

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

**CIV-2015-441-88
[2015] NZHC 2324**

UNDER the Companies Act 1993

IN THE MATTER OF the liquidation of Central tyres
Waipukurau Limited (in liquidation)

BETWEEN CENTRAL TYRES WAIPUKURAU
LIMITED (IN LIQUIDATION)
First Applicant

DAMIEN GRANT and STEVEN KHOV
Second Applicant

AND MICHAEL JOHN PALLESEN
First Defendant

MICHAEL JOHN PALLESEN,
KAYLENE RUTH PALLESEN and
MARCUS EDWARD MCCARTHY
Second Defendants

Hearing: On the papers

Counsel: B J Norling for Applicants

Judgment: 24 September 2015

JUDGMENT OF WILLIAMS J

[1] The second applicants, Damien Grant and Steven Khov, are liquidators of the first applicant Central Tyres Waipukurau Ltd. The respondent, Michael Pallesen, is the sole director of Central Tyres.

[2] Mr Pallesen, Kaylene Pallesen and Marcus McCarthy are trustees for the Tutuki Trust. The Trust owns all shares in Central Tyres. The trustees are the intended second defendants in the substantive proceeding.

[3] Central Tyres was placed into liquidation by the High Court at Napier on 16 April 2015.

[4] The liquidators seek a without notice freezing order under Part 32 of the High Court Rules in relation to property held personally by Mr Pallesen. That property is as follows:

- (a) 134 Mt Herbert Road, Waipukurau with identifier HBF4/585 and legal description of Lot 4 Deposited Plan 14052;
- (b) 40 – 20 Norman Smith Street, Nukuhau with identifier SA20B/102 and legal description Lot 1 Deposited Plan South Auckland 14890; and
- (c) The proceeds of the sale of 16 Abbot Avenue, Waipawa with identifier HBM2/334 and legal description of Lot 13 Deposited Plan 20858.

[5] The applicants in their statement of claim allege that Mr Pallesen as director of Central Tyres:

- (a) allowed the company to be traded recklessly, contrary to s 135 of the Companies Act 1993;
- (b) breached the director's duty of care owed to Central Tyres, contrary to s 137 of the Companies Act;
- (c) failed to ensure that Central Tyres kept proper accounting records, contrary to s 194 of the Companies Act; and
- (d) caused Central Tyres to advance sums to himself and the Trust.

[6] The applicants say Mr Pallesen's personal liability arises under ss 300 and 301 of the Companies Act, set out below.

[7] Overall, the applicants assess their financial claims to be worth \$1,461,629.91, comprising:

- (a) \$426,495.87 for breaches of director's duties;
- (b) \$74,157.57 for overdrawn personal current account;
- (c) \$181,749.47 for overdrawn trust current account; and
- (d) \$779,227.00 for intercompany receivable.

[8] The liquidators say they have a good arguable case in these respects and that there is a real risk Mr Pallesen will attempt to dispose of the property described above in order to defeat judgment against him.

Background

[9] Kieran Jones (employed by the liquidators) has filed an affidavit in support of the application. The affidavit sets out the background to the liquidators' claims.

[10] It appears the last annual report prepared for Central Tyres was to the year ending 31 May 2012. At that point Mr Pallesen had an overdrawn current account of \$5,162.00. Prior to the liquidation Mr Pallesen had made \$58,034.12 in payments from Central Tyres to himself and third parties (the trust) for personal use. Those payments comprised debit transactions, internet banking transactions, ATM withdrawals and personal transfers. There is interest on the overdrawn current account balance of \$10,061.45. Those payments for personal benefit plus interest total \$74,147.57.

[11] Central Tyres has, as far as the liquidators' investigations have found, only one current account with the Bank of New Zealand. Mr Jones' analysis of the current account balance reveals payments from Central Tyres towards a home loan, a credit card in the name of M J Pallesen, Sovereign Insurance policies. None of these debts is related to the business of Central Tyres. There are unexplained ATM withdrawals and personal transfers marked 'personal' and 'drawings'.

[12] In relation to the alleged breaches of director's duties under the Companies Act, Mr Jones and Mr Khov interviewed Mr Pallesen on oath on 24 June 2015. A number of observations are recorded by Mr Jones that relate specifically to the alleged breaches of the Companies Act:

- (a) Mr Pallesen exited from the day-to-day operations of Central Tyres around August 2012 and resumed an 'overseeing role' – the operations were left in the hands of an employee not qualified to run the business, leaving him to make important financial decisions with almost no oversight, to the point of liquidation;
- (b) as a result, creditors are unpaid and Central Tyres' tax obligations were not complied with – the company was allowed to continue trading by Mr Pallesen.
- (c) Mr Pallesen delegated responsibility for keeping financial and accounting records to an employee not qualified to undertake that task and with no expertise in the area – the records were subsequently inaccurate and, because of the lack of supervisions, the Mr Pallesen was unable to acknowledge Central Tyres was insolvent;
- (d) Mr Pallesen's oversight extended to checking the funds in the bank account one or two times a month, despite knowing this was an inadequate and incomplete measure of Central Tyres' financial position;
- (e) Mr Pallesen acknowledged his failure to recognise the position and 'pull the pin' meant that Central Tyres continued trading insolvent, incurring further debts to creditors; and
- (f) Mr Pallesen confirmed he knew Central Tyres couldn't trade out of the accrued debt at October 2014 (six months prior to liquidation).

[13] Mr Jones also addressed whether Mr Pallesen may have any possible defence. Those that he contemplates are:

- (a) that Mr Pallesen may have made undocumented payments from Central Tyres to creditors that would be considered capital introductions (but the lack of records hamper the ability to pinpoint any such payment); and
- (b) that Mr Pallesen may have made direct capital introductions (funds or equipment) into Central Tyres that have not been recorded (but on the evidence there are no such recorded introductions).

[14] However, being the sole director during the period of the alleged offending, Mr Pallesen has not sought legal advice in relation to his duties as a director, nor has he engaged an accountant to prepare records (because Central Tyres did not have the funds).

[15] Mr Jones sets out that there is a real risk Mr Pallesen will dispose of assets, namely the three properties owned by him that I have identified. On 18 September 2015, 10 days after receiving a letter from the liquidators detailing the claims against him, Mr Pallesen transferred one of the properties to an unknown third party. Investigations relating to that property reveal there was no advertisement of the sale. The suggestion is that it was transferred in a secrete transaction.

Freezing orders

[16] A freezing order may be granted under Part 32 if:

- (a) the liquidators can establish they have a good arguable case against Mr Pallesen on the substantive claims made against him;
- (b) there are available assets to which the order can attach, and clear connections between the defendants and the companies;

- (c) there is a factual basis upon which a prudent, sensible, commercial person might properly infer a danger that the Mr Pallesen may dissipate or dispose of assets so as to defeat a judgment against him; and
- (d) the overall interests of justice must fall on the side of the need to protect creditors against any prejudice or hardship to the defendants.

The legislation

[17] The relevant sections of the Companies Act that Mr Pallesen is alleged to have breached are as follows:

135 Reckless trading

A director of a company must not—

- (a) Agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
- (b) Cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

137 Director's duty of care

A director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,—

- (a) The nature of the company; and
- (b) The nature of the decision; and
- (c) The position of the director and the nature of the responsibilities undertaken by him or her.

194 Accounting records must be kept

- (1) The board of a company must ensure that there are kept at all times accounting records that—
 - (a) correctly record the transactions of the company; and
 - (b) will enable the company to ensure that the financial statements or group financial statements of the company comply with generally accepted accounting practice (if the

company is required to prepare such statements under this Act or any other enactment); and

- (c) will enable the financial statements or group financial statements of the company to be readily and properly audited (if those statements are required to be audited).
- (2) The board of a company must establish and maintain a satisfactory system of control of its accounting records.
- (3) The accounting records must be kept—
 - (a) in written form in English; or
 - (b) in a form or manner in which they are easily accessible and convertible into written form in English.
- (4) If the board of a company fails to comply with the requirements of this section, every director of the company commits an offence and is liable on conviction to the penalty set out in section 374(3).

[18] The Court's ability to declare a director personally liable for the failure to keep proper accounting records is found in s 300, and in s 301 for breaches of other duties owed to the company. Those sections provide as follows:

300 Liability if proper accounting records not kept

- (1) Subject to subsection (2) of this section, if—
 - (a) a company that is in liquidation and is unable to pay all its debts has failed to comply with—
 - (i) section 194 (which relates to the keeping of accounting records); or
 - (ii) section 201 or 202 (which relates to the preparation of financial statements or group financial statements) or any other enactment that requires the company to prepare financial statements or group financial statements; and
 - (b) The Court considers that—
 - (i) The failure to comply has contributed to the company's inability to pay all its debts, or has resulted in substantial uncertainty as to the assets and liabilities of the company, or has substantially impeded the orderly liquidation; or
 - (ii) For any other reason it is proper to make a declaration under this section,—

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

- (2) The Court must not make a declaration under subsection (1) of this section in relation to a person if the Court considers that the person—
 - (a) Took all reasonable steps to secure compliance by the company with the applicable provision referred to in paragraph (a) of that subsection; or
 - (b) Had reasonable grounds to believe and did believe that a competent and reliable person was charged with the duty of seeing that that provision was complied with and was in a position to discharge that duty.
- (3) The Court may give any direction it thinks fit for the purpose of giving effect to the declaration.
- (4) The Court may make a declaration under this section even though the person concerned is liable to be convicted of an offence.
- (5) An order under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.

301 Power of court to require persons to repay money or return property

- (1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—
 - (a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and
 - (b) order that person—
 - (i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or
 - (ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or
 - (c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.

- (2) This section has effect even though the conduct may constitute an offence.
- (3) An order for payment of money under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.
- (4) In making an order under subsection (1) against a past or present director, the court must, where relevant, take into account any action that person took for the appointment of an administrator to the company under Part 15A.

Assessment

[19] I am satisfied there is a good arguable case that the liquidators' claims can be made out against Mr Pallesen at a substantive trial. The allegations must be capable of tenable argument and supported by sufficient evidence, but may reflect the early stage of the proceeding.¹ I am satisfied that the combination of the accounting evidence and especially the under oath interview with Mr Pallesen provide a sufficient basis for that belief. In particular, I am satisfied the evidence:

- (a) makes arguable that Mr Pallesen was not acting as a "reasonable director" as required by s 137 of the Companies Act;
- (b) makes arguable that Mr Pallesen as a director allowed the company to trade recklessly, and in a manner "likely to create a substantial risk of serious loss" to creditors, in contravention of s 135, by leaving the business of Central Tyres to those not suited for such a role;
- (c) establishes a tenable argument that Mr Pallesen is personally liable to repay money or return property as a result of those breaches under s 301; and
- (d) makes arguable that Mr Pallesen was responsible for, and did not keep proper accounting records and therefore did not discharge the obligations under s 194, thereby establishing a tenable argument he is personally liable for all or any part of Central Tyres' debt under s 300.

¹ *Dotcom v Twentieth Century Fox Film Corp* [2014] NZCA 509 at [18]; citing *Hannay v Mount* [2011] NZCA 530 at [20]-[22] and *Wing Hung Printing Ltd v Saito Offshore Pty Ltd* [2010] NZCA 502, [2011] 1 NZLR 754.

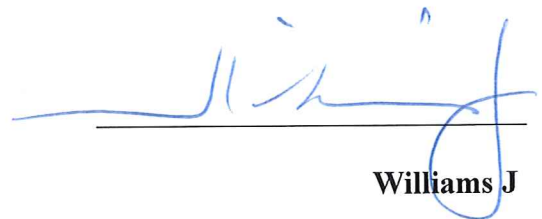
[20] I am satisfied that the two remaining properties and the proceeds of the sale of 16 Abbot Avenue, Waipawa are assets of Mr Pallesen to which the freezing order may apply. I am also satisfied that, based on the recent transfer of 16 Abbot Avenue, there is danger of (further) dissipation.

[21] Finally, I am satisfied that the interests of justice weigh in favour of protecting the liquidators (and therefore the creditors of Central Tyres) and that any prejudice or hardship to Mr Pallesen will be limited. I note in that respect, the applicants have filed a signed undertaking as to damages.

Orders

[22] I make the following orders:

- (a) The draft freezing order is granted in the terms sought.
- (b) The order is to be served forthwith on the respondent and the intended defendants in the substantive proceeding.
- (c) The freezing order will remain in place until 6 November 2015 unless extended by this Court on or before that date.
- (d) Costs are reserved.



Williams J