of Appeal Highlights Need to Amend the Companies Act in Latest Mainzeal Decision" (7 April 2021) Duncan Cotterill <[www.duncancotterill.com](http://www.duncancotterill.com)>.

<sup>372</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [12].

<sup>373</sup> McRae, above n 225, at 349.

<sup>374</sup> Sam Holden, Janko Marcetic and others *Litigation & Dispute Resolution – Trends and Insights* (Chapman Tripp, August 2020) at 5.

<sup>375</sup> "The Mainzeal Collapse and What Could've Been Done Differently" (1 March 2019) Duncan Cotterill <[www.duncancotterill.com](http://www.duncancotterill.com)>; and Conder and Fraundorfer, above n 226, at 152.

<sup>376</sup> Grantham and Rickett, above n 33, at 589; and *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [58].

<sup>377</sup> Gamble, above n 249, at 8.

<sup>378</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [73] and [76]; *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [442] and [446]-[452]; and *Mainzeal Property and Construction Ltd (in liq) v Yan*, above n 335, at [168].

<sup>379</sup> Conder and Fraundorfer, above n 226, at 148.

### *C Debut's Frosty Reception in the High Court*

Two recent decisions show the High Court distinguish the Supreme Court's *Debut* decision.<sup>380</sup>

In *Watts & Hughes Construction Ltd v Biala* the High Court noted the Supreme Court in *Cooper* did not engage with whether it is legitimate for companies experiencing temporary financial difficulties to continue trading nor relevant case law, meaning the cases under the orthodox pragmatic approach remained open. So, the Court reverted to the pragmatic *Mason* approach.<sup>381</sup> The Court also reiterated the difference between negligence (what reasonable directors would have done or foreseen) and punishable reckless trading. Here, the facts involved considering the risks a start-up company faced.<sup>382</sup> The directors undertook a sober assessment and made a calculated risk to start-up the business and undertake related activity based on their experience. There was a reasonable expectation the business would trade profitably.<sup>383</sup> Their decisions did not depart “markedly from *orthodox business practice* and involved...extensive...unusual risk to...creditors” to be reckless.<sup>384</sup> That does not change in hindsight just because trading expectations were not met.<sup>385</sup> Notably, in contrast to *Debut*, even if s 135 had been breached, compensation would not have been ordered because the \$39,000 loss to Watts and Hughes, a large construction company, was not ‘serious’.<sup>386</sup> The Court’s appreciation of commercial reality is clear in the very pragmatic judgment which does not follow *Debut*.

Secondly *Banks v Farmer*.<sup>387</sup> The Court emphasised the policy rationale in the long title requires balancing protecting stakeholders, *including the entity itself* and encouraging legitimate business risks/judgement.<sup>388</sup> This gives proper weight to the CA’s dual-purpose and entity focus. Like *Watts and Hughes v Biala*, Moore J relied on orthodox authorities, as

---

<sup>380</sup> There are other recent decisions. They are standard cases and not of particular note. Other recent cases include *Parkinson v O'Brien on Behalf of General Dynamics Corporation Ltd* [2021] NZCA 309; *O'Brien v Parkinson & Others* [2021] NZHC 1193; *New Zealand Labour Enterprises Limited & Anor v Sembhi & Anor* [2021] NZHC 986; *Kelstworural Ltd (in liq) v Mounsey-Ross* [2021] NZHC 1632; and *Independent Carpets Ltd (in liq) v Carpet Call 2000 NZ Ltd* [2021] NZHC 1750.

<sup>381</sup> *Watts & Hughes Construction Ltd v Biala*, above n 287, at [22]-[27].

<sup>382</sup> At [28]

<sup>383</sup> At [33]-[62].

<sup>384</sup> At [60]; and compare to *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [72].

<sup>385</sup> At [28] and [43].

<sup>386</sup> At [70].

<sup>387</sup> *Banks v Farmer & Others*, above n 287.

<sup>388</sup> At [364]-[368].

well as the Court of Appeal in *Mainzeal* and (boldly) *Debut*.<sup>389</sup> Moore J emphasised directors do not become liable simply by trading after insolvency, a court is to consider upside to the business (to respect directors wide discretion in matters of business judgement) and that it is risk and loss to the *company* as a whole.<sup>390</sup> Moore J reemphasised courts must avoid hindsight judgements as they do not fully comprehend difficult commercial choices. The directors breached s 135 by continuing trade after a deal essential to the company's solvency failed. But no compensation was awarded as the plaintiff was not at risk of further loss.<sup>391</sup>

These judgments show clear preference for the pragmatic approach. They balance the CA's dual-purpose and should be the approach consistently applied.

#### ***D Overarching Criticisms of the Modern Judgments and Judiciary***

Section 135 remains uncertain after almost 30 years in force. The recent strict decisions make continued trading and directorships daunting due to potentially wide personal liability.<sup>392</sup> The exclusion of considering risk commensurate with reward, excluding commercial reality/orthodoxy and imposition of hindsight on alternatives creates a harsh environment leading to chapter two inefficiency concerns.<sup>393</sup>

Commentators' concerns (in chapter three) eventuated. The broad objective wording allows commercially inexperienced judges to take an approach/gloss that enables them to 'stamp' their own judgement on experienced businesspeople with minimal consideration of the difficulties directors face (directors will not truly know a company is salvageable until future events transpire).<sup>394</sup> Judges allocate risk in the way they think fair rather than based on underlying principles.<sup>395</sup> Commentators suggest directors are perceived as villains and that judges traditionally sympathise with creditors.<sup>396</sup> This approach is evidenced through the increasing breadth and burden of directors' duties, which are actually owed to the company,

---

<sup>389</sup> At [369]-[387].

<sup>390</sup> At [385]-[387]; in line with *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [31]-[33].

<sup>391</sup> At [375] [386] and [451]-[455].

<sup>392</sup> Conder and Fraundorfer, above n 226, at 178-179.

<sup>393</sup> Bos and Wiseman, above n 17, at 266-267.

<sup>394</sup> Grantham and Rickett, above n 33, at 56-57; Farrar and Hanrahan, above n 41, at 574; Bos and Wiseman, above n 17, at 264 and 267.

<sup>395</sup> Farrar and Hanrahan, above n 41, at 567 and 571-572.

<sup>396</sup> Bos and Wiseman, above n 17, at 266 and 268; Keay, above n 16, at 439-441; and Keay, Loughrey and others, above n 201, at 644-645.

in the interests of protecting creditors.<sup>397</sup> Unprincipled decisions based on intuition leave directors uncertain as to how their conduct will be judged<sup>398</sup> and creditors unsure on when to bring a claim.<sup>399</sup> For example, in *Debut* all three courts came to different conclusions based on ‘cherry picking’ facts to suit their outcome. In other jurisdictions and New Zealand’s past, directors found solace in the business judgment rule.<sup>400</sup> The Law Commission stated courts were not to second-guess directors who were permitted wide discretion in business matters.<sup>401</sup> Furthermore, the deregulatory North American influence on the CA requires understanding law and economics.<sup>402</sup> But, the business judgment rule and director discretion in common law have diminished.<sup>403</sup> This also impinges upon separate legal identity.<sup>404</sup> Thus, it is unsurprising the success of s 135 cases is high.<sup>405</sup>

These criticisms are illustrated by the harsh judgment of the High Court in *Mainzeal*, and Supreme Court and High Court in *Debut*. Their stringent approaches to s 135 fail to give weight to both aspects of the long title. On the other hand, the pragmatic decisions of the Court of Appeal in *Debut* and *Banks v Farmer* show appreciation of commercial reality and balancing between protection and efficiency.

Commentators and directors believe the harsh approach to reckless trading duties will negatively impact directorships.<sup>406</sup> 47% of directors in the Institute of Director’s 2020 Survey felt increased personal liability made them more cautious in business decision-making.<sup>407</sup> Risk aversion means boards miss valuable opportunities for the company. Targeting directors personally adds to an already large legal onus, compliance activities increased for 70% of

---

<sup>397</sup> This view has been long established per Brennan, above n 94, at 1-2; and Lo, above n 116, at 233.

<sup>398</sup> Bos and Wiseman, above n 17, at 267; and Deane, above n 117, at 4.

<sup>399</sup> Fitzsimons, above n 22, at 285-287; and Farrar and Hanrahan, above n 41, at 571-572.

<sup>400</sup> Grantham and Rickett, above n 33, at 568; Watts, above n 42, at 129 and 240-242; and Law Commission, above n 8, at [212].

<sup>401</sup> Law Commission, above n 9, at [138]-[144].

<sup>402</sup> Fitzsimons, above n 22, at 284-285, 287 and 292-293.

<sup>403</sup> Sealy, above n 50, at 80; and Andrew Keay, Joan Loughrey and others “Business judgment and director accountability: a study of case-law over time” (2020) 20 J. Corp. Law Stud. 359 at 359 and 361.

<sup>404</sup> Farrar and Hanrahan, above n 41, at 567.

<sup>405</sup> Taylor, above n 1, at 186.

<sup>406</sup> This refers to the inefficiency concerns considered in chapter two. For further discussion on this point, including empirical evidence, see Farrar and Hanrahan, above n 41, at 590; Farrar and Tennent, above n 21, at 246; and Keay, Loughrey and others, above n 403.

<sup>407</sup> Institute of Directors New Zealand and ASB *Director Sentiment Survey 2020* (Institute of Directors, December 2020) at 4.

directors. This takes time away from performance and strategy.<sup>408</sup> In 2019 and 2020, 40% of directors said the scope of director responsibilities is more likely to deter them from governance roles. It is fundamental to good governance and New Zealand's prosperity that skilled individuals are directors.<sup>409</sup>

Part of the uncertainty comes from the courts taking different theoretical approaches to the corporate objective.<sup>410</sup> A judge's personal preference affects the interpretation and outcome of a case. For example, *Banks v Farmer* and the Court of Appeal in *Debut* took an ET approach. Focusing on the company resulted in commercial and balanced decisions. In comparison, the Court of Appeal in *Mainzeal* took a SP shifting approach<sup>411</sup> and the Supreme Court<sup>412</sup> and High Court<sup>413</sup> in *Debut* and High Court in *Mainzeal*<sup>414</sup> took a creditor primacy approach. These approaches lead to overprotection of creditors at the cost of directors because a creditor focus holds creditors' interests are paramount.<sup>415</sup> The focus on creditors results in erroneously focusing on insolvency, requiring excessive caution and viewing the company's funds as creditor property ("using creditors' money" to trade).<sup>416</sup> The focus should be on the company as an entity with its own property. The corporation's interests are paramount and are not to be confused with creditors. Section 135 is specifically owed to the company, the remedy goes into the company's fund and loss is calculated by reference to the company.<sup>417</sup> This has also

---

<sup>408</sup> Selwyn Eathorne *Submission on the Law Commission's Issues Paper on Class Actions and Litigation Funding* (Institute of Directors New Zealand, March 2021) at 3.

<sup>409</sup> At 8.

<sup>410</sup> No approach has been firmly adopted, *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [28]-[31].

<sup>411</sup> The Court's commentary/discussion on the Companies Act shows a SP understanding, *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [205], [214], [218], [230], [231] and [232]. The reference to 'shareholder funds' and general SP suggest the Court would see the company using 'creditor funds' when 'shareholder funds' run out, *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [140] and [233].

<sup>412</sup> The focus on creditors can be seen in the emphasis on the insolvency statutory priorities, the formal mechanisms, liquidation, consulting creditors and not allowing risk and reward being balanced, any shortfall/compartamentalising of creditors nor consideration of orthodox business practice. *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [32]-[35], [42]-[49], [72]-[76], [176] and [174]-[181].

<sup>413</sup> Some examples of the creditor centric approach in the High Court are, the approach to s 131 was too objective *Debut Homes Ltd (in liq) v Cooper*, above n 244, at [43]-[50], little weight was given to mitigating factors and a very high amount awarded in compensation *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [63] and [95], different factual findings from the Court of Appeal *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [40], [41], [47]-[49], [56], [60] and [82] and creditor focus with little mention of the company *Debut Homes Ltd (in liq) v Cooper*, above n 244, at [46] [47] [50] [53].

<sup>414</sup> The over protection of creditors illustrates this point. An example is the terminology of 'creditor money/funds'. *Mainzeal Property and Construction Ltd (in liq) v Yan*, above n 335 at, [203], [280], [164] and [166].

<sup>415</sup> Keay, above n 26, at 306.

<sup>416</sup> Watts, above n 277, at [62]; Conder and Fraundorfer, above n 226, at 151; and Buckley, above n 12, at 1389.

<sup>417</sup> Watts, above n 277, at [56]-[57].

led to the anomaly that s 135 claims cannot be made during solvency as there is no loss to creditors – despite the legislature’s intention for application throughout the company’s life.<sup>418</sup> The focus on creditors means ET’s broader approach and focus on maximising value and financial sustainability is lost.<sup>419</sup> ET provides a medium between excessive risk and excessive caution, a creditor focus requires directors choose risk-averse courses which do not always benefit the company.<sup>420</sup> Furthermore, Canadian courts where ET is prevalent and the CA originates, allow discretion and business judgement. A director should not be held back from taking actions that benefit the company merely because one creditor may not benefit, or it may impact solvency. An entity focus aligns with the CA and promotes valuable business activity.<sup>421</sup>

Another issue is some courts still look to English jurisprudence despite the clear departure from English company law.<sup>422</sup> One of the main consequences of this has been the focus on insolvency. Section 214 of the Insolvency Act (the s 135 equivalent) only applies upon financial distress.<sup>423</sup> The focus on insolvency also applies to the creditor regarding sub-provision in the s 172 duty.<sup>424</sup> Throughout s 135’s history courts have focused on the point of insolvency, even though the CA does not require this or the solvency test be used, and intentionally moved away from the insolvency regime and removed the Law Commissions’ reference to solvency from the provision.<sup>425</sup> The insolvency focus of the United Kingdom duties is one of their most problematic features because there is no clear pronouncement of the form of financial distress and it is difficult to identify the point of insolvency.<sup>426</sup> Whilst the financial state of the company has relevance to s 135, the courts should not be distracted by technicalities.<sup>427</sup> The solvent or insolvent view taken makes no allowance for diverse situations.<sup>428</sup>

---

<sup>418</sup> Arthur, above n 138, at [54].

<sup>419</sup> Dalkie, above n 314, at 65.

<sup>420</sup> Key, above n 77, at 638; and Callison, above n 56, at 435.

<sup>421</sup> Dalkie, above n 314, at 65-66.

<sup>422</sup> Watson and Taylor, above n 12, at 132.

<sup>423</sup> Insolvency Act (UK), s 214 and 246ZB; and Key, above n 135, at 4-5.

<sup>424</sup> As discussed, their Companies Act takes a SP approach which shifts focus to creditors upon insolvency. Companies Act (UK), s 172; Key, above n 31, at 305-306; and Sealy, above n 10, at 178-180.

<sup>425</sup> Watson and Taylor, above n 12, at 604.

<sup>426</sup> Andrew Key “Another way of Skinning a Cat: Enforcing Directors’ Duties for the Benefit of Creditors” (2004) 17 *Insolv.Int.* 1 at 5-6.

<sup>427</sup> Sealy, above n 10, at 178.

<sup>428</sup> Dalkie, above n 314, at 64-65

All the uncertainty makes the law inaccessible.<sup>429</sup> Recourse to the courts is already slow and expensive.<sup>430</sup> Private enforcement has been low due to inadequate funding and because unsecured creditors are often only owed small amounts making legal action unviable.<sup>431</sup> The long processes of *Mainzeal* and *Debut* illustrates these issues. Mainzeal's creditors are still waiting for litigation to end and may face years of delay.<sup>432</sup> The access to justice issue will be assisted by the growing class action and litigation funding sectors providing affordable mechanisms for group claimants to pursue actions.<sup>433</sup> However, increased litigation funding has negative consequences too. It may lead to greater risk aversion in director decision-making and increase compliance burdens. This occurred in Australia, resulting in long-term negatives impacts on economic growth and employment.<sup>434</sup>

The increased risk of litigation the recent decisions expose directors to and the growing litigation funding and class action environment has contributed to New Zealand's volatile D&O insurance market.<sup>435</sup> Insurers have noted the expanded role and responsibilities of directors, growth in class actions and litigation funding, the notable legal developments, substantial court awards against directors, the decreasing protection provided by the business judgement rule, the uncertain and increasingly risky claims environment and increased risk of insolvency.<sup>436</sup> The high profile Mainzeal 'group action' has particularly caught insurers attention.<sup>437</sup> As a result, It has been difficult and costly to renew D&O insurance. Coverage is shrinking and lower limits are offered.<sup>438</sup> This is concerning because the factors increasing insurance costs also increase directors' need for insurance, adding to directors' vulnerability.<sup>439</sup>

---

<sup>429</sup> Keay, above n 63, at 615.

<sup>430</sup> Kersey, Upson, Walker and Lamb, above n 348; and Law Commission, above n 9, at [144].

<sup>431</sup> Taylor, above n 1, at 179-182.

<sup>432</sup> Kersey, Upson, Walker and Lamb, above n 348.

<sup>433</sup> *Litigation Forecast 2021*, above n 262, at 14; Eathorne, above n 408, at 2.

<sup>434</sup> Eathorne, above n 408, at 4-5; and Parliamentary Joint Committee on Corporations and Financial Services *Litigation Funding and the Regulation of the Class Action Industry* (Senate Printing Unit, December 2020) at [5.13].

<sup>435</sup> *Litigation Forecast 2021*, above n 262, at 9; and Eathorne, above n 408, at 6-7.

<sup>436</sup> MinterEllisonRuddWatts, Marsh and Institute of Directors New Zealand *Directors and Officers Insurance: Trends and Issues in Turbulent Times* (Institute of Directors New Zealand, June 2019) at 3-4; and *Litigation Forecast 2021*, above n 262, at 11-12.

<sup>437</sup> *Litigation Forecast 2021*, above n 262, at 10; Holden, Marcetic and others, above n 374, at 5; and Marsh and Institute of Directors New Zealand, above n 436, at 3.

<sup>438</sup> *Litigation Forecast 2021*, above n 262, at 8-11; and Marsh and Institute of Directors New Zealand, above n 436, at 4.

<sup>439</sup> Marsh and Institute of Directors New Zealand, above n 436, at 3; at Eathorne, above n 408, at 7

These issues with the judiciary's commercial law decisions have from time to time lead to calls for corporate governance disputes to be taken away from the courts and transferred to specialist dispute resolution tribunals/panels of businesspeople or corporate advisors.<sup>440</sup> An example is the Takeover's Panel whose experienced members aim to provide "clarity, certainty, awareness and fairness for everyone involved in major share transactions".<sup>441</sup> However, the issues are a consequence of s 135's drafting – its broad objective standard, the uncommercial, confused and unsatisfactory wording.<sup>442</sup> As considered in relation to the Resource Management Act 1991, we do not want judges having such wide discretion, it is outside their role and the consequences are unsatisfactory.<sup>443</sup> An easier solution than setting up a specialist dispute resolution framework is to amend the provision.

### ***Conclusion***

Given the extensive issues with s 135 and judiciary's approach it is not surprising the Government shares the Court of Appeal's view that a review of the law is warranted.<sup>444</sup> A provision that clearly entrenches the pragmatic approach, includes a partly subjective aspect enforcing consideration of business judgement and reality is permissible, enforces movement away from a rigid insolvency focus, reemphasises the duty is owed to the company and entrenches the net deterioration calculation would capture the CA's dual-purpose and entity focus. This will help the section capture the truly reckless conduct it was intended to protect the company from. Providing certainty and entrenching the pragmatic approach creates substantive and procedural fairness for creditors and directors. A directors' duties purpose provision reaffirming the relevance of the long title in the application of directors' duties would also help the courts.

---

<sup>440</sup> Farrar and Hanrahan, above n 41, at 567-568.

<sup>441</sup> At 568; and "About the Panel" Takeovers Panel Te Pae Whitimana <[www.takeovers.govt.nz](http://www.takeovers.govt.nz)>.

<sup>442</sup> Watts, above n 239, at 1; and Watson and Taylor, above n 10, at 608.

<sup>443</sup> Sian Elias, Chief Justice of the Supreme Court of New Zealand "Righting Environmental Justice" (paper presented to the Resource Management Law Association Salmon Lecture, July 2013) at 4, 6-7 and 13; and Anderson, above n 15, at 228.

<sup>444</sup> Holden, Marcetic and others, above n 374, at 4.

## Chapter Five: Overlapping Directors Duties – Superfluous

### Section 135

New Zealand law provides creditors many tools for compensation and protection, including broad overlapping directors' duties which indirectly benefit creditors.<sup>445</sup> This gives rise to the question of whether the problematic s 135 is needed.<sup>446</sup>

#### *I Delaware and Canada*

Delaware and Canada are useful to consider as neither impose insolvent trading duties on directors.<sup>447</sup> In 2007 the Delaware Supreme Court denied creditor rights to bring direct claims.<sup>448</sup> The Court denied a duty to creditors because it would create uncertainty, conflict with the duty to maximise value and was unnecessary as creditors have other legal protections.<sup>449</sup> Canadian law also does not include an insolvent trading duty. Directors have duties of loyalty and care.<sup>450</sup> The Supreme Court of Canada held the duties were only owed to the company because the Canada Business Corporations Act states the corporation is the beneficiary, a range of statutory remedies are available to creditors and ET means the company's interests overlap with other constituencies.<sup>451</sup>

This approach had mixed consequences. In Delaware, the lack of insolvent trading duty led to unchecked chaos.<sup>452</sup> This has not occurred in Canada. The different outcomes can be attributed to the different underlying theories in the jurisdictions. Delaware is a SP

---

<sup>445</sup> Ross, above n 24, at 37; and Harris, above n 14, at 3.

<sup>446</sup> Due to constraints, this chapter will not consider provisions beyond directors' duties to the company under the Companies Act. This chapter also focuses on the overlap between s 135 and ss 136, 137 and 131 as opposed to critiquing the provisions. This chapter will largely not discuss remedies.

<sup>447</sup> Harris, above n 14, at 11; and Licht, above n 101, at 25.

<sup>448</sup> For more see Jared Ellias and Robert Stark "Delaware Corporate Law and the 'End of History' in Creditor Protection" (research paper, UC Hastings, 2020) (forthcoming) at 14-23; Licht, above n 101, at 28-29; *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 100 (Del. 2007) at 103; and *Quadrant Structured Prod. Co. v. Vertin*, 102 A.3d 155, 176 (Del.Ch. 2014) at 176.

<sup>449</sup> *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, above n 448, at 94 and 100-103; Ellias and Stark, above n 448, at 19-24; Grantham and Rickett, above n 33, at 591; Hargovan and Todd, above n 119, at 163-177; and Bainbridge, above n 67, at 345-348.

<sup>450</sup> Canada Business Corporations Act 1985 (CA) s 122; *Doing Business in Canada* (Fasken Martineau DuMoulin LLP, 2019) 55-56; and *Responsibilities of Directors in Canada* (Torys LLP, 2009) at 16-18.

<sup>451</sup> Canada Business Corporations Act (CA), s 241; Licht, above n 101, at 23 and 25-27; *Peoples Department Stores Inc. (trustee of) v Wise*, above n 72, at 481-482; and *BCE Inc v 1976 Debentureholders*, above n 72, at 71, 82 and 84; *Responsibilities of Directors in Canada*, above n 450, at 16-19; Vasudev and Watson, above n 37, at 115-116; Couwenberg and Lubben, above n 101, at 64-65; and Harris, above n 14, at 11-12.

<sup>452</sup> Jared Ellias and Robert Stark "Bankruptcy Hardball" (2019) 308 Cal.L. 1 at 1-10 and 66-67.

jurisdiction. SP governance focuses excessively on shareholders, leaving little room for creditors in ‘the company’, which enabled directors to engage in tactics harmful to creditors for shareholder benefit.<sup>453</sup> In comparison, Canada is a strong ET jurisdiction that mandates the company’s interests are furthered (prohibiting excessive risk).<sup>454</sup> During financial difficulty creditor interests strongly shape behaviour.<sup>455</sup> This shows general directors’ duties may be sufficient.<sup>456</sup>

## ***II Overlapping Director’s Duties – No Gap to Fill?***

There are relevant tools and statutory liabilities for insolvent trading in property, insolvency, taxation, company law and more.<sup>457</sup> However, the other directors’ duties owed to the company alone show significant overlap with s 135.<sup>458</sup> Section 135 claims (under s 301) are often combined with claims for breach of s 131(1), s 136 and s 137.<sup>459</sup> Section 135 may be an unnecessary duplication of these duties.<sup>460</sup>

### ***A Section 136***

Section 136 states directors must not agree to the company incurring obligations it cannot perform. It applies throughout the company’s life and is owed to the company.<sup>461</sup> Section 136 is closely related to s 135 as the other ‘insolvent trading duty’ (even though it does not refer

---

<sup>453</sup> At 1-3, 10-12 and 15.

<sup>454</sup> Buckley, above n 12, at 1387 and 1398; *Peoples Department Stores Inc. (trustee of) v Wise*, above n 72, at 4481-82; and *BCE Inc v 1976 Debentureholders*, above n 72, at, 82 and 84.

<sup>455</sup> *Peoples Department Stores Inc. (trustee of) v Wise*, above n 72, at 482. For more discussion on this point see chapter one.

<sup>456</sup> Vasudev and Watson, above n 37, at 116.

<sup>457</sup> Claims for breaches of insolvent trading duties are often combined with claims of a different nature Taylor, above n 1, at 186-187. For comment on contractual options, Taylor, above n 1, at 192; recourse for the IR, Inland Revenue Department *Income Tax and Goods and Services tax – Director’s liability and the COVID-19 “safe harbour” in schedule 12 to the Companies Act 1993* (Public Ruling BR PUB 20/06); Property Law Act 2007, ss 347 and 348 and pt 6 sub-pt 6; tort and Fair Trading Act 1986 actions, Watson and Noonan, above n 14; insolvent antecedent transaction provisions under the Insolvency Act 2006, Heath and Whale, above n 22, at [24]; Companies Act ss 300, 56, 289, 138A(1), 380, 298, 299, 297, 292, 293, 296, Heath and Whale, above n 22.

<sup>458</sup> Companies Act, s 169(3); and Julie Cassidy “Wake up New Zealand: Directors’ Duties Reform Responses to the Global Financial Crisis” (2014) 20 NZBLQ 181 at 183; and Watson and Taylor, above n 10, pt 5; and Campbell, Watts, Francis and others, above n 18, at [24].

<sup>459</sup> Taylor, above n 1, at 186.

<sup>460</sup> Julie Cassidy “Superfluous or Superlative: The Role of Reckless/Insolvent Trading prohibitions in New Zealand, Australian and South African Directors’ Duties Regimes” (paper presented to the Corporate Law Teachers Association Annual Conference, Melbourne, February 2020) at 3 and 7.

<sup>461</sup> Companies Act, ss 136 and 169(3); and Watson and Taylor, above n 10, at 625; *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [165] and fn 190.

to creditors).<sup>462</sup> The provisions are so similar they were included under the same section in the Law Commission's draft.<sup>463</sup> Taking risk and incurring an obligation are similar questions.

Section 136 has three elements; the defendant is the director, an obligation was incurred, and when the obligation was incurred, the director did not honestly believe (subjective test) on reasonable grounds (objective test - considering if the director acted as a reasonable director would have) the company could perform the obligation.<sup>464</sup> The second element has been debated. Previously, the absence of 'causes' or 'allows' like s 135 and considering the director's belief – suggesting knowledge is relevant, was taken to indicate 'agree' accompanied by 'incur' requires a positive act of agreement to incur a specific *contractual* obligation, not obligations from the general running of the company (which s 135 covers).<sup>465</sup> This aligns with the other traditional distinction between the insolvent trading duties – that s 136 deals with capital account (one off specific transactions) and s 135 deals with revenue account (the general running of business) obligations.<sup>466</sup> *Debut* and *Mainzeal* rejected these interpretations as having no policy reason or support in the text or wider context.<sup>467</sup> This means s 136 now applies to tax debts, general trading, classes of obligations, all obligations incurred by the company after a point in time and long-term obligations where no basis for confidence in the company's long-term position existed.<sup>468</sup> The wider interpretations of s 136 are unnecessary as the conduct would fall under s 135.<sup>469</sup> This means s 136 operates even more like s 135.

As the Supreme Court interpreted away the main factors differentiating ss 135 and 136 they appear to have tried to create a new basis for distinguishing the duties. This was largely

---

<sup>462</sup> Watson and Taylor, above n 10, at 603.

<sup>463</sup> Law Commission, above n 8, at 241-242.

<sup>464</sup> *Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396, at 45; *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [285]-[286]; and Howes, Revill and Clark, above n 208, at [CA136.07].

<sup>465</sup> *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [66], *Peace and Glory Society Ltd (in liq) v Samsa*, above n 464, at [44]; *FXHT Fund Managers Ltd (in liq) v Oberholster* (2009) 10 NZCLC 264,562 (HC) at [40]; Howes, Revill and Clark, above n 208, at [CA136.04]; Ross, above n 24, at 44; Watson and Taylor, above n 10, at 626.

<sup>466</sup> *Peace and Glory Society Ltd (in liq) v Samsa*, above n 464, at [44]; *Grant v Johnston*, above n 209 at [43]; and Farrar, above n 167, at 174.

<sup>467</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [91]-[96] and fn 104; and *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [272]-[287].

<sup>468</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [283] and [459]-[460]; and *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [91]-[96]

<sup>469</sup> Conduct is discussed below; Howes, Revill and Clark, above n 208, at [CA136.01].

reflected in the remedies discussion. Section 136 has traditionally been interpreted as sharing s 135's rationale. However, the Supreme Court held s 136 focuses on individual creditors and protects new creditors being enticed (preventing "robbing of Peter to pay Paul"). The Supreme Court felt the concern was exacerbated by dishonest directors avoiding compensation orders if they maintain a net deficit under the net deterioration approach. So, the Supreme Court stated a restitutionary approach was needed to address harm to the company under s 136.<sup>470</sup> This distinction was unfortunately confirmed by the Court of Appeal in *Mainzeal*.<sup>471</sup> Watts suggests ss 136 and 135 were meant to be "two ways of skinning a cat".<sup>472</sup> Forcing differences in odd ways creates issues. This is shown in *Mainzeal* where both courts struggled to decide which section was most appropriate.<sup>473</sup>

The changed approach to remedies and purpose does not change what s 136 covers – shown by the Supreme Court in *Debut* holding the same actions breached both sections.<sup>474</sup> Like s 135 claims, claims under s 136 are brought in circumstances where directors permit the company to incur liabilities when the company is insolvent or becomes insolvent from a transaction.<sup>475</sup> As a result, in many cases the duties are claimed (successfully) together.<sup>476</sup>

Sections 135 and 136 cover the same scenarios. This is not desirable as multiple duty breaches increases damages.<sup>477</sup> It unfairly and unnecessarily penalises directors for the same act multiple times. Australia and United Kingdom only have one provision targeting insolvent trading, the second limb of their (civil liability) approach is the general duty of good faith.<sup>478</sup> This enforces that only one insolvent trading duty is needed. As s 135 is generally more problematic, perhaps it is suitable to remove.<sup>479</sup>

---

<sup>470</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [165]-[166]; for more discussion on the restitutionary approach see chapter four and Heath and Whale, above n 22, at [32.3.6]; Watts, above n 277; and Watts, above n 239.

<sup>471</sup> *Yan v Mainzeal Property and Construction Limited (in liquidation)*, above n 2, at [296]-[297].

<sup>472</sup> Heath and Whale, above n 22, at [32.3.6].

<sup>473</sup> "Court of Appeal Highlights Need to Amend the Companies Act in Latest Mainzeal Decision", above n 371.

<sup>474</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [94]-[95].

<sup>475</sup> Watson and Taylor, above n 10, at 628; and *Goatlands Ltd (in liq) v Borrell*, above n 159, at [113].

<sup>476</sup> Examples include *Goatlands Ltd (in liq) v Borrell*, above n 159; *Rowmata Holdings Ltd (in liq) v Hildred*, above n 225; *Syntax Holdings (Auckland) Ltd (in liq) v Bishop* [2013] NZHC 2171; *Madsen-Ries v Just (No 1)* [2013] NZHC 2254; and *Vance v Jefferys* [2014] NZHC 1932.

<sup>477</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [162], [164] and [167]; and Watson and Taylor, above n 10, at 632.

<sup>478</sup> Licht, above n 101, at 27-28.

<sup>479</sup> Taylor, above n 1, at 76.

## **B Section 131(1)**

Section 131 restates the common law bona fide requirement on directors exercising their discretion. Section 131(1) imposes a duty on a director to act in good faith and in what the director believes to be the best interests of the company.<sup>480</sup> Section 131 is fundamental to directors' responsibilities, an overarching positive duty and a fiduciary duty. It is a broad duty, so it imposes a number of requirements that overlap with other duties.<sup>481</sup>

Section 131 is a subjective test analysing what directors honestly viewed as the company's best interests on the facts. To act in the company's best interests directors should identify, assess and compare options.<sup>482</sup> For a time, the Courts' approach became increasingly objective, requiring any belief to be reasonably held.<sup>483</sup> This was criticised given s 131's subjective wording.<sup>484</sup> The Supreme Court recently rejected the objective overlay as the wording and legislative history are expressed subjectively.<sup>485</sup> They also accepted s 131 reflects the business judgement rule.<sup>486</sup> The Supreme Court's s 131 approach aligns more with the long title and juxtaposes the harsh s 135 test - potentially attempting to differentiate them. However, the Court added a caveat that an irrational or unreasonable belief would breach s 131, importing a similar objective overlay to the one rejected.<sup>487</sup>

The 'best interests of the company' has been a key issue.<sup>488</sup> Chapter one discussion on the corporate objective is relevant to what is 'the best interests of the company'.<sup>489</sup> Whilst no theoretical approach has been adopted, it has been long established the duty includes considering creditors.<sup>490</sup> The rationale for including creditors under s 131 is shared with s 135.<sup>491</sup> The concept developed collectively across the Commonwealth.<sup>492</sup> Cooke J's

---

<sup>480</sup> Companies Act, s 131; and Campbell, Watts, Francis and others, above n 18, at [24.9].

<sup>481</sup> Watson and Taylor, above n 10, at 519, 530-531 and 521; and Rosemary Langford *Best Interests: Multifaceted but not Unbounded* (University of Melbourne Law School, 2016) at 21.

<sup>482</sup> *Hedley v Albany Power Centre* (2006) NZCLC 264,095 at [64]; and Watson and Taylor, above n 10, at 521.

<sup>483</sup> *Soujourner v Robb* HC Christchurch CIV-2004-476-000568, 4 July 2006, at [102]; and Watson and Taylor, above n 10, at 525.

<sup>484</sup> Tompkins, above n 151, at 17; and Campbell, Watts, Francis and others, above n 18, at [24.9].

<sup>485</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [110] and [112].

<sup>486</sup> Tompkins, above n 151, at 17; and Howes, Revill and Clark, above n 208, at [CA131.02].

<sup>487</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [109] and [113].

<sup>488</sup> Langford, above n 481, at 1.

<sup>489</sup> Bede Harris "Fiduciary Duties of Directors Under the Companies Act 1993" (1994) NZLJ 242 at 414.

<sup>490</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at 28-32.

<sup>491</sup> See chapter two discussion; and Van Zwieten, above n 104, at 2.

<sup>492</sup> Licht, above n 101, at 28-29; *Walker v Wimborne*, above n 71; *Nicholson v Permakraft (NZ) Ltd*, above n 83; *Peoples Department Stores Inc. (trustee of) v Wise*, above n 72; *Credit Lyonnais Bank Nederland, N.V. v. Pathe*

judgment in *Nicholson v Permakraft* is the origins of considering creditors under s 131 in the vicinity of insolvency.<sup>493</sup> This concept continued to develop and was affirmed in later New Zealand cases even with the express enactment of the reckless trading duty.<sup>494</sup> The Supreme Court in *Debut* accepted considering creditors upon insolvency and stated this means considering all creditors.<sup>495</sup> Whilst there is academic disagreement on including creditors – the requirement is entrenched.<sup>496</sup>

Typical s 131 cases significantly overlap with s 135.<sup>497</sup> Section 131 includes where directors have a conflict of interest with the company and act for their own or a third party's benefit to the company's detriment, directors misusing company property, failing to consider the company's interests (including the consider creditor concept) and allowing trading and/or improper transactions in insolvency or which cause insolvency.<sup>498</sup> The similarities mean conduct which breaches s 131 usually breaches s 135.<sup>499</sup> The Court of Appeal's analysis in *Debut* is especially telling as ss 131 and 135 are so similar they were considered concurrently.<sup>500</sup> Again, the Supreme Court held Cooper was liable under s 131 for the same reasons as s 135.<sup>501</sup> Furthermore, the tests are increasingly similar with the courts requiring directors identify options available under s 135, which is required under s 131.<sup>502</sup> Section 131 and 135 are so similar their counterparts are considered the 'two prongs' of the Anglo-Australian approach to directors' insolvent trading.<sup>503</sup>

---

*Communs. Corp.*, above n 71; *West Mercia Safetywear Ltd v Dodd*, above n 145; and *Kinsela v Russell Kinsela Pty Ltd (in liq)* above n 145.

<sup>493</sup> Heath and Whale, above n 22, at [32.2.3]; and *Nicholson v Permakraft (NZ) Ltd*, above n 83, at 249-250.

<sup>494</sup> For example, *Robb v Soujourner* [2007] NZCA 493 at [25]; and *FXHT Fund Managers Ltd (in liq) v Oberholster*, above n 465, at [19].

<sup>495</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [28]-[31] and [177]; and Taylor, above n 1, at 172 and 177-178.

<sup>496</sup> The controversy of including creditors was discussed in chapter one, for more see Watts, above n 277, at 61 and Heath and Whale, above n 22, at [32.3.4].

<sup>497</sup> *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [61]; and Van Zwieten n 104, at 25.

<sup>498</sup> *FXHT Fund Managers Ltd (in liq) v Oberholster*, above n 465; *Robb v Soujourner*, above n 494; *Debut Homes Limited (in liquidation) v Cooper*, above n 2; *Madsen-Ries and Vance v Petera*, above n 156; *Hedley v Albany Power Centre*, above n 482; *Delegat v Norman*, above n 225; *Madsen-Ries v Greenhill*, above n 226; and *Morgenstern v Jeffrey* [2014] NZCA 448.

<sup>499</sup> William Porter "The Insolvent Trading Safe harbour Uncertainty Prevails" (2020) 25 NZBLQ 227 at 232.

<sup>500</sup> *Cooper v Debut Homes Ltd (in liq)*, above n 243, at [34]; *Madsen-Reis v Cooper*, above n 300, at 45.

<sup>501</sup> *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [39], [41], [99] and [116]-[119].

<sup>502</sup> See chapter four discussion; *Hedley v Albany Power Centre*, above n 482, at [64]; and *Debut Homes Limited (in liquidation) v Cooper*, above n 2, at [76].

<sup>503</sup> Licht, above n 101, at 27.

These examples and analysis of the broad s 131 show it has been interpreted and applied in a way that covers s 135.

### ***C Section 137***

Section 137 is a duty owed to the company throughout its life. It states directors must exercise the care, diligence and skill a reasonable/competent director would in the circumstances. This is an objective standard.<sup>504</sup> However, there is an aspect of subjectivity as the section also states the standard directors must meet is determined by the nature of the company, decision, director's position/responsibilities and other relevant factors.<sup>505</sup>

Breaches of ss 135 or 136 usually breach s 137 because ss 135 and 136 are instances of the general duty of care.<sup>506</sup> Section 135 especially overlaps with s 137 as both are objective duties that consider whether sufficient care was taken.<sup>507</sup> Most s 137 proceedings have occurred in insolvency under s 301.<sup>508</sup> As a result, there are many examples of breaches of s 137 arising from actions also breaching s 135.<sup>509</sup>

Again, this brings into question whether the more specific s 135 is needed when relevant wrongdoing can be covered by the broader s 137.

### ***Conclusion***

New Zealand has too many provisions.<sup>510</sup> Sections 131, 136 and 137 show s 135 is not required to protect creditors and the company.<sup>511</sup> As New Zealand is not a strong SP jurisdiction like Delaware, we do not need duties explicitly reminding directors of creditors. ET protects all stakeholders where their interests are relevant which means broader duties suffice. However, until ET is firmly adopted, s 135 should remain to avoid following Delaware's 'chaos', especially as New Zealand has many SMEs where risks of opportunism

---

<sup>504</sup> Companies Act, ss 137 and 169(3); Howes, Revill and Clark, above n 208, at [CA137.02]; and *Madsen-Ries v Just*, above n 476, at 31.

<sup>505</sup> Companies Act, s 137; and *Grant v Johnston*, above n 209, at [36].

<sup>506</sup> Ross, above n 24, at 47; and John Farrar "The Duty of Care of Company Directors in Australia and New Zealand" (1996) 4 *CanterLawRw* 228 at 231-232; and Farrar and Tennent, above n 21, at 240-241.

<sup>507</sup> Cassidy, above n 458, at 17.

<sup>508</sup> Watson and Taylor, above n 10, at 650.

<sup>509</sup> Examples include *Cool Cars (Wholesale) Ltd (in liq) v Sharma*, above n 235; *Ocean Boulevard Properties Ltd v Everest*, above n 235; *Rowmata Holdings Ltd (in liq) v Hildred*, above n 225; *Morgenstern v Jeffreys*, above n 498; and *Grant v Johnston*, above n 209.

<sup>510</sup> Farrar and Tennent, above n 21, at 239-240.

<sup>511</sup> Hayne, above n 61, at 805.

are greater.<sup>512</sup> However, the analysis also shows increased certainty and/or decreased scope of s 135 would not leave lacunas.

---

<sup>512</sup> See chapter two.

## Chapter Six: A Safe Harbour Solution

One common option floated to address the harshness of s 135 is a safe harbour.<sup>513</sup> Safe harbours can be a process or defence.<sup>514</sup> Safe harbours specify certain conduct will not violate the correlating rule. They aim to eliminate disincentives discouraging desirable behaviour and promote better behaviour.<sup>515</sup>

### *I Utility of COVID-19 Safe Harbours*

Safe harbours were widely used during the global financial crisis.<sup>516</sup> So, it is unsurprising safe harbours became prevalent during COVID-19 to help directors.<sup>517</sup> In May 2020 the New Zealand COVID-19 insolvent trading duties safe harbour was implemented.<sup>518</sup> COVID-19 uncertainty exacerbated risks for directors continuing trade.<sup>519</sup> The safe harbour freeing directors from liability was intended to discourage premature liquidations and help businesses survive.<sup>520</sup> The safe harbour applied to companies who could pay debts at 31 December 2019 and companies incorporated on/after 1 January 2020 but before 3 April 2020 who acted in good faith and believed the company had or would likely have, significant liquidity problems from COVID-19, and the company would likely be able to pay debts on/after 30 September

---

<sup>513</sup> *Litigation Forecast 2021*, above n 262, at 7; Kersey, Upson, Walker and Lamb, above n 348; and Dalkie, above n 280, at 68.

<sup>514</sup> *Business Set-up, Transfer and Closure* (Productivity Commission of Australia, Inquiry Report 75, September 2015 at 380-381.

<sup>515</sup> Elizabeth Brown “No Good Deed Goes Unpunished: Is There a Need for a Safe Harbor for Aspirational Corporate Codes of Conduct” (2008) 26 *Yale.L.&Pol’yRev.* 367 at 372, 402-403 and 410-413.

<sup>516</sup> Harris, above n 14, at 1, 8 and 11; Firew Tiba “Safe Harbour Carve-Out for Directors for Insolvent Trading Liability in Australia and it’s Implications” (2019) 53 *U.S.F.L.Rev.* 43 at 46 and 49; and Iris Chiu “Relief and Rescue: Suspensions and Elasticity in Financial Regulation, and Lessons from the UK’s Management of the COVID-19 Pandemic Crisis” (2021) 64 *Wash.J.L.&Pol’y.* 63 at 66-667.

<sup>517</sup> Kristin Van Zwieten “The Wrong Target? COVID-19 and the Wrongful Trading Rule” (17 April 2020) Oxford Business Law Blog <[www.law.ox.ac.uk](http://www.law.ox.ac.uk)>; Mark Kleinman “Coronavirus: Ministers Race to Reform Insolvency Laws” (25 March 2020) Sky News <[www.news.sky.com](http://www.news.sky.com)>; Lichat, above n 101, at 18 and 31; Damian Schade “2020 New Zealand Insurance Market Recap Series – Liability” (17 December 2020) Marsh <[www.marsh.com](http://www.marsh.com)>; Institute of Directors New Zealand and ASB, above n 407, at 4-5 and 6; COVID-19 Response (Further Management Measures) Legislation Bill (244-1) (explanatory note); Lidia Xynas and Alexander Xynas “Insolvency and the Australian Safe Harbour Reforms of 2017 – Do they Adequately Support all Australian Directors in Fulfilling their Role as a Fiduciary of their Company in 2021?” (2021) 36 *AJCL* 1; and Noel McCoy *A COVID-19 Directors’ Guide to Avoiding Personal Liability in Circumstances of a Company’s Financial Distress and Possible Insolvency* (Norton Rose Fulbright, September 2020)

<sup>518</sup> COVID-19 Response (Further Management Measures) Legislation Act 2020 sch 3; Companies Act, sch 12; Porter, above n 499, at 228.

<sup>519</sup> Holden, Marcetic and others, above n 374, at 1; and Arthur and Lethbridge, above n 183, at 19.

<sup>520</sup> David Webb, Shawni Hadfield and others “COVID-19: Temporary ‘Safe Harbour’ Provisions for Directors: An Update to the Companies Act 1993” (12 May 2020) Deloitte <[www2.deloitte.com](http://www2.deloitte.com)>; Van Zwieten, above n 517; Companies Act, sch 12 cl 1; COVID-19 Response (Further Management Measures) Legislation Bill (244-1) (explanatory note), above n 517, sch 2 pt 2.

2021.<sup>521</sup> In forming their opinion, directors could consider the likelihood of conditions improving, reaching an arrangement with creditors and other relevant matters. But, the safe harbour excluded truly reckless trade – unsalvageable ‘zombie companies’.<sup>522</sup> Other duties still applied, and directors needed to make careful assessments.<sup>523</sup> The broader approach, subjective element and exclusion of only truly reckless conduct aligns with the pragmatic approach. The safe harbour also does not focus on insolvency (liquidity is preferred).<sup>524</sup> This means the safe harbour avoids the issues the s 135 approach suffers in this respect.<sup>525</sup> If a strict solvency test had been used it is unlikely directors would have relied on the safe harbour due to the difficulties calculating solvency in uncertain times. This safe harbour gave directors time to seek advice and plan.<sup>526</sup>

However, there have been criticisms of the safe harbour. For example, that more guidance was needed, the interaction of the safe harbour with other duties was unclear and it did not contain a long-term focus.<sup>527</sup> But, this safe harbour passed under urgency to lessen the burden and uncertainty of COVID-19, not absolve directors of all duties nor apply in the long-term.<sup>528</sup> Any permanent safe harbour would require more precision, deeper consideration of surrounding provisions and long-term considerations. However, the COVID-19 safe harbour shows progress in the right direction and provides a starting point for New Zealand to develop from.

Rather, the major criticism of the safe harbour should be that it was temporary.<sup>529</sup> As the year did not end in the dire state predicted, the safe harbour was not extended. But, COVID-19’s impacts may be long-lasting.<sup>530</sup> Furthermore, needing a safe harbour highlights the draconian nature of s 135, it should be able to apply in all circumstances.<sup>531</sup> A safe harbour would also

---

<sup>521</sup> Companies Act, sch 12 cl4-6.

<sup>522</sup> Companies Act, sch 12 cl 1; and Porter, above n 499, at 231-232.

<sup>523</sup> Webb, Hadfield and others, above n 520; Schade, above n 517; Holden, Marcetic and others, above n 374, at 4; and Arthur and Lethbridge, above n 183, at 19.

<sup>524</sup> Porter, above n 499, at 231-232.

<sup>525</sup> See chapter four.

<sup>526</sup> *Litigation Forecast 2021*, above n 262, at 5; and Webb, Hadfield and others, above n 520.

<sup>527</sup> For more criticisms of the safe harbour see Porter, above n 499, at 231-233.

<sup>528</sup> Van Zwieten, above n 517.

<sup>529</sup> Companies Act, sch 12 cl 5 .

<sup>530</sup> *Litigation Forecast 2021*, above n 262, at 3, 5 and 7; Holden, Marcetic and others, above n 374, at 4; and Institute of Directors New Zealand and ASB, above n 407, at 12.

<sup>531</sup> Watts, above n 239, at 1.

align s 135 with the CA's rescue goal by encouraging restructuring. Permanent reform is warranted.<sup>532</sup>

## ***II Lessons from Australia's Safe Harbour***

Australia has a permanent safe harbour to balance out their stringent insolvent trading duty.<sup>533</sup> The duty forces directors to enter fatal formal mechanisms on suspicion of insolvency. Like s 135, this made directors risk-averse, and prematurely liquidate.<sup>534</sup> The safe harbour intends to combat this and encourage informal restructuring and entrepreneurship.<sup>535</sup>

The safe harbour facilitates informal restructuring by excluding personal liability under s 588G if, after a director suspects the company may become or be insolvent, they start developing actions reasonably likely to lead to a better outcome for the company than immediate administration or liquidation and debt is incurred directly or indirectly with that action.<sup>536</sup> This moves focus to directors conduct rather than solely on the timing of insolvency.<sup>537</sup> There is no set time period for the safe harbour, it is fact-dependent.<sup>538</sup> This allows qualifying companies to continue trading and incurring debts. The safe harbour is not defeated by a failed result. This considers the unpredictable nature of restructuring processes.<sup>539</sup> The safe harbour excludes directors who failed to pay employees and meet tax obligations within the previous 12 months.<sup>540</sup> Australia's safe harbour gives directors 'breathing space', reduces the stigma surrounding financial difficulties, encourages

---

<sup>532</sup> *Litigation Forecast 2021*, above n 262, at 7; and Arthur and Lethbridge, above n 183, at 19.

<sup>533</sup> Corporations Act 2001 (AU), ss 588G and 588GA.

<sup>534</sup> Jason Harris "Reforming Insolvent trading to Encourage Restructuring: Safe Harbour of Sleepy Hollows?" (2016) JBFLP 294 at 294-295; Helen Anderson "Shelter from the Storm: Phoenix Activity and the Safe Harbour" (2018) 41 MelbULawRw 999 at 1003-1004; and Tiba, above n 516, at 44-45 and 59-60.

<sup>535</sup> Robert Boadle "The New Insolvent Trading Defence: Striking a Better Balance for Creditors and Directors" (2017) 39 LSJ 72 at 72-73; Tiba, above n 516, at 48; and *Business Set-up, Transfer and Closure*, above n 514, at 373-379; and Treasury Laws Amendment (2017 Enterprise Incentive No.2 Bill) Bill 2017 (No. X) (explanatory note) at 5-8.

<sup>536</sup> Corporations Act, s 588GA; Farid Assaf, Tim Bednall and others *Australian Corporation Law Principles and Practice* (loose-leaf ed, LexisNexis) at [3.2A.0333].

<sup>537</sup> Treasury Laws Amendment (2017 Enterprise Incentive No.2 Bill) Bill 2017 (No. X) (explanatory note), above n 535, at 8-11-13; *Review of the Insolvent Trading Safe Harbour* (Treasury of Australia, Consultation paper, September 2021) at 7; and Xynas and Xynas, above n 517, at 20.

<sup>538</sup> Assaf, Bednall and others, above n 536, at [3.2A.0333]; and Corporations Act, s 588GA(1)(b)(i)-(iv).

<sup>539</sup> Sam Marsh and Shane Roberts "Insolvency Safe Harbour for 'Honest' Directors" (2017) Gov.Dir.J. 275 at 275 and 277-279.

<sup>540</sup> Corporations Act, s 588GA(4).

proactivity, taking reasonable risks, encourages directors to remain in control and avoid premature liquidations.<sup>541</sup>

Whilst the safe harbour was welcomed, it was imperfect.<sup>542</sup> Some of the main criticisms are as follows. The safe harbour is inaccessible to SMEs who experience delays in meeting employee and tax requirements.<sup>543</sup> There was disappointment insolvency remained a key element as the difficulties related to the ‘insolvency’ tests still characterised the Australian approach.<sup>544</sup> Not mandating consultation with qualified experts in the safe harbour has also been criticised. Directors who do not consult experts are in the same position as before the safe harbour. Experts provide important guidance and objectivity.<sup>545</sup> Furthermore, the safe harbour does not achieve a restructuring culture because it only addresses one issue in Australia’s legal landscape.<sup>546</sup> Nor did anything change to help the process of informal restructuring, a process safe harbour would have been preferable.<sup>547</sup> One of the main criticisms is the lack of clarity and complexity. For example, the safe harbour’s duration and ‘better outcome’ is unclear.<sup>548</sup> There is too much flexibility, directors want additional guidance.<sup>549</sup>

Whilst the safe harbour is impeded by factors unique to Australia, it shows New Zealand’s legislature clarity, inclusivity, qualified experts, cohesion with surrounding provisions, addressing underlying issues and moving away from insolvency are desirable.

---

<sup>541</sup> Xynas and Xynas, above n 517, at 20; Lisa Filippin and Alan Mitchell “Eligibility for Safe Harbour: Practical Considerations for Directors, Advisers and External Administrators” (2019) ARITAJ 27 at 27; and Treasury Laws Amendment (2017 Enterprise Incentive No.2 Bill) Bill 2017 (No. X) (explanatory note), above n 535, at 8-11.

<sup>542</sup> s 588HA; *Review of the Insolvent Trading Safe Harbour* (Treasury of Australia, Consultation paper, September 2021); and Xynas and Xynas, above n 517, at 1.

<sup>543</sup> Ashley Black, judge of the Supreme Court of New South Wales “Recent Developments in Insolvency Law” (Speech presented to the Australian Restructuring Insolvency and Turnaround Association National Conference, 9 August 2017) at 7-9; and Ian Ramsay and Stacey Steele *The ‘Safe Harbour’ Reform of Directors’ Insolvent Trading Liability in Australia: Insolvency Professionals’ Views* (Melbourne University Law School, 2020) 1t 15-16.

<sup>544</sup> Tiba, above n 516, at 51.

<sup>545</sup> Ramsay and Steele, above n 543 at 19 and 25-26; Xynas and Xynas, above n 517, at 26-27; and Taylor, above n 1, at 194-195.

<sup>546</sup> At 1005-1006; Tiba, above n 516, at 49; and Harris, above n 534, at 301-302.

<sup>547</sup> Anil Hargovan “The New Insolvency Provisions are Yet to Make an Impact” (21 November 2018) University of New South Whales Business School <[www.unsw.edu.au](http://www.unsw.edu.au)>; and Tiba, above n 516, at 61-62.

<sup>548</sup> For more on areas of uncertainty see Harris, above n 534, at 295; Xynas and Xynas, above n 517, at 21-26; Boadle, above n 535, at 73; and Assaf, Bednall and others, above n 536, at [3.2A.0333]; Hargovan, above n 547.

<sup>549</sup> Hargovan, above n 547; Ramsay and Steele, above n 543, at 19 and 21.

### ***III Harmonisation***

A safe harbour is also attractive as it would help align New Zealand with Australia.<sup>550</sup> Harmonisation creates certainty, consistent treatment and decreased costs.<sup>551</sup> Harmonisation is important for companies operating in both countries. Undertaking Australia's safe harbour likely breaches s 135 based on *Debut*'s stance on informal restructuring and insolvent trading. This may impede Trans-Tasman activity.

#### ***Conclusion***

The COVID-19 safe harbour showed s 135 is not fit for purpose. The criticisms of Australia's provision provide important lessons. They should not dissuade consideration of a safe harbour as Australia has unique issues. To remedy concerns the underlying issue needs to be addressed. In Australia the underlying issue is the collection/group of statutory liabilities, whereas in New Zealand, the issue is s 135 itself. The other key difference is the goal. Australia's goal was encouraging informal restructuring whereas New Zealand's goal should be mitigating draconian liability for honest directors. The former targeting a process, the latter a defence.

A permanent New Zealand safe harbour should be introduced after s 135 itself has been reshaped along pragmatic lines to ensure the safe harbour does not fall on the current issues.<sup>552</sup> Whilst New Zealand's COVID-19 safe harbour is imperfect, it is a good start. Providing time frames, guidance on actions, being inclusive, introducing a 'friendlier' subjective standard cohesive with s 131, only excluding truly reckless conduct and moving away from focusing on insolvency should be retained. These fit with the pragmatic approach, provide flexibility and support rescue. Further guidance, long-term thinking and requiring qualified expert advice would also be beneficial.

---

<sup>550</sup> *The Australia – New Zealand Closer Economic Relationship* (Ministry of Foreign Affairs and Trade, 2005) at 31-32; and *Harmonisation of Legal Systems Within Australia and Between Australia and New Zealand* (House of Representatives Standing Committee on Legal and Constitutional Affairs, November 2006) at 28 and 30-39.

<sup>551</sup> At 5-8.

<sup>552</sup> Harris, above n 543, at 295.

## Conclusion

Section 135 requires amendment. The provision is poorly formulated, employing elusive terms from a highly criticised test that does not connect well to the ‘reckless trading’ rationale of the duty nor the entity focus. This makes it difficult for directors to know the obligation imposed. But, prima facie, the wording imposes a strict liability negligence type obligation. Such an overbearing provision leads to the typical inefficiency consequence of reckless trading duties. It stifles legitimate business activity by causing risk aversion and a shortage of qualified directors.

This left the courts with the burden of making the provision ‘work’. The objective broad wording gave courts large discretion. After initial disagreement, the courts moved towards a pragmatic approach. This approach balanced business judgement and realities with the objective nature of the provision. This pragmatic approach meant only genuinely reckless behaviour was caught. However, recent judgments, specifically *Debut* and *Mainzeal*, show divergence and therefore uncertainty remains. Both decisions stray from the pragmatic approach and entity focus of s 135. The strict decisions mean directors effectively give creditors guarantees of solvency. This gave life to commentators’ fears. Such an approach does not comport with the realities of business where decisions require balancing risk and reward, focus on the company and occur in a volatile environment. The utility of the company as a risk-taking vehicle through separate legal identity is diminished. The approach makes s 135 unworkable in practice and does not fulfil the CA’s dual-purpose of encouraging business risk/judgement and protection of stakeholders nor the entity focus.

The immediate negative impacts of this have been felt in New Zealand’s D&O insurance market, director sentiment and class action environment.

The law is currently uncertain, does not support rescue, does not promote efficiency nor uphold separate legal identity. It is excessively flexible (enabling disparate rulings) and overbearing.

A solution is needed. Rewording the provision, removing the provision and including a safe harbour were discussed.

In deciding the appropriate remedy, reference to underlying principles and theory are important. Certainty, flexibility, efficiency, fairness, separate legal identity, limited liability and a rescue culture all need to be given effect in company law. As the reckless trading duty cases and s 135 provision show – this is a difficult balance to strike. Underlying theory on the corporate objective guides the law. The CA is similar to an ET approach. Under this conception s 135 should move away from insolvency and creditors and towards an entity view encouraging legitimate risks for value maximisation and rescue for sustainability.

As a result, the suggested remedy is a combination of amending s 135, imposing a safe harbour and including a directors' duties purpose section. Whilst the overlapping duties makes removing the provision viable, s 135 should not be removed until ET has been mandated, to avoid the chaos that Delaware experienced. This dissertation has stayed within the bounds of company law and focused on the company. Without full analysis of interconnected areas of law, it is unwise/impossible to make concrete recommendations on how to resolve all s 135's issues. Prima facie, the provision itself should entrench the pragmatic approach to refocus on true reckless conduct. This involves recognising business reality, orthodoxy and judgement, allowing the balancing of risk commensurate with reward and time for decision-making. This will help only capture illegitimate conduct. Amendment should reinforce the movement away from an insolvency/creditor focus and affirm an entity approach and net deterioration damages calculation. Whilst amending s 135 could be enough, leaving the judiciary substantial discretion with s 135 has proven problematic. To avoid repetition of similar issues a safe harbour should be implemented. The COVID-19 safe harbour is a good start. A directors' duties purpose section containing the long title would help show courts the CA's dual-purpose applies to s 135.

## Bibliography

### *A Cases*

#### *1 New Zealand*

- Banks v Farmer & Others* [2021] NZHC 1922
- Benchmark Building Supplies Ltd v Jackson* (2001) 9 NZCLC 262,612 (HC)
- Cool Cars (Wholesale) Ltd (in liq) v Sharma* [2014] NZHC 256
- Cooper v Debut Homes Ltd (in liq)* [2019] NZCA 39
- Debut Homes Limited (in liquidation) v Cooper* [2020] NZSC 100
- Debut Homes Ltd (in liq) v Cooper* [2018] NZHC 453
- Delegat v Norman* [2012] NZHC 2358
- Fatupaito v Bates* [2001] 3 NZLR 386
- FXHT Fund Managers Ltd (in liq) v Oberholster* (2009) 10 NZCLC 264,562 (HC).
- Goatlands ltd (in liq) v Borrell* HC Hamilton CIV-2005-419-1643, 14 December 2010
- Grant v Johnston* [2016] NZCA 157
- Hedley v Albany Power Centre* (2006) NZCLC 264,095
- Hildred v Rowmata Holdings Ltd (in liq)* [2015] NZCA 106
- Independent Carpets Ltd (in liq) v Carpet Call 2000 NZ Ltd* [2021] NZHC 1750
- Kelstworural Ltd (in liq) v Mounsey-Ross* [2021] NZHC 1632
- Kings Wharf Coldstore Ltd (in rec and in liq) v Wilson* (2005) 2 NZCCLR 1042 (HC)
- Lee v Lee's Air Farming Ltd* [1961] NZLR 325 (PC).
- Löwer v Traveller and Waller* [1988] NZCA 36/04
- Macaura v Northern Assurance Co Ltd* [1925] AC 619 (HL).
- Madsen-Ries v Just (No 1)* [2013] NZHC 2254
- Madsen-Ries and Vance v Petera* [2015] NZHC 538
- Madsen-Ries v Petera* [2016] NZCA 103
- Madsen-Ries v Greenhill* [2016] NZHC 3188
- Mainzeal Property and Construction Ltd (in liq) v Yan* [2019] NZHC 255
- Mason v Lewis* [2006] 3 NZLR 225
- Mason v Lewis* [2006] 3 NZLR 225
- Morgenstern v Jeffreys* [2014] NZCA 449
- Mountfort v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104 (HC)
- New Zealand Labour Enterprises Limited & Anor v Sembhi & Anor* [2021] NZHC 986
- Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA)

*Nippon Express (New Zealand) Ltd v Woodward* (1998) 8 NZCLC 261,765 (HC)  
*O'Brien v Parkinson & Others* [2021] NZHC 1193  
*Ocean Boulevard Properties Ltd v Everest* (2000) 8 NZCLC 262,289  
*Parkinson v O'Brien on Behalf of General Dynamics Corporation Ltd* [2021] NZCA 309  
*Peace and Glory Society Ltd (in liq) v Samsa* [2009] NZCA 396  
*Re Bennett, Keane & White Ltd (in liq) (No 2)* (1988) 4 NZCLC 64,317 (HC)  
*Re Gellert Developments Ltd (in liq)* (2002) 9 NZCLC 262,942 (HC)  
*Re Group Hub Ltd (in liq)* HC Hamilton CP18/00, 1 November 2001  
*Re Hilltop Group Ltd (in liq)* (2001) 9 NZCLC 262,477 (HC)  
*Re Lake Tekapo Motor Inn Ltd (in liq)* (1987) 3 NZCLC 100,156 (HC)  
*Re Petherick Exclusive Fashions Ltd (in liq)* (1987) 3 NZCLC 99,946 (HC)  
*Re South Pacific Shipping Ltd (in liq)* HC Christchurch CIV-1998-409-000069, 12 February 2004  
*Rowmata Holdings Ltd (in liq) v Hildred* [2013] NZHC 2435  
*R v Harney* [1987] 2 NZLR 576 (CA)  
*Salomon v A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22 (HL).  
*Soujourner v Robb* HC Christchurch CIV-2004-476-000568, 4 July 2006  
*Robb v Soujourner* [2007] NZCA 493  
*Syntax Holdings (Auckland) Ltd (in liq) v Bishop* [2013] NZHC 2171  
*Ten Pin Properties Ltd v Bowlarama (NZ) Ltd* HC Christchurch M655/89, 18 December 1989  
*Thompson v Innes* (1985) 2 NZCLC 99,463 (HC).  
*Vance v Jefferys* [2014] NZHC 1932  
*Watts & Hughes Construction Ltd v Biala* [2020] NZHC 3041  
*Yan v Mainzeal Property and Construction Limited (in liq)* [2021] NZSC 109  
*Yan v Mainzeal Property and Construction Limited (in liquidation)* [2021] NZCA 99  
2 Australia  
*Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722 (NSWCA).  
*Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* [2008] WASC 239  
*Walker v Wimborne* [1976] HCA 7  
3 Canada  
*Peoples Department Stores Inc. (trustee of) v Wise* [2003] SCCA 133  
*BCE Inc v 1976 Debentureholders* [2008] SCCA 202

#### *4 United Kingdom*

*West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (CA).

*R v Lawrence (Stephen)* [1982] AC 510 (HL).

#### *5 United States of America*

*Credit Lyonnais Bank Nederland, N.V. v. Pathe Communs. Corp.*, 215 A.3d 12150 (Del.Ch. 1991)

*Quadrant Structured Prod. Co. v. Vertin*, 102 A.3d 155, 176 (Del.Ch. 2014)

*N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 100 (Del. 2007)

### ***B Legislation***

#### *1 New Zealand*

Companies Act 1933

Companies Act 1955

Companies Act 1993

COVID-19 Response (Further Management Measures) Legislation Act 2020

Interpretation Act 1999

Insolvency Act 2006

Financial Markets Authority Act 2011

Property Law Act 2007

Te Awa Tupua (Whanganui River Claims Settlement) Act 2017

Te Urewera Act 2014

Companies Bill 1900 (50-1)

#### *2 Australia*

Coronavirus Economic Response Package Omnibus Act 2020 (AU)

Corporations Act 2001

Corporations Amendment (Corporate Insolvency Reforms) Act 2020 (AU)

#### *3 Canada*

Canada Business Corporations Act 1985

#### *4 United Kingdom*

Companies Act 2006

Insolvency Act 1986

### ***C Books and Chapters in Books***

- Helen Anderson *Corporate Directors' Liability to Creditors* (Lawbook Co, Pymont, 2006)
- John Farrar *Corporate Governance – Theories, Principles and Practice* (3rd ed, Oxford University Press, Victoria, 2008)
- John Farrar, Sian Elias, Peter Watts and others *Contemporary Issues in Company Law* (Commerce Clearing House, Auckland, 1987)
- John Farrar and Pamela Hanrahan *Corporate Governance* (1st ed, Lexis Nexis Australia, Australia, 2016)
- Vanessa Finch *Corporate Insolvency Law Perspectives and Principles* (2nd ed, Cambridge University Press, Cambridge, 2009)
- Ross Grantham and Charles Rickett *Corporate Personality in the 20<sup>th</sup> Century* (1st ed, Hart Publishing, Oxford, 1998)
- Ross Grantham and Charles Rickett *Company and Securities Law* (Brookers, Wellington, 2002)
- Reinier Kraakman, John Armour, Paul Davies and others *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed, Oxford University Press, Oxford, 2017)
- Andrew Keay “Board Accountability and the Entity Maximization and Sustainability Approach” in Barnali Choudhury and Martin Petrin *Understanding the Company – Corporate Governance and Theory* (Cambridge University Press, Cambridge, 2017) 271
- Mike Ross *Directors' Liability and Company Solvency: the New Companies Act* (Commerce Clearing House, Auckland, 1994)
- Mike Ross *Corporate Reconstructions: Strategies for Directors* (CCH New Zealand, Auckland, 1999)
- Lynne Taylor and Grant Slevin *The Law of Insolvency in New Zealand* (Thomson Reuters, Wellington, 2016)
- Susan Watson and Lynne Taylor *Corporate Law in New Zealand* (1st ed, Thomson Reuters New Zealand, Auckland, 2018)
- PM Vasudev and Susan Watson *Corporate Governance After the Financial Crisis* (Cheltenham, United Kingdom, Northampton, 2012)
- Peter Watts *Directors' Powers and Duties* (2nd ed, LexisNexis New Zealand, Wellington, 2015)

### ***D Journal Articles***

Jan Adriaanse “The Uneasy Case for Bankruptcy Legislation and Business Rescue” (2014) 2 NIBLeJ 119

Helen Anderson “Directors’ Personal Liability to Creditors: Theory versus Tradition” (2003) 8 DeakinLawRw 209

Helen Anderson “Creditors’ Rights of Recovery: Economic Theory, Corporate Jurisprudence and the Role of Fairness” (2006) 30 Melb. U. L. Rev. 1

Helen Anderson “Directors’ Liability to Creditors – What are the Alternatives?” (2006) 18 Bond Law Rev. 1

Helen Anderson “Directors’ Liability for Corporate Faults and Defaults – An International Comparison” (2009) 18 Pac.Rim.L&Pol’y.J. 1

Helen Anderson "Shelter from the Storm: Phoenix Activity and the Safe Harbour" (2018) 41 MelbULawRw 999

Michael Arthur “Reckless Trading Damages” (2013) NZLJ 51

Stephen Bainbridge “Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency” (2007) 1 J. Bus. & Tech. L. 335

Stephen Bainbridge “Twilight in the Zone of Insolvency: Fiduciary Duty and Creditors of Troubled Companies - Presentation of Much Ado About Little? Directors' Fiduciary Duties in the Vicinity of Insolvency” (2007) 1 J. Bus. & Tech. L. 281

Robert Boadle “The New Insolvent Trading Defence: Striking a Better Balance for Creditors and Directors” (2017) 39 LSJ 72

Michael Bos and Martin Wiseman "Directors' liabilities to creditors" (2003) NZLJ 262

William Brandt and Christine Vnace “Deepening Insolvency and the United Kingdom’s Wrongful Trading Statute: A Comparative Discussion” (2006) 19 Insolv.Int 156

Elizabeth Brown “No Good Deed Goes Unpunished: Is There a Need for a Safe Harbor for Aspirational Corporate Codes of Conduct” (2008) 26 Yale.L.&.Pol’yRev. 367

Lynn Buckley “The Foundations of Governance: Implications of Entity Theory for Directors’ Duties and Corporate Sustainability” (2021) 25 J. Manag. Gov. 1385

J. William Callison “Why a Fiduciary Duty Shift to Creditors of Insolvent Business Entities is Incorrect as a Matter of Theory and Practice” (2007) 1 J. Bus. & Tech. L. 431

Iris Chiu “Relief and Rescue: Suspensions and Elasticity in Financial Regulation, and Lessons from the UK’s Management of the COVID-19 Pandemic Crisis” (2021) 64 Wash.J.L.&Pol’y. 63

Julie Cassidy “Wake up New Zealand: Directors’ Duties Reform Responses to the Global Financial Crisis” (2014) 20 NZBLQ 181

Tim Conder and David Fraundorfer “Trade Better” (2019) NZLJ 148

Oscar Couwenberg and Stephen J. Lubben “ Solving creditor problems in the twilight zone: Superfluous law and inadequate private solutions” (2013) 34 Int.Rev.LawEcon. 61

Thomas Clarke “Deconstructing the Mythology of Shareholder Value: A Comment on Lynn Stout’s “The Shareholder Value Myth”” (2013) 3 Account. Econ. Law 15

Paul Dalkie “Insolvent Trading and Directors’ Duties” (2021) NZLJ 64

Paul Davies “Directors’ Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency” (2006) 7 Eur. Bus. Organ. Law Rev. 301

Francis Dawson “Acting in the Best Interests of the Company — For Whom Are Directors 'Trustees'?” (1984) 11 NZULR 68

Jared Ellias and Robert Stark “Bankruptcy Hardball” (2019) 308 Cal.L. 1

Sebastian Ellice “Is Voluntary Administration Failing Companies? An Investigation Into the Operation of Voluntary Administration in New Zealand from Inception To 2019” (2021) 52 VUWLR 29

John Farrar “The Duty of Care of Company Directors in Australia and New Zealand” (1996) 4 CanterLawRw 228.

John Farrar “Directors’ Duties and Corporate Governance in Troubled Companies” (2001) 8 CanterLawRw 99

John Farrar and Doug Tennent “The Unfitness of Directors, Insolvency and the Consequences – Some Comparisons” (2005) 11 CanterLawRw 239

Peter Fitzsimons “Australia and New Zealand on Different Corporate Paths” (1994) 8 OtagoLawRev 267

Lisa Filippin and Alan Mitchell “Eligibility for Safe Harbour: Practical Considerations for Directors, Advisers and External Administrators” (2019) ARITAJ 27

Christine Gordon and Ben Stewart “Class Actions – Are we in or out?” (2021) NZLJ 104

Brian Gould “Director’s Personal Liability – Assesses the Likely Impact of s 135 Companies Act 1993” (1996) NZLJ 437

Ross Grantham “New Zealand – Reforming the Duties of Company Directors” (1991) 12 Comp.Law 27

Aurelio Gurrea-Martínez “Towards an Optimal Model of Directors’ Duties in the Zone of Insolvency: An Economic and Comparative Approach” (2020) 22 SMU 1

Henry Hansmann and Reinier Kraakman “The End of History for Corporate Law” (2001) 89 *Geo.L.J.* 439

Anili Hargovan and Timothy Todd “Financial Twilight Re-Appraisal: Ending the Judicially Created Quagmire of Fiduciary Duties to Creditors” (2016) 78 *U. Pitt. L. Rev.* 135

Michelle Harner “A More Realistic Approach to Director’s Duties” (2013) 15 *Tenn.J.Bus.L.* 15

Bede Harris “Fiduciary Duties of Directors Under the Companies Act 1993” (1994) *NZLJ* 242

Jason Harris “Director Liability for Insolvent Trading: Is the Cure Worse than the Disease?” (2009) 23 *AJCL* 1

Jason Harris “Productivity Commission Safe harbour Proposal for Insolvent Trading” (2016) *Gov.Dir.J.* 9

Jason Harris “Reforming Insolvent trading to Encourage Restructuring: Safe Harbour of Sleepy Hollows?” (2016) *JBFLP* 294

Kenneth Hayne “Directors' Duties and a Company's Creditors” (2014) 38 *MelbULawRw* 795

Christopher Haynes “The Solvency Test: A New Era in Directorial Responsibility” (1996) 8 *Auckland U. L. Rev.* 125

Sefan HC Lo “Proposals for Insolvent Trading Laws in Hong Kong: A Comparative Analysis” (2020) *J.Int'l&Comp.L.* 229

Jennifer Hill and Matthew Conaglen “Directors’ duties and Legal Safe Harbours: a Comparative Analysis” (2017) 29 *ECGI* 305

Muir Hunter “The Nature and Functions of a Rescue Culture” (1999) 104 *Com. L.J.* 426

Andrew Keay “The Director’s Duty to Take into Account the Interests of Company Creditors: When is it Triggered?” (2001) 25 *MelbULawRw* 315

Andrew Keay “Directors’ Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors” (2003) 66 *Mod. L. Rev.* 665

Andrew Keay “Directors Taking into Account Creditors’ Interests” (2003) 24 *Comp.Law* 300

Andrew Keay “Another way of Skinning a Cat: Enforcing Directors’ Duties for the Benefit of Creditors” (2004) 17 *InsoLv.Int.* 1

Andrew Keay “Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach” (2005) 64 *Cambridge L.J.* 614

Andrew Keay “Wrongful Trading and the Liability of Company Directors: Theoretical Perspective” (2006) 25 *Leg Stud* 431

Andrew Keay “Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model” (2008) 71 Mod. L. Rev. 663

Andrew Keay “The Ultimate Objective of the Company and the Enforcement of the Entity Maximisation and Sustainability Model” (2010) 10 J. Corp. Law Stud 35

Andrew Keay “Risk, Shareholder Pressure and Short-Termism in Financial Institutions: Does Enlightened Shareholder Value Offer a Panacea?” (2011) 5 Law Financial Mark. Rev. 435

Andrew Keay and Rodoula Adamopoulou “Shareholder Value and UK Companies: A Positivist Inquiry” (2012) 13 Eur. Bus. Organ. Law Rev. 1

Andrew Keay “Wrongful Trading: Problems and Proposals” (2014) 65 NILQ 63

Andrew Keay “The Shifting of Directors’ Duties in the Vicinity of Insolvency” (2015) 24 Int.Insolv.Rev 140

Andrew Keay and Joan Loughrey “ The Framework for Board Accountability in Corporate Governance” (2015) 35 Legal Stud 252

Andrew Keay “Financially Distressed Companies, Restructuring and Creditors’ interests: what is a Director to do?” (2019) LMCLQ 297

Andrew Keay and Joan Loughrey “The Concept of Business Judgment” (2019) 39 Leg Stud 36

Andrew Keay, Joan Loughrey and others “Reviewing Directors’ Business Judgements: Views from the Field” (2020) 47 J.L.& Soc.639

Andrew Keay , Joan Loughrey and others “Business judgment and director accountability: a study of case-law over time” (2020) 20 J. Corp. Law Stud. 359

Brian Keene “Directors’ Powers and Duties” (2010) NZLJ 162

Amir Licht “My Creditor’s Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency” (2021) ECGI 1

Phillip Lipton “ The Introduction of Limited Liability into the English and Australian Colonial Companies Acts: Inevitable Progression or Chaotic History?” (2018) 41 Melb Univ Law Rev 1278

Sean Lyons “Value Preservation Increasingly Acknowledge as Primary Purpose and Fiduciary Duty” (2021) SSRN 1

Sam Marsh and Shane Roberts “Insolvency Safe Harbour for ‘Honest’ Directors” (2017) Gov.Dir.J. 275

Sam Marsh and Shane Roberts “Personal Liability for Insolvent Trading: Company Directors Find Berth in Safe Harbour” (2017) Gov.Dir.J. 611

Allan McRae “Reckless Trading” (2019) NZLJ 419

Allan McRae “Reckless Trading” (2019) NZLJ 349

Allan McRae “Reckless Trading” (2020) NZLJ 30

Sneha Mohanty and Vrinda Bhandari “The Evolution of the Separate Legal Personality Doctrine and Its Exceptions: A Comparative Analysis” (2011) 32 *Comp.Law.* 194

Gabriel Moss “Comparative Bankruptcy Cultures: Rescue or Liquidation: Comparison of Trends in National Law—England” (1997) 23 *Brook. J. Int'l L.* 115

Gabriel Moss “No Compensation for Wrongful Trading – Where Did it All Go Wrong?” (2017) 30 *Insolv.Int.* 49

Chris Noonan and Susan Watson “The Foundations of Corporate Governance in New Zealand: A Post-Contractualist View of the Role of Company Directors” (2007) 22 *NZULR* 649

William Porter “The Insolvent Trading Safe harbour Uncertainty Prevails” (2020) 25 *NZBLQ* 227

Oksana Pryshchepa, Kevin Aretz and Shantanu Banerjee “Can Investors Restrict Managerial Behavior in Distressed Firms?” (2013) 23 *J. Corp. Finance* 222

John Quinn “The Duty to Act in the Interests of the Company: Simply a Duty to Increase Shareholder Wealth?” (2015) 7 *UCD Working Papers* 1

Edward Rock “For Whom is the Corporation Managed in 2020?: The Debate over Corporate Purpose” (2020) 515 *ECGI* 1

Mike Ross “Trade or Bust” (2001) NZLJ 454

Mike Ross “Assessing Damages for Reckless Trading” (2002) NZLJ 178

Len Sealy “Directors’ ‘Wider’ Responsibilities – Problems Conceptual, Practical and Procedural” (1987) 13 *MonashULawRw* 164

Len Sealy “Reforming the Law on Directors’ Duties” (1991) 12 *Comp.Law* 175

Len Sealy “Director’s Duties Revisited” (2001) 22 *Comp.Law* 79

Simone Sepe “Directors’ Duty to Creditors and the Debt Contract” (2007) 1 *J. Bus. & Tech. L.* 553

Mark Story “Māori Governance: Meeting the Cultural Challenge” (2005) 25 *NZM* 7

Lynn Stout “On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)” (2013) 36 *Seattle Univ. Law Rev.* 1169

Lynne Taylor “Funding Insolvent Company Claims” (2013) 25 *NZULR* 587

Lynne Taylor “Directors’ Duties on Insolvency in New Zealand: an Empirical Study” (2019) 28 NZULR 171

Linda Te Aho “Corporate Governance: Balancing Tikanaga Māori with Commercial Objectives” (2005) 8 Yearb.N. Z.jurisprudence 300

Firew Tiba “Safe Harbour Carve-Out for Directors for Insolvent Trading Liability in Australia and it’s Implications” (2019) 53 U.S.F.L.Rev. 43

David Tompkins “Directing the Directors: the Duties of Directors under the Companies Act 1993” (1994) 2 WkoLawRw 13

Kristin Van Zwieten “Disciplining the Directors of Insolvent Companies: Essay in Honour of Gabriel Moss QC” (2020) 33 I.I.J. 2

Seppo Villa “ Creditor Protection and the Application of the Solvency and Balance Sheet Tests under the Company Laws of Finland and New Zealand” (2008) 1

Sara Wahl “Creditors vs. Directors and Officers: D&O Insurance – Panacea or Tar Baby?” (2003) 24 Andrews' Bank & Lender Liab. Litig. Rep. 16

Susan Watson and Chris Noonan “The corporate shield: What happens to directors when companies fail?” (2005) Auckl.Univ.Law.Rev. 27

Susan Watson “How the Company Became an Entity: A New Understanding of Corporate Law” (2015) 120 J. Bus. Law. 1

Susan Watson “Corporate Law and Governance” (2018) 2 NZLR 275

Susan Watson “The Corporate Legal Person” (2019) 19 J. Corp. Law Stud.137

Peter Watts “Company Contract, and Reckless Trading: Re Global Print Strategies Ltd” (2009) 15 NZBLQ 3

Peter Watts "Debut Homes in the Supreme Court—a Product of the Vicarage?" (2020) CSLB 107.

Peter Watts “Directors’ Duties after *Debut Homes* – A Return to the Scene” (2021) 6 CSLB 55

Peter Watts “Why as a Matter of English-Law Principle Directors Do Not Owe a Duty of Loyalty to Creditors Upon Insolvency” (2021) 2 J.B.L. 103

Joseph Williams “Lex Aotearoa: An Heroic Attempt to Map the Māori Dimension in Modern New Zealand Law” (2013) 21 Wai.L.Rev. 1

Lidia Xynas and Alexander Xynas “Insolvency and the Australian Safe Harbour Reforms of 2017 – Do they Adequately Support all Australian Directors in Fulfilling their Role as a Fiduciary of their Company in 2021?” (2021) 36 AJCL 1

Aisha Yaqoob “Two Fundamental Principles of Company Law?” (1997) 18 Comp.Law. 14  
Jacob Ziegel “Creditors as Corporate Stakeholders: The Quiet Revolution - An Anglo-Canadian Perspective” (1993) 43 UTP 511  
Kristin van Zwieten “Director Liability in Insolvency and its Vicinity” (2018) 38 Oxf. J. Leg. Stud.382

### ***E Parliamentary and Government Materials***

#### *1 New Zealand*

(15 December 1992) 532 NZPD

(23 February 1993) 533 NZPD

(21 September 1993) 538 NZPD

Companies Bill 1900 (50-1) (Select Committee Report)

COVID-19 Response (Further Management Measures) Legislation Bill (244-1) (explanatory note)

*Departmental report to the Epidemic Response Committee* (MBIE, 11 May 2020)

*Epidemic Response Committee “COVID-19 Response (Further Management Measures) Legislation Bill”* (May 2020)

Inland Revenue Department *Income Tax and Goods and Services tax – Director’s liability and the COVID-19 “safe harbour” in schedule 12 to the Companies Act 1993* (Public Ruling BR PUB 20/06)

Law Commission *Company Law, a Discussion Paper* (NZLC PP5, 1987)

Law Commission *Company Law Reform and Restatement* (NZLC R9, 1989)

Law Commission *Company Law Reform: Transition and Revision* (NZLC, R16, 1990)

Law Commission *Insolvency Law Reform: Promoting Trust and Confidence – An Advisory Report to the Ministry of Economic Development* (NZLC, SP11, 2001)

Special Committee to Review the Companies Act *Final Report of the Special Committee to Review the Companies Act* (1973)

#### *2 Australia*

*Australian Government Response to the Productivity Commission Inquiry into Business Set-Up, Transfer and Closure* (Australian Government, May 2017)

*Business Set-up, Transfer and Closure* (Productivity Commission of Australia, Inquiry Report 75, September 2015)

*Harmonisation of Legal Systems Within Australia and Between Australia and New Zealand* (House of Representatives Standing Committee on Legal and Constitutional Affairs, November 2006)

Parliamentary Joint Committee on Corporations and Financial Services *Litigation Funding and the Regulation of the Class Action Industry* (Senate Printing Unit, December 2020)

*Review of the Insolvent Trading Safe Harbour* (Treasury of Australia, Consultation paper, September 2021)

Treasury Laws Amendment (2017 Enterprise Incentive No.2 Bill) Bill 2017 (No. X) (explanatory note)

### ***F Reports***

Christopher Cowton *Putting Creditors in Their Rightful Place: Corporate Governance and Business Ethics in the Light of Limited Liability* (University of Huddersfield Business School)

*Doing Business in Canada* (Fasken Martineau DuMoulin LLP, 2019)

Selwyn Eathorne *Submission on the Law Commission's Issues Paper on Class Actions and Litigation Funding* (Institute of Directors New Zealand, March 2021)

Sean Gamble *Construction's Insolvency Predicament: Cooper, Mainzeal and Reckless Trading* (Hesketh Henry)

Sam Holden, Janko Marcetic and others *Litigation & Dispute Resolution – Trends and Insights* (Chapman Tripp, August 2020).

*The Insolvency Safe Harbour* (Australian Institute of Company Directors)

Institute of Directors New Zealand and ASB *Director Sentiment Survey 2020* (Institute of Directors, December 2020)

Rachel Jones, Erin Matariki Carr and Liam Stoneley *Te Ao Māori Trends and Insights* (Chapman Tripp, June 2017)

Rosemary Langford *Best Interests: Multifaceted but not Unbounded* (University of Melbourne Law School, 2016)

*Litigation Forecast 2021* (MinterEllisonRuddWatts, February 2021)

London School of Economics *Study on Directors' Duties and Liability* (European Commission, April 2013)

Noel McCoy *A COVID-19 Directors' Guide to Avoiding Personal Liability in Circumstances of a Company's Financial Distress and Possible Insolvency* (Norton Rose Fulbright, September 2020)

Christie McGrath *Managing Insolvency* (ACID, November 2020)

MinterEllisonRuddWatts, Marsh and Institute of Directors New Zealand *Directors and Officers Insurance: Trends and Issues in Turbulent Times* (Institute of Directors New Zealand, June 2019)

*Overview of the Australian Insolvent Trading Prohibition and the Safe Harbour Protections* (Baker McKenzie, 2020)

Ian Ramsay and Stacey Steele *The 'Safe Harbour' Reform of Directors' Insolvent Trading Liability in Australia: Insolvency Professionals' Views* (Melbourne University Law School, 2020).

*Responsibilities of Directors in Canada* (Torys LLP, 2009)

*Stakeholder Governance – A Call to Review Directors' Duties* (New Zealand Institute of Directors and MinterEllisonRuddWatts, 2021)

*The Australia – New Zealand Closer Economic Relationship* (Ministry of Foreign Affairs and Trade, 2005)

Valmaine Toki *Culture – the Foundation of Māori Governance* (Chartered Secretaries New Zealand, 2013)

### ***G Dissertations***

John Bovaird Brennan “The Companies Act 1993 and Common Law Directors' Duties to Creditors: The Demise of Redundant Judicial Sympathies” (LLM Research Paper, University of Victoria, 1995)

Sofia Cvitanovich “Directing the Company in a Changing Climate” (LLB (Hons) Dissertation, University of Otago, 2020)

### ***H Internet Resources***

“About the Panel” Takeovers Panel Te Pae Whitimana <[www.takeovers.govt.nz](http://www.takeovers.govt.nz)>.

Scott Barker, Bridie McKinnon and Luke Sizer “Court of Appeal Delivers Mainzeal Decision: Significant Implications for Insolvent Trading” (1 April 2021) Buddle Findlay <[www.buddlefindlay.com](http://www.buddlefindlay.com)>

Iris H-Y Chiu “Relief and Rescue Policies in Financial Regulation at the Time of the Pandemic” (4 February 2021) Oxford Business Law Blog <[www.law.ox.ac.uk](http://www.law.ox.ac.uk)>.

“Court of Appeal Highlights Need to Amend the Companies Act in Latest Mainzeal Decision” (7 April 2021) Duncan Cotterill <[www.duncancotterill.com](http://www.duncancotterill.com)>.

“Directors’ Duties in Canada: Considerations in Emergency Situations” (1 April 2020) Dentons <[www.dentons.com](http://www.dentons.com)>.

Sean Gollin “Court of Appeal Confirms Liability of Mainzeal Directors” (31 March 2021) MinterEllisonRuddWatts <[www.minterellison.co.nz](http://www.minterellison.co.nz)>.

Richard Gordon “Directors’ duties and the case for vulnerable trading?” (17 July 2019) MinterEllisonRuddWatts <[www.minterellison.co.nz](http://www.minterellison.co.nz)>.

Anil Hargovan “The New Insolvency Provisions are Yet to Make an Impact” (21 November 2018) University of New South Wales Business School <[www.unsw.edu.au](http://www.unsw.edu.au)>.

Matt Kersey, Jeremy Upson, Nathaniel Walker and Gordon Lamb “Mainzeal Judgement: Court of Appeal Finds Directors Liable with Quantum Still to be Clarified” (6 April 2021) Russell McVeagh <[www.russellmcveagh.com](http://www.russellmcveagh.com)>.

Mark Kleinman “Coronavirus: Ministers Race to Reform Insolvency Laws” (25 March 2020) Sky News <[www.news.sky.com](http://www.news.sky.com)>.

Amir Licht “My Creditor’s Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency” (23 November 2020) Oxford Business Law Blog <[www.law.ox.ac.uk](http://www.law.ox.ac.uk)>.

Damian Schade “2020 New Zealand Insurance Market Recap Series – Liability” (17 December 2020) Marsh <[www.marsh.com](http://www.marsh.com)>.

“The Mainzeal Collapse and What Could’ve Been Done Differently” (1 March 2019) Duncan Cotterill <[www.duncancotterill.com](http://www.duncancotterill.com)>.

Kristin Van Zwieten “The Wrong Target? COVID-19 and the Wrongful Trading Rule” (17 April 2020) Oxford Business Law Blog <[www.law.ox.ac.uk](http://www.law.ox.ac.uk)>.

David Webb, Shawni Hadfield and others “COVID-19: Temporary ‘Safe Harbour’ Provisions for Directors: An Update to the Companies Act 1993” (12 May 2020) Deloitte <[www2.deloitte.com](http://www2.deloitte.com)>.

“Small Business” Ministry of Business, Innovation and Employment <[www.mbie.govt.nz](http://www.mbie.govt.nz)>.

### ***Other Resources***

Michael Arthur and Jacque Lethbridge “In short: Debut Homes ltd – Implications for Directors” (paper presented to New Zealand Law Society Council of Legal Education, Auckland, December 2020)

Farid Assaf, Tim Bednall and others *Australian Corporation Law Principles and Practice* (loose-leaf ed, LexisNexis)

Ashley Black, judge of the Supreme Court of New South Wales “Recent Developments in Insolvency Law” (Speech presented to the Australian Restructuring Insolvency and Turnaround Association National Conference, 9 August 2017)

Neil Campbell, Peter Watts, Kim Francis and others *Morison’s Company and Securities Law* (loose-leaf ed, LexisNexis)

Julie Cassidy “Superfluous or Superlative: The Role of Reckless/Insolvent Trading prohibitions in New Zealand, Australian and South African Directors’ Duties Regimes” (paper presented to the Corporate Law Teachers Association Annual Conference, Melbourne, February 2020)

Roderick S Deane “Besieged by Duties – Will the New Companies Act Work for Directors” (paper presented to the Company Law Conference, 1994)

Sian Elias, Chief Justice of the Supreme Court of New Zealand “Righting Environmental Justice” (paper presented to the Resource Management Law Association Salmon Lecture, July 2013)

Jared Ellias and Robert Stark “Delaware Corporate Law and the ‘End of History’ in Creditor Protection” (research paper, UC Hastings, 2020) (forthcoming)

Susan Glazebrook, judge of the Supreme Court of New Zealand “Statutory interpretation, tax avoidance and the Supreme Court: reconciling the specific and the general” (paper presented to the New Zealand Institute of Chartered Accountants Tax Conference, Auckland, 2013)

Paul Heath and Michael Whale ed *Heath and Whale on Insolvency* (loose-leaf ed, LexisNexis)

Linda Howes, Stephen Revill and Kath Clark *Company Law* (loose-leaf ed, Thomson Reuters)

*Madsen-Reis v Cooper* [2019] NZSC Trans 23.

Hugh Rennie and Peter Watts “Directors’ Duties and Shareholders’ Rights” (paper presented to the New Zealand Law Society, 1996)

Helen Winkelmann, Susan Glazebrook, and Ellen France, judges of the Supreme Court of New Zealand “Climate Change and the Law” (paper presented to the Asia Pacific Judicial Colloquium, Singapore, 2019)

Wolters Kluwer “What’s New, March 2020” (case updates, March 2020)