CONSTRUCTION'S INSOLVENCY PREDICAMENT: *COOPER*, *MAINZEAL* AND RECKLESS TRADING

By Sean Gamble

Introduction

The construction industry has become increasingly vulnerable to insolvency events in recent times. On appointments, liquidators frequently investigate the conduct of the directors leading up to the company's insolvency. In particular, a focus has been investigating whether directors allowed the company to engage in reckless trading. Over the past two decades the Courts have developed a broadly accepted approach to interpreting the reckless trading provision, section 135 of the Companies Act 1993 (the **Act**). This approach has granted directors a significant degree of discretion as to what degree of risk they are justified in exposing their companies to, as well establishing an accepted level of risk to protect creditors. The current COVID-19 crisis will undoubtedly challenge the construction industry and is likely to precipitate events which heighten the risk of insolvency.

The high-profile decision in *Mainzeal Property and Construction Ltd v Yan & Ors* (***Mainzeal***) has disrupted the traditional interpretive approach and incorporated novel considerations into reckless trading analysis.[1] Although the decision in *Mainzeal* may be viewed as a product of its exceptional facts, this essay argues that the High Court's approach to assessing liability and quantum of loss is open to critique, adding a degree of unnecessary complexity to the reckless trading assessment.

In order to assess the *Mainzeal* decision, and potential drawbacks with its approach, this essay will compare it with the Court of Appeal decision in *Cooper v Debut Homes Ltd* (***Cooper***).[2] This judgment, released two weeks prior to *Mainzeal* captures and expands on the orthodox interpretation of reckless trading. *Cooper* underscores that s 135 should be interpreted in light of its purpose - namely that directors should be afforded a reasonable level of trust when assessing business risk. Both decisions are under appeal, allowing this essay to evaluate the contrasting decisions.

Construction sector and insolvency

The construction sector is a substantial player in the New Zealand economy. The sector is the fourth largest employer in New Zealand, employing approximately 250,000 workers.[3] The industry also comprises 6.1% of New Zealand's GDP and contributed NZD15 billion to the economy in 2017.[4] These impressive figures have continued to expand since the significant rebuild of Christchurch following the 2010 and 2011 earthquakes.[5] Statistics New Zealand has outlined that growth has continued to increase steadily at approximately 4.5% annual growth for enterprises, meaning that over the past decade the construction industry has grown to the largest size in its history.[6]

Despite the growth of the construction sector, its expansion has not been without complications – recently described as a "profitless boom" which has not promoted strength and stability.[7] The BDO 2019 Construction Industry Annual Report

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1 *Mainzeal Property and Construction Ltd (in liq) v Yan* [2019] NZHC 255.
2 *Cooper v Debut Homes Limited (in liq)* [2019] NZCA 39.
3 *Future Demand for Construction Workers – Projections from the National Construction Occupations Model* (Ministry of Business, Innovation and Employment, July 2017) at 3.2.
4 Nikki Mandow "Seeking solutions for construction's 'profitless boom'" Newsroom (Online ed, New Zealand, 7 November 2019).
5 Mandow, "Seeking solutions for construction's 'profitless boom'".
6 "Construction industry at the top of the ladder for business counts growth" (25 October 2019) Statistics New Zealand https://www.stats.govt.nz/news/construction-industry-at-the-top-of-the-ladder-for-business-counts-growth.
7 Mandow, "Seeking solutions for construction's 'profitless boom'".

Hesketh Henry

explains that low profit margins remain a perennial issue for the industry.[8] Some have attributed the continuing trend of insolvencies in the construction sector to poor cash flow, and onerous and unbalanced risk allocation provisions in construction contracts.[9]

The Government has acknowledged insolvency risk in the industry in several recent announcements. Building and Construction Minister Hon Jenny Salesa introduced Crown Contracting Guidelines for public sector construction projects over $9 million. One stated goal of the Guidelines has been to reduce construction firms' volatility by increasing transparency in respect of pricing, risk and liabilities for those risks.[10] The Construction Sector Transformation Plan addresses several areas of concern within the construction sector and specifically identifies companies operating on low profit margins as a risk to industry stability.[11]

In addition to the challenges already identified by the Government, COVID-19 presents further significant challenges to an already fragile industry. Widespread disruption has already affected the economy and is expected to continue. In efforts to counter the anticipated economic downturn, the Government has signaled further plans for construction and infrastructure to feature as a key component of the post-lockdown recovery.[12] Although the Government's commitment provides some certainty, it is also likely that the disruptions will result in increased insolvencies in the construction sector. In this context, it will become all the more important for directors to understand their duties under the Act.

Traditional Expectations of Directors

Directors of companies are bound by the duties found in the Act, some of which are also found at common law.[13] The Act focuses on four key director's duties. Put briefly, these are duties to:

- act in good faith and in the best interests of the company (or parent company);[14]
- exercise the director's powers for their proper purpose;[15]
- not trade recklessly;[16] and
- not incur obligations for the company without reasonable belief that they can be met.[17]

Reckless trading – Section 135

The current reckless trading provision at s 135 is the product of several significant reforms to corporate governance legislation. Its 1955 predecessor created liability for directors of companies which were liquidated due to fraudulent practices.[18] In 1980, a new Companies Act was enacted which expanded that liability to include those directors who were "knowingly a party to the carrying on of any business of the company in a reckless manner."[19]

The wording of the current Act now encompasses a broader definition of reckless trading:[20]

> *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 to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.*

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8 "Challenges for the construction industry – BDO Construction Survey 2019" BDO New Zealand (Online ed, 10 October 2019).

9 Henry Oliver "How is a major contractor going bust in the middle of NZ's building boom? The Spinoff (Online ed, New Zealand, 1 August 2018).

10 New Zealand Government "New rules to help construction companies" (Press release, 29 September 2019).

11 New Zealand Government "Government and construction industry to build big, lift productivity with Transformation Plan" (Press release, 26 January 2020).

12 New Zealand Government "Government seeks infrastructure projects" (Press release, 1 April 2020).

13 *Sojourner v Robb* [2006] 3 NZLR 808 (HC) at [100].

14 Companies Act 1993, s 131.

15 Companies Act 1993, s 133.

16 Companies Act 1993, s 135.

17 Companies Act 1993, s 136.

18 Michael Harris *Laws of New Zealand* Director's Duties (online ed) at [194].

19 Companies Amendment Act 1980, s 32.

20 Companies Act 1993, s 135.

It is important to note that this duty is owed to the company, not to its shareholders or creditors.[21] Paragraphs (a) and (b) of s 135 capture all behavior of directors, regardless of directness.[22] This wording is broad enough to capture those directors who claim they had no intention to engage in reckless trading.

The orthodox approach to the interpretation of s 135 is based on the decision in *Mason v Lewis* which has summarised the aspects of the duty as the following:[23]

(a) the duty is owed by directors to the company;

(b) whether a director has engaged in reckless trading is an objective test;

(c) the focus is not on the director's belief, but on the manner in which a company is carried on, and whether this manner creates a substantial risk of serious loss; and

(d) when a company enters financial strife there must be an ongoing sober assessment by the directors into the company's likely future income and prospects.

Section 135 is not directed at analysing a company's business, but the manner in which the directors conduct the company.[24] In other words, the reckless trading provision focuses on how a business is conducted, regardless of the risk profile of that business. The wording of the section requires directors to assess whether the company's position is likely to create a substantial risk of serious loss to creditors. This question can be set out in three parts:[25]

(a) *The company's manner of trading must be likely to give rise to risk*. Analysis here focuses on the likelihood that the actions or inactions of directors will create a risk of serious loss.

(b) *That risk must be substantial.* Although there is debate as to what amounts to substantial, it is not a risk that a director would be expected to ignore.[26]

(c) *That risk must be of serious loss to creditors*. The loss to creditors must be of a sufficiently serious nature.

Section 135 does not make directors automatically liable if their company nears or enters insolvency, and neither does loss alone.[27] However, Courts have been quick to note that companies which are at this point increase the risk of directors breaching s 135.[28] There are some rare examples where directors have permitted trading to either avoid or substantially limit loss to creditors. In *Fatupaito v Bates* the Court held that directors may be permitted to continue trading in order to collect pre-existing debts or to generate significant income from already existing projects.[29]

In spite of the strict wording, directors are not required to act with total risk aversion. Section 135 creates an objective standard of assessing the likelihood of business risk. Recognising that risk is inherent in business, Courts have traditionally endorsed a deferential approach, allowing directors a degree of risk taking in the regular course of business.[30] *Re South Pacific Shipping Limited (in liq)* endorses an approach that considers whether a business has engaged in legitimate or illegitimate risk taking.[31] This position has become the orthodox analysis and is in accordance with the stated purposes of the Act, namely:[32]

> *"(d) to encourage efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgment while at the same time providing protection for shareholders and creditors against the abuse of management power…"*

Directors found to be in breach of s 135 may face personal liability under s 301 of the Act. Under s 301, the Court may order a director to repay or restore the money or property, or contribute an amount to the assets of the company by way of compensation, "as the Court thinks just".[33]

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21 Companies Act 1993, s 169(3).
22 *Cooper v Debut Homes Limited*, above n 2, at [29].
23 *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [51].
24 *Grant v Johnston* [2016] NZCA 157 at [36].
25 Alan McRae "Reckless Trading" (2019) NZLJ 349.
26 *Grant v Johnston* [2016] NZCA 157 at [37].
27 Alan McRae "Reckless Trading" (2019) NZLJ 349.
28 McRae, "Reckless Trading" (2019) NZLJ 349.
29 *Fatupaito v Bates* [2001] 3 NZLR 386 (HC) at [77].
30 *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 (HC).
31 *Re South Pacific Shipping Ltd.*
32 Companies Act 1993, long title.
33 Companies Act 1993, s 301.

Cooper v Debut Homes Ltd

The decision in *Cooper* endorses the orthodox approach to s 135, and adds to the matters the Court should have regard to when undertaking the business risk assessment.

Background

Debut Homes Ltd (**Debut**), a property development company, found itself in financial difficulties by the end of October 2012. At this time Mr Cooper, the sole director of Debut and full time employee, was left with four incomplete properties.

Debut was in debt to several secured creditors and had also incurred liabilities to the IRD. On advice from his accountant and in spite of his financial predicament, Mr Cooper decided to complete the unfinished properties with the goal of selling the completed homes to create a surplus to (at least partially) satisfy some of Debut's debts. After completing the homes Debut paid the net profit of the sales to several secured creditors. No GST was paid on the sale of the properties. Outstanding debts to several secured creditors and unsecured creditors remained, as did obligations to the IRD.

On application by the IRD, Debut was placed into liquidation. The proceedings brought by the liquidators claimed that Mr Cooper was in breach of several of his duties as a director – specifically that by continuing to trade and completing the homes he had breached s 135.

High Court decision

The High Court agreed with the liquidators and found that Mr Cooper had breached his duties as a director. Specifically, Mr Cooper agreed to take on GST obligations when he entered into agreements to sell the completed properties. In early November 2012 Mr Cooper met his accountant where Mr Cooper decided that trading of Debut would be limited to completion of the outstanding properties (to be sold as soon as completed). The Court found from this point Mr Cooper could not have reasonably believed that when it came to finalising the sale and purchase agreements for the properties, the company would be able to meet its GST obligations.

Mr Cooper was also found to be in breach of s 135 through prioritising his own interests above other creditors. Mr and Mrs Copper, through a trust, agreed to lend funds to Debut as working capital. They were the only trustees and the loan was secured by a general security agreement. The Coopers used surplus proceeds from the sale of the properties to repay some of the company's debt to the trust, among other secured creditors. The Court viewed the repayments to the trust and other secured creditors as neglecting the company's obligations to the IRD. Mr Cooper collected the GST on the sale of the properties but this was not paid to the secured creditors. Overall, the Court found that Mr Cooper had not adequately considered all obligations Debut owed to creditors and instead prioritised his own interests as trustee of the trust.

The loan to Debut by the Cooper's trust was not fully repaid and Mr Cooper worked for a year and a half without pay. The Court recognised these contributions, but found that Mr Cooper had favoured secured creditors (including his trust), and was under the mistaken belief that by completing the construction and sale of the properties, Debut was improving the position of unsecured creditors like the IRD. The Court held that the unsecured creditors were worse off as a result of Mr Cooper's decision to complete the outstanding properties.[34] Mr Cooper was required to pay $280,000 to the liquidators under s 301 of the Act.[35]

Court of Appeal decision

The Court of Appeal overturned the High Court judgment, highlighting the traditional view that discretion should be afforded to directors in exercising their judgment.

The Court considered the IRD did not become a creditor until the GST on the property sales became payable. Pursuant to the Goods and Services Tax Act 1985, the GST liabilities were not payable until the supply of the houses.[36] Further, Debut had potentially incurred GST liability from when the property was purchased for development, although the amount of that liability would not be realised until supply.

The Court found that if Mr Cooper had decided to not complete the homes and sell them in November 2012, the IRD would not have been paid. The Court did not agree with the liquidators' position that, if the homes had been sold at that point, that the GST liability would have been an issue for the mortgagee. Instead, it was not clear what position the IRD would have been left in. Overall, the Court of Appeal held that it was not possible (in a net cash sense) to determine whether the IRD was in a worse position because of the actions Mr Cooper took to complete the homes.

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[34] *Cooper v Debut Homes Limited,* above n 2, at [14].
[35] At [19].
[36] Goods and Services Tax Act 1985, s 8.

Breach of duties

The Court was required to assess Mr Cooper's decision to continue trading, despite Debut's financial situation. In assessing whether the decision to continue trading was a legitimate or illegitimate risk, the Court expanded on this assessment stating that in addition to considering the downside to any business decision, directors (and therefore Courts) are also required to consider the potential upside to continued trading.[37] In undertaking its assessment, the Court of Appeal considered the following:

(a) It was not disputed by the liquidators that Mr Cooper completed the homes in good faith and aimed to ensure the homes would achieve a higher value on sale creating a surplus which could be used to provide some relief to secured creditors;[38]

(b) Mr Cooper sincerely believed that the GST liability to the IRD could be resolved in the long term;[39]

(c) Whether as the liquidator proposed, Mr Cooper could have resigned as director in November 2012 or asked a creditor to apply for Debut to go into liquidation. The Court determined that as the sole director, Mr Cooper could not resign;[40]

(d) The professional advice defence would not have been available to Mr Cooper because the advice he sought to rely on did not fall within the statutory definition of professional advice;[41]

(e) The action to progress the properties was not creating a new debt and increasing the liability to the IRD was not in bad faith;[42]

(f) Mr Cooper's inability to complete the homes was unforeseen and resulted in unexpected costs, which in the Court's opinion did not amount to bad faith;[43] and

(g) Departing from the High Court, the Court of Appeal considered the use of the Cooper's trust funds and Mr Cooper's 18 months of unpaid work were evidence of good faith.[44]

Considering the above factors together, the Court determined that Mr Cooper decision to complete the homes was not in bad faith, was ultimately based on an intention to improve the position of creditors and in the circumstances, was a reasonable commercial decision.

Mr Cooper was not found to have breached his duties; however the Supreme Court has granted the liquidators' application to appeal the Court of Appeal decision.[45]

Mainzeal Property and Construction Ltd v Yan & Ors

The High Court decision in *Mainzeal,* released two weeks before *Cooper*, held that the high profile directors had breached their duties and in doing so, adopted a novel approach in finding liability and quantifying loss flowing from that liability.

Background

For a time Mainzeal was New Zealand's third largest construction company - responsible for construction of Spark Arena and the Supreme Court complex. Established in 1968, the company traded (publicly for much of its existence) until it was placed into liquidation in 2013. By the time of its collapse, Mainzeal was embedded in a labyrinth of interrelated entities. In 2004 Mainzeal was wholly owned by Richina Pacific Ltd (**Richina**), its parent company. The majority shares in Richina were held by an investment consortium (the **wider group**) which were pursuing investments in China. At this time Mainzeal created an independent board comprising Clive Tilby and Richard Yan, with Dame Jenny Shipley as Chair. Sir Paul Collins joined the board in the years following. Mr Yan also represented the wider group

Richina had overall control as the majority shareholder in Mainzeal, and was predominantly utilised this to procure loans from Mainzeal to Richina for the wider group's investments. From 2005 onwards, Mainzeal provided over $40 million in loans for these investments. The funds provided for acquiring the Chinese assets appeared in Mainzeal's accounts as assets. As a result, from the time Mainzeal began providing these loans, if the debt could not be recovered, the company's liabilities would exceed its assets. Mr Yan represented to Mainzeal that support and repayment of the loans was possible,

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37 *Cooper v Debut Homes Limited*, above n 2, at [33].
38 At [47].
39 At [61].
40 *Cooper v Debut Homes Limited*, above n 2, at [58].
41 At [77].
42 At [45].
43 At [53].
44 At [53].
45 *Debut Homes Limited (in liq) v Cooper* [2019] NZSC.

contingent on Mainzeal's continuing support of the wider group. These promises, as well as the documents recording the details of the loans were not recorded as legal documents.

Throughout 2008 and 2009 the New Zealand operation (Mainzeal) was further segregated from the wider group which operated in China (the **Restructuring Dates**). From 2012, Mainzeal's financial situation began to deteriorate. Mainzeal had critical cash-flow issues which escalated with a complex Siemens construction project which resulted in a series of unfavourable adjudication proceedings brought against the company.

Despite earlier verbal assurances of support, Mr Yan later confirmed that there was no ability for support from the wider group to assist Mainzeal and that the prior loan commitments could not be relied upon. In early 2013 Mainzeal was placed into liquidation. The liquidators commenced proceedings against Mainzeal's directors claiming they had engaged in reckless trading by allowing the company to trade while balance sheet insolvent and that the directors ought not to have relied on the informal assurances of support from the wider group.

Liability under s 135

In its assessment of s 135, the High Court first found that for a liability to arise, the "manner of trading must give rise to a substantial risk of company failure causing a deficiency in liquidation resulting in a serious loss to creditors."[46] The Court considered the reckless trading provision establishes a reasonably high threshold to be established for liability to be found, being "more than negligence".[47]

Cooke J endorsed the distinction between legitimate and illegitimate risk, noting that s 135 is not intended to apply to regular business risk. Cooke J reasoned that s 135 should not be interpreted in such a way so as to create liability for legitimate risk based on the concept of limited liability in company law and the protection limited liability affords to companies as risk taking entities.[48] Accordingly, the "substantial risk of serious loss" in the provision entails risks that are abnormal or unreasonable risks.[49]

The Court also noted that when a company is technically insolvent (and perhaps even before that point), directors must be conscious that it is not only shareholders' capital that is being risked, but also creditors'.[50] At this point of technical insolvency directors must be aware that trading may result in substantial risk of serious loss to creditors – i.e. reckless trading.

The Court found that Mainzeal was balance sheet insolvent from as early as 2005, as the debt owed to Mainzeal from the wider group loans was not recoverable in reality. The loans were not recoverable for two practical reasons. Firstly, the entities in the wider group were not in a financial position to repay the loans. Secondly, the loans were not recorded in legally binding documents, reducing the ability of Mainzeal to compel repayment.

The reliance on the wider group assurances proved to be a major mistake for Mainzeal's directors. Cooke J considered these assurances as foundational to determining whether the directors had engaged in reckless trading. The directors had placed their faith in the wider group assurances as a safeguard to the company's future trading. Further constraints on retrieving the loans included Mainzeal's separation from the rest of the broader group and strict Chinese regulations regarding extraction of funds from China. The Court found that the directors could not reasonably rely on these assurances to ensure that the company could survive if financial circumstances became difficult.

By relying on generic assurances from the wider group, the Court found that Mainzeal's directors had adopted a policy of trading while the company was balance sheet insolvent. It was argued on behalf of the directors, at all material times Mainzeal was solvent in a liquidity sense. The Court was not swayed on this point and highlighted that liquidity is not determinative and that balance sheet insolvency is key in an assessment of reckless trading as balance sheet insolvency is highly relevant to the effect on creditors. Further, the directors argued that assurances of support from the wider group were of a nature that could be relied on – several of the assurances in the later period taking the form as a contractor's bond to assist Mainzeal in securing construction tenders. Again the directors were not entitled to rely on these vague assurances, particularly given the tight Chinese restrictions on recovering funds out of China.

From about 2010 Mainzeal's trading had been poor. It was susceptible to large one-off loses, and its trading performance was unpredictable. At this point Mainzeal was entangled in the leaky-building saga and continuing issues with its Siemens contract. The Court noted that a company with a strong capital base, or financial backing to match, may be able to weather such conditions. However, the directors were not entitled to rely on the wider group assurances and did not have a capital base to offset their losses. It was argued the directors were entitled to rely on their auditors who had signed off on

46 *Mainzeal v Yan*, above n 1, at [162].
47 At [168].
48 At [165].
49 At [165].
50 At [166].

Mainzeal's accounts and were particularly aware of the loans made to the wider group. Despite sign off from auditors, the Court found that the directors are responsible for the solvency of the company, not auditors.

The Court's approach to determining liability under s 135 was novel as it ultimately found the directors liable for allowing the company to trade "in a vulnerable state" over several years, rather than the traditional approach of identifying the breach of s 135 and identifying the losses arising from that breach.[51] The Court provided guidance on what the directors could have done to avoid this vulnerable trading position. Again, this was particularly focused on retrieving loans from the wider group. Despite the practical difficulties associated with recovering funds from China, Cooke J stated that the directors should have focused on retrieving these loans through formalising the loans in a legally binding loan documents, requesting evidence on the difficulties of receiving funds from China, pressuring the wider group for a change to arrangements that required Mainzeal to fund the wider groups investment activity, and threatening to resign in response to reluctance from Mr Yan.[52]

Quantifying loss to creditors

In cases of reckless trading, the Courts have traditionally assessed liability as accruing from a nominal date where the company should have been put into liquidation (the **counterfactual date**). From this counterfactual date the losses to creditors are assessed. Here, the Court determined that the counterfactual date method was not appropriate as ceasing to trade entirely was not a commercially sensible option available to the directors. Liquidating Mainzeal would have created significant losses to creditors – Mainzeal also had the Siemens contract underway which was providing some income. In defending their decision to continue trading, the directors argued that by continuing to trade they had saved creditors several million dollars in losses.[53]

Instead the Court held that the full amount owed to unsecured creditors ($110 million) was attributable to the directors on account of permitting Mainzeal to trade in a vulnerable state. Cooke J reduced this liability to $36 million for discretionary factors relating to causation, culpability and duration of trade.[54] The Court found that despite the fact that Dame Jenny Shipley, Mr Gomm and Mr Tilby acted honestly and in good faith they were still liable for reckless trading. Mr Yan was held liable for the full $36 million, with Dame Jenny and Mr Tilby and Mr Gomm responsible for $6 million each, jointly with Mr Yan.

This decision has been appealed to the Court of Appeal which held a five day hearing in July 2020.

The correct approach?

Although the facts of *Mainzeal* have been described as exceptional, Cooke J was presented with a situation not uncommon to other reckless trading cases. This essay contends that *Mainzeal* could have been decided utilising a traditional reckless trading assessment, and that vulnerable trading approach adds needless complexity to the s 135 analysis. Further, the extended traditional approach in *Cooper* which represents a clear approach to reckless trading, which respects business judgment and the principles of the Act which is crucial for providing some measure of certainty to directors (particularly those involved in construction) in an increasingly unsettled future.

In *Mainzeal*, liability was found on the directors allowing the company to continue trading while in a vulnerable position. Two key time periods are relevant in the Mainzeal story: In 2005 where loans to the wider group from Mainzeal began in earnest and by the Restructuring Dates, where Mainzeal was not in a reasonable position to rely on the assurances of the wider group. Cooke J found that the date of breach was in January or July 2011, however there would have been no reason to liquidate at this point as it would not have been a sensible commercial decision, and no further loss had occurred from this date. Cooke J outlined that Mainzeal was trading while in a vulnerable state as losses which had occurred prior to 2011, remained and could be triggered as Mainzeal continued to trade. These insolvency losses were to be avoided by the directors as their trading continued. However, this position appears somewhat artificial. It seems difficult for a director to avoid losses which have already occurred.[55] Under the vulnerable trading position, and the traditional approach the losses already existed and could be viewed as able to be triggered at any moment of trading.[56]

This essay agrees that the relevant losses did occur before January or July 2011; however the vulnerable trading analysis can be avoided if the breach is found at an earlier point in time. It is possible the directors breached their duties at the Restructuring Dates, or even earlier in 2005 when the wider group loans substantially increased.[57] Liability under s 135 can be found in the directors' unreasonable reliance on the wider group's assurances. Although Cooke J considered that reliance on the loans began to be unreasonable at the Restructuring Dates, this essay contends that the breach can be

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[51] *Mainzeal v Yan*, above n 1, at [258].
[52] *Mainzeal v Yan*, above n 1, at [418]-[424].
[53] At [396].
[54] At [428].
[55] Alan McRae "Reckless Trading" (2019) NZLJ 419.
[56] McRae, "Reckless Trading" (2019) NZLJ 419.
[57] McRae, "Reckless Trading" (2019) NZLJ 419.

established when the loans to the wider group began to substantially increase in 2005. At this time the loans were also materially irrecoverable from China, and not recorded in legally binding documents. Accordingly, this essay considers it possible and desirable to apply a traditional reckless trading analysis to *Mainzeal*, despite the extreme facts.

On the whole, the consequences of the *Mainzeal* approach add a significant level of complexity to the reckless trading assessment. If followed, Courts may look to include director's behavior which has otherwise not been included in the reckless trading assessment. Although *Mainzeal* appears to link vulnerability to creation of loss, it nevertheless widens the traditional test for reckless trading. Expectations placed on directors should be clear; where uncertainty exists there remains room for the more unscrupulous players to exploit perceived gaps and ambiguities.

Mainzeal appears to take a hindsight approach which no longer makes the counterfactual date the desirable method for determining when directors ought to have liquidated their company. This approach widens potential liability for directors, analysing what directors should have done, even if liquidation is not a desirable option. In its place, directors may now have greater need to seek and implement accounting and legal advice. Although directors should continue to cautiously consider their duties, and positions of their companies, certainty should be key to determining the actions directors can undertake.

The approach in *Cooper* is an affirmation of the traditional reckless trading assessment, expanding on the business judgment consideration. While *Cooper* responds to entirely different facts to *Mainzeal*, its endorsement of the traditional approach, and business judgment assessment is beneficial in ensuring directors are clear in their role.

Although the appeal decisions from *Cooper* and *Mainzeal* are eagerly anticipated, regardless of their outcome, there will be increased focus on directors and their duties in the coming months and years. Nevertheless, both cases highlight the practical steps that directors (construction sector specifically) should take to protect themselves, their businesses and creditors. Accounts, particularly calculating and recording liabilities will require greater attention from directors. Related party transactions and loans should also be attended to closely, with directors needing to ensure any loans are suitably recorded in legal documents and directors should consider whether the agreements recorded in those documents are enforceable.

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