#15.

IN THE HIGH COURT OF NEW ZEALAND REGISTRY

CIV-2011-404-1328
[2012] NZHC 332

IN THE MATTER OF	Flat Bush Property Limited
BETWEEN	FLAT BUSH PROPERTY LIMITED (IN LIQUIDATION) First Plaintiff
AND	GILBERT DALE CHAPMAN AS LIQUIDATOR OF FLAT BUSH PROPERTY LIMITED (IN LIQUIDATION) Second Plaintiff
AND	JONATHAN MARK POLGLASE Defendant

Hearing: 21 February 2012

Counsel: A Swan for Plaintiffs
A Hayes for Defendant

Judgment: 21 February 2012

ORAL JUDGMENT OF ASSOCIATE JUDGE R M BELL
Application for security for costs

Solicitor:
Blackwells, Auckland, for Plaintiffs
Cook Morris Quinn (A J Hayes/A C Cook) P O Box 1295 Auckland 1140 for Defendant

Copy:
Andrew M Swan, P O Box 5444 Auckland 1141, for Plaintiffs

[1] The defendant, Mr Polglase, has applied for security for costs. Before I address that application, I set out some of the background to this litigation.

[2] In 2007, eight parties entered into a joint venture agreement to buy, subdivide and develop lots at 305 Murphy's Road, Flat Bush, Auckland. The parties were the trustees of the Polglase Flat Bush Investment Trust, the Polglase Investment No.2 Trust, the Pearce Flat Bush Investment Trust, the Gasparich Flat Bush Investment Trust, the Zander Flat Bush Investment Trust, the Sidnam Flat Bush Investment Trust, JBO5 Investments Ltd and Group Trustee Ltd (as trustee of the Puhinui Trust).

[3] Flat Bush Property Ltd had bought the property at Murphy's Road. It held land for the joint venture partners as a bare trustee. There was also a deed of trust and deed of indemnity, to which Flat Bush Property Ltd was a party. An unsigned copy of that deed was put in evidence. The plaintiff has apparently proceeded on the basis that it is unsure whether it can place weight on that deed, as it does not appear to have been signed. I was assured by Mr Hayes that the defendant and other joint venture partners regard that deed as binding and effective. In particular they say that the indemnity provisions were acted on throughout.

[4] If Flatbush Property Ltd – and I think this is common ground - held that property on trust as a bare trustee for the joint venture partners, it seems to me that there would be an indemnity in any event. That is because equity would always provide for an indemnity in these situations and that is the position under s 38 of the Trustee Act 1956.

[5] On 17 July 2007, Flat Bush Property Ltd entered into a written contract with Auckland Concrete Homes Ltd for the development work, specifically the construction of eight apartments on the property. Auckland Concrete Homes Ltd is a company associated with a Mr Jason Frost and a Mr Tony Songhurst.

[6] The contract price for Auckland Concrete Homes Ltd was $2,199,000 inclusive of GST. Construction work started in October 2007. The date of practical completion of the contract is in contention but it appears that the bulk of the work was completed in November 2008. By March 2009 separate titles had issued for each apartment and Flatbush Property Ltd transferred the apartments to various third parties. Those third parties represented the interests of the joint venture partners. In particular, one apartment was transferred to a company associated with Mr Polglase. Other apartments were transferred to Hawthorn Properties Ltd, whose shareholders and directors mirrored that of Flat Bush Property Ltd.

[7] At the end of the contract work by Auckland Concrete Homes Ltd there were unresolved differences between Auckland Concrete Homes Ltd and Flat Bush Property Ltd. Auckland Concrete Homes Ltd claimed that it had not been paid in full. Flat Bush Property Ltd contested that, and said that Auckland Concrete Homes Ltd had not completed all the work, and that there were defects in the work carried out by Auckland Concrete Homes Ltd. Those differences are the sort that may arise from time to time between an employer and a building contractor. The evidence shows that there were attempts to try and reach resolution on these matters, but without success.

[8] In this proceeding, each side asserts that it has merit. A security for costs application is not an appropriate proceeding for deciding the merits of a building dispute when there are arguments as to building quality and defects. All I can decide for this case is that Auckland Concrete Homes Ltd has an arguable case that it has not been paid in full, and Flat Bush Property Ltd appears to have an arguable case that it is entitled to claim credits for set-off for uncompleted and defective work.

[9] Auckland Concrete Homes Ltd served a statutory demand under s 289 of the Companies Act on Flat Bush Property Ltd on 22 March 2010. The amount required to be paid under the notice was $74,146.13. That was made up of an unpaid invoice of approximately $56,000 with the remaining amount being claimed for interest under the building contract.

[10] Flat Bush Property Ltd filed an application to set aside the statutory demand under s 290 of the Companies Act on the basis that there was a substantial dispute whether or not the debt was owing, and also that it had a counterclaim, set-off or cross-demand which exceeded the amount of the demand. It filed that application on 12 April 2010. Unfortunately for it, it was out of time and had not met the 10 working days deadline under s 290. It later withdrew its application but reserved its rights to say that it contested that it owed Auckland Concrete Homes Ltd any money.

[11] Auckland Concrete Homes Ltd later filed a liquidation application. Flat Bush Property Ltd did not resist the application. The court made an order that Flat Bush Property Ltd be put into liquidation on 16 June 2010. Mr Chapman was appointed liquidator. As liquidator, Mr Chapman has accepted the claim by Auckland Concrete Homes Ltd for its debt. While there is some evidence that at one stage he may have been inclined to listen to claims by Mr Polglase that Flat Bush Property Ltd is a creditor of Auckland Concrete Homes Ltd, it is clear from a liquidator's report that he regards Auckland Concrete Homes Ltd as creditor and rejects Flat Bush Property Ltd as a creditor of Auckland Concrete Homes Ltd.

[12] In the meantime – and this is since this application has been filed - Auckland Concrete Homes Ltd has gone into liquidation. That company had initially funded this claim. Mr Chapman is the liquidator of Auckland Concrete Homes Ltd. I was informed by counsel that Auckland Concrete Homes Ltd has creditors of about $500,000. The major creditor appears to be Inland Revenue which is owed approximately $100,000 as a preferential creditor.

[13] The defendant in this proceeding, Mr Polglase, was a director of Flat Bush Property Ltd. He appears to have been the key person who dealt with Auckland Concrete Homes Ltd. The liquidator has issued this proceeding in both the name of the company and his own name as plaintiffs.

[14] The statement of claim has two causes of action. The first alleges against Mr Polglase, that he breached his duties as a director under ss 131, 135 or 137 of the Companies Act. The breaches are said to have arisen by allowing the company to

incur an obligation when Mr Polglase knew that the company would not be able to perform it, failing to act in good faith and in the best interests of the company by permitting the company not to pay the final debt due to Auckland Concrete Homes Ltd, failing to ensure that sufficient funds were retained in the company to pay any liability, and by allowing the business of the company to be carried on in a manner likely to cause loss to creditors and failing to exercise the care, diligence and skill expected of a reasonable director. The claim is made under s 301 of the Companies Act. That section specifically allows claims to be brought by a liquidator, and also by a creditor of a company.

[15] The relief claimed in the first cause of action includes a claim which would apparently cover the costs of the liquidation of Flat Bush Property Ltd. I query whether that part of the claim is sustainable. It seems to me that ordinarily when a claim is made against a director under s 301 in respect of the indebtedness of a company, and that indebtedness has led to a loss for the company, a director is normally only liable for up to the extent of the debt, where the indebtedness is attributable to a breach of his duty. I recognise that the courts exercise a discretion to reduce the amount of compensation, but I am not aware of the discretion being exercised to award amount higher than the indebtedness for which the director is said to be liable.

[16] In defence of the claim for breach of director's duty, I understand that Mr Polglase will contest that Flat Bush Property Ltd owed any money at all to Auckland Concrete Homes Ltd. Second, he will also run the argument that he was not in breach of any duty to the company because the company had the benefit of the indemnity provisions in the deed of bare trust and that indemnity will be effective to allow Flat Bush Property Ltd to recover from the joint venture partners for the amount of any liability that was truly incurred.

[17] The second cause of action is under the Fair Trading Act. It alleges that, while a director of Flat Bush Property Ltd, Mr Polglase engaged in misleading or deceptive conduct, that Auckland Concrete Homes Ltd was misled or deceived by the conduct and it suffered loss as a result. On that pleading, it may well be that Auckland Concrete Homes Ltd has a cause of action against Mr Polglase. At this

stage it is not for me to comment whether it has. However, what is not clear to me is that Flat Bush Property Ltd or its liquidator could make a claim when it has not suffered any loss as a result of that misleading conduct of its director. I raised this with Mr Swan. He was not ready to deal with that issue and had not come to court ready to face a strike-out application. I do not take the matter further other than to say that my present impression is that the second cause of action may not in fact be a tenable cause of action as presently framed.

[18] I return to the first cause of action. That cause of action is framed against Mr Polglase as director of the company. It may be that there is an alternative cause of action available to the plaintiffs. That is a claim relying on the indemnity. The indemnity would arise either under the deed of trust, clause 4 being the indemnity provision, or at equity or under the Trustee Act. Certainly this is a case where the joint venture partners caused Flat Bush Property Ltd to enter into the building contract with Auckland Concrete Homes Ltd. As they instigated the liability of the trustee, the trustee is entitled to look to the joint venture partners as beneficiaries for indemnification. There are authorities on that point: *Hardoon v Belilios* and *Balsh v Hyham.*[1]

[19] I also refer to Mr Polglase's defence contesting that Flat Bush Property Ltd owes any money at all to Auckland Concrete Homes Ltd. As already noted, Mr Chapman, as liquidator, has accepted a proof of claim by Auckland Concrete Homes Ltd. It appears that if Mr Polglase wishes to contest Mr Chapman's acceptance of that claim, he will have to apply to the Court for an order reversing the decision of Mr Chapman. He can make such an application under s 284(1)(b) of the Companies Act. Directors of a company are entitled to make applications under s 284 of the Companies Act, subject to leave being granted. Here, it seems to me that Mr Polglase has a very real interest in the issue because he has been sued for breach of duty as director in respect of that alleged liability of the company. There is no formal application by Mr Polglase to grant leave under s 284 but it seems to me that in these circumstances this would be a very proper case for leave to be granted to make such an application.

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[1] *Hardoon v Belilios* [1901] AC 118 (PC) and *Balsh v Hyham* (1728) 2 P. Wms 453.

[20] I turn now to the application for security for costs. Rule 5.45 says:

5.45 Order for security of costs

(1) Subclause (2) applies if a Judge is satisfied, on the application of a defendant,—

(a) that a plaintiff—

(i) is resident out of New Zealand; or

(ii) is a corporation incorporated outside New Zealand; or

(iii) is a subsidiary (within the meaning of section 5 of the Companies Act 1993) of a corporation incorporated outside New Zealand; or

(b) that there is reason to believe that a plaintiff will be unable to pay the costs of the defendant if the plaintiff is unsuccessful in the plaintiff's proceeding.

(2) A Judge may, if the Judge thinks it is just in all the circumstances, order the giving of security for costs.

(3) An order under subclause (2)—

(a) requires the plaintiff or plaintiffs against whom the order is made to give security for costs as directed for a sum that the Judge considers sufficient—

(i) by paying that sum into court; or

(ii) by giving, to the satisfaction of the Judge or the Registrar, security for that sum; and

(b) may stay the proceeding until the sum is paid or the security given.

(4) A Judge may treat a plaintiff as being resident out of New Zealand even though the plaintiff is temporarily resident in New Zealand.

(5) A Judge may make an order under subclause (20 even if the defendant has taken a step in the proceeding before applying for security.

(6) References in this rule to a **plaintiff** and **defendant** are references to the person (however described on the record) who, because of a document filed in the proceeding (for example, a counterclaim), is in the position of plaintiff or defendant.

[21] An application under r 5.45 follows four steps:

(a) Has the applicant satisfied the court of the threshold under r 5.45(1)?

(b) How should the court exercise its discretion under r 5.45(2)?

(c) What amount should security for costs be fixed at?

(d) Should a stay be ordered?

Has the applicant satisfied the court of the threshold under r 5.45(1)?

[22] Mr Polglase relies on the ground that there is reason to believe that the plaintiffs will be unable to pay his costs if the plaintiffs are unsuccessful in their proceeding.

[23] The first plaintiff, Flat Bush Property Ltd, is in liquidation. It appears to be quite clear that it holds no funds at all, and was at all times an assetless trustee. There is no evidence that it has funds to meet any of the costs that might be made against it.

[24] Mr Chapman is an insolvency practitioner. Ordinarily there would not be any question as to the ability of an insolvency practitioner to meet an order for costs if a claim brought by him as liquidator were unsuccessful. However, somewhat exceptionally, there is cause for concern when it comes to Mr Chapman.

[25] Mr Polglase has referred to two proceedings, CIV-2010-404-8383 and CIV-2011-404-6729. These are bankruptcy proceedings brought by the current liquidators of the East Tamaki Curry House Ltd against Mr Chapman and an application to set aside a bankruptcy notice. The bankruptcy proceedings were to enforce orders that had been made against Mr Chapman in his capacity as former liquidator of East Tamaki Curry House Ltd (in liquidation).

[26] On 27 January 2012, the applications were called in front of me. I was advised that the matters at issue between Mr Chapman and the current liquidators had been resolved. The current liquidators were granted leave to withdraw their application. Mr Chapman withdrew his application to set aside the bankruptcy notice. Mr Swan urges on me that as the bankruptcy matters had been resolved then there cannot be any question as to Mr Chapman's solvency. Mr Hayes urges

otherwise. He makes the point that the liabilities of Mr Chapman were orders made against Mr Chapman in his capacity as liquidator and included orders as to costs. The current liquidators of East Tamaki Curry House Ltd were put to the trouble of taking bankruptcy proceedings to obtain satisfaction. *McGechan*[2] (at HR5.45.02) says:

> An applicant does not have to prove inability to pay in the normal civil sense. In the absence of direct evidence it can be sufficient to produce evidence of surrounding circumstances from which an inference of an ability to pay can reasonably be drawn.

The authority cited for that is *Totara Investments Ltd v Abooth Ltd.*[3] The text goes on to say:

> Failure by a plaintiff to disclose his financial circumstances may give rise to an adverse inference as to ability to meet costs.

The authority cited there is *Arklow Investments Ltd v MacLean.*[4].

[27] In my view, Mr Polglase has established that there is reason to believe that Mr Chapman will be unable to pay costs if the plaintiffs' proceeding is unsuccessful. There is in my view a very real risk of non-payment, given the difficulties that Mr Chapman has apparently had in the past in being unable to comply with orders of this court made against him in his capacity as a liquidator. Accordingly I find that Mr Polglase has satisfied the threshold test under r 5.45(1).

How should the court exercise its discretion under r 5.45(2)?

[28] On the exercise of the discretion, the decision of the Court of Appeal in *A S McLachlan v MEL Network Ltd*[5] provides useful guidance:

> [13] Rule 60(1)(b) High Court Rules provides that where the Court is satisfied, on the application of a defendant, that there is reason to believe that the plaintiff will be unable to pay costs if unsuccessful, "the Court may, if it thinks fit in all the circumstances, order the giving of security for costs". Whether or not to order security and, if so, the quantum are discretionary. They are matters for the Judge if he or she thinks fit in all the circumstances.

[2] *McGechan on Procedure* HR5.45.02.
[3] *Totara Investments Ltd v Abooth* HC Auckland CIV-2007-404-9090, 4 May 2009.
[4] *Arklow Investments Ltd v MacLean* (1994) 8 PRNZ 188, 199
[5] *A S McLachlan v N E L Network Ltd* (2002) 16 PRNZ 747.

> The discretion is not to be fettered by constructing "principles" from the facts of previous cases.
>
> [14] While collections of authorities such as that in the judgment of Master Williams in *Nikau Holdings Ltd v BNZ* (1992) 5 PRNZ 430, can be of assistance, they cannot substitute for a careful assessment of the circumstances of the particular case. It is not a matter of going through a checklist of so-called principles. That creates a risk that a factor accorded weight in a particular case will be given disproportionate weight, or even treated as a requirement for the making or refusing of an order, in quite different circumstances.
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> [15] The rule itself contemplates an order for security where the plaintiff will be unable to meet an adverse award of costs. That must be taken as contemplating also that an order for substantial security may, in effect, prevent the plaintiff from pursuing the claim. An order having that effect should be made only after careful consideration and in a case in which the claim has little chance of success. Access to the Courts for a genuine plaintiff is not lightly to be denied.
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> [16] Of course, the interests of defendants must also be weighed. They must be protected against being drawn into unjustified litigation, particularly where it is over-complicated and unnecessarily protracted.

[29] In the exercise of the discretion, it is necessary to bear in mind that this is a claim brought by a company in liquidation and by a liquidator. Traditionally, there has been an aversion to requiring liquidators to provide security for costs where proceedings are brought by a company in liquidation.

[30] There is a useful review of the authorities in the decision of Gallen J in *Cory Wright & Salmon Ltd v KPMG Peat Marwick*.[6] In particular, as an example of the traditional approach, Gallen J refers to the decision of Hardie Boys J in *Re World Style Builders Ltd*.[7] There, Hardie Boys J followed earlier decisions and noted that the liquidator exercises a statutory function primarily for the benefit of creditors but having a strong public interest component. Hardie Boys J also noted that the persons sought to be made liable were persons closely involved in the operation of the company, and that that fact provided some justification for the court's refusal to order security. The company's insolvency may very well have resulted from their own actions. He also noted that any security would have to be put up by creditors, and he did not consider that appropriate. That is very much the traditional approach.

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[6] *Cory Wright & Salmon Ltd v KPMG Peat Marwick* [1993] 2 NZLR 701 at 704-705.
[7] *Re World Style Builders Ltd* (1982) 1 NZCLC 98,401.

[31] There has, however, been a trend to order liquidators and companies in liquidation to put up security for costs. I note that increasingly the courts have drawn a distinction between claims brought by a company in liquidation alone, and a claim brought by a liquidator. The relevance of the distinction is that a company in liquidation may have only its own assets available to meet any claim for costs, whereas a liquidator may be personally liable for costs and may have to look to his own assets if the assets of the company are insufficient. The courts will be less inclined to require a liquidator personally to provide security for costs on the basis that any order for costs would be made against him personally, which is more likely to provide better protection than a company in liquidation alone.

[32] I have been told that this claim was initially financed by Auckland Concrete Homes Ltd, but that now that it is in liquidation it is no longer funding the litigation.

[33] The defendant portrays the matter as the creditors of Auckland Concrete Homes Ltd and Mr Chapman litigating with impunity in the sense that they have arranged for this claim to be brought while really having nothing to lose if any order for costs is made against them.

[34] Against that, I also note that Auckland Concrete Homes Ltd is in the position of many building contractors who carry out work and at the end of the contract then run into disputes when they try to extract the final payments. It is not for me to say whether their claim is justified or not. But experience tells us that building contractors can have very real problems in extracting final payments from employers. The situation Auckland Concrete Homes Ltd has run into here, with the employer alleging defects, is an all too familiar one. I note that the Construction Contracts Act was in part enacted to deal with those kinds of problems. But those remedies have not been invoked here. It does not appear that they would have been of any avail to Auckland Concrete Homes Ltd in any event.

[35] Putting aside Mr Polglase's potential liability for breach of duty, this case is really one about trying to collect payments by a building contractor when liability is disputed at the end of the contract. That is a significant factor that needs to be taken into account when assessing whether security for costs should be ordered. I am also

conscious of the fact that if I were to make a substantial order for costs, that is likely to prevent the liquidator being able to pursue the claim at all. At the same time, I also appreciate the risk to Mr Polglase in having to face this case being run against him and then finding that he has no recourse to costs if he is ultimately successful.

[36] My view is that some amount for security for costs ought to be awarded, but the amount ought to be modest.

How much should be ordered for security for costs?

[37] Mr Hayes tendered a calculation of costs. He calculated it on a 2B basis and estimated that five days hearing time would be required. He calculated the total time required was 35.2 days and the total possible costs award was $66,364.00 and disbursements of $1,752. Realistically, the claim by Flat Bush Property Ltd is, at its top, an amount of about $74,000 with perhaps something more for interest charges. It seems absurd that a claim for $74,000 should be subject to an order for security for costs of $66,000.

[38] I accept that the claim has to be heard in this court because this case is likely to involve the hearing of an application under s 284 of the Companies Act. But for that matter, this case would be better removed to the District Court. However, I am confident that because of the small amount of money involved, the parties will be motivated to conduct their cases efficiently, to get to a hearing promptly and to see that the time spent on the hearing is spent as usefully as possible and is not wasted.

[39] Accordingly, I accept Mr Swan's submission that five days is probably excessive as an estimate of the hearing time required for this case. I also take into account that it is normal to give some discount from the amount awarded for costs. As I have indicated, I regard the matter as requiring further tempering, because of the risk that any substantial order for costs could snuff out any hope of the claim being heard at all.

[40] In my view, an adequate amount to fix for security for costs is $15,000. If the plaintiffs are confident of success, the plaintiffs should be able to be put up that sum,

but at the same time it makes them face up to the fact that costs are real and that they need to put some money up front as an assurance to the defendant that the claim is being pursued seriously.

Should a stay be ordered?

[41] This case primarily involves a building dispute. The prospect of running a full defended hearing on a building dispute where the sum at issue is about $74,000 or so is unattractive. I note that the parties had earlier tried to resolve matters without success. It is my hope that they will be able to look at this matter and see if they can resolve the matter without further time in court. Accordingly I propose to defer for a short period the time when security is to be provided.

[42] I order that the security for costs is to be paid into court by *30 April 2012*. If payment is not made by that date then the proceeding is to be stayed.

[43] I also make a further order that if the payment into court has not been made by *30 May 2012*, then Mr Polglase may apply to the court for an order striking out the claim.

[44] Mr Polglase is entitled to costs on the security for costs application. The normal approach follows for costs on an interlocutory application. As he has succeeded on that application, he is entitled to have costs fixed now and payable now. There is an order for costs in favour of Mr Polglase on a 2B basis, and also on the basis that his application has required a hearing time of three-quarters of a day.

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R M Bell
Associate Judge