CASE NOTES

Zurich Australian Insurance Ltd v Cognition Education Ltd

SAMUEL JENSEN*

I INTRODUCTION

Since the enactment of the Arbitration Act 1996, the extent to which parties with arbitration agreements have access to the courts has been uncertain. The Arbitration Act prohibits a court from intervening in an arbitration unless that intervention is allowed by the Act. One such provision for judicial intervention is where “there is not in fact any dispute between the parties.”

Zurich Australian Insurance Ltd v Cognition Education Ltd, a recent case of the Supreme Court, has clarified the meaning of this phrase by attributing the words with a narrow meaning, thereby limiting the scope of judicial interference in arbitration and solidifying New Zealand as a pro-arbitration jurisdiction.

II BACKGROUND

Facts

Cognition Education Ltd had several contracts with the Abu Dhabi Education Council for the provision of management services for public schools. Cognition obtained insurance cover from Zurich Australian Insurance Ltd to protect against frustration of the Council contracts. The insurance agreement contained a sweeping arbitration clause:

Any dispute, controversy or claim arising out of, relating to, or in connection with this Insurance Policy, shall be finally settled by arbitration.

The Council refused to make payments due under the agreement with Cognition. Cognition settled with the Council for less than its contractual entitlement and sought to recover the shortfall under its policy with Zurich.

* BAppSci (Otago), LLB(Hons) student at the University of Auckland.
1 Arbitration Act 1996, sch 1, art 5.
2 Article 8(1).
4 At [5].
Zurich refused the claim, prompting Cognition to seek summary judgment. Zurich objected to the High Court's jurisdiction based on the arbitration clause in the insurance agreement and sought a stay of proceedings under art 8(1) of the Arbitration Act 1996 in order to allow the dispute to proceed to arbitration.

The relevant part of art 8(1) reads as follows:

A court before which proceedings are brought in a matter which is the subject of an arbitration agreement shall ... stay those proceedings and refer the parties to arbitration unless it finds ... that there is not in fact any dispute between the parties with regard to the matters agreed to be referred.

It is important to note that the italicised words are known as the "added words". When drafting art 8(1) of the Arbitration Act, the Law Commission added them to the wording provided in the Model Law on Commercial Arbitration, which formed the basis of the Act.

The parties' arguments focused on the definition of "dispute". There were two possible formulations:

(a) that the defendant has a sufficient case to withstand a summary judgment application, that is, it has an arguable defence;

or alternatively,

(b) that it is not immediately demonstrable either that the defendant is not acting bona fide in asserting that there is a dispute or that there is, in reality, no dispute.

Cognition argued for the broad test. If summary judgment is sought and then opposed by a stay application, a single assessment of the merits would result in either summary judgment being entered or the proceedings being stayed and the dispute referred to arbitration. Zurich argued for the narrow test, which would restrict the jurisdiction of the courts and allow Zurich to more easily obtain a stay of proceedings. Under this test, the stay application would have to be assessed first. Only if it were declined would a court be able to assess the summary judgment application. The case therefore focused on which test and corresponding process was correct.

The Position Prior to the Arbitration Act 1996

Under s 5 of the Arbitration Act 1908 — which applied to domestic arbitrations — the relevant inquiry when assessing a stay application was whether the applicant had an arguable defence to the plaintiff's claim. The

5 (Emphasis added).
8 Zurich (SC), above n 3, at [10].
9 See Royal Oak Mall Ltd v Savory Holdings Ltd CA106/89, 2 November 1989 at 9.
position was different under s 4(1) of the Arbitration (Foreign Agreements and Awards) Act 1982, which applied to international arbitrations. The courts would only refuse to stay the proceedings when the defendant was acting in bad faith by requesting a stay, thereby abusing the court’s process. Neither statute contained the added words.

III PROCEDURAL HISTORY

High Court

At first instance, Associate Judge Bell defined the issue as a contest between pragmatism (the broad test) and principle (the narrow test). His Honour held that the broad test was the correct approach subject to three qualifications:

(a) A court will only grant summary judgment if it is satisfied that there would be no benefit in requiring the parties to take the matter to arbitration (drawing an analogy with the summary judgment inquiry of there being no purpose in proceeding to a full trial);

(b) A court retains discretion to refuse summary judgment even when there is a basis for it; and

(c) International arbitrations may be treated differently.

Associate Judge Bell favoured the broad test because his Honour thought that the Law Commission would not have inserted the added words to the Arbitration Act without reason. Therefore, it was likely that the added words were included to alter the Model Law by importing the summary judgment test. His Honour stated that the principled approach was a submission about what the law should be, rather than what the law is.

Associate Judge Bell concluded that pragmatism should prevail over principle. Few cases will be determined differently under each test and it is convenient to have the same inquiry for both types of application. Moreover, the objective broad test, relying upon the summary judgment test, is less susceptible to abuse by parties than the subjective narrow test.

10 See Baltimar Aps Ltd v Nalder & Biddle Ltd [1994] 3 NZLR 129 (CA) at 135.
11 Cognition Education Ltd v Zurich Australian Insurance Ltd t/a Zurich New Zealand [2012] NZHC 3257 at [46].
12 At [61].
13 At [54].
14 At [55]-[59].
15 At [60].
16 At [47].
17 At [50].
18 At [48]-[49].
19 At [49].
Zurich unsuccessfully appealed to the Court of Appeal. Like Associate Judge Bell, the Court of Appeal emphasised that “Parliament does nothing in vain”, reasoning that the added words must necessarily have some effect. If “dispute” were given a narrow meaning based on good faith, the added words would serve no purpose because, without a bona fide dispute, there would be nothing that could be referred to arbitration in the first place. The Court of Appeal reasoned that, for the added words to have any effect, “dispute” must have an expanded meaning requiring a court to determine if one exists objectively.

The Court of Appeal was also persuaded by the state of the law prior to the enactment of the Arbitration Act. Their Honours considered that the added words were included to preserve the position in Royal Oak Mall Ltd v Savory Holdings Ltd under the new regime. Moreover, majority opinion in the United Kingdom is that the added words import the broad test. This jurisprudence led the Court of Appeal to conclude that the inclusion of the added words was a deliberate policy decision by Parliament to adopt the broad test.

IV THE SUPREME COURT DECISION

Arnold J — writing for the unanimous Supreme Court — put forward three principal reasons for allowing Zurich’s appeal and favouring the narrow test.

The Supreme Court began by looking at the natural meaning of the added words. Their Honours were of the opinion that the phrase “is not in fact any dispute” favoured the narrow interpretation. If a defendant in a proceeding has no bona fide defence, then there is no dispute to be referred to arbitration. If there is a bona fide defence — even though it is unarguable and could ordinarily be disposed of summarily — there is still a dispute that can be referred to arbitration. The Court of Appeal used the same reasoning to support the broad test, opining that because the narrow test was implicit, the words were intended to go further than the narrow test. The Supreme Court, on the other hand, was of the opinion that the words did not add

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20 Zurich Australian Insurance Ltd v Cognition Education Ltd [2013] NZCA 180, [2013] 3 NZLR 219 at [77] (Zurich (CA)).
21 At [67].
22 At [67].
23 At [67].
24 At [68]–[69].
25 At [32]–[34] and [48]–[54].
26 At [71].
27 Zurich (SC), above n 3, at [36].
28 Zurich (CA), above n 20, at [67].
anything beyond making explicit what was already implicit (that there had to be a dispute).\(^{29}\)

The Supreme Court supported its interpretation by referring to New Zealand’s international obligations.\(^{30}\) Article 8(1) applies to domestic and international arbitrations.\(^{31}\) It follows that international obligations are evoked, including those under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which is worded in a way that can only support the narrow test.\(^{32}\) Interpreting provisions consistently with international obligations is an established canon of interpretation.\(^{33}\) The Supreme Court cited commentary on the Convention, which explained that adopting the Convention and including the added words does not change the Convention; rather, it merely makes explicit what was implicit.\(^{34}\)

The Supreme Court concluded its justification of the narrow test by referring to three purposes of the Arbitration Act that support the narrow test:

(a) Promoting consistency with international arbitral regimes based on the Model Law;\(^{35}\)
(b) Giving effect to New Zealand’s obligations under the Convention;\(^{36}\) and
(c) Recognising the importance of party autonomy and limiting the scope of judicial intervention in arbitration.\(^{37}\)

V COMMENT

One’s view as to whether the Supreme Court’s decision is correct will depend on which interpretive tools are highlighted. The Supreme Court emphasised international obligations, whereas the Court of Appeal emphasised the legal and legislative history of art 8(1).

In so doing, the Supreme Court refuted the lower courts’ analyses by referencing the Law Commission’s discussion that the added words only made explicit the requirement of a dispute.\(^{38}\) But this does not clarify what

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30 *Zurich (SC)*, above n 3, at [40].
31 Arbitration Act, ss 6–8.
32 Convention on the Recognition and Enforcement of Foreign Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 7 June 1959), art 2(3). This is the same wording as the Arbitration (Foreign Agreements and Awards) Act 1982 where the Court of Appeal favoured the narrow interpretation: see *Baltimar*, above n 10.
33 See generally *Ye v Minister of Immigration* [2009] NZSC 76, [2010] 1 NZLR 104 at [24]; *Sellers v Maritime Safety Inspector* [1999] 2 NZLR 44 (CA) at 57; *New Zealand Air Line Pilots’ Association Inc v Attorney-General* [1997] 3 NZLR 269 (CA) at 289; and *Tavita v Minister of Immigration* [1994] 2 NZLR 257 (CA) at 266.
34 Van den Berg, above n 29, at 147.
35 *Zurich (SC)*, above n 3, at [40]; and Arbitration Act, s 5(b).
36 *Zurich (SC)*, above n 3, at [40]; and Arbitration Act, s 5(f).
37 At [42].
38 At [47]–[48].
amounts to a “dispute”. It remains open whether dispute means a bona fide dispute (narrow test) or an arguable dispute (broad test). In that regard, the Law Commission stated that a court could refuse to stay an action if the case could properly be disposed of summarily, thereby supporting the broad test. Therefore, the Supreme Court’s analysis of the Law Commission report may not respond to the Court of Appeal’s analysis as emphatically as their Honours suggest and even appears to support the broad test.

Notwithstanding that, the Supreme Court cannot be criticised for taking its interpretive lead from international obligations in place of a more traditional purposive approach. Arbitration is, after all, very commonly used for international dispute resolution. Furthermore, the utility of summary judgment can easily be overstated thereby stretching the definition of “dispute” beyond Parliament’s intention.

Generally speaking, the characteristics of disputes that are subject to summary judgment are such that the result should not differ if the dispute was determined in arbitration. Therefore, the ability to save time and money by utilising the summary judgment procedure adds weight to the broad test favoured by the High Court and Court of Appeal. However, courts in New Zealand have the ability to determine complex questions of law and hear full arguments in summary judgment hearings. Determining whether there is no defence in those complex situations tempers the pecuniary and temporal advantages of summary judgment.

It can be difficult to differentiate situations where summary judgment is a less appropriate substitute for arbitration and situations where summary judgment may be preferable. Therefore, a decision had to be made as to whether both of these types of disputes should be amenable to summary judgment (the broad test) or whether they should be required to proceed to arbitration (the narrow test). Because the advantages of summary judgment are sometimes illusory, time and money might better be spent in the parties’ tribunal of choice, thus supporting the Supreme Court’s analysis.

The Supreme Court’s decision thus emphasises party autonomy and limits the power of the courts. Despite lacking substantive authority, initiating court proceedings will at the very least enable a court to compel the other party to arbitrate and in certain circumstances determine the dispute. For the most part, however, the law has been rendered certain — parties bound by an arbitration clause must determine all bona fide disputes at arbitration. This is a welcome outcome and a win for arbitration, irrespective of its correctness as a matter of statutory interpretation.
I INTRODUCTION

The Supreme Court’s decision in *Re Greenpeace of New Zealand Inc* concerns how “charitable purpose” is to be assessed under s 5 of the Charities Act 2005.1 More specifically, it addresses the extent to which an organisation’s “political purpose” can be a “charitable purpose” and whether an organisation that engages in illegal activities can also maintain a charitable purpose.

The appeal followed a lengthy legal battle between Greenpeace New Zealand and the Charities Services and Registration Board, who declined to register Greenpeace as a charity on the ground that two of its objectives were political, not charitable, in nature.2 The Supreme Court, by a three-two majority, delivered its judgment in favour of Greenpeace, holding that the political purpose exclusion should no longer be applied in New Zealand, changing the operation of s 5 of the Charities Act.3

The decision has left commentators divided. Some see it as a victory for organisations with political purposes,4 while others note that the decision has much wider legal,5 and fiscal, ramifications.6 Given the significant consequences for charities law in New Zealand, it is important to consider the implications of the decision.

II BACKGROUND

In New Zealand, organisations can apply to register under the Charities Act if they are “established and maintained exclusively for charitable purposes”.7 The primary advantage of being registered as a charity is the income tax exemption and relief that charitable status provides, as well as the ability of donors to claim tax credits when making donations to charities.8

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1 *Re Greenpeace of New Zealand Inc* [2014] NZSC 105, [2015] 1 NZLR 169 [*Greenpeace (SC)*].
2 *Re Greenpeace of New Zealand Inc* Charities Commission 2010–7, 15 April 2010 [*Greenpeace (Charities Commission)*].
3 *Greenpeace (SC)*, above n 1, at [3].
4 Hayes Knight “Greenpeace’s legal win — What it means for NZ Charities” (10 August 2014) <www.hayesknight.co.nz>.
7 Charities Act 2005, s 13.
8 *Greenpeace (SC)*, above n 1, at [1].
Charities Act defines "charitable purpose" in accordance with the Charitable Uses Act 1601 (Eng), and the common law's four "heads" of charity — "the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community". The fourth head, "any other matter beneficial to the community", is one that courts, understandably, find the most difficult to apply. With respect to a "non-charitable" purpose, the Charities Act does not prevent an organisation from qualifying for charitable status if a non-charitable purpose "is merely ancillary to a charitable purpose".

When the Charities Act came into force, it required all organisations formerly recognised as charities by Inland Revenue to have their charitable status assessed by the Charities Commission. Greenpeace's application was declined on the grounds that two of its objectives were political and not charitable in nature. The Court of Appeal confirmed the political purpose exclusion in New Zealand; that political purposes cannot be charitable unless they are ancillary to an organisation's primary purpose. Greenpeace appealed to the Supreme Court.

### III SUPREME COURT DECISION

Greenpeace appealed on two points of law. First, it argued that the law had developed so that a political purpose can sometimes be charitable and thus not excluded under s 5 of the Charities Act. This argument was based on the High Court of Australia's decision *Aid/Watch Inc v Commissioner of Taxation*, where the majority recognised that political advocacy can sometimes be charitable. Secondly, Greenpeace argued that an illegal purpose should not disqualify an organisation from maintaining a charitable purpose.

#### The Political Purpose Exclusion and Section 5

The majority (Elias CJ, McGrath and Glazebrook JJ) agreed with Greenpeace's first submission regarding the political purpose exclusion:

> [3] A "political purpose" exclusion should no longer be applied in New Zealand: political and charitable purposes are not mutually exclusive in all cases; a blanket exclusion is unnecessary and distracts from the underlying inquiry whether a purpose is of public benefit within the sense the law recognises as charitable.

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9 Charitable Uses Act 1601 (Eng) 43 Eliz I c 4, at Preamble.
10 Charities Act, s 5(1).
11 Section 5(3).
12 See *Greenpeace (Charities Commission)*, above n 2, at [6].
In coming to this conclusion, the majority placed great emphasis on the need for the law of charities to be flexible and responsive to change in social conditions, stating that a strict political purpose exclusion would hinder this. They also stated that the development of the doctrine is relatively recent, based on little authority, and subject to varied justifications. The majority reviewed the political purpose exclusion's adoption in case law, including the leading Court of Appeal case on non-charitable purposes, Molloy v Commissioner of Inland Revenue. The majority critiqued the application of Molloy in New Zealand, choosing to depart from its conclusion.

A more difficult issue for the majority was that s 5(3) of the Charities Act expressly adopted the common law and, more specifically, Molloy. The Select Committee that reviewed the Charities Bill identified “position of advocacy” to be a key area of concern with respect to the charitable purpose test. It thus recommended that the Charities Act should include a provision codifying the common law with respect to non-ancillary secondary purposes. Section 5(3) was the result of those discussions. It states: “[t]o avoid doubt”, if the purpose of an organisation includes “a non-charitable purpose (for example, advocacy) that is merely ancillary to a charitable purpose” of the organisation, then “the presence of that non-charitable purpose does not prevent [it] from qualifying for registration” as a charity. Section 5(4) expands on what is meant by “ancillary”.

In light of subss (3) and (4), the majority held that the Charities Act does not require an absolute political purpose exclusion. Further, s 5(3) provides an exemption for non-charitable political activities that are no more than ancillary. However, it does not exclude political purposes that are charitable in and of themselves. This is a notably different view from that adopted by the Court of Appeal in Greenpeace and Molloy, and the minority in the Supreme Court (William Young and Arnold JJ). In coming to this view, Elias CJ stated that a reference to common law is a reference to how it develops over time:

There is no inconsistency between s 5(3) and development of what is charitable . . . . It says nothing about the scope of the purposes the common law recognises from time to time as being charitable.

15 Greenpeace (SC), above n 1, at [60] and [71].
16 At [59].
17 See [32]-[47].
18 At [60].
19 Molloy v Commissioner of Inland Revenue [1981] 1 NZLR 688 (CA) at 695.
20 Greenpeace (SC), above n 1, at [39]-[47].
21 At [3].
22 At [48].
23 At [48].
24 (12 April 2003) 625 NZPD 19941 per Hon Judith Tizard.
25 Section 5(3).
26 Greenpeace (SC), above n 1, at [54].
27 At [57].
28 At [124]. The minority's view was that removing the political purpose exclusion in New Zealand was difficult to reconcile with the text of s 5(3).
29 At [56].
The majority stated that s 5(3) applies generally to all ancillary purposes, of which "advocacy" is one example. Therefore, they found that the Court of Appeal erred in its finding that s 5(3) is a general prohibition on advocacy unless merely ancillary to a primary charitable purpose.

The Majority’s Approach in Assessing Whether a Political Purpose is Charitable

Put simply, the majority’s view is that where an organisation’s purpose involves advocacy, it is to be treated as “one facet of whether [it is] a purpose [which] advances the public benefit in a way that is within the spirit and intendment of the statute of Elizabeth I”. In assessing this, the majority noted that, in most cases, advocacy will not be charitable due to the inherent difficulty in assessing whether certain ends promoted by an organisation would advance the public benefit. Another difficulty the majority noted was the potential inability to find analogous cases “built on the spirit of the preamble”. Nonetheless, the majority favoured this assessment over a blanket exclusion of political purposes because of its ability to “be responsive to the way society works”. Therefore, if a political purpose is found to advance the public benefit based on the above assessment, it is not excluded by s 5(3). Rather, it is a charitable purpose under s 5(1). Conversely, if it is found not to advance the public benefit, or it cannot be determined whether or not it will advance the public benefit, it will be excluded as a charitable purpose if it is not merely ancillary. If it does not advance the public benefit but is no more than ancillary to the organisation’s primary charitable purpose, it will be permitted under s 5(3) and will not prevent the organisation from maintaining a charitable purpose.

Are Greenpeace’s Political Purposes Charitable?

Greenpeace amended its purposes while the case was before the Court of Appeal. Its political purposes include the “promotion of conservation, peace, nuclear disarmament and the elimination of all weapons of mass destruction” and the:

... adoption of legislation, policies, rules, regulation and plans which further the objects of the Society ... and support their enforcement or implementation through political or judicial processes as necessary, where such promotion or support is ancillary to those objects.

30 At [57].
31 At [58].
32 LA Sheridan “Charitable Causes, Political Causes and Involvement” (1980) 2 The Philanthropist 5 at 16 as cited in Greenpeace (SC), above n 1, at [72].
33 At [73].
34 At [70].
35 At [77] (emphasis omitted).
The Court of Appeal found that the promotion of peace was for the public benefit under the fourth head, as it was uncontroversially within the spirit of the Preamble. However, the Court referred the case back to the Charities Registration Board to assess whether Greenpeace’s political advocacy objective was “truly ancillary to its principal objects” under s 5(3).

Both the majority and minority of the Supreme Court held that the Court of Appeal incorrectly assessed the charitable purpose of Greenpeace when it concluded that the purpose of promoting nuclear disarmament and the elimination of weapons of mass destruction was charitable.

The majority found this assessment was incorrect for a number of reasons. First, they stated that if a political advocacy objective is found to be charitable in its own right (as the Court of Appeal found), the need for that objective to be ancillary under s 5(3) is not required; “[t]he only issue could be whether the activities undertaken are sufficiently connected to the charitable object to be within it.”

Secondly, the majority found the Court of Appeal’s reliance on the lack of controversy regarding Greenpeace’s political purposes was “misplaced.” Finally, and in the author’s view most importantly, due to the jurisdictional function of the Court, it has no means of judging whether Greenpeace’s political purposes would advance the public benefit; this was largely a matter of opinion and not “self-evident” from Greenpeace’s political purposes. The majority gave guidance on this point. They stated that the important consideration is that where a charity promotes “an abstraction, such as ‘peace’ or ‘nuclear disarmament’”, the focus should be on how the abstraction is to be furthered — the manner of promotion, rather than the objects being promoted. This is because:

Even if an end in itself may be seen as of general public benefit (such as the promotion of peace) the means of promotion may entail a particular point of view which cannot be said to be of public benefit.

With respect to Greenpeace’s political purposes, therefore, all the judges agreed that Greenpeace’s application should be remitted back to the Charities Registration Board to be reheard in light of the Supreme Court’s reasoning.

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37 Greenpeace (CA), above n 13, at [81]–[82].
38 At [72].
39 At [87] and [91].
40 Greenpeace (SC), above n 1, at [3].
41 At [126].
42 Greenpeace (CA), above n 13, at [71].
43 Greenpeace (SC), above n 1, at [85].
44 At [99].
45 At [101].
46 At [102].
47 At [116].
48 At [104].
Illegal Activities

With respect to the second issue on appeal, both the majority and minority agreed with the Court of Appeal’s view — that an organisation that engages in or pursues illegal purposes or activities is not entitled to register as a charity. A charity that does so would not be able to maintain its charitable purpose and can be removed from the register for “serious wrongdoing”. The Supreme Court also agreed that the issue is a matter of “fact and degree”, which requires assessing the nature and seriousness of the illegal activity, attribution to the organisation, processes to prevent the illegal activity, its intention and frequency.

IV IMPLICATIONS OF THE DECISION

The majority’s decision has been both critiqued and commended. In the author’s view, the majority’s decision shifts the charitable purpose test to a more reasonable assessment, focused on public benefit, rather than the application of a rigid exclusion. Nevertheless, it is likely that the practical implications for charities following the abolition of the political purpose exclusion have been overstated.

Although the decision may give hope to organisations that have, based on their political purposes, unsuccessfully applied for charitable status in the past, it is unlikely that a reassessment of charitable purpose following this decision will change the result of a former application. The ruling must be read in light of the Supreme Court’s cautionary comments — it will be uncommon for political purposes to be self-evidently charitable. Organisations with political purposes are still faced with the difficulty of demonstrating that the manner in which they pursue their objectives advances the public benefit. This must be an assessment that a court can undertake: it must be “self-evident” and capable of demonstration by evidence. This is not an easy exercise, as indicated by the Charities Board’s latest guidelines on charitable purpose and political activity. In addition, the majority and minority applied different legal tests. This suggests that, although the legal test has changed, the new test will often lead to the same outcome.

Another point suggesting the scope of charitable purposes will remain largely untouched is that the Supreme Court appreciated the fiscal

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49 At [105].
50 At [105] and [107]; and Charities Act, s 32.
51 Greenpeace (CA), above n 13, at [97].
52 See Barker, above n 5; and Gousmett, above n 6.
53 See Hayes Knight, above n 4.
54 See Hayes Knight, above n 4; and Gousmett, above n 6.
55 Greenpeace (SC), above n 1, at [74], [101]–[102] and [114].
56 See [74].
58 See Greenpeace (SC), above n 1, at [126].
consequences associated with expanding charitable status.\textsuperscript{59} While some assert that the decision has the unintended consequence of allowing charities’ political activities to be subsidised by taxpayers (an issue requiring parliamentary redress),\textsuperscript{60} this may not be the case. The Supreme Court emphasised, on multiple occasions, that it would be unlikely for political purposes to also be charitable purposes.\textsuperscript{61}

This case has been labelled as a “landmark win”,\textsuperscript{62} which will “open the floodgates to charities undertaking political advocacy”,\textsuperscript{63} and has “made New Zealand democracy a little stronger”.\textsuperscript{64} However, a closer review of the majority’s decision suggests that its practical implications for charities and organisations with political purposes are far more modest.

\textsuperscript{59} At [30].
\textsuperscript{60} Gousmett, above n 6, at 337.
\textsuperscript{61} Greenpeace (SC), above n 1, at [74], [101]-[102] and [114].
\textsuperscript{62} Hayes Knight, above n 4.
\textsuperscript{63} Michael Gousmett, above n 6, at 331.
\textsuperscript{64} Nikki Papatsoumas “Greenpeace wins right to register as charity” The New Zealand Herald (online ed, New Zealand, 6 August 2014).
Case Notes

The Judicial Tightrope: Walking the Fine Line Between Commercial Certainty and Pari Passu

AIDAN LOMAS*

I INTRODUCTION

This case note considers Allied Concrete Ltd v Meltzer,1 and Timberworld Ltd v Levin.2 Both decisions deal with a narrow but important point of insolvency law.3 Allied Concrete concerns the defence in s 296(3) of the Companies Act 1993 (the Act), while Timberworld concerns the availability of the Australian “peak indebtedness” rule under s 292(4B). These decisions encourage certainty in insolvency law by providing clear guidance as to how those sections operate. However, some commentators will question the balance struck between the interests of creditors as a whole and individual creditors specifically. This case note begins by analysing Allied Concrete before turning to Timberworld. A discussion of the consequences for liquidators and creditors as a whole, and individual creditors follows.

II ALLIED CONCRETE

Background and Procedural History

The Supreme Court considered three appeals in a consolidated hearing, the facts of which can be summarised briefly. The appellants were trade creditors of the respondents. They had supplied various goods and services to the respondents on credit terms. In time, the respondent companies repaid the appellants for their goods and services. However, those payments were “insolvent transactions” pursuant to s 292 of the Act.4 Therefore, the respondent companies’ liquidators applied to void the transactions.5 If the liquidators were successful in voiding the transactions, the appellants would have been required to disgorge the value received from the insolvent transactions to the companies in liquidation. The appellants would then have had to wait in line — with all the other creditors — for some satisfaction of their debts through the liquidation process. Unsurprisingly, the appellants resisted the liquidators’ application.

* BA/LLB(Hons) student at the University of Auckland.

1 Allied Concrete Ltd v Meltzer [2015] NZSC 7.
2 Timberworld Ltd v Levin [2015] NZCA 111, [2015] 3 NZLR 365 [Timberworld (CA)].
3 Allied Concrete, above n 1, at [1]; and Timberworld (CA), above n 2, at [1].
4 Allied Concrete, above n 1, at [2]. This was not an issue before the Court.
5 At [10], [12] and [14].
The appellants sought to rely on the defence in s 296(3) of the Act. That provision provides:

A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or in equity, if the person from whom recovery is sought (A) proves that when A received the property—

(a) A acted in good faith; and
(b) a reasonable person in A's position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and
(c) A gave value for the property or altered A's position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

The Court of Appeal in Farrell v Fences & Kerbs Ltd held that s 296(3)(c) requires that "value" be new value that is "real and substantial" and given at the time of the insolvent transaction. As such, the "value" given by the appellants when the debt was created did not satisfy the requirements of the defence. Nor did the discharge of the debt because it was not "real and substantial". Farrell was followed in the High Court decision of Meltzer v Allied Concrete. The Supreme Court granted leave to appeal in both cases.

Issue

The issue before the Supreme Court was the meaning of the word "value" in s 296(3)(c). Specifically, whether "value" required "new value" given at, or after, the insolvent transaction occurred or whether the value that created the antecedent debt relationship was sufficient. The Supreme Court unanimously decided that the value given satisfied the requirements of s 296(3). McGrath, Glazebrook and Arnold JJ proceeded on the antecedent transaction hypothesis. However, Elias CJ and William Young J proceeded on the discharge hypothesis, holding that the discharge of the debt was sufficient value to satisfy the section. Importantly, the Supreme Court's decision overturned the previously accepted interpretation of s 296(3).

Reasoning

Arnold J, writing on behalf of the majority, began by noting the "stark" choice facing the Court. Upholding the Court of Appeal's interpretation of

6 Farrell v Fences & Kerbs Ltd [2013] NZCA 329 at [27]. See also Farrell v Fences & Kerbs Ltd [2013] NZCA 91, [2013] 3 NZLR 82 at [94]. The latter decision is an interim judgment issued by the same court.
7 Meltzer v Allied Concrete Ltd [2013] NZHC 977 at [29].
8 Allied Concrete Ltd v Meltzer [2013] NZSC 102.
9 Allied Concrete, above n 1, at [3] per McGrath, Glazebrook and Arnold JJ and [121] per Elias CJ.
10 At [177] per William Young J.
12 Allied Concrete, above n 1, at [55].
value would accord primacy to the interests of creditors as a whole “at the expense of fairness to individual creditors”.

But the broader interpretation of value would accord primacy to individual creditors at the expense of creditors as a whole.

With this background in mind, the majority looked at the Court of Appeal’s treatment of the provision’s language. The Supreme Court took issue with the Court of Appeal’s focus on the temporal linkage created by the word “when”. The Court of Appeal held that “when” indicated that the value given by the appellants must be temporally connected to the payment of the debt and, therefore, only new value met the provision’s requirements. The Supreme Court rejected this approach because “the word ‘when’ in s 296(3) does not have the significance that the Court of Appeal gave it”.

Rather, the use of the word “when” was to create a link between the requirements of paras (a), (b) and (c) and the discharge of the debt.

The majority also noted that the Court of Appeal’s approach inappropriately viewed the payment of the debt in a vacuum by ignoring the supply of goods or services that created the debt in the first place. Further disagreeing with the Court of Appeal, the Supreme Court held that the differences between the New Zealand and Australian statutes were insufficient to settle the correct interpretation.

The majority undertook an extensive historical evaluation of insolvency law beginning in the 19th century, while Elias CJ began with the judgments of Lord Mansfield in the 18th century. The majority found that there was a “long pedigree” of law recognising defences similar to s 296(3) and interpreting them to include value given when the debt was created.

Thus, Parliament would have to express a clear intention to override this longstanding interpretation; such an intention was absent from the enactment of the current s 296(3). Elias CJ’s historical sojourn led to a different conclusion. Her Honour’s view was that the discharge of the debt upon payment was itself sufficient value. Therefore, value was given by discharging the debt. William Young J joined Elias CJ in that view.

Although the Court was unanimous in its result, the judges differed in their reasoning.

The Supreme Court also undertook a close analysis of the legislative amendments to the Act. Both Elias CJ and the majority saw the Court of Appeal’s interpretation as too narrow when viewed in light of the “ordinary course of business” test’s replacement with the “continuing business relationship” test in the same tranche of amendments. Further, requiring new value (other than the discharge of a debt) would likely undermine other
parts of the defence because it may indicate some knowledge of financial
difficulty, consequently falling outside s 296(3)(b).23

Thus, the majority interpreted value as including the value given at
the creation of the antecedent debt, while the minority interpreted it as
including release from a debt. This difference in approach will be important
in future cases relying on s 296(3) as different factual circumstances may not
satisfy the majority’s approach.24

III TIMBERWORLD

Background and Procedural History

The Court of Appeal considered two consolidated appeals, the facts of which
can be summarised briefly. Northside Construction Ltd had a running
account with Timberworld Ltd and Tarsealing 2000 Ltd had a running
account with Z Energy Ltd.25 The liquidators, Henry Levin and Vivienne
Madsen-Ries, sought to void certain transactions because they were
“insolvent transactions” per s 292 of the Act.26 An insolvent transaction is
one entered into while a company is technically insolvent. Usually an
insolvent transaction results in a creditor receiving more than it would have
through liquidation.27 The additional value received by the creditor is called
the “preference”.28 Pursuant to s 292(1), a liquidator can void insolvent
transactions that occur in the “specified period” (two years prior to formal
insolvency).29

Section 292(4B) applied to the transactions because of the “running
account” between the parties. This section establishes a separate calculation
for whether a preference has occurred in relation to a continuing business
relationship, which includes a running account.30 Section 292(4B)(c)
provides that all transactions forming part of the relationship are to be
treated as a single transaction. Therefore, the liquidators must calculate the
preference as the net change in position between the parties.

The liquidators sought to maximise the preference calculation by
applying the Australian peak indebtedness rule. This rule operates to
artificially start the period of “all transactions” under s 292(4B)(c) at the
point when the debtor party is at its peak indebtedness.31 The effect of
starting the single transaction at this point is that it results in the largest
preference because, by definition, the net change in the debt will be a
reduction. The liquidators sought the maximum preference so as to have the

23 At [92] per McGrath, Glazebrook and Arnold JJ and [174] per Elias CJ.
24 At [179]-[182] per William Young J.
25 Timberworld (CA), above n 2, at [2].
26 See Companies Act 1993, s 292.
27 Section 292(2).
28 See Timberworld (CA), above n 2, at [65]-[66].
29 Section 292(5).
30 Section 292(4B)(a) and (c).
31 See Timberworld (CA), above n 2, at [35]-[36].
largest voidable transaction. This would result in maximum value being returned to the general pool of company assets. Unsurprisingly, Timberworld and Z Energy resisted the liquidators’ application of the peak indebtedness rule.

The High Court rejected the liquidators’ attempts to use the peak indebtedness rule. In Levin v Timberworld Ltd, Timberworld appealed on separate issues and the liquidators cross-appealed to apply the peak indebtedness rule. The liquidators also appealed Levin v Z Energy Ltd. The Court of Appeal heard these appeals together.

Issue

The main issue before the Court of Appeal concerned the permissible starting point of a single transaction under s 292(4B)(c) of the Act. The liquidators asserted that it was their prerogative to choose the starting point of the single transaction. The creditors opposed this, favouring an earlier date that would include transactions from them to the company. This inclusion would reduce the calculated preference and therefore the quantum of the voidable transaction.

The impact of the starting point can be demonstrated by considering the specific transactions in question. In Z Energy, there was a balance of $0 two years before formal insolvency. Upon formal insolvency, the balance had returned to $0. Therefore, treating all transactions that occurred as a single transaction meant there was no change and thus no preference. However, at the point of peak indebtedness, Tarsealing owed Z Energy $293,555.86. Accordingly, the liquidators sought to void $293,555.86. Less dramatic, but still illustrative, is the situation in Timberworld. Using the commencement of the specified period as the starting point for the single transaction, the preference was $29,490.46. But using the peak indebtedness rule, the quantum of the preference increased to $47,963.95.

Decision

The Court of Appeal was faced with competing High Court dicta: four cases rejected the peak indebtedness rule; one case applied it; and another endorsed it in obiter. Nevertheless, the Court of Appeal was unanimous in its decision.

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33 Timberworld (CA), above n 2, at [4].
34 At [3].
35 At [1].
36 At [2].
37 At [7]–[13].
38 Timberworld (HC), above n 32, at [52]; Z Energy, above n 32, at [17]; Shephard v Steel Building Products (Central) Ltd [2013] NZHC 189 at [35]–[36]; and Grant v Nauhria Precast Ltd [2014] NZHC 800 at [17].
39 Farrell v Max Birt Sawmills Ltd [2014] NZHC 3391 at [77].
40 Blanchett v McEntee Hire Holdings Ltd (2010) 10 NZCLC 264,763 (HC) at [69].
The liquidators’ argument relied heavily on Australian jurisprudence to support applying the rule in New Zealand.\(^{41}\) In Australia, the peak indebtedness rule began in *Rees v Bank of New South Wales*.\(^{42}\) However, the Court of Appeal noted that the rule’s development was stunted as it was applied without any “explanation or policy justification”\(^{43}\). The Court considered nine other Australian cases before concluding that it “located no Australian authorities offering a considered analysis of the rule.”\(^{44}\)

The Australian s 588FA of the Corporations Act 1992 (Cth) is materially similar to New Zealand’s s 292(4B). Neither section expressly includes the peak indebtedness rule, nor do their respective legislative materials even mention the rule. As a result, the Court rejected the liquidators’ argument that Parliament intended the peak indebtedness rule to apply simply because it adopted a similar provision to Australia.

The liquidators’ attempt to import the peak indebtedness rule ultimately failed when the Court of Appeal considered the High Court of Australia case *Airservices Australia v Ferrier*.\(^{45}\) The Court of Appeal found that Australian jurisprudence favouring the rule did “violence to [the] principle” laid down by the High Court of Australia and thus did not reflect the true position of Australian law.\(^{46}\) Having rejected the rule, their Honours turned to matters of practicality and policy.

The central policy justification for the peak indebtedness rule is the pari passu principle. The argument is that allowing trade creditors to retain a preference favours them at the expense of the creditors as a whole. The Court rejected this argument because, by definition, businesses in a continuing business relationship return value received with supplies. These supplies are then available to the creditors as a whole upon liquidation. Any value received above the value of supplies will be returned as a voidable preference without the peak indebtedness rule applying. Further, the Court recognised that in enacting s 292(4B), Parliament chose a policy balance that favours commercial certainty and ongoing trade at the expense of the pari passu principle. Ultimately, the Court was persuaded that if Parliament wanted peak indebtedness, it would have provided for it. Therefore, as Parliament had not provided for the rule, and no compelling reasons had been adduced to include it, the Court rejected it.

\(^{41}\) *Timberworld (CA)*, above n 2, at [39].

\(^{42}\) *Rees v Bank of New South Wales* (1964) 111 CLR 210.

\(^{43}\) *Timberworld (CA)*, above n 2, at [37].

\(^{44}\) At [41].

\(^{45}\) *Airservices Australia v Ferrier* (1996) 185 CLR 483; and see *Timberworld (CA)*, above n 2, at [75]–[84].

\(^{46}\) *Timberworld (CA)*, above n 2, at [81].
IV CONSEQUENCES FOR LIQUIDATORS, CREDITORS AS A WHOLE AND INDIVIDUAL CREDITORS

Liquidators

These decisions provide certainty, which in turn provides useful guidance for liquidators. While liquidators would have preferred *Allied Concrete* to be decided the opposite way, they can still resist s 296(3) defences by focusing on the other elements. Indeed, the Supreme Court made heartening comments regarding the difficulty of meeting the defence.\(^47\) This, however, means that litigation will now focus on the issue of knowledge, which will require greater use of discovery and cross-examination. This in turn may make voidable transactions litigation more costly and time consuming. *Timberworld* again was determined against the liquidators' submissions. Nevertheless, the Court of Appeal clarified the starting point for a single transaction in a continuing business relationship. Liquidators will continue to seek the maximum recovery for the company in liquidation, now with the benefit of clear rulings on two important issues of insolvency law.

Creditors as a Whole

The effect of these decisions is that liquidators will be able to return less money to the general pool of assets. Thus, creditors as a whole will have less money available to be distributed to them. Yet, as the Court in *Timberworld* noted, rejecting the peak indebtedness rule does not have a negative impact on creditors as a whole.\(^48\) Any net preference during the specified period and technical insolvency will still be voidable. All other transactions between the company and the creditor will balance out because the company has received value, which is available to the liquidator and then creditors as a whole.

Individual Creditors

Individual creditors now find themselves in a better position. *Allied Concrete* adopted a broader interpretation of "gave value" under the s 296(3) defence.\(^49\) This means an individual creditor is more likely to satisfy the defence. However, the test has two other limbs that the Supreme Court referred to as "significant requirements, not easily met".\(^50\)

*Timberworld* rejected an interpretation of s 292(4B) that would import the peak indebtedness rule. This means that any preference gained by an individual creditor will be less than if the rule had applied unless, of course, the point of peak indebtedness occurred at the beginning of the

\(^{47}\) *Allied Concrete*, above n 1, at [105].
\(^{48}\) *Timberworld* (CA), above n 2, at [94].
\(^{49}\) *Allied Concrete*, above n 1, at [106].
\(^{50}\) At [105].
specified period. Therefore, the balance has moved in the favour of individual creditors.

V CONCLUSION

Insolvency is a zero-sum game. By definition, there will be less value realised through liquidation than there are debts. As such, insolvency cases have winners and losers. These two cases were "won" by individual creditors and "lost" by liquidators and creditors as a whole. These outcomes are not devastating, however. Rather, the balance between individual creditors and creditors as a whole has been readjusted. The Supreme Court decision in Allied Concrete overturned the orthodox understanding of "gave value" and the Court of Appeal decision in Timberworld resolved an issue that had contradictory High Court dicta. While these cases provide some certainty in insolvency law, the courts must continue to clarify other, less certain areas of the field.