Mainzeal saga ends in the Supreme Court

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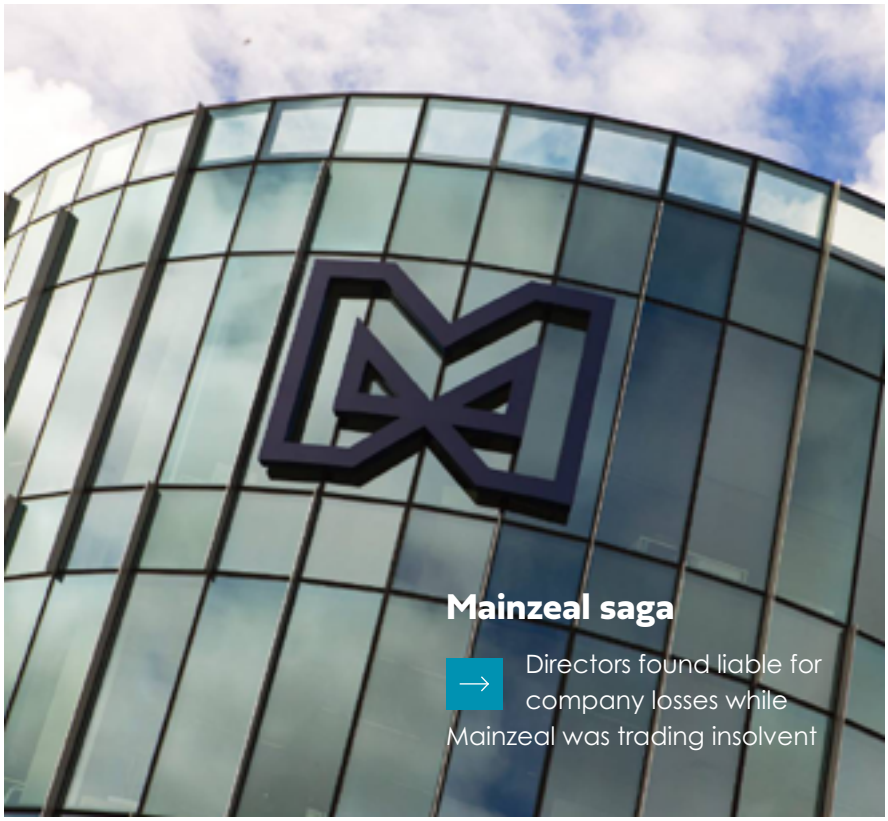
In ***Yan v Mainzeal Property and Construction Limited*** **[2023] NZSC 113** the Supreme Court upheld damages against Mr Yan in the sum of $39.8 million and the remaining three directors (including Dame Jenny Shipley) jointly with Mr Yan in the sum of $6.6 million, plus 10 years' worth of interest. The directors' appeals from the Court of Appeal decision were rejected and the liquidators' cross-appeal was successful in part. The decision provides highly useful guidance to directors of financially distressed companies.

Background

From 2005 Mainzeal Property and Construction Limited (**Mainzeal**) had traded balance sheet insolvent, using creditors' funds as working capital. Mainzeal indicated a net asset position which was boosted by related party advances which Mainzeal was unable to recover. At all material times Mainzeal was part of the Richina Pacific group of companies, which had business interests in China. Mainzeal was placed into receivership and liquidation in February 2013. The liquidation left $110 million in unsecured creditors.

In 2015 the liquidators brought proceedings against the former directors of Mainzeal under sections 135, 136 and 301 of the Companies Act 1993. The



liquidators alleged that from January 2011 the directors had all agreed to:[1]

a. the business of the company being carried on in a manner likely to create a substantial risk of serious loss to creditors, in breach of section 135 of the 1993 Act; and
b. the company incurring obligations to creditors when they did not believe on reasonable grounds that the company would be able to perform those obligations when required to do so, in breach of section 136 of the 1993 Act.

In 2018 the liquidators pursued an eight week trial before Justice Cooke, which resulted in High Court decisions one and two in 2019. The claim was primarily that from January 2011, the directors had agreed to business being carried out in breach of sections 135 and 136 of the Companies Act 1993. Central to the claim was that the directors permitted Mainzeal to trade while relying on non-enforceable assurances of financial support from other companies in the Richina Pacific group. These companies themselves did not have the ability to meet the assurances.

On 25 August 2023 the Supreme Court upheld the findings of the Court of Appeal, awarding compensation similar to the High Court and finding the directors had breached sections 135 and 136 of the Companies Act 1993. The Supreme Court considered historic legislation, law reform and case law at length, and ultimately called for further reform in the area.

Lower Court judgments

In the High Court Justice Cooke found the directors had breached section 135 by no later than 31 January 2011 and awarded compensation of $36 million, being approximately one-third of the total losses of $110 million. He dismissed the section 136 claim. Both the directors and liquidators appealed.

In the Court of Appeal, President Kós, Justices Miller and Goddard found the directors liable for breaches under sections 135 and 136. The Court agreed with Justice Cooke that by 31 January 2011 the directors had breached section 135. It held the proper measure for loss for breach of section 135 in this case was the extent to which the company's financial position deteriorated between the breach date and the date of liquidation. As there was no proof Mainzeal's position had deteriorated, no damages were awarded.

The Court of Appeal determined that the directors were found liable to pay compensation for their breach of s 136 on a new debt approach, to be quantified by the High Court.2 There were

1 *Yan v Mainzeal Property and Construction Limited* [2023] NZSC 113 at [3].
2 *Yan v Mainzeal Property and Construction Limited* [2021] NZCA 99, [2021] 3 NZLR 598; applying *Madsen-Ries*

two groups of obligations: (1) obligations incurred with regard to four major contracts from 31 January 2011; and (2) all obligations incurred from 5 July 2012 onwards. Justice Goddard for the Court found that the Mainzeal directors did not have reasonable grounds to think the first category's major obligations would be met nor any of the second category's from that time. The new debt approach focused on the amount of debts incurred after the relevant breach dates, to the extent that those debts remain unpaid at liquidation and incurred when there were not reasonable grounds for believing they would be honoured.3 Section 136 focuses on particular creditors while section 135 focuses on creditors as a whole.

The Supreme Court appeal intervened, and the matter was not remitted to the High Court.

Supreme Court judgment

The Supreme Court has provided an overarching framework for directors' duties under the Companies Act 1993 for companies trading with questionable solvency, seen through the lens of creditors. While creating duties owed to the company, sections 135 and 136 are to be interpreted and applied as having the purpose of creditor protection.

Where a company is in a precarious financial position, the directors:

- have a continuing obligation to monitor the performance and prospects of their company;
- will have a reasonable time to decide what course of action they will take;
- should obtain independent advice when the company is near-insolvent;
- should recognise the long-term strategy of trading while balance sheet insolvent is generally not acceptable;
- will have a standard of reasonableness attached to their decisions, which involves business judgment;4
- can only rely on assurances of financial support from shareholders of other companies if they are legally, and practically enforceable;
- will be held to a higher standard if they are directors of complex companies;
- if continuing to trade, must have a sound strategy; and
- should protect creditors.

The Supreme Court outlined a policy which recognises that when a company is insolvent (or near insolvent), its creditors have at least a significant economic stake in its affairs.5 The Supreme Court found there had been net deterioration under section 135 and new debt losses under section 136. This meant the Supreme Court followed the Court of Appeal and did not award losses for the section 135 breach, but did for the section 136 breach. The quantification was the loss those creditors suffered.

Under section 301 the Court has a discretion to enable a response to be crafted to suit the circumstances of the dispute. A factor focused on by the Court as between the directors was culpability. Mr Yan was found liable for the full amount of $39.8 million plus interest while the liability of the remaining directors was limited to $6.6 million each plus interest.

Conclusion

The Supreme Court has helped identify where the balance lies in New Zealand for the protection of creditors and directors trying to rescue a company. It draws the boundary between legitimate risk taking and abuse of management powers at the expense of creditors.

(as liquidators of Debut Homes Ltd (in liq)) v Cooper [2020] NZSC 100, [2121] 1 NZLR 43.

3 *Yan,* above n 2, at [531] and [536].

4 *Yan,* above n 1, at [273].

5 *Yan*, above n 1, at [198].

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