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IN THE HIGH COURT OF NEW ZEALAND
CHRISTCHURCH REGISTRY

CIV 2010-409-002698

BETWEEN	STEVE MOWAT BUILDING & CONSTRUCTION LIMITED Plaintiff
AND	BOAT HARBOUR HOLDINGS LIMITED Defendant

Hearing: 11 February 2011

Counsel: D R Tobin for Plaintiff
J Moss for Defendant

Judgment: 17 February 2011

JUDGMENT OF FOGARTY J

Introduction and background to plaintiff's caveat

[1] The plaintiff, a builder, applies for an order that a caveat not lapse. The caveat is lodged against a student housing complex in Dunedin which the builder has recently completed. The complex was developed by a company now in liquidation called Dolphin Street Development Ltd. Dolphin was an entity formed by a friend of Mr Mowat to purchase four existing villas and build a student housing complex. From the point of view of Dolphin the project was a disaster. The result is that the builder is now seeking $500,000 in the liquidation of Dolphin.

[2] To get the financing for the project Dolphin borrowed from Kiwibank and from a company called Viaduct Capital Ltd. These financiers would not lend without an underwriting agreement. On 14 October 2009 for a fee of $200,000, Boat Harbour Holdings Ltd, a development company, entered into a written sale and purchase agreement to purchase the student housing complex on the later of: 25 June 2010, practical completion, issue of titles, or local authority code

compliance certificate. The purchase price was $4,066,666.70 plus GST. There was a separate agreement between the same parties and the financiers by which Boat Harbour could be discharged of this obligation. The decision to discharge was to be made by the financiers. Associated with this agreement was the question of the release of the deposit to the vendor, Dolphin. The deposit in the contract was $450,000. It was paid into a trust account. If Boat Harbour was released from the underwriting agreement the deposit plus interest was paid back to it. If it was not released the deposit was paid over to the vendor, Dolphin.

[3] It soon became reasonably clear that the project was not going to plan. Very early on into the project in December 2009 there were meetings between the builder, Dolphin, Boat Harbour and the financiers.

[4] In the meantime Boat Harbour had caveated the property giving notice of its equitable title under the agreement for sale and purchase.

[5] In June 2010 the financiers decided not to release Boat Harbour from the underwriting agreement. Probably this followed their doubt as to the ability of Dolphin to complete the project. The underwriting sale and purchase agreement then went forward. The deposit of $450,000 was paid over to Dolphin Street.

[6] On 22 July the builder lodged a claim against Dolphin under the Construction Contracts Act 2002. On 13 August the adjudicator's determination awarded the builder a sum of approximately $200,000. On 18 August the plaintiff applied to the District Court to register the award and sought the issue of a charging order. On the same day Dolphin and Boat Harbour varied and then settled their agreement for sale and purchase, bringing forward the settlement date, but at a reduced price of $3,816,666.70 plus GST. Boat Harbour became the registered proprietor of the land. The price was reduced by $250,000. About a fortnight later on 3 September Dolphin was placed into voluntary liquidation.

[7] Boat Harbour then entered into an agreement with the builder to complete the building. The builder subsequently registered a caveat claiming an interest in equitable fee simple by reason of a trust.

Prejudicial disposition argument in support of caveat

[8] Mr Tobin advanced a number of arguments in support of the caveat. He suggested that the underwriting agreement was for below market consideration. He argued that the settlement on 18 August was a prejudicial disposition by Dolphin of Boat Harbour over Mowat, and others, such as the Inland Revenue Department. He contended that the acquisition of the land was unjust enrichment.

[9] A caveat can be sustained only if it is plain that none of these three arguments could possibly succeed. There is also a question of residual discretion which I will return to at the end of the judgment. Accordingly, I examine the second of Mr Tobin's submissions being the prejudicial disposition cause of action, which seems to me to be the strongest of the three arguments proffered. This argument relies on ss 344-350 of the Property Law Act 2007.

[10] The argument for the plaintiff builder Mowat is that the agreement for sale and purchase between Boat Harbour and Dolphin was renegotiated for a lower price and settled on 18 August with the intention of defeating the builder pursuing the arbitration award in its favour for $200,000 and likely knowing that there were more sums claimed by the builder against Dolphin. The intention of this transaction was to eliminate the prospect that Boat Harbour would be an unsecured creditor pursuing a dividend in liquidation of part of the $450,000 deposit that it had paid. This would follow a collapse of Dolphin, and non completion of the agreement for sale and purchase.

[11] If a transaction is set aside as a prejudicial disposition the assets transferred can be recovered. Section 344 provides:

> **344 Purpose of this subpart**
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> The purpose of this subpart is to enable a court to order that property acquired or received under or through certain prejudicial dispositions made by a debtor (or its value) be restored for the benefit of creditors (but without the order having effect so as to increase the value of securities held by creditors over the debtor's property).

[12] In this case the assets would likely be transferred to the liquidators of Dolphin who in turn would be obliged to hold the asset for the benefit of the secured and unsecured creditors of Dolphin, or Boat Harbour would be directed to pay more for the property to the liquidators. See s 350.

[13] Given that I am examining whether it is plain that this argument cannot succeed, it is appropriate and sufficient that I work with the evidence that has been placed before me by the parties, who have had some months notice of this hearing, being alert to note the inferences that may be favourable to the plaintiff.

[14] It is probable that there is a close link between the two events of 18 August 2010: the builder's application for a charging order on 18 August; and, the developers' variation and settlement of the agreement for sale and purchase. Before the agreement was varied and settled an email was sent from Mr John Spencer of Boat Harbour on 6 August to representatives of Dolphin "*to bring the settlement forward to a date asap*", with "*a reduction in the purchase price of $250,000*".

[15] The liquidators of Dolphin have not provided any information for this hearing. Some inferences can be drawn from the way the agreement was varied. At the time the agreement was varied Boat Harbour was not obliged to settle. The building was not at the practical completion stage. A consultant Ortus had estimated the cost to complete at $80,000. The survey/title was not completed. The price was reduced by $250,000 of which $90,000 was for further building work. In addition to those costs Boat Harbour was to spend $40,000 to complete chattel purchases. Further, the sum of $50,000 was sought for the additional holding costs of Boat Harbour. I infer that this later sum was to compensate Boat Harbour for the greater interest cost of purchasing the property earlier.

[16] Mr Tobin criticised the purchase price initially of $4 million and criticised the reduced price even more. The price of the original sale and purchase is readily explicable. It was an underwrite agreement. Its principal function was to ensure that the financiers would recover their outlay. It can be inferred, and appears to be the assumption of counsel before me, that the original sale and purchase price would have reflected Dolphin's cost of acquisition of the four villas plus the cost of

demolition of these villas as part of site preparation and the construction of a student complex providing 46 rentable bedrooms, and the holding costs, particularly interest during the construction and fit out.

[17] Mr Tobin relied on his client's affidavit saying he understood the property was valued at $6 million and therefore this was a transaction for under value. I do not agree that this readily follows. I do not have any real difficulty with the likelihood that the building when completed and fully tenanted, with 46 bedrooms, would generate a net cashflow per annum which treated as a 5-10% return on capital would justify a market valuation of about $6 million.

[18] To be sure, when land was acquired the potential for redevelopment would, in the normal circumstances, have been included in the sale price. It would appear the land was purchased for $805,000 in March 2009. Holding costs may date from then. Normally there is a healthy margin demanded by developers who bear the cost of securing, holding and developing land for a new purpose and the risks that the project will break down at some point or the venture will not perform as expected. This can justify, where it is an underwriting agreement, a sale price reflecting the funding cost of acquiring the land plus the cost of building the units, plus the holding costs. It is unlikely that it was ever the intention of Dolphin to quit the property at this price. Dolphin's intention was likely to be to either hold the property and enjoy the revenue from 46 bedrooms or sell the property as a going concern for a price higher than $4 million.

[19] The disposal of the property on 18 August 2010 for the original funding costs less $250,000 is, however, another matter. The $90,000 cost to complete indicates that very little work was needed to be done before the buildings were practically completed. So the project was nearing completion as a construction project and ready to begin its life as a business at the end of the year. (Students at Dunedin typically sign up new leases at the end/beginning of the calendar year.)

[20] That suggests to me that by August 2010 the margin of risk that a buyer would expect to take, and the size of the future holding costs, were together far less than those prevailing back in October 2009. Accordingly, the value of the property

should have been tracking closer to the capitalisation of the expected net annual revenues. Mr Moss wants the Court to rely on rating value data of 1 July 2010, showing a capital value of $4.465 million, arguing that includes GST. I decline to do so. Such data is crude, and not a reliable indicator of current market value.

Why then would Dolphin sell on those terms?

[21] Neither the Dolphin shareholders, directors, nor its liquidators have provided the plaintiff with any information for this hearing. Mr Tobin's client understands that sale of this asset liquidated the assets of Dolphin. Dolphin was an entity incorporated or used solely for this project. This Court can presume that the financiers have been paid out and were probably the principal beneficiaries of the sale. In that sense the early settlement and associated variation preferred the banks, but they were secured creditors of Dolphin. The Boat Harbour email of 6 August referred to "*making sure the numbers stack up to cover repayment of other funders*".

[22] It is likely that Dolphin's obligation to the financiers was secured by personal guarantee and that the guarantor/s were the shareholders/directors or otherwise controllers of Dolphin.

[23] If Boat Harbour had not achieved the early settlement it seems likely that Dolphin would have gone into liquidation before the building was completed. Boat Harbour may have been able to waive the conditions postponing settlement and acquire the property for the original contract price. If they could not or did not the liquidators would sell the property on the open market after extensive advertising.

[24] The prime players in a prejudicial disposition are usually the debtors, here, Dolphin.

[25] Section 345 provides:

345 Interpretation

(1) For the purposes of this subpart, -

(a) a disposition of property prejudices a creditor if it hinders, delays, or defeats the creditor in the exercise of any right of recourse of the creditor in respect of the property; and

(b) a disposition of property is not made with intent to prejudice a creditor if it is made with the intention only of preferring one creditor over another; and

(c) a disposition of property by way of gift includes a disposition made at an undervalue with the intention of making a gift of the difference between the value of the consideration for the disposition and the value of the property comprised in the disposition; and

(d) a debtor must be treated as insolvent if the debtor is unable to pay all his, her, or its debts, as they fall due, from assets other than the property disposed of.

(2) In this subpart, unless the context otherwise requires,—

disposition means -

(a) a conveyance, transfer, assignment, settlement, delivery, payment, or other alienation of property, whether at law or in equity:

(b) the creation of a trust:

(c) the grant or creation, at law or in equity, of a lease, mortgage, charge, servitude, licence, power, or other right, estate, or interest in or over property:

(d) the release, discharge, surrender, forfeiture, or abandonment, at law or in equity, of a debt, contract, or thing in action, or of a right, power, estate, or interest in or over any property (and for this purpose a debt, or any other right, estate, or interest, must be treated as having been released or surrendered when it has become irrecoverable or unenforceable by action through the lapse of time):

(e) the exercise of a general power of appointment in favour of a person other than the donee of the power:

(f) a transaction entered into by a person with intent by entering into the transaction to diminish, directly or indirectly, the value of the person's own estate and to increase the value of the estate of another person

proceeds, in relation to any property, means -

(a) the proceeds of the sale or exchange of the property; and

(b) if the property is money, other property bought with that money

property includes the proceeds of any property.

[26] The argument before me was a comparison of the advantages and disadvantages of the earlier settlement as between Boat Harbour and the builder Mowat. Mr Moss relied on subs (1)(b) which says that it is not sufficient to intend only to prefer one creditor against the other. Note that this proposition can be read in the plural. It is also not sufficient to intend only to prefer one set of creditors against another set.

[27] The key qualifier in subs (1)(b) is "only". I think the proposition in subs (1)(b) is reflecting decisions frequently made by debtors, who are not insolvent, to prioritise payment of creditors when their cashflow and credit facilities are not sufficient to pay all debts as they fall due but when they have confidence that in the long run all debts will be paid. So it is often the case that the landlord, and suppliers of essential services such as telephone and power companies, will be paid whereas non essential suppliers will be left unpaid.

[28] Prejudicial preferences occur frequently when the disposer is insolvent, see s 346(2). Upon insolvency the consequence of paying one set of creditors against others entails the knowledge that that will be an enduring consequence of preference so that one set of unsecured creditors get a higher pay out in the dollar than the other. In that context an intent to prefer is also an intent to preclude recovery by the other creditors – so subs (1)(b) does not apply.

[29] There is a strong argument that Dolphin was insolvent on 18 August 2010. It went into liquidation on 3 September, 16 days later. The first report of the liquidators did not disclose any assets, tending to suggest that there were none.

[30] Drawing threads together it appears to be a reasonable argument that this property was deliberately sold by a varied agreement, at a reduced consideration, without advertising, in order to secure advantages to the shareholders and other

controllers of Dolphin at the expense of unsecured creditors including the builder Mowat having a prospect of obtaining some contribution to their debt. Had it been sold for a sum in excess of the debt to the secured creditors it would have produced a fund to make some payments to unsecured creditors, including the builder Mowat. There is a significant argument that the property was sold below market value on 18 August. I am satisfied that this may well be a case of a prejudicial disposition.

The exercise of discretion

[31] Mr Moss' answer to this prospect was that the caveat was erroneously drawn and could not be rescued. The caveat defines the caveatable interest as an "*equitable estate in fee simple pursuant to a claim by the caveator as beneficiary of a constructive trust imposed on the Registered proprietor, Boat Harbour Holding Limited as Trustee*".

[32] Upon recognition of a disposable disposition it is likely that the varied agreement and the settlement would be set aside, and vested in Dolphin in liquidation, or Dolphin ordered to pay compensation, s 350.

[33] In that sense it is appropriate to have described Boat Harbour as a constructive trustee. But we were all baffled as to the choice of the phrase "equitable estate in fee simple" to sum up the interest of the builder. It would have been better if the builder was described itself as one of a class of creditors who together and indirectly claimed an equitable estate in fee simple.

[34] There are a large number of cases in which Judges have refused to recognise caveats on the grounds that they have been poorly drawn and do not comply with either statutory requirements or the regulations. But usually, if not invariably, this is also coincidental with findings that the caveats were not sustainable. I am not aware of any High Court or appellate decision allowing a caveat to lapse in the presence of a caveatable interest due to poor drafting. There are obligations to draft the caveat according to the prescriptions of the statute and the regulations. They should be followed. But it does not follow that breach will end the caveat.

[35] There is another body of jurisprudence as to the scope of the discretion preserved in s 143(2) of the Land Transfer Act 1952:

> **143 Procedure for removal of caveat**
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> ...
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> (2) The Court, upon proof that notice of the application has been served on the caveator or the person on whose behalf the caveat has been lodged, may make such order in the premises, either *ex parte* or otherwise, as to the Court seems meet.

[36] My judgment is that the just outcome is to tolerate the inadequate drafting of the caveat but to control the future of the caveat by exercising the discretionary power reserved in s 143(2). Mr Tobin readily conceded that were the settlement price of $3.8 million the market value of the property on 18 August it would not be a prejudicial disposition. There was no expression of expert opinion before the Court as to value of the property on that date. I propose a regime whereby the caveat remains in place while the parties obtain opinions as to the market value of the property on 18 August 2010. Plainly, the builder Mowat is prepared to spend money trying to pursue recovery of some of its debt from Dolphin. It seems reasonable to impose on the builder Mowat in the first instance (subject to a later order of costs) the cost of obtaining an opinion from an independent expert valuer as to the market value of the property on that date. This opinion is to be obtained within two calendar months from the date of this judgment.

[37] Secondly, it is plainly inappropriate for the litigation to be pursued by the builder Mowat without, at the least, the liquidators being heard. Accordingly, I add the liquidators (Mr Hudson Biggs and Mr Trevor Laing) as second plaintiffs. I note that this does not of itself impose any cost liabilities on the liquidators. This will enable the liquidators to be informed of the litigation. The liquidators may take a passive role but adding the liquidators will enable the Court, if necessary, should the caveator's claim prove meritorious, to exercise the powers under s 350 and vest the property in the liquidators pursuant to s 350(1)(b). The alternative solution might be a settlement or judgment whereby Boat Harbour pay the difference between its purchase price and the market value to the liquidators.

[38] Accordingly, the application that the caveat not lapse succeeds. The applicant is entitled to costs. I assess those costs on a 2B basis. If the parties cannot agree on a calculation I will receive written submissions of no more than five pages exchanged in advance more or less simultaneously.

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