

IN THE COURT OF APPEAL OF NEW ZEALAND

CA68/01
CA69/01
CA70/01

BETWEEN UNITED HOMES (1998) LIMITED,
UNITED HOMES (1994) LIMITED,

APPELLANTS

AND M L WORKMAN

RESPONDENT

BETWEEN TUSCANY TOWERS LIMITED

APPELLANT

AND A J WORKMAN & OTHERS

RESPONDENTS

BETWEEN HERITAGE COURT
DEVELOPMENTS LIMITED

APPELLANT

AND A J WORKMAN & OTHERS

RESPONDENTS

HEARING: 17 MAY 2001

CORAM: MCGRATH J
ELLIS J
MCGECHAN J

APPEARANCES: R M BELL FOR APPELLANTS
W W PETERS AND H S MACDONALD FOR
RESPONDENTS

JUDGMENT: 25 MAY 2001

JUDGMENT OF THE COURT DELIVERED McGECHAN J

The Appeals

These are three appeals heard together against a decision of the Master dated 15 March 2001 declining applications under s290 Companies Act 1993 to set aside statutory demands.

The demands concerned were in respect of amounts said to be standing to the credit of Respondents in “shareholders’ current accounts”, otherwise known as “shareholders’ term funds”, in the various companies. The companies contended an agreement existed under which those credit balances could not be called up without agreement on the part of all shareholders, and that the true credit balances concerned were very substantially lower than the sums demanded. The Master found against the companies’ contentions.

In a subsequent decision dated 6 April 2001 Nicholson J extended time for payment to 5 p.m. 31 May 2001. No appeal is brought by either side against that extension.

For convenience, we will term the Appellant companies “the Companies”, and will term the Respondents “the Workmans”. The Appellant United Homes (1994) Limited is unnecessarily involved, and will not be referred to further.

Further evidence and further factual submissions

The Workmans sought leave to adduce further evidence before this Court in the form of an affidavit dated 16 May 2001 by Mr A J Workman. We record that leave was refused, and the affidavit has not been received.

The companies’ submissions sought to procure much the same outcome by outlining evidence which it is said would be available on a further defended hearing. The further evidence rules are not to be outflanked in that way. Those informal indications are not taken into account.

Some background facts

The general background is not much in dispute.

The Workmans and three other groupings are shareholders in a group of companies which carries on business as developers. Mr A L Workman and three others were directors. Differences emerged. There was a parting of the ways put by the Master at around September 2000, between the Workmans and the three remaining groups. (There is a fifth group involved in the Heritage company, but its existence is not material). Mr Workman was removed as a director, and was excluded from the business. The Workmans' shareholdings remained unaffected.

The companies operate on a 31st March financial year. The shareholders have run accounts with the companies variously described as "shareholders current accounts" and "shareholders term fund accounts". Both descriptions appear within accounts produced. As is common, these reflected balances carried forward, credits (including dividends) and debits (drawings) during the year concerned, and a final adjusted balance for each shareholder in each financial year.

Accounts for the year to 31 March 1999 showed the Workmans having credit accounts of \$6,015 in United (1988), \$2,760 in Tuscany, and \$7,206.50 in Heritage.

Further "accounts" drawn as at 31 March 2000 came into circulation amongst directors and shareholders at some point prior to mid August 2000. These showed substantial dividends credited to shareholders' current accounts/shareholders' term funds accounts. With those dividends so credited, and after allowance for minor adjustments, those "accounts" to 31 March 2000 showed the Workmans as having credit accounts of \$6093.33 in United (1988), \$9821.43 in Tuscany, and \$154,957.25 in Heritage. We place the reference to "accounts" in parentheses as the status of those accounts is in question. There is no evidence those particular accounts were signed, adopted by directors or shareholders, or that the directors gave related s52 certificates of solvency.

In addition to those "accounts" certain so-called "shareholder dividend statements" were circulated amongst directors and shareholders. These were partly printed, and

partly hand-written by a director Mr Mathers. They noted “dividends” for the year ending 31 March 2000, stated to have been declared and paid on 30 March 2000, and proceeded to give gross dividends, imputations, and net dividends said to have been paid. These were the dividends reflected in the “accounts” to 31 March 2000 just referred to.

Following his exclusion from the business Mr A L Workman was in need of funds. Working on the basis that the “accounts” and “dividends” to 31 March 2000 shown in those documents were valid and effective, the Workmans served statutory demands dated 22 December 2000 for the 31 March 2000 balances shown as due.

The statutory demand against United Homes (1988) Limited was mistakenly addressed as to “United Homes (1998) Limited”, a company which does not exist. The amount claimed clearly cross-referenced to the shareholder’s current account in the “accounts” to 31 March 2000 for United Homes (1988) Limited. Some attempt was made both before the Master and in this Court to contend the demand was invalid on that account. There could not possibly have been any misunderstanding, and no more will be said on that point.

The companies filed applications to set aside the statutory demands on 11 January 2001. No question arises as to time limits. The Workmans filed Notices of Opposition. A hearing was arranged for 2 March 2001

On 1 March 2001 the remaining three directors of the companies, without reference to the Workmans are said to have approved or purportedly approved further accounts to 31 March 2000 which differed substantially from the “accounts” previously circulated upon which statutory demands had been based. Dividends reflected in the previous accounts were no longer shown. The substantial amounts concerned were treated as held back within retained earnings. The shareholders current accounts/shareholders term funds were shown as reduced to \$5144.40 in United (1988), \$2780 in Tuscany, and \$7206.50 in Heritage.

Evidence : Agreement not to withdraw funds

Affidavits were filed for the companies by a director Mr Grant.

Mr Grant deposed initially in the case of each company that “there was a clear express agreement between shareholders that shareholders would not be entitled to draw from these funds [‘shareholders term funds’] without the express agreement of all other shareholders”. No particulars were given of the date, personnel involved, or other circumstances of that asserted “clear express agreement”. No documentary substantiation was produced. Following denial by Mr A L Workman of the existence of “any such agreement” Mr Grant deposed “...there was clear agreement and understanding that one shareholder could not alone immediately draw out that shareholder’s term funds”. Mr Grant noted there were three “good commercial reasons” for that situation (i) shareholders wished to maintain parity in term funds (ii) shareholders appreciated the company relied on the funds for cashflow and solvency purposes (iii) consistency with a covenant in a loan agreement between Westpac and Paradise Shores Limited, a member of the group, not to withdraw shareholders’ funds without consent.

Mr Grant proceeded to state “there was never any question about any of these matters until the Workmans made their demands”.

As noted, the Workmans deny the existence of any agreement. Mr Workman alleges an understanding that the funds concerned were “on demand”.

Evidence : The 31 March 2000 accounts and dividends

Mr Grant deposed that shareholders do not have “current accounts” with the companies but have “shareholders term funds”. Mr Grant deposed initially (10 January 2001) that the last set of accounts approved by “shareholders” was to 31 March 1999, showing certain term funds in figures already noted. “Draft” financial statements for the year ending 31 March 2000 had been prepared but had not been approved by all “shareholders”. Present thinking was to not approve those accounts, but to retain earnings in the companies, without declaring dividends.

Mr A L Workman deposed in response that the 31 March 2000 accounts concerned were supplied in response to a request to the companies' accountants, and were supported by the dividend statements in the handwriting of Mr Mathers. Mr A. L Workman deposes he was requested to sign off those accounts in mid August 2000 as a shareholder, but did not do so, expressing the view such was a directors' function.

Mr Workman asserts an understanding that approval by shareholders is not required. He asserts the dividend shown in the accounts has been declared and paid; putting this as a representation in the accounts on which he relied. No details are given of the manner and extent of that reliance.

Mr Grant amplified by two further affidavits. The first (24 January 2001) stated the directors had not authorised a distribution; and had not signed a certificate of solvency under s52(2) in relation to those accounts. The documents on which the Workmans were relying were, Mr Grant deposed, no more than a "proposal" by two others (Mathers and Johnson) for payment of dividends, reflected in the "draft" accounts.

The second (1 March 2001) produced the different accounts to 31 March 2000 already noted.

There is also evidence from a forensic accountant Mr A N Frankham. It is a mixture of admissible expert evidence as to commercial and accountancy practice, and inadmissible assertions or conclusions as to matters of law. It suffices for present purposes to note the following *de bene esse*: (i) Dividends now are paid and declared by directors of the company and do not require shareholder approval, this being a position differing from that prevailing under the Companies Act 1955. (ii) A shareholder was entitled to rely upon the advice contained in the shareholder dividend statements and to seek recovery of the amount of the dividend paid to the credit of his current accountant. (iii) The declaration and payment of a dividend, and the approval of annual financial statements of a company, are separate and distinct issues: an earlier declaration and payment of a dividend cannot be affected by subsequent approval or otherwise of the financial statements. (iv) Correspondingly,

the fact a dividend may have been based on draft financial accounts not adopted by shareholders is not relevant.

The Master's decision

The Master approached decision on a criterion that the companies were required to show a “fairly arguable basis” on which they were not liable on the demands: *Forge Holding Limited v Kearney Finance (NZ) Limited* (unreported, HC Christchurch, 20 June 1995 M.No.149/95, Tipping J); *Queen City Residential Limited v Patterson Co-Partners Architects Limited (No. 2)* (1995) 7 NZCLC 260, 936. There has been no suggestion that was not an appropriate approach.

The Master turned somewhat briefly to the status of the shareholder's current accounts/shareholders term funds. The Master noted arguments that no dividend has been declared, and no final accounts drawn up, as contrasted with draft dividend payments and draft financial statements. Likewise, the fact of subsequent approval of accounts showing no dividends and reduced shareholders' term funds was noted. The forensic accountant's evidence that shareholders' advances comprising dividends are payable on demand in absence of specific restrictions, and that dividends do not require shareholder approval, likewise was noted. No specific analysis followed, but clearly by the end of the judgment the Master reached the view that the current accounts/shareholders' term funds (including dividends) as specified in the statutory demands were due and owing. The judgment speaks (paragraph 17) of the Workmans' “prima facie right to demand on reasonable notice the dividend held in the company in the shareholders' account”. The “accounts” and associated dividend statements on which the Workmans rely evidently were preferred to the subsequent 1 March 2001 accounts.

The Master analyses rather more fully the alleged agreement not to withdraw. The affidavit evidence is reviewed much along the lines we have already noted. The Master notes the absence of any resolution or written records, and considered there was no “definitive” evidence of any such agreement. Mr Grant's evidence was put as “at best” implying an “understanding” which was not legally enforceable.

There is an additional matter. The Master noted *Tracy Properties Limited v Helen Finley Tracy* (unreported, HC Auckland, 7 June 1988, CP933/88, Sinclair J) cited for the Workmans. The Master noted Sinclair J adopted as his test that an applicant must establish “a strong prima facie case of the existence of a genuine dispute on substantial grounds as to the existence of the debt”. The Master also noted Sinclair J’s view that the current account in that case “became payable upon demand provided reasonable notice was given”. It is possible, although far from clear, that the Master carried this exacting test over into determination of the present s290 application. If so, it put the matter rather too high against the companies, although in the end that did not matter. It also appears to be origin of the Master’s ultimate reference to the Workmans having a prima facie right to demand “on reasonable notice”. We do not find ourselves assisted by *Tracy Properties* which is on quite different facts.

The Master dismissed the applications to set aside the statutory demands, giving extended time for payment.

Decision : Agreement not to withdraw

We agree with the Master’s finding there was no fairly arguable basis supporting an agreement not to withdraw without consent.

The companies assert the existence of such a restraining agreement, and bear the burden of proving a fairly arguable case as to its existence.

The Court is not required in cases of this character meekly to accept without question whatever unvarnished statements may happen to be made on affidavit. The Court is entitled to act in a more robust and common-sense manner. The principles developed in cognate fields such as applications to remove caveats, and opposition to summary judgment (e.g. *Eng Mee Yong v Letchumanan* (1980) AC 331; *Bilbie Dymock Corporation v Patel* (1987) 1 PRNZ 84) apply by analogy.

Mr Grant’s simple assertion of a “clear express agreement” without substantiating background is bare to the point of being unconvincing. If an agreement is clear and

express, there should be no difficulty in identifying the date and place of its making, the persons involved in its making, and the manner of its statement and/or recording. No such details are given. If it is clear and express, corroboration might be expected from the other two shareholding interests involved. There is none. The only word is that of Mr Grant. In a matter of such importance, effectively amounting to a freeze upon the payment of indebtedness and enjoyment of profits, documentation would be expected. There is none produced.

The unease which all this causes is not improved by Mr Grant's subsequent redefinition of the initially asserted "clear express agreement" as a "clear agreement and understanding", dropping away reference to its "express" character and endeavouring to confer some wider "understanding" or hybrid character. It must be said that something the companies claim to be "clear" seems more than difficult for them to capture.

There is of course some force in the inferences invited from commercial factors such as the desirability of parity in shareholder advance levels, the need to retain funds for cashflow and solvency purposes, and to meet institutional requirements. However, even on the material before us, parity was not an invariable rule. The 1999 accounts, for example, showed one shareholder group (Potter) with term funds in debit \$27,043.50 while others were in credit \$7,206.50. Any retained cash is of course desirable for a cash-hungry development company, but need as opposed to desirability is not developed or detailed. There is only one institutional requirement put forward. It is in relation to a different member of the group, and was not a general requirement across the present companies.

On the other hand, contrary inferences are open as to commercial likelihoods. It does not seem particularly likely that a shareholder would bind itself on some open-ended basis to leave in all advances, including even allocated profits, unless all other shareholders agreed to drawings being made. Voluntary restraint is one thing. Acceptance of such a severe legal impediment is quite another.

It seems to us quite clear that any restraint upon withdrawing the current account/shareholders' term funds (and the item has both labels) developed as a

matter of understanding short of actual legal obligation. The question of legal obligation is not the subject of any identified clear agreement of a binding character. It is not the court's job to construct one from nothing.

Decision : Accounts and dividends

We are unable to agree with the Master's conclusions as to the 31 March 2000 accounts and the associated dividends.

The statutory demands assert company indebtedness, in the various figures claimed, on "shareholders' current account otherwise known as shareholders' term funds" as at 31 March 2000.

The sole evidence of indebtedness on current account in those figures is the "accounts" to 31 March 2000 drawn in those terms. The Workmans contend those accounts are backed by the "shareholders' dividend statements" which identify or purport to identify dividends declared and paid on 30 March 2000 in figures carried into those current account balances. The Workmans have no evidence as to the validity and effect of these "accounts" and dividend statements beyond their ex facie appearance. There is no evidence the accounts were approved, signed, or dated by directors or shareholders. The standard form for accounts envisages signature by directors of the annual report and signature by shareholders of a resolution of approval, whether the latter is required at law or not. The evidence is that Mr Workman himself actually declined to sign in August 2000. The associated dividend statements are in the handwriting of a director Mr Mathers, but are not signed by him or otherwise authenticated or dated. There is contrary evidence that the documentation on which Mr Workman relies was no more than a proposal by Messrs Mathers and Johnson for payment of dividends, that proposal being reflected in "draft" accounts. There is no declaration of solvency under s52(2) as is required and would be expected if the dividends integral to the current account totals actually had been declared. The subsequent adoption (it is said) of different 31 March 2000 accounts, not showing dividends and with correspondingly reduced current account credits, is at best weak evidence in itself, but it is consistent with previous accounts and dividends not having gone further than the "proposal" stage.

We do not find that Mr Frankham's general evidence much assists. Certainly, if a dividend in fact has been declared and paid then that must be reflected in subsequent financial statements, and is not open to readjustment. However, the situation in the present case presents as one in which it is not shown, in fact, that any such dividend was declared and paid. Mr Frankham's threshold is not reached.

It is at least fairly arguable on the material presented that the accounts (and behind that the dividends) on which the Workmans base the greater proportion of their various statutory demands did not come into effect. With that being so, it is at least fairly arguable that the Workmans are not owed the greater part of the current account indebtedness shown in those accounts.

There can be and is no dispute, on the other hand, that the Workmans were and are owed small residual balances carried through from the 1999 accounts into all versions of the 31 March 2000 accounts, in two cases, with slight adjustments i.e.

United Homes (1988).....	\$5,144.40
Tuscany.....	\$2,780.00
Heritage.....	\$7,206.50

Under s290(5) and (6) a statutory demand is not to be set aside by reason only of material misdescription of the debt unless the Court considers substantial injustice would be caused if it were not set aside. Obviously it would be a substantial injustice to allow the demands to stand so far as including dividend-based current account items over and above those residual balances. They are significant sums which could cause liquidity embarrassment. The courts have come to recognise that statutory demands can be allowed to stand in reduced figures representing items not open to dispute. Examples of such division and reduction can be found in *Arbridge Developments Limited v Webberley Developments* (unreported, HC Auckland, M285-IMOO, 2 May 2000, Master Kennedy-Grant; *City Jet Limited v Pratt & Whitney Canada A'Asia (Pty Ltd)* (1999) 8 NZCLC 262, 104 Master Faire; and *Jenko International Limited v NZ Dairy Ingredients Limited* (unreported, HC Christchurch, M68/00, 22 June 2000, Master Venning).

Applying those principles to the present case, the statutory demands should be set aside *except* in relation to those residual balances. There is no call to alter the 31 May 2001 deadline for payment given the small sums involved.

Costs

The appeal has succeeded in substantial part, but not entirely. The Appellants moreover have failed on one of the two crucial issues. Costs should be tempered accordingly.

Order

- (1) The appeal is allowed in part: the statutory demands are set aside except as to the following sums

United Homes (1988) Limited.....\$5,144.40

Tuscany Towers Limited.....\$2,780.00

Heritage Court Developments Ltd.....\$7,206.50

- (2) Appellants will have one sum of \$1,000 in costs against all Respondents together with disbursements and reasonable travelling and accommodation expenses of counsel as agreed or failing agreement as approved by the Registrar.

Solicitors:

Webb Ross Johnson, Whangarei, for Appellants
Thomson Wilson, Whangarei, for Respondents