IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CRI 2009-004-1388

THE QUEEN

v

KENNETH ROGER MOSES
MERVYN IAN DOOLAN
DONALD MENZIES YOUNG

Hearing: 21, 22, 23, 24, 25, 28, 29, 30, 31 March 2011
1, 4, 5, 6, 7, 8, 11, 12, 13, 14, 15, 18, 19, 20, 28, 29 April 2011
2, 3, 4, 5, 6, 9, 10, 11, 12, 13, 17, 18, 19, 20, 23, 24, 25, 26, 27, 30, 31 May 2011
1, 2, 3, 9, 13, 14, 15 and 16 June 2011
8 July 2011

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Judgment: 8 July 2011

Reasons: 8 July 2011

REASONS FOR VERDICT OF HEATH J

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1. The accused, the charges and my verdicts

[1] At material times, Mr Roger Moses, Mr Mervyn Doolan and Mr Donald Young were directors of Nathans Finance NZ Ltd (Nathans). Each has been charged with six counts, under s 58 of the Securities Act 1978 (the Act).[1] The charges arise out of the distribution of offer documents,[2] allegedly containing untrue statements, through which Nathans offered debt securities to the public:[3]

(a) Count 1: Between 13 December 2006 and 30 August 2007, distributing an investment statement dated 13 December 2006 containing an untrue statement.

(b) Count 2: Between 13 December 2006 and 30 March 2007, distributing Prospectus No 8 dated 13 December 2006 containing an untrue statement.

(c) Count 3: Between 29 March 2007 and 30 August 2007, distributing Prospectus No 8 (pursuant to an extension certificate) containing an untrue statement.

(d) Count 4: On 14 May 2007, distributing an advertisement (a letter to investors dated 14 May 2007) containing an untrue statement.

(e) Count 5: On 12 July 2007, distributing an advertisement (a letter to investors dated 12 July 2007) containing an untrue statement.

(f) Count 6: On 6 August 2007, distributing an advertisement (a letter to investors dated 6 August 2007) containing an untrue statement.

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[1] Set out in full at para [23] below. The Securities Act 1978 has been amended a number of times since the events in issue. The provisions to which I refer are those in force at the relevant time.
[2] I use the term "offer documents" when referring, in a compendious way, to two or more of the prospectus (including the extension certificate), investment statement and advertisements.
[3] The indictment and the particulars provided to support it are considered in Part 3 of these reasons.

[2] Each accused pleaded not guilty to all charges and elected trial without a jury. The trial was conducted before me over 54 sitting days, from 21 March to 16 June 2011.

[3] A fourth director, Mr Hotchin, was charged in respect of the three distributions that occurred between 13 December 2006 and 15 April 2007; the latter being the date on which his resignation as a director of Nathans took effect. On 25 February 2011, Mr Hotchin entered guilty pleas to counts 1, 2 and 3. On 4 March 2011, he was sentenced by Lang J.[4] Mr Hotchin was called by the Crown to give evidence against his fellow directors.

[4] Earlier today I found Mr Moses, Mr Doolan and Mr Young guilty on counts 1, 2, 3, 4 and 6. Convictions were entered on each of those charges. The three accused were found not guilty on count 5 and discharged.

[5] These are my reasons for returning those verdicts. While it is unusual for full reasons to be given in Judge-alone trials,[5] it is appropriate in a case such as this. The prosecution is of public interest. Nathans was one of a number of finance companies that collapsed in 2006 and 2007. Public investors lost significant sums of money. This is the first case of its type to come before this Court. Others are to follow. Both the accused and the public are entitled to understand fully the reasons for my verdicts.[6]

[6] I thank counsel for their considerable assistance. I intend no disrespect to them in not setting out or reviewing their comprehensive closing arguments in detail. I have carefully considered the relevant evidence and closing addresses. I have elected to deal only with those matters that are essential to my decisions. I

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[4] *R v Hotchin* HC Auckland CRI 2009-092-20927, 4 March 2011, Lang J. I record, in accordance with advice given to counsel prior to the trial beginning, that I have not read Lang J's sentencing notes. I refrained from doing so because Messrs Moses, Doolan and Young dispute aspects of the summary of facts agreed between the Crown and Mr Hotchin, on the basis of which he was sentenced. I agreed with counsel for the accused that it was appropriate to embark on my task as a fact-finder in this trial without reference to those agreed facts.

[5] See, generally, *R v Connell* [1985] 2 NZLR 233 (CA) at 237; *R v Eide (Note)* [2005] 2 NZLR 504 (CA) and *Wenzel v R* [2010] NZCA 501 at paras [39] and [40].

[6] See *R v Eide (Note)* [2005] 2 NZLR 504 (CA) at para [21], in the context of reasons for verdicts in fraud cases. In my view, a similar approach is required in a case such as this, though I emphasise that no allegation of dishonest conduct is made against the accused.

acknowledge that any summary of the voluminous evidence that I have heard and read will necessarily be both selective in its content and incomplete in nature. I also accept that time constraints have resulted in these reasons being far longer than is desirable.

2. General background

[7] Nathans was a wholly owned subsidiary of VTL Group Ltd (VTL).[7] VTL and Nathans were incorporated on 23 December 1997 and 23 July 2001, respectively. In 2004, after the sale of 7.5 million shares to the public at $1.00 per share, pursuant to a registered prospectus, VTL was listed on the New Zealand Stock Exchange. After the float, interests associated with Messrs Doolan and Hotchin each owned 33.2% of the company, while those associated with Mr Gary Stevens (a director of VTL) and Mr Moses each owned 4.1%.[8] The public shareholding in VTL amounted to 25.4% of its share capital.

[8] Nathans carried on business as a finance company. It solicited funds from the public, through the issue of secured debenture stock. That method of raising capital is regulated by the Act. Offers to invest in "debt securities" were made through the use of prospectuses, investment statements and advertisements. Pursuant to a deed of trust dated 15 November 2001, Perpetual Trust Ltd (Perpetual) was appointed as trustee for the secured debenture holders. On 20 August 2007, Perpetual placed Nathans in receivership, on the basis of its insolvency. There is a deficiency as to secured debenture holders of something in the order of $174 million.

[9] Nathans was established for the purpose of providing working capital to VTL. First tier financiers (such as trading banks) do not ordinarily lend to such a company. VTL had no trading history. Its primary asset was intellectual property. It possessed few tangible assets against which security could be taken. Its business involved the acquisition of vending machines (depreciating assets) and the

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[7] VTL was previously called Vending Technologies Ltd. Its name was changed to VTL Group Ltd on 12 March 2004.
[8] The shares were owned, respectively, by Mrs Doolan (as trustee of the McConnochie Trust), Mrs Hotchin (as trustee of the Boston Trust), Mr and Mrs Moses (as trustees of the Nadia Investment Trust) and Gary Stevens, Shirley Stevens and Charles Carlton (as trustees of the Milford Way Trust).

installation of a unique proprietary software into them. To maximise returns from the software product, VTL intended to establish a network of franchised machine operators to lease the machines from subsidiary companies.

[10] All of Nathans' directors were, at one time or another, members of the VTL board:

(a) Messrs Doolan and Hotchin were directors of both VTL and Nathans from their respective incorporations. Mr Hotchin resigned as a director of Nathans on 31 March 2007, effective from 15 April 2007.

(b) Mr Moses joined the Nathans' board on 11 August 2003 and that of VTL on 4 May 2004. Mr Moses became the chairman of the Nathans board around September 2005, after Mr Hotchin resigned from that position.

(c) Mr Young was appointed as a director of Nathans on 12 September 2005 and of VTL on 13 December 2006.

Both Mr Hotchin and Mr Doolan lived overseas during parts of 2004 and 2005. Initially, they were based in the United Kingdom. Subsequently, Mr Hotchin moved to Boston to manage VTL's interests in the United States. Mr Doolan returned to New Zealand in July 2005.

[11] Mr Stevens was the only director of VTL who was not also a member of the Nathans board. Nevertheless, he attended a number of Nathans' board meetings and appears to have taken an active role in its affairs; particularly, in relation to strategic considerations. Although Mr Stevens did not give evidence, the contemporary documents indicate that his shadowy figure was lurking in the background when many significant decisions affecting Nathans' business interests were made, particularly in late 2006 and throughout 2007. Instructively, Mr Hotchin described Mr Stevens both as his "boss" and as a "shadow director" of Nathans.

[12] Although its name replicated those of finance companies previously associated with L D Nathan & Co Ltd[9] (a well-known name in Auckland business circles), Nathans was not connected to that group. I am satisfied that the name was chosen (before either Mr Moses or Mr Young became involved) to lend a degree of respectability to a new entrant into the finance market.

[13] The charges arise out of a series of events from the issue of a prospectus and investment statement in December 2006 through to Nathans' receivership, in August 2007. The prospectus and an investment statement were lodged with the Registrar of Companies on 13 December 2006. An extension certificate[10] was signed by two directors of Nathans (Messrs Doolan and Hotchin) and dated 29 March 2007. Registration of that document (on 30 March 2007) enabled Nathans to continue to solicit funds under the December 2006 prospectus. On 14 May, 12 July and 6 August 2007, letters were forwarded to investors. The Crown alleges that those letters constitute "advertisements" as defined in the Act.[11] There is a dispute about whether the July letter falls within that definition.

3. The indictment and its particulars

[14] Following their committal, the Crown filed an indictment against the three accused and Mr Hotchin. After Mr Hotchin's pleas of guilty were entered, an amended indictment was filed. That formed the basis on which the trial proceeded.

[15] On 24 May 2010, the accused requested further particulars of the indictment. Following correspondence, the Crown responded formally to the request on 20 December 2010. As a matter of law, the trial proceeds on the basis that the indictment contains those further particulars.[12]

[16] The Crown made it clear that while it had "referred to a number of untrue statements in the particulars", it also relied on the offer documents and

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[9] Nathans Finance No 1 Ltd and Nathans Finance Ltd.
[10] Securities Act 1978, s 37A(1A).
[11] Ibid, s 2A.
[12] Crimes Act 1961, s 334(2).

advertisements "read as a whole and the overall impression conveyed by them".[13] Reliance was placed on the whole of the offer documents in order to provide a context within which to assess whether misleading statements had been made.[14]

[17] Mr Gedye for Mr Doolan (supported by counsel for both Mr Moses and Mr Young) emphasised a fundamental tenet of fair trial principles: an accused has the right to know in detail the nature and cause of any charges that he or she may face, in order to meet them. Mr Gedye submitted that the Court ought not to go beyond specific statements identified by the Crown in the particulars of each count to find that an untrue statement was made. He submitted that it was impermissible for the Crown arbitrarily "to seek to find a home for pure omissions by pointing to some oblique or distant or contrived relevance to an existing statement". Mr Gedye used the term "pure omission" to refer to something that was not material to an existing statement in a prospectus or advertisement.

[18] To support those submissions, Mr Gedye referred to the Securities Commission's *Report of an Enquiry into a Registered Prospectus issued by Agricola Resources Limited dated 3 June 1986*[15] and relied on the wording of s 55(a)(ii) of the Act, a provision that, on his submission, "requires a direct and close and natural connection between the omitted matter and the statement relied on".[16]

[19] Section 55 of the Act is designed to provide a wider meaning to the word "untrue" than its popular use. For present purposes, the focus is on whether a relevant offer document is "misleading". Section 55 states:

> **55 Interpretation of provisions relating to advertisements, prospectuses, and registered prospectuses**
>
> For the purposes of this Act,—
>
> (a) A statement included in an advertisement or registered prospectus is deemed to be untrue if—

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[13] Citing *Aaron's Reefs Ltd v Twiss* [1896] AC 273 (HL) at 281; *Arnison v Smith* (1889) LR 41 Ch D 348 (CA) at 369 and *R v Rada Corp Ltd (No 2)* [1990] 3 NZLR 453 (HC) at 474.
[14] Securities Act 1978, s 55(a).
[15] Securities Commission *Report of an Enquiry into a Registered Prospectus issued by Agricola Resources Limited dated 3 June 1986* (1991) [*Agricola Resources* report].
[16] See also paras [43] and [44] below.

(i) It is misleading in the form and context in which it is included; or

(ii) It is misleading by reason of the omission of a particular which is material to the statement in the form and context in which it is included:

(b) A statement is deemed to be included in an advertisement or registered prospectus if it is—

(i) Contained in the advertisement or registered prospectus; or

(ii) Appears on the face of the advertisement or registered prospectus; or

(iii) Contained in any financial statements, report, memorandum, or document that accompany, or are incorporated by reference or referred to in, or distributed with, the advertisement or registered prospectus:

(c) A certificate registered under section 37A(1A) of this Act, and any financial statements that accompany that certificate, shall be deemed to be included in the registered prospectus to which the certificate relates.

[20] When pressed, Mr Gedye accepted that some form of logical linkage between an omission and a particular statement might be appropriate, but he emphasised the element of proximity. While I accept the thrust of Mr Gedye's submission based on the purpose of particulars, a narrow approach to relevant contextual evidence is unwarranted. Section 55(a)(ii) recognises that "suppression of the truth suggests the false".[17] A half truth can be as much misleading as a lie. If the absence of something material could lead an investor not to take account of factors relevant to an investment decision, s 55(a)(ii) will apply. The authorities make the obvious point that it is the overall impression conveyed by the offer document that is important, not a painstaking analysis of individual sentences contained in it.[18]

[21] It is true, as Somers J said in *R v Arnold (No 1)*,[19] that the "object of particulars is to enable [an accused] to know fairly what he has to meet". However, there is no prejudice to an accused unless he or she were taken by surprise in

[17] John Farrar and Mark Russell *Company Law and Securities Regulation in New Zealand* (Butterworths, Wellington, 1985) at 365, adopted in the *Agricola Resources* report, at para 9.8.
[18] See *Peek v Gurney* (1872) LR 6 HL 377 (HL) at 386; *Arnison v Smith* (1889) LR 41 Ch D 348 (CA) at 369 per Lord Halsbury LC; *Aaron's Reefs Ltd v Twiss* [1896] AC 273 (HL) at 281; *R v Kylsant* [1932] 1 KB 422 (CA) at 448-449; *R v Rada Corporation Ltd* [1990] 3 NZLR 438 (HC) at 446-447 and *R v Rada Corporation Ltd (No 2)* [1990] 3 NZLR 453 (HC) at 474.
[19] *R v Arnold (No 1)* [1977] 1 NZLR 718 (SC) at 721.

answering the charges. In the course of a trial spanning some three months, there was no suggestion, at any stage, that the accused were surprised by the way in which the Crown put its case or that some other form of prejudice had resulted. While it is necessary for the Crown to be kept within the limits of its particulars, a relatively broad view of the contextual evidence is appropriate when considering the specific allegations of untrue statements.

[22] That approach is consistent with the way in which the Court deals with applications to amend an indictment during a trial. If there were debate about the terms of a particular count, it is always open for the Crown to seek leave to amend, to conform to proof.[20] There is no reason why any different approach should be taken in respect of particulars. The critical issue is whether the accused have been taken by surprise or have been prejudiced in the way in which the defence was (or could have been) conducted. In this case, they have not.

4. The Crown case in outline

[23] A director of a company that distributes a prospectus or an advertisement (including an investment statement) that contains an untrue statement commits a criminal offence, punishable on conviction on indictment by a maximum term of imprisonment of five years or a fine of $300,000.[21] Section 58 of the Act provides:

> **58 Criminal liability for misstatement in advertisement or registered prospectus**
>
> (1) Subject to subsection (2) of this section, where an advertisement that includes any untrue statement is distributed,—
>
> (a) the issuer of the securities referred to in the advertisement, if an individual; or
>
> (b) if the issuer of the securities is a body, every director thereof at the time the advertisement is distributed—
>
> commits an offence.
>
> (2) No person shall be convicted of an offence under subsection (1) of this section if the person proves either that the statement was immaterial or that

[20] Crimes Act 1961, s 335(1) and (2).

[21] If the offence were a continuing one a further fine of $10,000 per day may be imposed in respect of every day that the offence continues.

he or she had reasonable grounds to believe, and did, up to the time of the distribution of the advertisement, believe that the statement was true.

(3) Subject to subsection (4) of this section, where a registered prospectus that includes an untrue statement is distributed, every person who signed the prospectus, or on whose behalf the registered prospectus was signed for the purposes of section 41(b) of this Act, commits an offence.

(4) No person shall be convicted of an offence under subsection (3) of this section if the person proves either that the statement was immaterial or that he or she had reasonable grounds to believe, and did, up to the time of the distribution of the prospectus, believe that the statement was true.

(5) Every person who commits an offence against this section is liable—

(a) on conviction on indictment to—

(i) imprisonment for a term not exceeding 5 years; or

(ii) a fine not exceeding $300,000 and, if the offence is a continuing one, to a further fine not exceeding $10,000 for every day or part of a day during which the offence is continued; or

(b) on summary conviction to—

(i) imprisonment for a term not exceeding 3 months; or

(ii) a fine not exceeding $300,000 and, if the offence is a continuing one, to a further fine not exceeding $10,000 for every day or part of a day during which the offence is continued.

It is common ground that each of the offer documents was "distributed" on or about the dates alleged in the specific counts, for the purposes of s 58(1) and (3).[22]

[24] The Crown's specific allegations that the offer documents contained "untrue" statements may, conveniently, be distilled and classified under eight headings:[23]

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[22] When the hearing ended on 16 June 2011, an appeal from Venning J's judgment in *R v Petricevic* HC Auckland CRI 2008-004-29179, 25 March 2011 had been heard by the Court of Appeal but judgment remained reserved. That case considers the meaning of "distribution" in the context of a charge which alleges that an offer document became misleading after it was originally distributed; the question being whether the concept of "distribution" is a continuing one. That point does not arise in this trial. The issue was left on the basis that if any of the accused were convicted and the Crown wished to raise the issue of a continuing offence as an aggravating factor on sentencing, it would be open for the accused to request a disputed fact hearing: Sentencing Act 2002, s 24. The Court of Appeal's judgment was delivered on 5 July 2011: *R v Steigrad* [2011] NZCA 304. I have endeavoured to incorporate any relevant observations.

[23] A summary confined to five headings under which the particulars are grouped is set out at para [213] below.

(a) Misleading statements that advances to VTL and its subsidiaries (the inter-company advances) had been made on a "commercial arm's length basis", normally for terms no longer than 12 months;

(b) Omitting to disclose an expectation that each of the inter-company advances would be rolled-over on due date, with all interest being capitalised;

(c) Omitting to disclose the true extent of VTL business-related indebtedness;[24]

(d) A misleading statement that the liquidity of Nathans was supported by VTL;

(e) Omitting to disclose a significant deterioration in the liquidity profile of the company between the financial statements for the year ended 30 June 2006 and the date of distribution of the prospectus, investment statement, extension certificate and advertisements respectively;

(f) A misleading statement that Nathans had no bad debts;

(g) Misleading statements about the standard of corporate governance, credit assessment and credit management processes that operated within Nathans; and

(h) Misleading statements relating to the growth of a commercial lending book and diversification of lending undertaken by Nathans.

[25] The Crown's fundamental complaint is that the directors allowed the various offer documents to go into the market containing materially misleading information about core aspects of Nathans' business and its actual financial position.

[24] This is a term I have adopted. I define it at para [151](b) below.

5. The defence cases in outline

(a) No untrue statements

[26] Mr Moses, Mr Doolan and Mr Young each contend that the statements were not misleading. Their position is that a notional reader of the prospectus, investment statement and advertisements would have gained a proper understanding of the position of the company and the relevant investment risks from the text of the various offer documents and the audited financial statements contained in the prospectus.

[27] The accused place greater emphasis on the *literal accuracy* of statements made in the prospectus, including the figures contained in the financial statements. In contrast, the Crown approach was more focussed on the *impression* likely to be gained by a recipient of the relevant offer document.

(b) Immateriality and reasonable belief of truth

[28] If, contrary to their contention, I were to find that one or more of the statements in the offer documents was untrue, each director says that any misleading statement was immaterial or that he had, at the relevant time, an actual belief based on reasonable grounds that the statements were true.[25]

[29] I agree with counsel for the accused that the reasonableness of any such belief should be assessed from the perspective of each individual director, based on the information available to him at the relevant time. I eschew a "hindsight" based evaluation that would likely be over-critical of a director's actions. Deliberately, I take a (contemporary) "boardroom", rather than a (financial autopsy) "courtroom", approach.

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[25] Securities Act 1978, s 58(2) and (4). Resolving a prior debate on this issue, the Court of Appeal has confirmed that s 58(2) and (4) should be treated as affirmative defences: *R v Steigrad* [2011] NZCA 304 at para [44].

[30] Reliance on other persons is a significant aspect of each director's belief that the statements were true. On occasions the directors relied on each other; for example, when one reported to the board on a particular issue for which he had primary responsibility. More generically, the directors say that they relied on information conveyed to them by:

(a) Members of Nathans' senior management team (including in-house counsel) who had the responsibility to undertake specific tasks in relation to the offer documents.

(b) Nathans' auditors, Staples Rodway. They provided two unqualified audit opinions; one on the financial statements for the year ended 30 June 2006 and the other for the purposes of the prospectus.

(c) Perpetual and the Registrar of Companies, on their examination of the prospectus and investment statement.

(d) External advisers, such as lawyers, accountants and valuers.

6. Securities Act 1978: the statutory scheme

[31] It is unlawful to make an offer of securities to the public unless it is made in (or accompanied by) an investment statement, an authorised advertisement that is not an investment statement, or in (or accompanied by) a registered prospectus.[26] In 2006 and 2007, the form of a prospectus and an investment statement had to comply with both the Act and the Securities Regulations 1983 (the Regulations).[27]

[32] An investment statement must state that there is a registered prospectus containing an offer of securities to which it relates[28] and bring to the attention of

[26] Ibid, s 33(1).
[27] Ibid, s 33(1)(a) and (c). The regulations in force between November 2006 and August 2007 were the Securities Regulations 1983. The Securities Regulations 2009 came into force on 1 October 2009.
[28] Ibid, s 38E(1)(c).

potential investors that other important information is available about the securities.[29]

[33] Nathans was subject to that regulatory regime because it offered debt securities to the public. A "debt security" is one in which the investor has the right to be repaid its money.[30] No debt security may be offered to the public for subscription unless a trustee has been appointed and the trust deed has been registered with the Registrar of Companies.[31] Perpetual was appointed as trustee under a trust deed dated 15 November 2001.

[34] A prospectus has a lifespan of nine months from the date of the last audited financial statements. In this case, the last audited accounts were for the year ended 30 June 2006, so the period of nine months expired on 31 March 2007. That period can be lengthened if an extension certificate were signed on behalf of all directors.[32] In that certificate, all directors of the issuer, having made due enquiry, must state that, in their opinion:[33]

> (a) The financial position shown in the statement of financial position referred to in paragraph (b) of this subsection has not materially and adversely changed during the period from the date of that statement of financial position to the date of the certificate; and
>
> (b) The registered prospectus is not, at the date of the certificate, false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances.

Such a certificate is deemed to be part of the registered prospectus to which it relates.[34]

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[29] Ibid, s 38D(1)(b).
[30] Ibid, s 2(1), definition of "debt security".
[31] Ibid, s 33(2).
[32] Ibid, s 37A(1A).
[33] Ibid, s 37A(1A)(c)(i) and (ii).
[34] Ibid, s 55(c).

[35] An offer of securities to members of the public has never been treated as akin to offers to acquire other commodities. As long ago as 1877, Lord Coleridge CJ in *Twycross v Grant*[35] explained why, in a passage that is as true today as it was 134 years ago:

> All purchasers equally run the risk of buying a comparatively worthless article, and of being misled by untrue representations as to its nature and value; and from risks of this kind no special legislation was necessary to protect shareholders. The value of a share in a company, however, depends not only on those circumstances which regulate the value of all saleable commodities, but also on persons by whom and the mode in which the capital of the company is to be dealt with. *It is utterly immaterial to an ordinary purchaser to know what the vendor will do with the purchase money when he gets it*: the purchaser has no further interest in it. *But an applicant for shares in a company is in a totally different position. This money becomes part of the capital of the company; and to him it is all important to know what sort of persons are to have the control of his money where has paid it, and how that money is to be applied*, whether upon the enterprise itself or in remunerating, perhaps with lavish extravagance, those who have brought the company to its existence. (my emphasis)

[36] The purpose of the Act is the protection of investors: *Re AIC Merchant Finance Ltd*.[36] Richardson J described the "pattern of the Securities Act and the sanctions it imposes" as designed "to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for securities". The underlying policy is simple. Full disclosure enables a potential investor to make an informed decision whether to invest. Equally, a potential investor cannot make an informed choice without all information that is both relevant and material to the decision:[37]

> It is perhaps true to say that the premise underlying the Securities Act, as with much commercial law, is that the best protection of the public lies in full disclosure of the company's affairs and of the security it is offering. That then allows the investor to make an informed investment decision, which in turn facilitates the functioning of financial markets.

[37] The content of a prospectus and an investment statement is prescribed by the Regulations. In the context of an offer of debt securities:[38]

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[35] *Twycross v Grant* (1877) 2 CPD 469 at 483. See, more generally, Andrew Borrowdale and others *Morison's Securities Law* (looseleaf ed, LexisNexis) at para [1.6].
[36] *Re AIC Merchant Finance Ltd* [1990] 2 NZLR 385 (CA) at 391-392 per Richardson J. Neither Casey J nor Doogue J disagreed with Richardson J's analysis.
[37] Ibid, at 392. See also *DFC Financial Services Ltd v Abel* [1991] 2 NZLR 619 (HC) at 629 per Fisher J and *R v Steigrad* [2011] NZCA 304 at paras [75] and [76].
[38] Securities Regulations 1983, regs 3(2) and 7A.

(a) Every registered prospectus relating to an offer of debt securities must contain all of the information, statements, certificates and other matters specified in Schedule 2.

(b) While the *minimum* information to be contained in an investment statement is set out in Schedule 3D to the regulations there is no limitation on the information that may be contained in that type of document.[39]

[38] Section 58 of the Act is one of the criminal sanctions imposed to encourage compliance with the statutory regime. Directors also face the prospect of civil liability.[40] Both civil and criminal sanctions are directed to a situation in which false material statements are made in a prospectus or an advertisement.

7. Elements and onus of proof on a s 58 Securities Act charge

[39] The charges in relation to the prospectus and extension certificate are brought under s 58(3);[41] those in relation to the investment statement and letters to investors invoke s 58(1).[42] The offences are ones of strict liability. The Crown is not required to prove any criminal intent on the part of the directors. While an honest director can be guilty of an offence, no person can be convicted if he or she were to prove either that the statement was immaterial or that he or she had reasonable grounds to believe and did, up to the time of the distribution of the offer document, believe that the statement was true.[43]

[40] A strict liability offence is justified by the nature of an offer of securities to members of the public. The public rely on those responsible for making the offer to disclose everything of relevance that is likely to be material to the investment decision. Investors do not have insider knowledge. The need for a serious sanction for non-disclosure arises out of the prospect of loss being suffered by innocent

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[39] Securities Act 1978, s 38E(3); Securities Regulations 1983, reg 7A(5).
[40] Securities Act 1978, s 56.
[41] Counts 2 and 3: see para [1] above.
[42] Counts 1, 4, 5 and 6: see para [1] above.
[43] Securities Act 1978, s 58(2) and (4).

investors through reliance on misleading statements, whether made deliberately or innocently.

[41] Section 58(1) and (3) require the Crown to prove that a statement is "untrue". There are two types of statements that will be deemed "untrue". The first applies to an affirmative statement, contained in the relevant offer document. Section 55(a)(i) deems a statement to be "untrue" if it were misleading in the "form and context in which it is included".[44] The other is an omission. The "omission of a particular which is material to the statement in the form and context in which it is included" is also deemed to be "untrue".[45]

[42] Two points should be made about the inquiry into whether a statement is misleading. The first is that the question must be judged contextually, not literally. Second, even if there may be some truth in what is said, a statement that fails to divulge the whole truth may also be false and, therefore, misleading.[46]

[43] The question whether the offer document contains an affirmative statement that is "untrue" is viewed through the eyes of a notional investor.[47] The inquiry is objective in nature. The onus of proving that a misleading statement has been made rests on the Crown. That must be proved beyond reasonable doubt. If the Crown were to prove a misleading statement to that standard, the onus shifts to the directors to demonstrate, on a balance of probabilities, that it was immaterial or that he or she had reasonable grounds to believe that the statement was true.[48]

[44] When the Crown seeks to rely on an omission, the position is slightly different. As part of its obligation to prove beyond reasonable doubt that the statement is misleading, the Crown must also prove (to the same standard) that the statement is misleading by reason of an omission which is material to the statement. It is then a discrete question whether an accused can establish, on a balance of probabilities, that a statement that is deemed to be misleading is, nevertheless,

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[44] Ibid, s 55(a)(i).
[45] Ibid, s 55(a)(ii).
[46] See the authorities collected in n 17 and 18 above.
[47] *R v Rada Corporation Ltd (No 2)* [1990] 3 NZLR 453 (HC) at 465.
[48] Care must be taken to consider the questions of "immateriality" and "reasonable grounds" discretely, as they raise different issues. See *Department of Justice v Witehira* (1996) 7 NZCLC 261,184 (DC) as an illustration of a problematic approach, in that regard.

immaterial to any investment decision. Therefore, the defences available under s 58(2) and (4) are equally available in circumstances where s 55(a)(ii) is invoked.

[45] Questions of materiality or immateriality are opposite sides of the same coin. Using the term "immaterial" as his starting point, Mr Gedye submitted, citing *District Registrar of Companies v Heenan*,[49] that the term should be interpreted as "of no essential consequence; unimportant". In *Heenan*, Judge Callaghan had referred to the definition of "immaterial" in the *Oxford English Dictionary*, having previously considered a discussion of the term "materiality" in *Coleman v Myers*[50] and *TSC Industries Inc v Northway Inc*.[51] Mr Gedye urged caution in a case where the question of materiality was not "exceedingly clear".

[46] Mr Carruthers QC, for the Crown, relied on *Coleman v Myers* and a very recent decision of the Supreme Court of the United States, in *Matrixx Initiatives, Inc v Siracusano*.[52] Judgment in that case was delivered on 22 March 2011, the day after this trial began. *Matrixx* involved a case of alleged securities' fraud under § 10(b) of the Securities Exchange Act of 1934 (US) and Rule 10b-5 of the Securities and Exchange Commission Rules. The rule made it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made ... not misleading".

[47] In *Matrixx*, the appellant had urged the Supreme Court to depart from the test of "materiality" adopted and applied by that Court in both *TSC Industries*[53] and *Basic, Inc v Levinson*.[54] The Court declined to do so, endorsing its earlier approach. Sotomayor J, delivering the judgment of a unanimous Court, said:[55]

> ... assessing the materiality of adverse event reports is a "fact-specific" inquiry ... that requires consideration of the source, content, and context of the reports. …
>
> Application of *Basic's* "total mix" standard does not mean that pharmaceutical manufacturers must disclose all reports of adverse events.

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[49] *District Registrar of Companies v Heenan* (1997) 8 NZCLC 261,334 (DC) at 261,349.
[50] *Coleman v Myers* [1977] 2 NZLR 225 (CA).
[51] *TSC Industries Inc v Northway Inc* 426 US 438 (1976).
[52] *Matrixx Initiatives, Inc v Siracusano* 563 US __ (2011) (slip opinion) at 9-10.
[53] *TSC Industries*, at 449 and *Basic Inc v Levinson* 485 US 224 (1988) at 231-232.
[54] *Basic Inc*, at 226.
[55] *Matrixx Initiatives*, applying *Basic* at 232.

> .... The question remains whether a *reasonable* investor would have viewed the nondisclosed-information "as having *significantly* altered the "total mix" of information made available". (original emphasis)

[48] That test that has been consistently applied in the United States and is the basis for the test of materiality adopted by the Court of Appeal in *Coleman v Myers*, Cooke J having relied on *TSC Industries*, where it was first expressed. While using different wording, it also accords with other authorities that are helpfully summarised in an article by Peter Fitzsimons, "'Materiality" and the Securities Act 1978".[56] Mr Fitzsimons discussed the development of the law relating to "materiality", in the context of the Act. It appears that when the Davey Committee reported to the Parliament of the United Kingdom in 1895, it emphasised the importance of disclosure by indicating that a prospectus should disclose everything which could reasonably influence the mind of an investor of average prudence.[57] That expression of the concept takes on particular significance in New Zealand, given the adoption of the "prudent but non-expert" investor as the person to whom an investment statement is directed.[58]

[49] Our Court of Appeal in *R v Baxter*[59] referred to a "piece of information ... which the recipients of the prospectus certainly needed in order properly to be able to assess the risk of the investment. Cooke J, in *Coleman v Myers*,[60] spoke of something between a situation in which a potential investor "might" or "would" be influenced by omitted information. He also referred to "considerations which can reasonably be said, in the particular case, to be likely materially to affect the mind of a vendor or a purchaser", in the context of an agreement to sell shares in a company.[61]

[50] Examples of the use of different phrases to capture the same concept can be found in one of the older cases, *Broome v Speak.*[62] At first instance, Buckley J spoke

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[56] Peter Fitzsimons "'Materiality' and the Securities Act 1978" (2000) Companies and Securities Law Bulletin 18. See also Fitzsimons' helpful summary of the provisions in the Securities Act and Regulations that focus on questions of "materiality".
[57] Davey Committee *Report of the Companies Acts (Amendment) Committee* (C 7779, 1895) at para 6.
[58] Securities Act 1978, s 38D(a). See also paras [52]-[70] below.
[59] *R v Baxter* [1998] 3 NZLR 144 (CA) at 157.
[60] *Coleman v Myers*, at 334 per Cooke J, with whom neither Woodhouse J nor Casey J differed on this point.
[61] Ibid, at 334, relying on the test expressed by Marshall J in *TSC Industries*, at 449.
[62] *Broome v Speak* [1903] 1 Ch 586 (Ch and CA).

of withheld information that, if disclosed, would reasonably "deter or tend to deter an ordinary prudent investor from applying for the shares".[63] In the Court of Appeal, Collins MR, while approving Buckley J's formulation, expressed the view that an intended investor was entitled "to have every element for enabling him to form a judgment, as to whether he will or will not subscribe for shares, fairly put before him ...".[64] Cozens-Hardy LJ wrote of "a contract ... of such a nature that the intending investor may reasonably require to consider it before determining whether he shall or shall not apply for shares in the company".[65]

[51] Respectfully, in company with Cooke J, I do not consider it is appropriate to attempt to define the concept of "materiality" too tightly. The various phrases found in the Davey Committee report and the cases to which I have referred are all based on a common theme. At the risk of adding a further phrase to the debate, if there were something that ought to have been disclosed that could well have made a difference to the decision whether to invest, it would almost inevitably be characterised as "material".

8. The impact of the "investment statement" regime

[52] Existing authorities on s 58 prosecutions are concerned only with prospectuses and advertisements. The events described in those cases pre-date the Securities Amendment Act 1996, by which the investment statement regime was introduced. The nature and purpose of that regime impacts on the characteristics of the investor from whose perspective a determination must be made about whether a statement in an offer document was misleading and, if so, material to an investment decision.

[53] The investment statement regime was introduced in response to a report by the Task Force on Private Provision for Retirement (the Todd report).[66] The proposal to introduce a more informal disclosure document was adopted in the Accord on

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[63] Ibid, at 604.
[64] Ibid, at 621 and 622.
[65] Ibid, at 629.
[66] Jeff Todd "Private Provision for Retirement: The Way Forward" (Task Force on Private Provision for Retirement, December 1992) [the Todd report].

Retirement Income Policies (the Accord) entered into by the National, Labour and Alliance political parties in August 1993:[67]

> 4.1 Disclosure about savings products
>
> Having considered the recommendations of the Task Force, the Parties agree that in respect of unit trusts, superannuation schemes, life insurance, and other financial investment products offered to the public (referred to as "savings products" in this Accord), legislation should be enacted to provide that –
>
> (a) certain statutory minimum disclosure requirements should apply in respect of all savings products (both when the initial commitments are made and on an annual basis thereafter);
>
> (b) the disclosure requirements should require the cost-effective disclosure of information which meets the reasonable needs of the prudent but non-expert investor;
>
> (c) the disclosure requirements should facilitate comparisons between savings products.

[54] Those sentiments were repeated in subsequent recommendations of the Working Group on Improved Product and Investment Adviser Disclosure (the Working Group)[68] and the select committee report that considered the Investment Product and Adviser (Disclosure) Bill 1995, by which the proposed investment statement regime was introduced into Parliament.[69]

[55] Those responsible for the reforms labelled the notional investor as a "prudent but non-expert" person. Reflecting the terms of the Accord, the Working Group identified four "key principles" for the development of minimum requirements:[70]

(a) A disclosure policy, to provide such investors with sufficient information to enable them to make their own informed decisions;

(b) Coverage of all public offerings, so that the disclosure requirements extend to all investment products offered to the public;

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[67] An Accord on Retirement Income Policies (August 1993), cl 4.1.
[68] The Working Group was established in December 1993 to develop recommendations for the implementation of Part 4 of the Accord.
[69] Investment Product and Adviser (Disclosure) Bill 1995 (138-2) (select committee report).
[70] Ibid, at ii; see also (22 August 1996) 557 NZPD 14255.

(c) The need for neutral and equivalent rules to avoid regulatory distortions arising from different disclosure requirements that lack a coherent rationale; and

(d) The need for the new rules to be cost effective.

[56] The Todd report considered that information in a prospectus was not "consistently provided in an understandable or reliable form by existing providers of financial advice".[71] In the context of a particular focus on the type of information that would assist people to make decisions about and to save for their retirement, the Todd report referred to "the information [that] savers need to make quality decisions about the products that best suit their needs and preferences". That came to be the foundation for the investment statement.

[57] As an adjunct to its primary recommendation, the Todd report also recommended the introduction of legislation to address questions of disclosure from those who held themselves out as providing investment advice. Those recommendations were implemented by the Investment Adviser (Disclosure) Act 1996, in which definitions of both "investment advice" and "investment adviser" appear.[72]

[58] The Act confirms that the adequacy of information disclosed in an investment statement must be evaluated from the perspective of a "prudent but non-expert person". Section 38D provides:

> **38D Purpose of investment statement**
>
> The purpose of an investment statement is to—
>
> (a) Provide certain key information that is likely to assist a prudent but non-expert person to decide whether or not to subscribe for securities; and
>
> (b) Bring to the attention of such a person the fact that other important information about the securities is available to that person in other documents.

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[71] The Todd Report, at 71.
[72] See paras [68] and [69] below. This was the legislation in force in 2006 and 2007. With effect from 29 February 2008, the Investment Advisers (Disclosure) Act 1996 was repealed, by the Securities Markets Amendment Act 2006.

The need for "key information" to be disclosed is reinforced by reg 7A(1) of the Regulations. That provision refers to information that must be set out in an investment statement "in a succinct manner".

[59] While s 38D of the Act is clear about the intended audience of an investment statement and the perspective from which its content should be viewed, should the same approach be taken to a prospectus?

[60] Unlike an investment statement, the prospectus contains the last audited set of financial statements. In order to ensure that a prospective investor has access to all relevant information about the offer, the investment statement must advise that further information is available in the prospectus.[73] To that extent there is an intended linkage between the investment statement and the prospectus.

[61] Mr Gedye referred me to a number of authorities that have considered the perspective from which the content of a prospectus should be viewed. All of those authorities dealt with factual situations that arose before the investment statement regime came into force.

[62] In *R v Baxter*,[74] the Court of Appeal referred only to the "recipients of the prospectus". No consideration was given to the level of knowledge or financial literacy of such people. In *R v Rada Corporation Ltd (No 2)*,[75] Barker J used the terms "average investor" and "reasonable investor".[76] In interpreting the meaning of the term "short-term money market" as used in the prospectus, the Judge spoke of the "intelligent investor".[77] Later, his Honour spoke of what "investors reading the prospectus" would have taken from it.[78] In *District Registrar of Companies v Heenan*,[79] Judge Callaghan considered whether a mis-statement in a prospectus was "immaterial" from the perspective of a "reasonable investor".[80] All of these cases involved prosecutions under s 58 of the Act.

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[73] Securities Act 1978, s 38E(1)(c) and Securities Regulations 1983, reg 7A and Schedule 3D, cl 18.
[74] *R v Baxter* [1998] 3 NZLR 144 (CA) at 157.
[75] *R v Rada Corporation Ltd (No 2)* [1990] 3 NZLR 453 (HC).
[76] Ibid, at 465 and 471.
[77] Ibid, at 463.
[78] Ibid, at 477.
[79] *District Registrar of Companies v Heenan* (1997) 8 NZCLC 261,334 (DC).
[80] Ibid, at 261,349. The subsequent reference to "an actual investor's standpoint" would be

[63] The requirement to draw to an investor's attention the existence of any registered prospectus containing information about the same offer of securities suggests that the person reading the prospectus should be treated as the same "prudent but non-expert person" to whom the investment statement is directed.[81] The expression "prudent but non-expert person" is consistent with the view of the Davey Committee, back in 1895, when it spoke of the importance of disclosure to an investor of "average prudence". Although the investment statement now serves as the primary marketing document for those wishing to consider making an investment, it was anticipated that the notional investor would have the opportunity to review the prospectus also. In those circumstances, there is no good reason why a "prudent but non-expert person" ought not to be considered as the intended reader of a prospectus. I proceed on that basis.

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problematic if it were to suggest that a particular investor's approach might be determinative. The statutory requirements are focussed on the approach of a notional investor.

[81] This view is consistent with the select committee report on the Investment Product and Adviser (Disclosure) Bill. In addressing concerns raised by the New Zealand Law Society, the committee said: "The bill is not intended to change the substantive law. Statements are currently deemed to be included in an advertisement or registered prospectus if they are contained in any report, memorandum of document which accompanies the advertisement or registered prospectus or is incorporated by reference". See Investment Product and Adviser (Disclosure) Bill 1995 (138-2) (select committee report) at iv.

9. The characteristics of the "prudent but non-expert" person

[64] What are the characteristics of the "prudent but non-expert person"? For ease of reference, I use the term "notional investor" to refer to such a person, for the purpose of this part of these reasons.

[65] First, the notional investor must fall somewhere between one who is completely risk averse and someone who is prepared to take a high level of risk. The investor could be expected to know that the higher the interest rate offered, the greater the risk of loss.

[66] Second, the investor must be sufficiently intelligent and literate to understand the language employed in the narrative sections of both an investment statement and a prospectus. It must be assumed that such a person will have (or will obtain from an adviser) a general understanding of technical words (such as "debenture") and financial jargon (such as "roll-over"). Because of the postulated lack of expertise, the notional investor is expected to focus more on the narrative of the offer documents than on the financial statements.

[67] Third, the statutory scheme contemplates that the notional investor would seek assistance from a financial adviser.[82] While not expected to be financially literate (in the sense of being able to read financial statements, to comprehend all aspects of what is disclosed and to understand how the various parts of statements of accounting policies fit together), such a person is likely to have sufficient ability to comprehend competent advice about such matters.

[68] The likely ambit of advice may be important to the basis on which the investor makes an investment decision. The Investment Advisers (Disclosure) Act 1996 was enacted as a companion to the investment statement regime.[83] That statute defined the term "investment adviser" as one who "in the course of [his or her]

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[82] Securities Regulations 1983, Schedule 3D, cl 1.
[83] See para [56] above. The disclosure regime for investment advisers introduced by the 1996 Act was in force in both 2006 and 2007, when the offer documents in issue were distributed.

business or employment, gives investment advice".[84] Correspondingly, the term "investment advice" meant a "recommendation, opinion, or guidance given to a member of the public in relation to buying or selling (or not buying or selling) securities".[85] Subject to an exception carved out for journalists expressing views in that capacity,[86] a recommendation, opinion or guidance can be communicated in any form; including through the newspapers or television. A deliberate decision was made not to identify occupational groupings, because to do so might inappropriately exclude a wide range of people who offered investment advice.[87]

[69] Because it was necessary to put industry norms in place to encourage investment advisers to seek competent advice in areas in which they were inexperienced or unsophisticated,[88] the type of adviser to whom the investor was likely to go could not be expected to read and advise on a complicated set of financial accounts.

[70] Finally, the investor would be regarded as one of modest financial means; neither rich nor poor. A middle-income New Zealander may be an apt phrase. While having sufficient funds to obtain some advice about the proposed investment, the person concerned is unlikely to have the financial capacity to obtain detailed accounting advice; much less a forensic analysis of the financial data.

10. The regulatory regime: roles and functions

(a) Introductory comments

[71] In contending that they had reasonable grounds to believe that statements in the offer documents were true, each director says that he was entitled to rely on acts of others involved in the preparation of the documents. Such reliance may be permissible, provided there is nothing that puts a director on notice that further inquiry is necessary. The statutory definition of the phrase "due enquiry" in s 2B of

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[84] Investment Advisers (Disclosure) Act 1996, s 2(1), definition of "investment adviser".
[85] Ibid, definition of "investment advice".
[86] Ibid, definition of "investment advice", para (c)(i).
[87] See Investment Product and Adviser (Disclosure) Bill 1995 (138-2) (select committee report) at v.
[88] See *Armitage v Church* HC Wellington CIV 2009-485-1952, 27 May 2011 per Dobson J at para [65].

the Act and the more general reliance provisions set out in s 138 of the Companies Act 1993 have relevance.[89]

[72] In the present case, there are five classes of persons on whom the directors contend they relied when approving the offer documents: members of Nathans' senior management team, the auditors (Staples Rodway), the trustee (Perpetual), the Registrar of Companies and external advisers, such as lawyers, accountants and business valuers. Some analysis is required of the roles played by directors and those on whom they seek to rely in the prospectus and investment statement preparation process, to determine the extent to which reliance is justifiable.

[73] I emphasise that what follows does not purport to be a full legal analysis. It is more akin to a sketch of the respective roles, against which I can undertake a fact-specific analysis on reliance issues.

(b) Directors and management

[74] Directors direct; managers manage. That is the essential difference between governance and management. Directors establish the policy or rules that are to be implemented by management and put systems in place to ensure their instructions are carried out. In *Dairy Containers Ltd v NZI Bank Ltd*,[90] Thomas J expressed this idea as follows:[91]

> It should not be necessary to restate that it is the fundamental task of the directors to manage the business of the company. Theirs is the power and the responsibility of that management. To manage the company effectively, of course, they must necessarily delegate much of their power to executives of the company, especially in respect of its day to day operations. Although constantly referred to as "the management", the executives' powers are delegated powers, subject to the scrutiny and supervision of the directors. Responsibility to manage the company in this primary sense remains firmly with the directors.

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[89] See also paras [78] and [81] below.
[90] *Dairy Containers Ltd v NZI Bank* Ltd [1995] 2 NZLR 30 (HC) at 79.
[91] Ibid, at 79. This passage has been referred to with approval by the Court of Appeal in *Mason v Lewis* [2006] 3 NZLR 225 (CA) at [115].

[75] In many small companies, directors fulfil the dual roles of governance and management. In larger enterprises (such as Nathans), the functions are divided. The two approaches are reflected in s 128 of the Companies Act 1993:

> **128 Management of company**
>
> (1) The business and affairs of a company must be managed by, or under the direction or supervision of, the board of the company.
>
> (2) The board of a company has all the powers necessary for managing, and for directing and supervising the management of, the business and affairs of the company.
>
> (3) Subsections (1) and (2) of this section are subject to any modifications, exceptions, or limitations contained in this Act or in the company's constitution.

[76] Directors of finance companies operate in a dynamic business environment in which many difficult decisions of a significant nature must be made promptly, to respond to market pressures. A standard of near perfection is both undesirable and unattainable. The focus is on the range of reasonable courses open to directors, in the circumstances they face at the time a decision is made. That approach is reinforced by one of the purposes set out in the Long Title to the Companies Act 1993:

> (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; ...

[77] It is the duty of all directors to act in good faith and in the best interests of the particular company.[92] Where a company is a wholly-owned subsidiary of another, it is open to its directors, when exercising powers or performing duties as such, to act in the best interests of the holding company, even though that may not be in the best interests of the company. However, that exception applies only if the directors are expressly permitted to do so, by the constitution of the company.[93] In this case there is no evidence that the constitution permitted that to be done. Nor, in fact, did any of the directors suggest that they carried out their duties, as directors of Nathans, on that basis.

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[92] Companies Act 1993, s 131(1).
[93] Ibid, s 131(2).

[78] Any director, when exercising powers or performing duties as a director, is required to exercise the care, diligence and skill that a "reasonable director" would exercise in the same circumstances.[94] At face value, the notion of a "reasonable director" does not draw any distinction between those who act in executive or non-executive capacities. However, in determining whether the appropriate degree of care has been applied, "the nature of the responsibilities undertaken by" the particular director can be taken into account.[95] The division of responsibilities accords with the general reliance provisions in s 138 of the Companies Act, in that, in particular circumstances, a director is entitled to rely on any other director in performing his or her duties.[96]

[79] Under the statutory scheme, every director is required to sign a prospectus.[97] Section 58 of the Act makes it clear that the responsibility for ensuring that an offer document is not misleading rests on the directors. That is why a prospectus must inform potential investors of the name, address and technical or professional qualifications of any director of the issuer.[98] There is no similar requirement for a corporate issuer to disclose the names and qualifications of the company's senior management team. That is unsurprising. Those who subscribe for debt securities do so on the basis that the directors named in the prospectus have ultimate control and responsibility for their investment funds. Those who are held out to have appropriate qualifications and experience are likely to be seen as providing comfort to an investor, who may be investing limited funds to save for his or her retirement. Photographs and profiles of directors are often put into a prospectus or an investment statement to demonstrate to a potential investor that the directors have the necessary qualities and experience to act as their stewards and to safeguard their investment.

[80] So far as financial information is concerned, members of the board have a collective obligation to ensure that proper accounting records are kept.[99] They must correctly record and explain the transactions of the company, enable the financial

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[94] Ibid, s 137.
[95] Ibid, s 137(c).
[96] Ibid, s 138(1)(c). However, see *Adams v Thrift* [1915] 2 Ch 21 (CA) at 24 per Lord Cozens-Hardy MR, 25 per Pickford LJ and 26 per Warrington LJ and *Bundle v Davies* [1932] NZLR 1097 (SC) at 1099 per Myers CJ, on the limits of such reliance in the reasonable belief context.
[97] Securities Act 1978, s 41(1)(b).
[98] Securities Regulations 1983, Schedule 2, cl 5(1).
[99] Companies Act 1993, s 194(1). See also Securities Act 1978, s 53.

position of the company to be determined with reasonable accuracy at any time, enable the directors to ensure that financial statements of the company comply with s 10 of the Financial Reporting Act 1993 and enable the financial statements to be readily and properly audited.[100] After "due enquiry", directors must state, in a prospectus, whether, since the date of the last statement of financial position, there have been any circumstances that "materially adversely affect the profitability, value of assets or ability to pay liabilities within the next 12 months".[101] All of those factors suggest a need for more than a basic understanding of accounting principles.[102]

[81] Although those obligations are cast on directors, both s 2B of the Act and s 138 of the Companies Act 1993 recognise that, in certain circumstances, a director may rely on information from others. Neither s 2B nor s 138 create a defence to a criminal charge. Their relevance is to the adequacies of the inquiries actually made, the information on which the directors relied and the reasonableness of any such reliance.[103] By way of recent illustration, in the context of a prosecution of directors under the Financial Reporting Act 1993, Judge Jan Doogue, in *Ministry of Economic Development v Feeney*,[104] used s 138 to aid her inquiry into whether directors of a company took all reasonable and proper steps to ensure that its financial statements complied with that Act.

[82] Senior management will be delegated tasks by the directors. Subject to adequate monitoring of management by the directors or anything that may put a director on notice of the need for further inquiry,[105] reliance on information provided by management in their delegated areas of authority will generally be appropriate. But every reliance inquiry will be fact specific, taking into account both the

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[100] Ibid.
[101] Securities Regulations 1983, Schedule 2, cl 35. See also s 2B of the Act, where "due enquiry" is defined.
[102] See para [402] below.
[103] In *Paape v Fahey* (2005) 9 NZCLC 263,813 (HC) at paras [90] and [91], Ellen France J accepted that s 138 could inform the steps taken by directors in the context of obligations imposed by the Securities Act 1978.
[104] *Ministry of Economic Development v Feeney* (2010) 10 NZCLC 264,715 (DC). This decision was discussed in some detail in *Australian Securities and Investments Commission v Healey* [2011] FCA 717 at para [151] and following.
[105] Securities Act 1978, s 2B(1) and Companies Act 1993, s 138(2)(b) and (c).

obligations and responsibilities of particular directors and the nature of the tasks delegated to members of the management team.

[83] It is axiomatic that a director of a finance company will be assumed to have the ability to read and understand financial statements and the way in which assets and liabilities are classified. For example, a director of a finance company should be expected to know that a "current asset" is one expected to be realised within one year.[106]

[84] Without those basic skills, it would not be possible for directors to monitor and guide the finance company's business.[107] Occasionally, even directors with a significant accounting background will be entitled to rely on specialists who, in the context of the way in which the company's financial reporting is undertaken, can be expected to have explored a particular problem in greater detail and to have provided advice on which such a director might reasonably rely.[108]

[85] Directors need to have the characteristics, skills and experience to which I have referred to enable the fortunes of the company to be guided and for the management of the company to be monitored. Those obligations are cast upon all categories of directors, not just executive directors.[109]

[86] That is the context in which the directors' claims of reliance must be assessed. That approach is consistent with the terms of both s 2B of the Act and s 138 of the Companies Act 1993. Both of those provisions envisage the possibility of the need for further inquiry by a director, on the basis of information already held or incomplete information on which further explanation is required. The protections afforded by s 2B and s 138 will be forfeited if appropriate inquiry is not made.

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[106] The term "current assets" is defined by the Securities Regulations 1983, reg 2(1) in this way, reflecting orthodox and prevailing accounting standards.

[107] See, generally *Davidson v Registrar of Companies* [2011] 1 NZLR 542 (HC) at para [121] and *Australian Securities and Investments Commission v Healey,* at para [124]. See also para [401] below.

[108] See, for example, *Ministry of Economic Development v Feeney*, at para [64] in the context of the transitional period from the Generally Accepted Accounting Principles standards to the International Financial Reporting Standards.

[109] *Australian Securities and Investments Commission v Macdonald (No 11)* (2009) 230 FLR 1 at para [255] per Gzell J; approved by Middleton J in *Australian Securities and Investments Commission v Healey* at para [171]. See also *Mason v Lewis* [2006] 3 NZLR 225 (CA) at para [83] stating that "The days of sleeping directors ... are long gone".

[87] Such requirements are not unduly oppressive; nor could they be said to act as a disincentive to qualified persons acting as directors of finance companies.[110] They represent no more than the basic level of understanding needed to run a finance company, which any investor would expect a director to have.[111]

(c) The auditors

[88] An auditor is appointed at an annual general meeting of a company to report to the shareholders on the directors' stewardship of the company's assets.[112] That report must state the work undertaken, the scope and limitations of the audit, the existence of any other relationship the auditor has with the reporting entity or any of its subsidiaries, whether all information and explanations requested have been provided, whether proper accounting records have been kept and whether financial statements comply with generally accepted accounting practice.[113] The auditor must then express an opinion on whether the financial statements (and any group financial statements) give a true and fair view of the matters to which they relate and, if they do not, the express respects in which they fail to do so.[114]

[89] The Act and Regulations require audit functions to be performed by "qualified auditors" as defined.[115] In addition to the auditors' usual reporting requirements, an audit opinion completed for the purpose of a prospectus must state whether the financial statements and group financial statements comply with specified parts of the Regulations,[116] whether the relevant financial statements comply with generally accepted accounting practice and whether they give a true and fair view of the state of affairs of the entity and of its results and cash flows, for the period to which they relate.[117] The auditors' report must be included in the prospectus.[118]

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[110] See also *R v Steigrad* [2011] NZCA 304 at para [114].
[111] In relation to directors' principal duties, see, generally *Daniels v Anderson* (1995) 37 NSWLR 438 (CA) at 501-505 and *Francis v United Jersey Bank* 432 A 2d 814 (NJ 1981) at 821-823.
[112] Companies Act 1993, ss 196 and 205.
[113] Financial Reporting Act 1993, s16(1)(a)-(f).
[114] Ibid, s 16(1)(g).
[115] Securities Act 1978, s 2C, for the meaning of "qualified auditor".
[116] Securities Act 1973, s 50(1) and (2).
[117] Securities Regulations 1983, Schedule 2, cl 36(1)(f).
[118] Ibid, cl 36(1).

[90] The auditor must send to the trustee a copy of any report furnished to the company issuing the prospectus.[119] If the auditor becomes aware of any matter that is relevant to the exercise or performance of the powers or duties of the trustee, it must report in writing to the issuer, sending a copy of the report to the trustee. If requested by the trustee, the auditors must also furnish a report to the trustee on any aspect within the auditors' knowledge relevant to the exercise or performance of the powers or duties of the trustee.[120]

[91] Usually, auditors will obtain a "representation letter" from the directors that sets out facts on which the auditors have sought assistance and on which they have relied. Having said that, the auditors' functions necessarily carry with them a need to carry out independent inquiries (usually through sampling techniques) to ascertain whether the information provided in the financial statements of the issuer do, in fact, provide a true and fair view of the company's position.

(d) The trustee

[92] For a debt security, a trustee is appointed to protect the interests of public investors. The trustee's duties arise primarily from the terms of the trust deed under which it is appointed. In the trust deed of 15 November 2001, Nathans promised the trustee that it would duly and punctually observe, perform and fulfil all of the provisions of the trust deed that were binding on it. The obligation was reinforced by the form of the certificates required from directors on a quarterly basis. One of those (Schedule 3) was directed (among other things) to any materially adverse circumstances that had come to the attention of the directors; another (Schedule 4) was concerned with liquidity. The directors had ultimate responsibility for ensuring that accurate information was contained in those certificates. They knew that the trustee carried out its functions in reliance on what they reported. In this case, the chief financial officer of Nathans prepared mirror reports for the board, on which the directors say they relied in signing the quarterly reporting certificates. The extent to

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[119] Securities Act 1978, s 50(1).
[120] Ibid, s 50(3).

which they were entitled, without further inquiry, to rely on the certificate given to them by the chief financial officer is in issue.[121]

[93] By relying on certificates that directors provide, a trustee is able to exercise reasonable diligence, both to ascertain whether or not there has been any breach of the terms of the deed and whether or not the assets are sufficient or likely to be sufficient to pay maturing debenture stock. The provision of regular certificates avoids the need for the trustee to monitor the issuer's affairs in a more invasive manner.

[94] Once put on inquiry of potential problems, it is open for the trustee to obtain further factual information from the issuer. If, after "due enquiry",[122] a trustee is of the opinion that the issuer is unlikely to be able to pay all money owing in respect of the securities when it falls due for payment, it may apply to this Court for an order (among other things) imposing such restrictions on the activities of the issuer as may be necessary for the protection of the interests of security holders, restraining payment of any money by the issuer to security holders or any class of them or appointing a receiver or manager.[123]

[95] The trustee also has obligations of disclosure to the Registrar of Companies, if it were to hold information that, for example, led it to the opinion that the issuer was (or was likely to become) insolvent or was in serious financial difficulties.[124] The requirement for disclosure to the Registrar assists the latter to determine (for example) whether he or she should (in a wider public interest) exercise the power to declare a corporation "at risk".[125]

[96] Before advising the Registrar, the trustee is required to take reasonable steps to inform the company both of its intention to disclose and the nature of the

[121] For part of the period in question, Mr Doolan provided certificates for the board, as acting chief financial officer during an interregnum. See para [139] below.
[122] As defined in Securities Act 1978, s 2B.
[123] Securities Act 1978, s 49(1) and (3)(b), (e) and (f).
[124] Corporations (Investigation and Management) Act 1989, s 11(a).
[125] Ibid, s 30.

information.[126] Because of the need to act in the public interest, a trustee that discloses such information in good faith is immune from any form of proceeding.[127]

(e) Registrar of Companies

[97] In general terms, the Registrar of Companies is an administrative functionary whose task is to receive and register prospectuses and related documentation. The Registrar must register every prospectus delivered to him unless it does not comply with the Act, contains any misdescription or error, matter not clearly legible or contrary to law, or if the correct fee is not paid.[128]

[98] While there is a mandatory obligation for the Registrar to refuse registration if he or she were of opinion that the prospectus contains any statement that is false or misleading on a material particular or omits any material particular,[129] that duty must be understood in the context of what the Registrar is reviewing. In the absence of (for example) information gathered through an earlier exercise of the Registrar's powers of investigation[130] or inspection at the request (or with the approval) of the Securities Commission,[131] he or she does not hold detailed information about the issuer's business and can only exercise the power to refuse registration if put on inquiry by the content of the document (or other information received) and making whatever inquiries were considered appropriate.[132]

(f) External advisers

[99] At various times, the directors sought professional advice on particular issues that they say were relevant to their assessment of the content of the offer documents. For example, the directors say they were entitled to rely on the legal advice obtained from Minter Ellison Rudd Watts (Minter Ellison) about whether the prospectus was fully compliant.

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[126] Ibid, s 12.
[127] Ibid, s 15.
[128] Securities Act 1978, s 42(2).
[129] Ibid, s 42(3)(b).
[130] Under Part 1 of the Corporations (Investigation and Management) Act 1989.
[131] Securities Act 1978, ss 67A-68K.
[132] See Miller J's discussion of "substantial information assymetries" in *Davidson v Registrar of Companies* [2011] 1 NZLR 542 (HC) at para [99](b).

[100] Professionals such as solicitors, accountants and valuers respond to instructions provided by a client. Clients instruct; advisers advise. The quality of any advice is only as good as the information provided to the professional, on the basis of which he or she is asked to advise. In considering the extent to which directors are entitled to rely on external advice, some assessment must be made of the prime information on which the adviser acted and whether he or she was on inquiry as to the accuracy of that information.

11. Nathans' business operations

(a) The VTL group structure

[101] Nathans was one of many VTL subsidiaries. The subsidiaries' businesses fell into four categories: franchising arrangements in respect of the 24seven brand; management of the Shop24 businesses; two finance companies and four non-trading entities.

[102] There were two finance companies within the VTL group. One was Nathans. The other was VTL Group Finance Ltd, later called Chancery Finance Ltd (Chancery).[133] Both Nathans and Chancery solicited funds from the public. Neither Mr Moses nor Mr Young were directors of Chancery, though Mr Moses had some knowledge of its operations through his membership of VTL's board.

[103] The VTL business model assumes much significance in the present case because Nathans provided funding to VTL and trading subsidiaries involved in the franchising arrangements. Together, the loans made to VTL, 24seven Vending (Australia) Ltd, 24seven Vending (USA) Ltd, 24seven Vending Leasing Pty Ltd and VT Leasing Ltd comprise the inter-company debt. The 24seven companies carried on business as franchisors. Unless the context otherwise requires, I refer to all of these entities collectively as VTL.

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[133] For convenience, I use the term "Chancery" to refer to this company in periods before and after the formal change of name.

[104] "Shop24" was a different sort of enterprise. It involved the acquisition of moveable shop outlets in a container-sized structure. VTL acquired the rights to the licences from a company based in Belgium. That was done through one of VTL's subsidiaries, Shop24 NV. Shop24 Europe Ltd was involved in granting exclusive licences in Europe and non-exclusive licences for the United Kingdom. VTL Management UK Ltd was also engaged in the granting of non-exclusive licences within that country.

[105] In the 24seven businesses, the point of difference between VTL's business and its competitors was unique software installed into vending machines that allowed owners to track, from a remote location, such things as the number of items that had been sold, the amount of money actually paid into the machine and whether any technical faults had arisen that required prompt repair.

[106] The franchisor businesses had two aspects. One involved the purchase of vending machines and the installation of software into purchased machines. The other took the form of either selling franchises to a master franchisee or acquiring businesses that owned vending machines that had established sites. These businesses were carried on (primarily) in Australia and the United States of America.

[107] The franchisor sold franchising rights to a "master franchisee". The purchase price was funded by Nathans. A master franchisee paid a fee for rights to a specific geographic region and was to receive in return 20% of franchise sales, 50% of royalties[134] and 15% of machine rentals from the VTL subsidiary that owned the machines and undertook administrative and logistical duties.

[108] The master franchisees for California and a number of Australian states were Intelligent Vending LLC (IVL) and Advanced Vending Systems Pty Ltd (AVS) respectively. Those entities were (within their geographic area) responsible for selling franchises to individuals, known as operating franchisees. The master franchisee's tasks included establishment of various routes that a particular operating franchisee could acquire and use. A "route" was a selection of vending machines that an operating franchisee would manage, as part of his or her own business. The

[134] VTL received 10% of product sales, meaning the master franchisee's entitlement was 5%.

operating franchisee carried on business by collecting the money paid into the machines for the various products. At least initially, Nathans provided finance to many of the operating franchisees, even though most were based outside New Zealand.

[109] An operating franchisee could access information about the status of his or her machine through a laptop computer connected to the VTL system. VTL also had access to that data, to monitor the performance of the operator's business and to enable it to ensure that monies due to it and the master franchisee were paid.

(b) Nathans' directors

[110] The prevailing culture within the Nathans' board was very much that what was good for VTL was equally good for Nathans, and *vice versa*. That attitude pervaded the conduct of all four directors and provides the backdrop against which the views that individual directors held about Nathans' business prospects (at the times that the various offer documents were distributed) fall to be judged.

[111] Detailed profiles of each of Nathans' four directors were set out in the investment statement:

> **(a) Mr Roger Moses**
>
> Roger has significant and wide-ranging experience, especially in financial planning, where he was instrumental in the foundation and development of New Zealand's financial planning industry as well as acting as a business mentor for both new and experienced financial advisers. He founded New Zealand's first independent financial planning firm in 1972 and was strategically involved in the formation and development of the Industry body now known as the Institute of Financial Advisers (IFA).
>
> During his business career Roger has been involved in many successful business start-ups, including facilitating finance packages and developing marketing programs. Some of these include the successful Westgate Shopping Centre development in Auckland – the first open air 'mega' shopping centre of its type in New Zealand, Strawberry Fields Childcare, Calan Healthcare Property Trust and many successful fixed interest products.
>
> He continues to be very active with roles in both the business community and also with a number of charitable organisations and sporting bodies. Roger brings to the Nathans Finance NZ Limited Board a wealth of

experience, which will assist the Directors to maintain the managed growth of the finance book, he is also a member of the VTL Audit Committee that operates under a charter approved by the VTL Board.

(b) Mr Mervyn Doolan

Mervyn is a Chartered Accountant, with extensive international experience in corporate finance issues, international and domestic tax planning, mergers and acquisitions, corporate restructuring, and structured finance projects.

Previously, Mervyn has worked on substantial structured finance projects in New Zealand, the United Kingdom, the Netherlands, Japan and Australia. He was also a tax principal with Ernst & Young and a senior manager with State Bank of New South Wales in Sydney, as well as holding other senior management positions with international companies.

Mervyn’s current responsibilities for Nathans Finance NZ Limited include financial planning, structural development, systems implementation and overseeing the accounting and finance functions. He also serves as a director and executive director on a number of other boards, including previously being a major shareholder and director of a successful NZ finance company.

He has launched an initial public offer on the New Zealand Stock Exchange plus established several successful private companies.

Mervyn has a strong background in business and financial planning across a variety of sectors; he is a member of the VTL Audit Committee that operates under a charter approved by the VTL Board.

(c) Mr Don Young

Over a very successful business career, Don has had extensive experience in general and financial management, both in New Zealand and overseas.

Don is a Chartered Accountant and has held numerous senior management and executive roles, including Chief Financial Officer and Director of publicly listed companies both in the United Kingdom and New Zealand. In addition, he has held Chief Executive Officer positions with a NZ Financial Services company as well as a wholesaling and retailing group. He was previously co-owner and Joint Founding Director of Aqua-Cool Limited, which had grown over fifteen years to become one of the largest water cooler suppliers and the largest nationwide bottle delivery company in New Zealand.

Don serves on a number of other Boards in business and charitable organisations and brings considerable experience and expertise to the Nathans Board.

(d) Mr John Hotchin

> John has significant international business experience, which includes having provided strategic, marketing and IT consultancy services to a number of New Zealand, UK and Hong Kong companies. He currently serves as a director and executive director on a number of other boards.
>
> In these roles, his responsibilities have included the launch of several successful private companies, and an initial public offer on the New Zealand Stock Exchange. This included the establishment of a quality investor relationship programme, utilising a number of international and local financial advisers and shareholders. John was previously a major shareholder in a successful NZ finance company.
>
> John's contribution to Nathans Finance NZ Limited, in the areas of strategic development and marketing, has ensured we have built a strong client base, which provides steady, balanced growth of our finance book.

[112] I am satisfied that all of the directors attempted to give truthful evidence of what actually occurred. For understandable reasons, their recollections of events were, in some cases, imperfect. In the context of a detailed review of business activities from 2003 until August 2007, lapses in memories are to be expected. In a case like this, consistency with contemporaneous documentation is a better yardstick by which to measure the reliability of oral evidence. Oral evidence necessarily incorporates a degree of reconstruction. In addition, the nature of the human condition causes all of us to look back on past events on the assumption that we have always acted reasonably and responsibly, whether or not that is objectively true. I take those factors into account in assessing the reliability of evidence given by the directors and, indeed, other witnesses.

[113] Mr Hotchin struck me as an enthusiastic and energetic man who was prepared to take greater business risks than his co-directors. That approach reflected his background in marketing. He was always keen to accentuate the positive factors of VTL business-related activities. It is not hard to see Mr Hotchin as someone who promoted VTL business prospects positively (and passionately) in the boardroom environment. I assess him as someone whom his fellow directors should have realised had to be questioned closely on favourable reports about business developments of which they had much less knowledge, to avoid being influenced

unduly by an over-optimistic presentation that was not supported by hard financial data.

[114] Mr Hotchin did not regard himself as having any particular expertise in accounting and financial matters. He preferred to rely on internal management, external agencies and his co-directors to monitor financial information. Mr Hotchin was held out as someone whose "contribution ..., in the areas of strategic development and marketing, has ensured [that Nathans had] built a strong client base, which provides steady, balanced growth of [Nathans'] loan book".

[115] Mr Hotchin explained that his guilty pleas were entered on the basis that he now accepts that his honest belief of the truth of relevant statements at the time the various offer documents were distributed was not based on reasonable grounds. That view is not shared by his co-directors, who had less knowledge of the American business operations that Mr Hotchin oversaw.

[116] Mr Doolan had more business experience than Mr Hotchin. Nevertheless, I sensed an air of naiveté about some of his business dealings. Mr Doolan was prone to describe business activities and important events in very general terms. While I thought that he came close to being evasive at times, when pressed, he did his best to answer questions truthfully. Like Mr Hotchin, Mr Doolan had great faith in the VTL intellectual property product and business model, believing they would succeed to a significant extent in major markets, such as the United States. He had responsibility until early 2007 for the Australasian franchising operations.

[117] In his profile, Mr Doolan was described as having "current responsibilities" that included "financial planning, structural development, systems implementation and overseeing the accounting and finance functions". He was held out as a chartered accountant, with "extensive international experience in corporate finance issues, ... mergers and acquisitions, corporate restructuring, and structured finance projects".

[118] Having assumed office as a director in August 2003, Mr Moses became chairman of Nathans in or about September 2005. Potential investors were told that

he had been a mentor for "new and experienced financial advisers" in an industry that he had been instrumental in developing. While there is ample evidence of Mr Moses' desire to see the level of VTL's debt to Nathans reduced, in the three years or so that he chaired the board, the debt spiralled out of control.[135] Throughout that time, interest owing on the inter-company borrowings was (almost exclusively) capitalised. This accounted for a substantial part of the increase in the inter-company debt.

[119] Mr Moses sought to distance himself from any executive role.[136] He saw himself as an independent director with no executive responsibilities. Nevertheless, there is a reference in a paper prepared in February 2005, after a visit to the United States, to Mr Moses acting as the "supervisor" of two senior management personnel (Ms Short and Mr Leong), pending the appointment of a "permanent CEO". In the same document, Mr Doolan was assigned the task of "driving" the finance department until a replacement chief financial officer was found; those duties included preparation of the 2005/2006 operating plan and budgets.

[120] Mr Moses was also described as bringing a "wealth of experience" which would "assist the Directors to maintain the managed growth of the finance book". While not recorded in his profile, Mr Moses had also written (or co-authored) books on investment advice; for example, *Making Money Made Simple, Living Well in Retirement* and *Golden Rules of Wealth.*

[121] While Mr Moses had an office in another part of the building in which VTL and Nathans were situated, the evidence does not suggest that he spent much time in the VTL/Nathans' office area itself. There is evidence that he was consulted by senior management staff on occasion, particularly when Mr Doolan was not physically present.

[122] Mr Moses was also a business associate of Mr Stevens, and had been for some time. They both operated out of the suite of offices in which Mr Moses was located. I infer that Mr Moses was kept informed of VTL business developments by

[135] See para [154] below.
[136] However, see paras [397]-[402] below.

Mr Stevens informally, as well as in the context of VTL board meetings. Mr Stevens, like Mr Hotchin, was actively involved in VTL's business enterprises in the United States.

[123] Mr Young was an independent director of Nathans, joining the board in September 2005. He was the only director who had no equity interest in either VTL or Nathans. Nor did he have any indebtedness to either company, either personally or through any associated company or trust.

[124] Mr Young's experience was primarily in senior management. Those roles, together with his "extensive experience in general and financial management, both in New Zealand and overseas" were set out in his profile, together with his status as a Chartered Accountant. Mr Young had been chief financial officer in a company that was larger than VTL. He was also a successful businessman in his own right, having (together with a business partner) developed the "Aqua-Cool" water-cooling business to the point of a successful sale. While assiduous in going through board papers before Nathans' meetings and in asking questions at them, Mr Young tended to rely on what he was told by his co-directors about VTL issues; at least until his appointment to the VTL board and his first attendance at a VTL meeting on 19 December 2006.

[125] Mr Young's strengths lay in analysing the work undertaken by senior management and the reports that they had prepared for the board. It is clear from copies of board papers that he has retained, that he took care to prepare fully for board meetings and was skilful in identifying points on which further explanation was required from management. As a director, Mr Young's limitations were in the areas of policy and strategy.

[126] Members of the public reading the profiles of each of the directors would likely have seen a well balanced board. Mr Hotchin was said to have contributed to the strategic development and marketing of Nathans, in a manner that had enabled the company to build "a strong client base, which provides steady, balanced growth of" its "finance book". Mr Doolan had oversight of the company's accounting and finance functions, having had a good deal of international and domestic experience

in corporate finance, including mergers and acquisitions, corporate restructuring and structured finance projects. Mr Moses and Mr Young were independent directors, both of whom were well versed in finance issues and had the ability to understand the way in which the market worked. The profiles portrayed a particular mix of skills that was likely to have been attractive to potential investors.

(c) The senior management team

[127] At material times, only one of the senior management team was employed by Nathans: its general manager. The roles of senior management can best be considered by reference to a risk management policy that the board adopted in May 2004.

[128] The risk management policy defined the roles of members of the senior management team and directors, as well as establishing a number of committees. Policies were put in place to manage different business risks. Messrs Moses and Doolan deposed that this policy document remained in place for the balance of Nathans' trading life. No steps were taken to modify the policies when Mr Young joined the Nathans' board in September 2005.

[129] In May 2004, Mr Currie was the general manager of Nathans. His areas of responsibility were to report monthly to the board; to chair the credit, investment and management committees; to implement and achieve Nathans strategic plan and to oversee day-to-day operations of the business. Mr Currie reported directly to the Nathans' board.

[130] The chief financial officer of VTL was Ms Grant. She reported directly to the VTL board. Notwithstanding Mr Currie's roles, Ms Grant retained, as part of her responsibilities, oversight of Nathans in respect of regulatory and compliance issues, risk management, financial reporting and disclosure and related VTL/Nathans exposure.

[131] Ms Short was VTL's investment services manager. She worked for both companies from October 2001 until Nathans' receivership intervened. Ms Short

tended to take direction from Mr Hotchin, whom she regarded as a mentor in marketing matters.

[132] One of Ms Short's tasks was to make Nathans' financial products attractive to potential and existing investors. Her other areas of responsibilities were the management of Nathans' existing investor base (including investor services and retention), management of cashflow (as directed by the general manager and the investment committee) and daily, weekly and monthly investment reporting, as required by the general manager and the investment committee. Ms Short's ability as a writer also saw her playing a significant role in the drafting of prospectuses, investment statements and letters to investors. In late 2006 and in 2007, Ms Short took on a greater role in the oversight of the Australian business, after Mr Hotchin took over primary responsibility for that market.

[133] The management committee of Nathans comprised its general manager, the chief financial officer of VTL and one director of Nathans. Mr Doolan was the director who primarily fulfilled that role. However, from February 2007, this committee was left rudderless, so far as director participation was concerned. Mr Doolan, having been relieved of his VTL role in relation to the Australasian market, decided to reduce his time at the company's office.

[134] Mr Doolan's position was made known to other directors by Mr Stevens, on 13 February 2007. He advised that Mr Doolan had agreed to stay on as a "non-executive" director; he would make his knowledge and experience available in areas such as the audit process, trustee inquiries and dealings with the Inland Revenue Department and his commitment was reduced to about two days per week, generally Tuesday and Thursday. Mr Doolan was said to be available as a "duty director". No director substituted on the management committee for Mr Doolan during this period. Mr Hotchin was in the United States; in any event, by 15 April 2007, he had resigned as a director of Nathans. Neither Mr Moses nor Mr Young regarded themselves as having any executive role.

[135] The May 2004 policy also established a credit committee. It was made up of the general manager and all directors of Nathans. The credit committee's role was

"to review all new credit submission [sic] and to review material credit related issues concerning existing [Nathans] clients". The policy required "credit submissions" to be circulated by the general manager to all members of the credit committee. "Depending principally on the size of the exposure the General Manager [was to] forward the credit proposal to such members of the Credit Committee, as" he considered appropriate. Committee members were given the option of either responding directly to the general manager or requesting that a meeting be convened. No distinction was drawn between VTL-related credit applications and those made by third parties.[137] Most of the loan approval decisions in which directors participated were made by Mr Doolan and Mr Moses. The committee never met as a composite group in person.

[136] An investment committee was created to review cashflow projections of both Nathans and VTL on a regular basis "to ensure that an appropriate fundraising strategy is in place so that [Nathans] is able to meet its commercial objectives and so as to ensure that [Nathans] has sufficient liquidity on an ongoing basis". The principal tasks of the investment committee were to revise and set targeted levels of funds to be raised for a rolling six month period. The minutes of the investment committee were to be recorded and presented to the Nathans board for confirmation and approval. The members of the investment committee were Nathans' general manager, the chief financial officer of VTL, Nathans' investment services manager and any one director of Nathans. Mr Moses undertook that role.

[137] Mr Currie was general manager of Nathans from August 2003 until December 2004. Ms Wynn held that position in an acting role from January 2005 to July 2005. Mr Leong was general manager between June 2005 and early June 2007, having previously been employed from February 2005 as the company's lending manager. Mr Wright was contracted as chief executive officer of Nathans from May 2007, at about the time when Mr Leong decided to resign. Mr Wright did not give evidence.

[138] Mr Leong's evidence was that he, as general manager of Nathans, did not have access to computer systems containing information from the VTL side of

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[137] See para [144] below.

transactions, whereas senior management staff who carried out functions for both companies did. The transfer of money from Nathans to VTL business-related entities was effected through VTL staff, at appropriate levels.

[139] Ms Grant, as chief financial officer from December 2003 to March 2005 supervised the accounting staff. Between March and about August 2005 that role was assumed by Mr Cunningham. After Mr Cunningham's departure, there was then an interregnum, during which Mr Doolan was primarily responsible for functions that would ordinarily be performed by a chief financial officer; including the certification of various trust deed ratios for the board. His first certificate appears to have been given on 23 September 2005.

[140] Mr Bayer was appointed as chief financial officer on 1 May 2006 and served in that role until receivership. When appointed, Mr Bayer was relatively young and inexperienced. One of his team, Mr Bult, a financial accountant, appears to have worked primarily (if not exclusively) for Nathans. Mr Bult was employed some time around June 2005. One of his functions was to prepare and forward daily, weekly and monthly cashflow and liquidity information to the Nathans directors.

[141] Mr Steytler was legal counsel employed by VTL from July 2003 until May 2007. While he, too, was relatively inexperienced when he took up his employment, he was well regarded by all members of the board. No witness questioned his competence, integrity and conscientiousness. Mr Steytler resigned in May 2007. He was replaced by Mr Duggan, who held that position until receivership.

[142] Both Mr Leong and Mr Steytler decided to leave their respective employment around May 2007. While each was circumspect about their reasons for doing so, it is difficult to resist the inference that their departure was linked to a cessation of proper director contact and supervision during the first half of 2007.[138]

[143] All members of the senior management team in 2006 and 2007 were trustworthy and, generally, competent. I find that each of the senior management staff from whom I heard evidence (Ms Short, Mr Steytler, Mr Leong and Mr Bayer)

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[138] See paras [133] and [134] above.

were, subject to the requisite degree of supervision to be expected from any board of directors, able to carry out their respective functions capably. My one qualification relates to some problematic aspects of security for VTL business-related debts.[139] This is an area in which Mr Steytler and Mr Leong both had some involvement.[140]

(d) Nathans' credit management

[144] Discretionary limits for lending decisions were established as part of the risk management policy developed by Nathans' board, in May 2004:

> (a) Approval of new or increased credit exposures that were less than $1,000,000 required the approval of the Nathans' general manager and any one Nathans' director, or his designated nominee.
>
> (b) Approval of new or increased credit exposures greater than or equal to $1,000,000 required the approval of Nathans' general manager and any two of Nathans' directors, or their designated nominees.

At some later stage, the general manager was given a discretion to lend up to $250,000, without approval from a director.

[145] One of the central issues in this case involves disclosure to the public of the concentration risks stemming from the ratio of VTL business-related lending to the total of Nathans' receivables. The directors' contemporaneous view of a proper level of debt concentration in a finance company such as Nathans was captured in the May 2004 risk management policy:

> <u>(3) Concentration Risk</u>
>
> No one Borrower or Borrower Group shall comprise more than 10% of [Nathans'] total receivables book at any point in time.
>
> *At the time of writing this document [Nathans] has two Borrowers' who each have borrowings in excess of this level. [Nathans], together with its shareholder VTL Group, is working to ensure that by 30 June 2006 these*

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[139] Defined at para [151](b) below.
[140] See paras [147]-[149] below.

> *exposures are reduced to the prudent level of no greater than 10%.* (Original emphasis)

[146] Despite the wording of this policy, Mr Moses gave evidence that he believed the 10% limit applied to VTL and IVL individually. That would have made the actual "prudent level" 20% of Nathans total receivables book; a level which Mr Moses described in evidence as a "perfect world" one. At a subsequent strategy meeting in June 2004, the board proposed a "target composition of the receivables book as at ... June 2006" of "33% commercial receivables and 66% VTL related receivables". Mr Moses made a contemporaneous note, indicating that ratio was "still too high".

[147] There were shortcomings with the way in which management dealt with some issues involving security for loans, particularly in relation to VTL business-related debts. Some of these related to the age and type of assets (normally vending machines) used as security for some of the loans. On occasion, their ostensible value was less than the facility granted to the relevant VTL company by Nathans. Those issues ought also to have been known to those directors who signed the loan agreements containing the security clauses. They were there to be seen if the documents had been read.

[148] However, the most significant of the security concerns involves the intention of Nathans to take a general security agreement (GSA) over VTL's undertaking to secure all of the inter-company borrowings. In early 2006, it was reported to Nathans' board that a GSA had been taken. The board proceeded on that basis. Indeed, the prospectus specifically referred to the VTL loans as being secured over "all the assets of VTL", a reflection of an honest belief held by both directors and management of Nathans that a GSA had been executed and registered before 13 December 2006. That turned out to be incorrect. A GSA was not, in fact, registered until February 2007.

[149] Although counsel for the Crown criticised the directors in relation to the GSA issue, I do not believe that was wholly justified. The directors made a decision to obtain the security and were entitled to expect management to implement that decision. While it is appropriate to question whether the directors who signed loan

agreements involving VTL and Nathans in August 2006 were on notice of the problem, I am not prepared to be overly-critical of them in that regard. Execution of documents of that type was routine, once a decision to lend (or re-lend) had been made. The much more problematic aspect of the board's decision-making lay in the constant roll-overs of potentially impaired debt; an issue that tends to subsume and dwarf the security concerns.

12. Nathans' lending concentration

(a) Classifications

[150] During the evidence different descriptions were used to identify classes of indebtedness arising out of loans from Nathans. Some definition is required to avoid inappropriate comparison of figures at relevant times.

[151] In these reasons:

(a) I use the term "inter-company debts" to refer to moneys owing to Nathans by VTL, 24seven Vending (Australia) Ltd, 24seven Vending (USA) Ltd, VT Leasing Ltd and 24seven Vending Leasing Pty Ltd.

(b) The term "VTL business-related debts" combines the inter-company debts with those owed by IVL and AVS.

(c) The term "commercial" lending is used to cover the balance of Nathans' loan book. This category includes operating franchisees.

[152] In one significant aspect, this classification differs from that used for reporting purposes to the board. While the amounts owed by IVL and AVS were consistently advised to the board in Mr Leong's reports, they were treated as part of the "commercial" lending. I elect to treat them differently because the fortunes of IVL and AVS were inextricably linked to that of VTL. Those debts could not be repaid unless the respective businesses were sold as part of a wider disposal of VTL business units in the particular country. Where appropriate, I have endeavoured to

calculate the quantum of VTL business-related debts by reference to information in contemporary board papers. I accept that there could be some immaterial errors in my calculations.

[153] There was also "related party" lending. This involved trusts associated with Messrs Doolan, Hotchin and Stevens. Loans of about $1.15 million each were made to trusts[141] associated with Mr Hotchin and Mr Doolan allowing them to obtain a shareholding in an American company, All Seasons Services, Inc (All Seasons) of which VTL had acquired part. A further advance of $75,000 was made to a trust associated with Mr Stevens. Subsequently, that loan was increased to $125,000.

(b) The inter-company debts

[154] The staggering increases in the level of inter-company debt can best be tracked by reference to the financial year ended 30 June 2004. I use that date because of my earlier reference to the risk management policy, developed in May 2004, as a means of understanding the way in which the directors of Nathans approached repayment of the inter-company debt:[142]

(a)	30 June 2004	$11.65m
(b)	30 June 2005	$60.78m
(c)	31 December 2005	$73.63m
(d)	30 June 2006	$79.63m
(e)	31 December 2006	$95.28m
(f)	31 March 2007	$103.63m
(g)	30 June 2007	$108.50m

[141] Being the trusts that held shares in VTL: see para [7] above.
[142] See paras [144]-[146] above.

The amount owing at the date of receivership was also in the vicinity of $108 million.[143]

[155] Despite the frequently stated intentions of the directors to reduce the inter-company indebtedness, it grew by almost $100 million in a period of just over three years. The increase had three significant components. One was a continual outflow of money from Nathans to enable VTL to expand its businesses, particularly in the United States. The second was the regular capitalisation of interest due from VTL to Nathans. A third involved advancing money to VTL to prop up Chancery.

[156] Although the evidence on the third of those topics was not fulsome, it appears that, in late 2006, difficulties had arisen with Chancery's liquidity. Because Chancery had maturing debts owing to public investors, Nathans was called upon to advance further money to VTL so that it, in turn, could meet its guarantee to Chancery to repay its investors on time. In the Nathans board papers for the month ended November 2006 (for its meeting on 19 December 2006), quarterly payments of $356,000 were disclosed as having been met by Nathans. The evidence suggests that in total (at least) $1.75 million was appropriated from Nathans for this purpose, mostly in 2007. The effect of this was that, during that time, money received from Nathans' investors was being used to repay Chancery's own public investors.

(c) The VTL business-related and commercial debts

[157] To obtain a figure for what I have called "VTL business-related debts" it is necessary to add the amounts owing by IVL and AVS to the outstanding inter-company advances at the various dates.

[158] Starting from 30 June 2005, the IVL and AVS indebtedness to Nathans was:

	Date	IVL	AVS
(a)	30 June 2005	$21.92m	$13.54m

[143] Draft interim report to Ministry of Economic Development, prepared by Ferrier Hodgson and dated 17 August 2007.

(b)	31 December 2005	$22.18m	$13.53m
(c)	30 June 2006	$22.82m	$13.65m
(d)	31 December 2006	$23.31m	$13.66m
(e)	31 March 2007	$23.59m	$13.65m
(f)	30 June 2007	$23.89m	$13.60m

[159] As at 17 August 2007,[144] the total of the amounts owing by master franchisees to Nathans was estimated to total $43 million. The difference between that amount and the total of $37.49 million as at 30 June 2007 is accounted for by the inclusion of interest and a debt owed by the New Zealand master franchisee. As at the time of receivership, the total of the VTL business-related indebtedness was approximately $151 million.

[160] Because VTL made some interest payments in cash by VTL from January 2007 until receivership, the percentage of VTL business related indebtedness to Nathans remained reasonably static. At material times, the VTL business-related indebtedness, as a percentage of Nathans' receivables, was:[145]

(a)	30 June 2006	$116.10 million – 77.5%
(b)	31 December 2006	$132.25 million – 83.8%
(c)	31 March 2007	$140.87 million – 84.1%
(d)	30 June 2007	$145.99 million – 84.9%

[144] Draft interim report to Ministry of Economic Development, prepared by Ferrier Hodgson and dated 17 August 2007.

[145] These figures and those in paras [154], [158] and [162] are taken from the Nathans' general manager's report for board papers for those months' end. The figures differ in some respects from those summarised in a Crown exhibit to reflect how I read the relevant parts of the report. If anything, the figures I have used are more favourable to the accused.

[161] These percentages compare unfavourably with the "perfect world" objectives set out in the risk management policy of 2 May 2004, under the heading "concentration risk" and the revised "target composition of the receivables book as at ... June 2006" of "66% VTL related receivables". Even the latter was regarded by Mr Moses, at the time, as "still too high".[146]

(d) "Commercial" loans

[162] Including debts owed by operating franchisees, the commercial loan book made up the balance of the total receivables in each of the periods in question.[147] That meant that, as a percentage of the total receivables, the commercial loans were:

(a) 30 June 2006 22.5%

(b) 31 December 2006 16.2%

(c) 31 March 2007 15.9%

(d) 30 June 2007 15.1%

13. Preparation of the 2006 investment statement and prospectus

[163] Preparation of the December 2006 investment statement and prospectus began in about September 2006. The pre-existing practice of using the previous year's prospectus as a starting point was maintained. Messrs Steytler, Bayer and Leong and Ms Short, in conjunction with Mr Doolan, were involved in its preparation. At identified milestones, those with responsibility for progressing particular aspects of the preparation process liaised with external solicitors, Staples Rodway and the trustee, Perpetual.

[164] The 2006 prospectus team also had regard to a report issued by the Securities Commission on 22 April 2005, on the topic of public disclosure of information by

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[146] See paras [144]-[146] above.
[147] These figures require some adjustment to take account of debts owed by trusts associated with VTL/Nathans' directors but are more favourable to the accused.

finance companies in offer documents issued to members of the public.[148] There was also specific correspondence, in early 2006, between Nathans and the Commission about its 2005 prospectus. The correspondence arose out of the Commission's signalled review of a sample of finance company prospectuses, in early 2006.

[165] The Securities Commission's letter to Nathans was dated 20 March 2006. It referred specifically to the guidance on disclosure by finance companies, published in its April 2005 report. A number of issues were raised in the context of Prospectus No 7, registered on 19 December 2005, as well as in a number of advertisements. Issues involving business activities and risk were raised:

> Activities and risks
>
> 8. We understand from the investment statement that Nathans was originally established to finance the activities of the VTL Group, and that it has since expanded into other commercial lending but is still significantly exposed to VTL. We query whether there is sufficient information given about this relationship to enable investors to properly assess the associated risks. In particular, it is not clear what proportion of Nathans' funds are loaned to VTL and other related parties. There also appears to be very little information about non-VTL lending and the industry or geographical sector-specific, or other, risks that may be associated with it. May we please have your comments on this?
>
> 9. It appears that, at least to some extent, Nathans acts as a funding vehicle or conduit issuer for VTL. Have you considered whether VTL might itself be an issuer of the debt securities offered by Nathans? We would be interested in your comments on this.

[166] The Commission's letter was received by Mr Steytler and seen by, at least, Mr Doolan. Mr Steytler responded on 31 March 2006, on VTL letterhead. Relevantly, his response addressed the queries raised on activities and risks:

> 8. Investment Statement – Activities & Risks
>
> We consider that Nathans' exposure to its parent is covered in both the section "Activities" and as a risk matter in the section "What are my Risks?". The directors were at considerable pains to disclose the significance of the inter-group lending without being completely specific as to the quantum given that it would fluctuate over time.

[148] Securities Commission *Report on Disclosure by Finance Companies* (2005).

> 9. Investment Statement – Nathans as a funding vehicle
>
> We do not consider as a legal or practical matter that any money paid in consideration of the securities is received on behalf of VTL. Nathans is a separate entity, with a separate board of directors, and has a number of uses for its funds. It is not the agent of its parent and any inter-group lending is done on arms-length commercial terms.

On 19 April 2006, Mr Steytler advised the VTL directors (but not Mr Young) that the Commission did not propose to take "any further action" at that time.

[167] The Commission's report was made available to directors and known to them at the time the 2006 prospectus was being finalised. Mr Doolan had seen the correspondence. I consider it very likely that other directors did too; I refer to Mr Steytler's evidence in relation to the circulation of the Commission's letter to directors and the likelihood of a draft reply being sent by him to Mr Doolan and other directors for comment.

[168] Meetings of the project team were held from time to time, in seemingly informal circumstances. For most of the time, each worked on the tasks for which they had primary responsibility. All were involved in the team's final review process:

(a) Mr Steytler was responsible for legal aspects of the prospectus and for co-ordinating the team's work. His responsibilities included compliance issues, such as liaising with external solicitors, Perpetual and the Registrar of Companies. Mr Leong had attended a seminar on disclosure run by the Securities Commission and assisted with disclosure issues.

(b) Ms Short, as the marketing manager, took primary responsibility for the preparation of the narrative, on the basis of financial and legal advice obtained from both internal and external sources. Ms Short gave evidence of discussions with Mr Moses about the content of the chairman's letter. He had said that Nathans had a positive story to tell and that the key message was that there were no bad debts and no

problems of the type that had led to the collapse of three smaller finance companies, earlier in the year.

(c) Mr Bayer had responsibility for the financial statements and liaising with the audit team established by Staples Rodway for prospectus purposes. By this time, the directors had signed their annual accounts, for which Staples Rodway had provided an unqualified audit report. The accounts were signed and the opinion expressed on 5 September 2006.

(d) Mr Doolan had oversight of the project.

[169] Mr Steytler, Mr Leong and Ms Short all agreed that there was a culture of compliance within the Nathans' directorate. However, Mr Steytler expressed reservations about Mr Hotchin's commitment to the concept. He described Mr Hotchin as "aggressively commercial" in nature; a description I suspect that Mr Hotchin would wear as a badge of honour.

[170] There was a protocol to refer the prospectus to the directors for comment at the time of completion of various tasks. The directors had an opportunity to make comments on the narrative of the prospectus and investment statement and to require changes to be made to it. That was important because the directors were aware that, while the "risk" section was new, much of the narrative was adopted (or adapted) from the 2005 prospectus. The ability to comment provided the directors with an important opportunity to review the whole of the text in light of what they knew the current state of Nathans' business to be.

[171] In mid-November 2006, there were a number of communications between Mr Steytler and Nathans' external solicitors, Minter Ellison. The solicitors had concerns about the proposed section on risk, having regard to the Securities Commission's report.

[172] Minter Ellison reported to Mr Steytler on 14 November 2006. Mr Steytler's file indicates that he liaised with others in the management team (including

Mr Doolan) to make changes to the draft prospectus and investment statement. This was to comply fully with the strong recommendations made by the external solicitors for full disclosure of any risks, in light of the Commission's report and subsequent correspondence.

[173] After liaising with Mr Doolan and other members of the prospectus preparation team, Mr Steytler proposed that the inter-company advances from Nathans to VTL be disclosed as percentages of the total loan book in the "Risks" section of the documents. A calculation was done, showing that the inter-company indebtedness (of $79,630,043) amounted to 46.2% of the total assets, as set out in the 30 June 2006 financial statements. There is no evidence that Minter Ellison were advised that the inter-company indebtedness had increased substantially since June 2006.[149]

[174] When Mr Steytler circulated those proposals (together with a draft prospectus and investment statement containing those recommendations), he met with some resistance. The responses from directors reflected a very real tension between full disclosure to the public and the commercial imperative of "selling" the offer to the public.

[175] Mr Steytler forwarded to all directors a "clean" and a "full marked up" copy of the investment statement, indicating that similar documents would be forwarded shortly in relation to the prospectus. Comments from the auditors were also being considered at that time.

[176] After receipt of his copies of the investment statement, Mr Moses responded by saying that he regarded the requirements for the "Risk" section as being "tough" but added that, presumably, there was no option but to comply for regulatory purposes. Subsequently, Mr Hotchin responded from the United States. His view was much more trenchant. He considered that the "Risk" section of the investment statement should be "toned down". He regarded this aspect as a "major concern".

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[149] See paras [154] above and [416](b) below.

[177] Mr Steytler responded by indicating the basis on which the amounts and percentages of inter-company borrowings to total assets had been calculated. In the meantime, Mr Steytler continued to liaise with Mr Doolan, other members of the senior management team, the external solicitors, auditors and Perpetual.

[178] On 30 November 2006, at 5.13pm, Mr Moses expressed himself as "agreeing with the others". He said:

> We need to tread the fine line between being open and upfront, but not overly obvious. I hope the wording can be modified further to convey a true and realistic view of the risks without sticking it too far up the investors noses ... so to speak. Please see what can be done, while remembering of course that we have to watch the timing carefully.

[179] I remain unclear about what Mr Moses meant when stating that he was "agreeing with the others". There was no evidence of specific discussions among directors, whether formal or informal, during this period. I work on the premise that, while directors wished to comply with regulatory requirements, each accepted that there was a need to be "commercial"; otherwise, there would be no point in going to the market.

[180] Mr Steytler responded further at 6.17pm on 30 November 2006, copying in all other directors of Nathans and the prospectus team, to whom Mr Moses had also sent his email. He advised that the figures had been included on advice from the external solicitors. At 8.08pm on 30 November 2006, Mr Young responded to Mr Steytler with apparent agreement to the terms of the documents forwarded to him, adding that he "hoped" the "Risk" section met regulatory requirements.

[181] On 1 December 2006, at 2.46am, Mr Hotchin (then in the United States) responded in strong terms:

> I strongly urge that the RISK section is changed as if this is going to market NO cash will come in.
>
> This is totally none [sic] commercial and I dought [sic] that any other company would give such indephth [sic] details as this, this is simply not commercial.

> David [Steytler] you keep quoting our external solicitor as the driving force behind this, who is the solicitor and when did a lawyer take control of the decisions the BOARD make.
>
> I AM NOT HAPPY WITH THE RISK SECTION, IT NEEDS MODIFICATION URGENTLY.
>
> David, do not copy management on your reply. Please only address the DIRECTORS.

Although Mr Hotchin sought to downplay the tenor of his comments (characterising it as a petulant attempt to get his own way) any objective reading of his email would have identified a need to address a serious problem. Ironically, given his focus on marketing, Mr Hotchin appears to have been the only director to appreciate the need for a "board" decision on this issue.

[182] Mr Steytler, at 9.22am on 1 December 2006, noted the comments made by the directors and indicated that he was addressing them. What followed was a series of communications (mainly by email but also by telephone) between Mr Steytler and representatives of Minter Ellison, Ms Lane (the partner responsible) and Ms Bailey.

[183] It is clear from advice given by Minter Ellison at both 12.39pm and 2.05pm that the lawyers were not happy with excluding the specific amounts but suggested that if that were to occur wording along the lines of "very significant" or "almost half" should be used.[150] A draft that Mr Steytler had prepared after input from directors had used the word "significant proportion". The last email from Minter Ellison was, inadvertently, not forwarded to the directors by Mr Steytler. The directors say they would have complied with the solicitors' advice, had they received it.

[184] No board meeting was held to discuss the final content of the prospectus. Nor was there a telephone conference in which all directors participated to agree upon the narrative part of the prospectus, particularly those aspects that related to questions of risk. I find that surprising, given the nature of the concerns raised by Mr Hotchin in his email of 1 December 2006 and the knowledge that each director had of the more stringent requirements set out (generally) in the Securities

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[150] If the comparison was between inter-company debts and total receivables as at the date of the prospectus the percentage would have been over half.

Commission's 2005 report and (more specifically) the Commission's correspondence with Nathans, in early 2006.

[185] This was, as Mr Hotchin recognised in his email, a quintessential board issue. It involved a policy decision: to what extent do we emphasise risk? Had a meeting (or even a more informal teleconference) been held the directors would have turned their collective minds to the content of the risk section, on the basis of appropriate information to be obtained through management. An opportunity for the directors to ensure the "Risk" section was compliant was lost. At such a meeting, the directors could have read through the two offer documents and compared the content with the position that they knew existed. Further advice could have been sought on any agreed approach, based on an updated factual position on which the lawyers could advise. The absence of a collective discussion meant that the directors "considered" the documents on an individual basis and, in my view, failed to treat the issue with the solemnity it deserved. The fault for not convening a meeting must rest primarily with the chairman of the board, Mr Moses.[151]

14. The content of the investment statement and prospectus

(a) The investment statement

[186] The first page of the investment statement is headed "Important Information". The form of that part of the investment statement is prescribed.[152] In accordance with the statutory requirements, the document makes it plain that "investment decisions are very important" and "often have long-term consequences". The recipient is told to read all documents carefully, to ask questions and to seek advice before committing himself or herself to a contract.

[187] A list of questions follows. The recipient is told to "consider carefully the answers" to those questions, in light of information set out in the body of the document addressing them. Those questions include:

[151] See para [399] below.
[152] Securities Regulations 1983, Schedule 3D, cl 1(1).

(a) "Who is involved in providing [the investment] for me?";

(b) "What are my risks?"; and

(c) "What other information can I obtain about this investment?"

[188] The recipient is referred to the current registered prospectus and advised that "important information" can also be found in that document. The recipient is told that he or she is "entitled to a copy of that prospectus on request".

[189] An expectation that some investment advice will be sought comes from the second heading on the first page of the document: "Choosing an Investment Adviser". The recipient is advised that he or she has "the right to request from any investment adviser a written disclosure statement stating his or her experience and qualifications to give advice". Strong encouragement was given to request a statement of that type.[153]

[190] The next part of the investment statement consists of a letter from Nathans' chairman, Mr Moses. His experience and qualifications were also set out in the document.[154] In that, letter Mr Moses described Nathans as having "a proud history of providing investors with quality investment opportunities in Secured Debenture Stock", adding that the company continued "to deliver strong profit results". He referred to the financial statements for the year ended 30 June 2006, in which an audited net surplus of $4.97 million was reported; an increase of 47% on the previous year's result.

[191] Mr Moses referred to an "unblemished nil bad debts record", by reference to Nathans' "consistent profits", combined with its "robust credit assessment process and a strong level of corporate governance".[155]

[192] Mr Moses described Nathans as specialising in "commercial" lending. He pointed out that it provided "loans to a broad range of commercial entities, including

[153] See also paras [68] and [69] above.
[154] Mr Moses' profile is set out at para [111](a) above.
[155] The "nil bad debts" theme was a constant in Nathans (and VTL's) promotional activities: for example, see paras [243], [262] and [353] below.

franchisees under VTL's franchising brands 24seven and Shop24", stating that Nathans was not engaged in "higher risk" consumer areas, such as vehicle and retail consumer lending. He added that "Nathans has a growing commercial lending book that includes diverse sectors, such as manufacturing, recreation and leisure, hospitality, transport and service industries".

[193] In a summary of Nathans' business activities, potential investors were told that Nathans was a wholly owned subsidiary of a listed company, VTL, and that it had "provided financial accommodation and financial services, to both commercial entities and private individuals using the proceeds from the issue of debenture stock". The intended investor was then told that Nathans provided finance to individuals participating in VTL's franchising programmes under the 24seven and Shop24 brands. Reference was made to financing provided to VTL (and its related interests) for the acquisition of electronic vending equipment, vending operation franchises, as well as master and operational franchises in New Zealand, Australia, the United States of America, the United Kingdom and Europe. The summary continued:

> ... *In addition* the company provides commercial finance to a growing client base that includes diverse sectors, such as manufacturing, recreation and leisure, hospitality, transport and service industries. The Company does not provide consumer retail or motor vehicle finance. (my emphasis)

[194] VTL's principal activities were said to include franchising of the 24seven and Shop24 brands, vending machine technology development, commercial operations and finance. In explaining the nature of the financial arrangements between Nathans and VTL, the investment statement revealed that such advances had been made "on a commercial arms length basis, normally for terms no longer than 12 months" and that VTL was "actively seeking to repay these loans by arranging loan facilities in the country of origin". Specifically, the recipient was advised:

> If VTL Group becomes insolvent and is unable to repay this debt to the Company, then the financial position of the Company will change significantly.

[195] In another part of the investment statement the question “What are my risks?” was answered. Factors that could lead to the “risk” event of insolvency were identified:

(a) Borrowers might default and become unable to meet interest and principal payments.

(b) The concentration of a “significant” portion of Nathans loan portfolio to VTL and its subsidiaries, as well as individuals and entities participating in VTL’s franchising programme. Potential investors were told that, if some or all of the borrowers were simultaneously unable to repay the loans made by Nathans, “this could have a material adverse effect on” Nathans. The recipient was referred to the “Credit Risk” heading for further information.[156]

(c) Investors were told that, in the event of insolvency, they may, on maturity, receive less than the amount of their original investment.

[196] Two important aspects of the risk profile related to the parent company advances and general credit risks. Notwithstanding some repetition, I set them out in full. Using the term “Company” to describe Nathans, those issues were addressed as follows:

> ...
>
> ***Parent company***: The Company provides significant financial accommodation to its parent company VTL and to VTL subsidiaries. These advances make up a significant proportion of the Company’s current assets and are secured. Advances to VTL and its subsidiaries have been made on a commercial arms length basis, normally for terms no longer than 12 months. VTL and its subsidiaries are actively seeking to repay these loans by arranging loan facilities in the country of origin. However, if VTL becomes insolvent and is unable to repay this debt then the financial position of the Company will change significantly and the Company is likely to become insolvent itself.
>
> VTL’s insolvency could arise for a number of reasons. These include if VTL’s cost of funds or other expenses become excessive in relation to its revenue. VTL’s primary revenue source is derived from franchise sales, predominantly in the United States and Australasian markets. Other revenue

[156] See para [196] below.

streams include the collection of monthly monitoring fees and on-going sales royalty income from VTL's franchise business system, the sale of VTL hardware and software, and interest and fee income derived from finance company activities. In addition VTL receives revenue from the manufacture and commercial sales of Shop24 units. VTL Group's operating revenue for the period ending 30 June 2006 was $48.5 million, an increase of 13.9% on the previous reporting period. Operating expenses reduced by 28% to $43.1 million.

Specific risks

Credit risk: Nathans lends money to a variety of customers, including individuals, companies, and individuals participating in VTL's franchising programmes. The most significant credit risk is the risk that the Company is not able to recover loans in full from borrowers. The Company manages its exposure to credit risk by adhering to its credit policy. All loans are approved in accordance with this policy and loans are managed and reviewed on an ongoing basis by the General Manager and Directors. As part of this policy, limits on exposures with counter parties have been set and approved by the Board of Directors and are monitored on a regular basis. The Company performs credit evaluations on all customers requiring credit. If a loan develops, or appears likely to develop adverse features the loan file is transferred to the credit recovery team for ongoing management and recovery (if necessary). Where a borrower is unable to repay the debt owed for whatever reason, the credit recovery team will use all appropriate actions (including the enforcement of the security taken by the Company, and litigation where advisable) to avoid or mitigate loss to the Company.

The Company seeks to ensure that borrowers meet their obligations to it by taking appropriate security from these borrowers. However, it is possible that the value of security taken might fall rendering the Company unable to realise proceeds sufficient to satisfy the borrowers obligations. It is also possible that enforcement may not be possible or be prohibitively expensive.

Nathans' robust credit assessment and corporate governance processes have ensured that the Company has retained its unblemished nil bad debt record for the period ending 30 June 2006. The Company continues to make provision for doubtful debts.

...

Liquidity Risk: Liquidity risk is the risk that a company may (though solvent) encounter difficulties in raising funds at short notice to meet its financial commitments as they fall due. Details of the Company's liquidity profile are set out in the audited financial statements contained in the Prospectus. The Company has policies in place to ensure that all obligations are met within a timely and cost efficient manner, and prudential policies are regularly monitored. In addition, the Company monitors its liquidity ratios monthly against prior month and financial year performance. The Company's Trustee also monitors the Company's liquidity profile quarterly.

....

[197] The application form contains the following declaration:

4. DECLARATION AND SIGNATURE

> *I/We have read the Investment Statement dated 13 December 2006, as attached, and **1**. acknowledge that the investment is made in terms of the Investment Statement dated 13 December 2006 and as set out in the Trust Deed dated 15 November 2001 and the current registered prospectus.* **2**. hereby apply for Secured Debenture Stock as recorded overleaf. **3**. agree to accept the Secured Debenture Stock applied for or such lesser amount as may be allotted to me/us. **4*** nominate the adviser whose details appear on this application form as my/our adviser, and **5*** agree to Nathans Finance NZ Limited providing the nominated adviser access to information related to my/our investment under the terms of the Privacy Act 1993, as set out on in the 'How to invest with Nathans Finance NZ Limited' section on the reverse of this application form. **Cross out if not applicable* (my emphasis)

(b) The prospectus

[198] The first page of the prospectus disclosed that the purpose of the offer was to "provide funds for the development of [Nathans'] business of providing financial accommodation and financial services". There was no reference to the provision of working capital to VTL.[157]

[199] The prospectus (in all material respects) replicated the narrative of the investment statement; in particular, those parts dealing with Nathans' business activities and risks.[158] In those respects, the content of the prospectus reinforces the information gleaned from the investment statement.

[200] The investment statement specifically referred the notional investor to the liquidity profile.[159] That profile is part of the notes to the audited financial statements of Nathans, for the year ended 30 June 2006, under the heading "Liquidity Management". Note 19 states:

> **19 Liquidity Management**
>
> Liquidity risk is the risk that Nathans will encounter difficulty in raising funds at short notice to meet commitments associated with financial instruments. Nathans maintains sufficient liquid funds to meet its commitments based on historical and forecasted cash flow requirements. Call accounts and short term deposits are held to manage the treasury of Nathans by acting as a liquidity buffer. The exposure is reviewed on an ongoing basis from daily procedures to monthly reporting. *The liquidity of*

[157] Compare with para [419] below.
[158] See paras [193]-[196] above.
[159] See the "Liquidity Risk" section, set out at para [196] above.

Nathans is supported by intercompany borrowings from parent company, VTL, although VTL does not guarantee the Debenture Stock.

The companies maturity and repricing analysis are the same except for loans and advances. Loans and advances can be repriced at any time as they are subject to variable rates. (my emphasis)

[201] The tables that follow Note 19 provide the following information:

Liquidity Profile
June 2006

	Total	0-6 months	7-12 months	13-24 months	25-60 months	60+ months
	$	$	$	$	$	$
Financial Assets						
Finance receivables	58,442,889	9,176,031	25,189,845	21,859,075	12,212,098	5,840
Intercompany advances	79,630,043	39,500,000	40,130,043	-	-	-
Cash at bank	12,160,806	12,160,806	-	-	-	-
Other current assets	745,785	211,236	-	493,165	41,384	-
Taxation receivable	17,222	-	17,222	-	-	-
	160,996,745	61,048,073	65,337,110	22,352,240	12,253,482	5,840

...

Liquidity Profile
June 2005

	Total	0-6 months	7-12 months	13-24 months	25-60 months	60+ months
	$	$	$	$	$	$
Financial Assets						
Finance receivables	70,207,341	20,136,042	4,911,179	20,566,326	24,593,794	-
Intercompany advances	60,777,273	-	60,777,273	-	-	-
Cash at bank	5,300,000	5,300,000	-	-	-	-
Other current assets	756,483	720,759	-	-	35,724	-
Taxation receivable	-	-	-	-	-	-
	137,041,097	26,156,801	65,688,452	20,566,326	24,629,518	-

[202] Someone with a greater degree of financial literacy than the "prudent but non-expert" person might go deeper into the financial statements. As what is recorded there has some relevance to the "reasonable grounds" defence, I set out relevant parts. The statement of financial position as at 30 June 2006 revealed:

	Note	30 June 2006 $	30 June 2005 $
...			
Current Assets			
Cash at bank	5	12,160,806	5,300,000
Finance receivables	6	34,365,876	25,047,221
Intercompany advances	16	79,630,043	60,777,273
Other current assets	7	745,785	756,483
Income tax receivable	3	17,222	-
Total current assets		**126,919,732**	**91,880,977**
Non-Current Assets			
Finance receivables	6	34,077,013	45,160,120
Property, plant and equipment	8	11,326,095	5,682
Total non-current assets		**45,403,108**	**45,165,802**
Total assets		**172,322,840**	**137,046,779**

...

[203] The treatment given to both inter-company advances (under current assets) and finance receivables (under current and non-current assets respectively) suggest a need to consider notes 6 and 16 to the finance statement:

6 Finance receivables

	Note	30 June 2006	30 June 2005
		$	$
Receivable within one year			
Vending licences financing		26,309,364	20,143,213
Equipment financing		-	7,303
Other advances		8,448,064	5,043,348
		34,757,418	25,193,864
Less General Provision for doubtful debts		(132,736)	(146,643)
Less Specific Provision for doubtful debts		(258,806)	
Receivable within one year		34,365,876	24,047,221
Receivable beyond one year			
Vending licences financing		24,044,295	29,659,279
Equipment financing		3,000,000	9,507,577
Related party receivables		2,279,152	2,230,714
Other advances		4,954,114	3,762,550
		34,277,561	45,160,120
Less General Provision for doubtful debts		(200,548)	-
Receivable beyond one year		34,077,013	45,160,120
Total finance receivables		68,442,889	70,207,341

Vending licences financing loans are for terms ranging from three years to ten years and are secured over the borrowers rights, title and interest under the licencing agreements. The vending licences financing loans receivable within one year as at 30 June 2006, include a number of term vending licence receivables existing at 30 June 2006 that were refinanced in the current year.

Equipment financing loans are to finance the purchase of vending machines and motor vehicles. The loans are for terms of two to seven years and are secured over the vending machine assets.

Related party receivables include loans to The McConnochie Trust and Boston Trust, parties which are associated with directors John Hotchin and Mervyn Doolan. The loans are for a term of three years and are secured by shares in VTL Group Limited.

Other advances include general commercial lending and are for term up to three years. The company requires collateral or other security to support the loan.

....

16 Transactions with Related Parties

Nathans Finance NZ Limited is a wholly owned subsidiary of VTL Group Limited “VTL” (formerly: Vending Technologies Limited) (2005: 100% owned).

> VTL does not guarantee the obligations of Nathans Finance NZ Limited.
>
> Advances from Nathans to VTL and subsidiaries at 30 June 2006 totalled $79,630,043 (2005: $60,777,273). Interest is charged on advances at 13.0% per annum (2005: 13% pa).
>
> VTL Group Limited provides management and administration services to Nathans Finance NZ Limited, for which Nathans has paid $127,308 for the twelve months to 30 June 2008 (2005: $215,218).
>
> Nathans provides registry services to VTL Group Finance Ltd ("VTLGF"), a wholly owned subsidiary of VTL, for which VTLGF has paid $20,000 in the year ended 30 June 2006 (2005: $20,000).
>
> Nathans has a capitalised interest loan to Sally Hotchin as Trustee of The McConnochie Trust, a party associated with director John Hotchin, the sum of $1,163,795 for a term of three years at 13% (2005: 13%). At balance date the full amount of the loan is outstanding (2005: $1,115,357).
>
> Nathans has loaned Joanne Doolan as Trustee of Boston Trust, a party associated with director Mervyn Doolan, the sum of $1,115,357 for a term of three years at 13% (2005: 13%). At balance date the full amount of the loan is outstanding (2005: $1,115,357).
>
> No related party debts have been forgiven or written off (2005: $Nil).
>
> Nathans has paid Moses Stevens & Associates Limited $15,000 in the twelve months to 30 June 2006 for consulting services provided by Kenneth Roger Moses (Chairman) (2005: $2,250).
>
> Nathans has paid Crescent Consultancy Services Limited $20,052 in the twelve months to 30 June 2006 for directors fees for Donald Young (Director) (2005: $Nil).
>
> On the 30th of June 2006 Nathans purchased Vending Machines from 24seven Vending (NZ) Limited and 24seven Vending Leasing Pty Limited for $11,323,001. These machines are leased back to these companies.
>
> Foreign currency exposure is managed for Nathans Finance NZ Limited by parent company VTL Group Limited. The risk associated with holding assets denominated in foreign currencies is borne by and managed by VTL with a combination of currency options and foreign exchange contracts, in line with VTL Group policy.

[204] Note 23 to the financial statements dealt with the concentration of exposures to individual parties. Relevantly, that part of the prospectus stated:

> **23 Credit Risk**
>
> ...
>
> **Receivables Concentration**
>
> The six largest finance receivables account for 67.0% (2005: 70.5%) of total finance receivables.
>
> Three of the ten largest finance receivables arose from the sale by VTL of regional agencies ("master franchises") in New Zealand, Australia and USA. These finance receivables account for 53.1% (2005: 54.4%) of total finance receivables.
>
> **Geographic Concentration**

	Note	30 June 2006	30 June 2005
		$	$
Total New Zealand		17,726,435	23,751,368
Australia		17,667,874	16,856,243
USA		33,048,580	20,599,730
Total finance receivables		68,442,889	70,207,341

> In New Zealand, 83.2% of finance receivables (2005: 89.2%) are with entities located in the Auckland region.

In fact, the material concentration of lending lay in the VTL business-related debts. As at 30 June 2006, they totalled $116.1 million.[160] As a proportion of total receivables ($149.83 million),[161] the VTL business-related debts comprised 77.5%.

[205] Under the heading of "Statutory Information", seven material contracts were disclosed:

> **9 Material Contracts**
>
> 9.1 The only material contracts entered into by the Company within 2 years preceding the date of delivery of this Prospectus for registration to the date of this Prospectus are as follows:
>
> - a loan facility agreement dated 1 February 2005 between the Company and VTL whereby the Company rolled-over a loan facility of a maximum of $50,000,000 to provide funding for working capital. This loan facility was subsequently rolled-over on 1 August 2005 for the same amount.

[160] See para [160](a) above.
[161] See para [201] above.

- A loan facility agreement dated 27 February 2005 between the Company and VT Leasing Limited (a subsidiary of VTL) whereby the Company rolled-over a term loan facility of $2,020,000 for the acquisition of vending machines. The facility was subsequently rolled-over on 27 February 2006 for $2,040,000.

- a loan facility agreement dated 31 March 2005 between the Company and 24seven Vending (Australia) Limited (a subsidiary of VTL) whereby the Company provided a loan facility to a maximum of $10,000,000 to provide funding for working capital. The loan facility was subsequently rolled-over on 31 March 2006 for the same amount.

- a loan facility agreement dated 30 June 2005 between the Company and 24seven Vending (USA) Limited (a subsidiary of VTL) whereby the Company provided a loan facility to a maximum of $25,000,000 to provide funding for working capital. The loan facility was subsequently rolled-over on 30 June 2006 for the same amount.

- a loan facility agreement dated 30 April 2006 between the Company and 24seven Vending Leasing Pty Limited (a subsidiary of VTL) whereby the Company provided a loan facility to a maximum of $10,000,000 to provide funding for working capital.

- a vending machine sale agreement dated 30 June 2006 between the Company and 24seven Vending Leasing Pty Limited (a subsidiary of VTL) whereby the Company purchased 1,149 vending machines for a total AUD$7,695,932.99.

- an agreement for sale and purchase dated 30 June 2006 between the Company and 24seven Vending (NZ) Limited (a subsidiary of VTL) whereby the Company purchased 267 vending machines for a total of $1,913,184.20.

[206] The prospectus was signed by or on behalf of each director. Each made a statement that "having made due enquiry in relation to the period between the balance date of the financial statements ... and the date on which this Prospectus was delivered for registration" he was "of the opinion that no circumstances had arisen that materially adversely affect the trading or profitability" of Nathans, the value of its assets or its ability to pay its liabilities falling due within the next 12 months. The financial statements to which the directors referred had been signed by Mr Moses (the chairman) and Mr Doolan on 5 September 2006. Staples Rodway had expressed their opinion that the accounts disclosed a true and fair view of Nathans' affairs as at

that date. In addition, a letter lodged with the prospectus confirmed that the trustee believed the offer complied with relevant provisions of the trust deed.

15. What impression would the prudent but non-expert investor get?

[207] On the question whether there are any misleading statements in the investment statement and prospectus, it is necessary to consider the information from the perspective of the prudent but non-expert investor.[162] I find that, with advice from a competent financial adviser, the investment statement and prospectus would have imparted the following impression to such a person:

(a) The purpose of the offer was to provide up to $100 million "for the development of [Nathans'] business of providing financial accommodation and financial services".

(b) Nathans "continued" to deliver strong profit results. An increase of 47% was reported for the year ended 30 June 2006.

(c) The "significant" financial accommodation provided by Nathans to VTL and its subsidiaries were made on a commercial arm's length basis, normally for terms no longer than 12 months and were adequately secured. VTL and its subsidiaries were "actively seeking to repay" those loans by arranging facilities in the "country of origin". Attempts were also being made to lessen the concentration of inter-company borrowings and that Nathans was providing "commercial finance to a growing client base" in a number of diverse businesses.

(d) Strong corporate governance combined with robust credit assessment processes were applied to those occasions when VTL and its subsidiaries sought financial accommodation from Nathans. Those practices had led to no bad debts being written off. That impression is conveyed by statements that loans to VTL companies were made on the same basis as those made to arm's length third parties. An inter-

[162] See paras [64]-[70] above.

company loan would be treated no differently from any other loan, with regard to payment of interest, repayment of principal and, if necessary, enforcement of securities.

(e) Because the loans were usually for periods of no more than one year, Nathans had the opportunity to review the credit provided and, if necessary, to require repayment of the loans if circumstances so dictated.

(f) Although the loans to VTL and its subsidiaries represented a significant portion of Nathans' receivables' book, the terms of the lending and the financial position of VTL was good enough to allow it to support Nathans, in the event of some adverse economic event affecting Nathans' future viability. It was made clear that VTL did not guarantee Nathans' debts, including the secured debenture stock, and that Nathans was likely to become insolvent if VTL and its subsidiaries were unable to repay its debts, but no circumstances actually existed to suggest that was the position.

(g) The financial statements to the year ended 30 June 2006 had been audited. An unqualified audit report had been given stating that the accounts showed a true and fair view of the company's position at that date and also provided all information required by the Regulations.

(h) Perpetual, as trustee for the stockholders, had confirmed that the offer of securities complied with relevant provisions of the trust deed.

[208] What follows is a short summary of what I consider was conveyed to a notional investor by the narrative of the investment statement and prospectus:[163]

> Nathans is seeking up to $100 million to develop its business as a finance company. The company has delivered strong profit results for a number of years, including an audited net surplus of $4.97 million for the year ended 30 June 2006, an increase of 47% on the previous year's results. A strong level of corporate governance, combined with robust credit assessment processes

[163] Compare with my summary of the actual position, set out at para [225] below.

> have enabled all loan applications to be considered and determined on the same basis. No bad debts have resulted. While a significant proportion of Nathan's lending has been to its parent company, VTL, and its subsidiaries, those loans have been made on normal commercial terms, usually for periods of no more than 12 months. VTL and its subsidiaries are actively seeking to repay their debts in the country of origin. In addition, Nathans' receivables book is both growing and expanding into diverse business sectors.

[209] As at 13 December 2006, the inter-company debt stood at something in the region of $95 million, only $5 million less than the amount being solicited from the public.

16. The allegations of untrue statements: the investment statement and prospectus

[210] Counts 1 and 2 of the indictment are directed at the investment statement and prospectus respectively. I consider these together because the two documents are inter-linked and were distributed contemporaneously.

[211] From those documents, the public is said to have received misleading information on five topics: the extent of lending to related parties, the absence of bad debts, the growing and diverse nature of the commercial lending book, the credit assessment and management of loans, and the adequacy of liquidity.

[212] The Crown has provided, in its particulars of the counts, a series of examples to identify the specific statements on which reliance is placed. However, as indicated earlier, the Crown is not tied to the precise statements raised. It is entitled to rely on the overall impression gained from the offer documents.[164] The real issue is whether the investment statement and prospectus, read as a whole by a prudent but non-expert person, contained misleading statements on the topics to which the Crown referred in its statement of particulars.

[213] The Crown's position on the topics raised is:

---

[164] See para [20] above.

(a) Statements that advances to VTL and its subsidiaries had been made on a commercial arm's length basis were misleading because they did not identify the true nature and extent of the inter-company indebtedness, including the regular capitalisation of interest and the rolling-over of such debts. Further, those statements falsely suggested that loans to VTL were treated in the same way as arm's length borrowers.

(b) While, strictly speaking, Nathans had no bad debts (because none had ever been written off), the state of the VTL related-business debts was such that some or all of them ought to have been impaired.

(c) Statements about a "growing and diverse commercial lending book" were misleading because it gave the impression that Nathans was actively increasing the extent of third party loans when, in fact, it was the amount and proportions of VTL business-related debts that was increasing.

(d) The statement that there was "a strong level of corporate governance" and "robust credit management processes" were wrong because Nathans' business was not operated independently of VTL's and ordinary credit management procedures did not apply to VTL business-related debts.

(e) The investing public were misled about the serious deterioration in the liquidity profile and the way in which liquidity was monitored.

17. Were the statements in the investment statement and prospectus materially misleading?

[214] The question whether any of the statements were untrue is an objective one. It is viewed through the eyes of the prudent but non-expert investor. It is unnecessary for me to analyse all of the particulars on which the Crown relied. I am

satisfied that statements made in both the investment statement and the prospectus were material and misleading.

[215] It is the combination of statements and material omissions that conveyed a false impression to investors about the true nature of Nathans' business, the actual state of its financial health and the risks of the investment. Fundamentally, the problem was that a prudent but non-expert investor would necessarily think that all financial facilities granted by Nathans to VTL had been approved and were managed under the same "robust" credit processes as applied to third parties at arm's length from Nathans. The absence of any disclosure that loans made to VTL companies were consistently rolled over with interest capitalised was something that would undoubtedly have affected an investment decision. In addition, there was no disclosure of the debts owed by IVL and AVS, which fell into the same category.

[216] From at least June 2006, the directors of Nathans knew that there was no reasonable prospect that the inter-company debt could be repaid without VTL selling all or some of its business units. The loans could not be repaid out of revenue. The continual capitalisation of interest on loans to VTL demonstrated that not even that component could be met regularly out of income generated from VTL's businesses. This information was relevant to the investment risk because it was directly linked to the possibility that VTL may itself, become insolvent.[165]

[217] The loans made to both IVL and AVS fell into the same category. To repay those loans, their respective businesses had to be sold as part of any disposition of VTL's own business interests. Interest on IVL's and AVS' debts was capitalised regularly. To make matters worse, the extent of their combined indebtedness as at 30 June 2006 ($36.47 million)[166] was not disclosed at all. The closest to disclosure was the information imparted in Note 23 to the financial statements under the heading "Credit Risk".[167]

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[165] See para [196] above, under the heading "parent company" where it was disclosed that, if VTL became insolvent Nathans would likely enter that state.
[166] See para [158] above.
[167] See para [204] above.

[218] The directors placed weight on the suggestion that the impugned statements in the prospectus were literally true. An example is the phrase "commercial arm's length basis, normally for terms no longer than 12 months". While it was true to say that the terms contained in the revolving credit contract[168] into which VTL entered were the same (including interest rate) as those which would be offered to third parties, it was misleading to give the impression that VTL was treated in the same way as any other arm's length borrower. A "prudent but non-expert" investor is unlikely to think that a commercially driven lender would capitalise the interest or extend the amount or term of a loan to an arm's length third party, when it knows that the borrower cannot afford to pay either interest or principal from existing business revenue.

[219] Statements about good governance fall into a similar category. By 13 December 2006, Nathans had effectively delegated strategic decisions about its future to the board of VTL.[169] Strong corporate governance does not involve the delegation of strategic decisions about a company's business to its parent, particularly when the company is trading on funds from the public "to develop its business as a finance company".[170] In fact, the directors of Nathans knew, when the prospectus and investment statement went into the market, that the money received would mostly be used as working capital for VTL.[171]

[220] Likewise, to say that Nathans had "robust credit management" procedures was only half true. Such processes were in place for third party arm's length commercial lending and, arguably, for loans to operating franchisees. But application of "robust credit management" was not an apt term and to describe the way in which Nathans went about considering applications for finance from VTL business-related entities and subsequently monitoring them. Nor was it a true description of the lending to trusts associated with VTL/Nathans' directors.

[168] Even though the fact of the loan being a revolving credit facility on which VTL could draw at any time (up to its limit) was not disclosed to the public.
[169] See paras [330] and [331] below.
[170] See para [208] above.
[171] See also para [419] below.

[221] In cases involving VTL, IVL and AVS, loans were considered and made or renewed on the basis of a most cursory examination. Only on occasions when VTL had already exceeded the limit imposed by the existing facility was any enquiry of relevance made. Apart from that, the evidence reveals a continual lip-service to the need to reduce inter-company and VTL business-related indebtedness. Increases to the facility limits were sanctioned with barely any assessment of the borrower's ability to repay. The prudential debt ratio levels identified in May 2004 were allowed to balloon out further.[172] There was a general expectation that interest would be capitalised and revolving credit facilities renewed until such time as business units had been sold to reduce or repay the debts.[173] There were failures to take adequate security, though in the main they were attributable to management rather than the directors.

[222] In the case of loans made to trusts associated with Mr Doolan, Mr Hotchin and Mr Stevens, it is plain that no enquiry was made as to the capacity of the trustees to repay out of trust assets. Rather, the assumption was made that because the directors with whom the trusts were associated were known to be men of substance, the debts would be repaid. The folly of such an assumption is always revealed on insolvency: the receiver of Nathans has not yet been able to recover those debts, two of which were for sums in excess of $1 million.

[223] The information in the liquidity profile contained in the prospectus showed that the inter-company indebtedness was to be paid within 12 months when that was not the case. There was no note to the accounts to indicate the dates used in the liquidity profile were no more than maturity dates.[174] That impression was reinforced by the classification of the inter-company advance as a "current asset" in the financial statements, something that any competent director of a finance company should know carried with it a representation that the debt was expected to be repaid within 12 months.[175]

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[172] See paras [145]-[146] above.
[173] See para [216] above.
[174] It is common ground that prevailing accounting standards would have allowed the profile to be completed on the basis of maturity dates.
[175] See paras [202] above and [402] below.

[224] As at 13 December 2006, VTL could not support Nathans in the event of financial adversity. The statement made in the prospectus about the liquidity of Nathans being supported by VTL was untrue.[176] VTL did not (and could not) support Nathans; Nathans supported VTL.

[225] If the true position had been fully disclosed, potential investors would have been told something along the following lines:

> The main purpose of the offer is to provide working capital to Nathans' parent company, VTL, and its subsidiaries. While loans to those companies take the form of revolving credit contracts made on usual commercial terms normally for periods of no longer than 12 months, credit management processes used for other borrowers do not apply to them. Decisions about renewals of these loans are based on VTL's needs. The inter-company advances, taken together with two major loans to companies operating as VTL's master franchisees in the United States and Australia amount to [77.48% (as at 30 June 2006) or about 84% (as at September/October 2006)] of the total amounts owing by all borrowers to Nathans. VTL, its subsidiaries and the two master franchisees (IVL and AVS) are not able to repay their debts without selling all or some of their business units. Most of the interest on the VTL, IVL and AVS loans have been capitalised to date and there is an expectation that most (if not all) of the interest payable from now on will be capitalised during the period of the loans and that the loans will be renewed if those companies are not in a position to reduce or repay them when they fall due for repayment.

[226] It is only necessary to compare what ought to have been disclosed against the impression conveyed to potential investors from the misleading statements to see that it is patently unarguable that any of the misleading statements were immaterial to an investment decision and that the relevant omissions were material to what was conveyed by the statements in the offer documents. The information that was not disclosed was clearly relevant to investment risk and could well have affected a decision to invest.

[227] The Crown has proved beyond reasonable doubt that statements to which I have referred were misleading. Similarly, in relation to the failure to disclose certain particulars, the Crown has proved that such omissions were material to those statements. The directors have failed to prove, on a balance of probabilities, that the misleading statements were immaterial.

[176] See Note 19 of the financial statements in the prospectus, set out at para [200] above.

18. The extension certificate

(a) Alleged misleading statements

[228] Count 3 of the indictment is based on the extension certificate dated 29 March 2007. The certificate was signed by Mr Doolan and Mr Hotchin and registered on 30 March 2007. Mr Moses and Mr Young acknowledge that it was signed with their authority.

[229] Where no interim statement of financial position is contained or referred to in a registered prospectus, the issuer may deliver such a certificate to the Registrar. The content of the certificate is prescribed by s 37A(1A) of the Act:

> **37A Voidable irregular allotments**
>
> ...
>
> (1A) For the purposes of subsection (1)(c) of this section, if no interim statement of financial position is contained or referred to in a registered prospectus, an issuer may deliver to the Registrar for registration under this Act, and the Registrar shall register, a certificate that relates to the registered prospectus and that—
>
> (a) Is signed on behalf of all the directors by at least 2 directors of the issuer (or, where the issuer has only 1 director, by that director); and
>
> (b) Is dated no later than 9 months after the date of the statement of financial position contained or referred to in the registered prospectus; and
>
> (c) States that, in the opinion of all directors of the issuer after due enquiry by them,—
>
> (i) The financial position shown in the statement of financial position referred to in paragraph (b) of this subsection has not materially and adversely changed during the period from the date of that statement of financial position to the date of the certificate; and
>
> (ii) The registered prospectus is not, at the date of the certificate, false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances; and

(d) Where the registered prospectus relates to equity securities, debt securities, or participatory securities, is accompanied by financial statements—

(i) For the 6-month period from the date of the statement of financial position referred to in paragraph (b) of this subsection; and

(ii) Prepared in accordance with regulations as if they were required to be contained or referred to in a registered prospectus for those securities, except that they need not be audited.

....

[230] Mr Hotchin signed the certificate in unusual circumstances. The certificate was taken to Boston by Mr Steytler. Mr Hotchin signed the certificate without inquiry. Mr Doolan provided his signature when the document was brought back to New Zealand. Given the time difference between Boston and the United States it seems likely that the certificate was signed by Mr Hotchin before 29 March 2007 and dated when signed by Mr Doolan. It is unclear why the certificate was taken for Mr Hotchin to sign, when it could have been executed by either Mr Moses or Mr Young in New Zealand.

[231] The certificate stated:

Date: 29 March 2007

1 This certificate is given for the purposes of section 37A(1A) of the Securities Act 1978, in respect of a prospectus for the issue of Secured Debenture Stock dated 13 December 2006 and registered on 15 December 2005 (the "Registered Prospectus").

2 In the opinion of all directors of Nathans Finance NZ Limited after due enquiry by them –

(a) The financial position shown in the statement of financial position referred to in the Registered Prospectus has not materially and adversely changed during the period from the date of that statement of financial position (being 30 June 2006) to the date of this certificate; and

(b) The Registered Prospectus is not, at the date of this certificate, false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances.

3 Financial statements for the 6-month period from the date of the statement of financial position referred to in the Registered Prospectus accompany this certificate.

Signed on behalf of all the directors of Nathans Finance NZ Ltd:

...

[232] The Crown contends, on three bases, that the extension certificate was misleading:

(a) The prospectus continued to be misleading, in the same respects as alleged at the time of its initial distribution on 13 December 2006.

(b) The financial position shown in the audited accounts for the year ended 30 June 2006 in the registered prospectus had, in fact, materially and adversely changed in the period to the date of the certificate.

(c) The prospectus was misleading because it failed to refer, or give proper emphasis, to adverse circumstances:

(i) As at 28 February 2007, Nathans reported negative net cash flow for the month from operating activities of $1,378,275 and for the year to date of negative $6,966,006;

(ii) As at 28 February 2007, Nathans' cash at bank balance was significantly adverse to budget ($6.37 million actual compared to $21.76 million budgeted);

(iii) The level of loan impairment had increased;

(iv) The amount of interest capitalised on loans had increased; and

(v) Nathans' liquidity profile had significantly deteriorated, with a consequent risk to its solvency.

[233] Mr Carruthers drew my attention to the increase in the inter-company debt between 30 June 2006 and 31 March 2007. As at the former, the amount outstanding from VTL and its subsidiaries totalled $79.63 million. At 31 March 2007 that debt was $103.63 million.[177] Between 30 June 2006 and 31 March 2007, as a percentage of total finance receivables, the inter-company indebtedness had increased from 53.1% to 61.9%.

[234] Mr Gedye submitted that the extension certificate was completed at a time when a number of VTL's plans "were beginning to come together, all of which would impact positively on VTL's ability to repay or reduce the inter-company debt". He referred to evidence from both Mr Doolan and Mr Moses that this "was a positive and exciting time for the directors", who perceived the positions of both VTL and Nathans as improving, not deteriorating.

[235] In relation to liquidity monitoring, Mr Gedye submitted that Nathans was maintaining sufficient liquid funds, as at 29 March 2007, to meet maturing loans from investors. Although the amount of cash held in Nathans' bank accounts had diminished in the three months to 29 March 2007, Nathans still retained cash at bank in the sum of $4.85 million. Taking into account commitments of $2.79 million, a surplus of $2.06 million remained. In addition, the directors believed that, if necessary, they could draw on $10.6 million in cash received by VTL from a sale of its shares to support Nathans' position.[178] Nathans was forecasting positive cash balances of between $7.195 million and $8.743 million for the months of April to June 2007. Mr Gedye submitted that the liquidity profile incorporated in the accounts to 31 December 2006 (annexed to the extension certificate) had improved from that contained in the June 2006 financial statements.

[236] Counsel for Mr Moses and Mr Young supported Mr Gedye's submissions on these issues.

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[177] See para [154] above. Even on the basis of the unaudited financial statements, for the six months ended 31 December 2006, that were delivered for registration with the extension certificate, the inter-company debts had increased to $95,278,060.
[178] See para [293] below.

(b) Analysis

[237] Section 55(c) of the Act deems a registered extension certificate and any financial statements accompanying it to be included in the registered prospectus to which the certificate relates. That means the allegations of misleading statements I have addressed in relation to the prospectus and investment statement also apply to the extension certificate.

[238] The board did not consider (as a group) whether any adverse circumstances had arisen that required disclosure. The narrative of the prospectus did not change. The impression conveyed by a combination of misleading statements remained the same. In essence, my summary of what a prudent but non-expert investor would have taken from the investment statement and prospectus remains applicable.[179] A sum of money ($10.6 million)[180] had been received by VTL from a sale of some of its shares but that made no real difference to the position: at best it could have been used immediately to repay about 10% of the inter-company debts. I hold that the Crown has proved beyond reasonable doubt that the statements in the prospectus were misleading and that omissions were material to statements in the offer documents. The accused have failed to prove on a balance of probabilities that the misleading statements were immaterial.

[239] For completeness, I deal with the Crown's additional allegations that para 2 of the extension certificate itself contained two misleading statements.[181]

[240] The first allegation is that the financial position shown in the registered prospectus had, in fact, materially and adversely changed between 30 June 2006 and 29 March 2007. I agree with the Crown's submission in that regard. The increase in the inter-company indebtedness[182] and the lack of evidence of any repayments of the type contemplated by the liquidity profile in the 30 June 2006 financial statements[183]

[179] See paras [207] and [208] above.
[180] See para [293] below.
[181] The extension certificate is set out at para [231] above.
[182] See para [233] above.
[183] See para [223] above.

constituted a material and adverse change in Nathans' financial position. Knowledge of that change in position could well have affected a decision to invest or reinvest.

[241] In relation to para 2(b) of the certificate, in my view, it was misleading not to refer to the significant decrease in net cash flow.[184] The omission was of a material fact which failed to give proper emphasis to an adverse circumstance. By reason of that omission, the statement in para 2(b) is deemed to be untrue, given the statements about the cash flow referred to in the financial statements of 30 June 2006 and the interim accounts for the half year ended 31 December 2006.[185] Cash flow is vital to a finance company. Any significant decrease is likely to be taken into account when making a decision to invest or reinvest. The absence of this information meant that the notional investor did not have an opportunity to review the liquidity information in the prospectus, in the context of the actual decrease.

19. The letters to investors

(a) Letter of 14 May 2007

(i) Alleged misleading statements

[242] The letter of 14 May 2007 forms the basis of count 4 of the indictment. It is common ground that the letter is an "advertisement" as defined by s 2A(1) of the Act. That section provides:

> **2A Meaning of advertisement**
>
> (1) In this Act, unless the context otherwise requires, **advertisement** means a form of communication—
>
> (a) That—
>
> (i) Contains or refers to an offer of securities to the public for subscription; or
>
> (ii) Is reasonably likely to induce persons to subscribe for securities of an issuer, being securities to which the communication relates and that have been, or are to be, offered to the public for subscription; and

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[184] See para [232](c)(i) above.
[185] Securities Act 1978, s 55(a)(ii).

(b) That is authorised or instigated by, or on behalf of, the issuer of the securities or prepared with the co-operation of, or by arrangement with, the issuer of the securities; and

(c) That is to be, or has been, distributed to a person.

....

[243] The letter was sent to investors on Nathans' database. It was signed by Mr Moses, as chairman of Nathans. It said:

Exclusive Rate Offer – 10% p.a for 24 months

SECURITY, PERFORMANCE & PEACE OF MIND

Nathans has a proud history of providing investors with quality investment opportunities. *Nathans has a robust credit assessment process combined with a strong level of corporate governance. These factors have ensured that Nathans has retained its unblemished no bad debts written off record. Our investments* are current **'First Ranking'**[1] and *have the added comfort that Nathans has a proven track record in commercial lending.*[2]

Nathans does not lend into the 'higher risk' consumer areas such as vehicle and retail consumer lending – that means no cars and no small retail loans. Plus our professional and friendly team is committed to ensuring our investment process is simple and smart, so that investing with Nathans is made easy!

Invest with Confidence

Nathans is delighted to present our 'cornerstone' rate offer of **10.00% p.a. for 24 months** on its Secured Debenture Stock.[1] This exclusive offer is only available on the enclosed application form and will close on 29 June 2007.

Choose to have Interest Paid Monthly

Our terms range from 3 months to 5 years and for new investments **over $15,000** you can choose to have your net **interest paid monthly** directly into your bank account. For all other investments the minimum investment is $1,000 with interest paid quarterly.

Offer closes 29 June 2007

Before you invest please ensure you read the enclosed Investment Statement dated 13 December 2006[2] and simply complete the application form. Then make your cheque payable to **Nathans Finance NZ Ltd** (crossed "Not Transferable") and return in the reply paid envelope as provided.

At Nathans we understand the importance of investment decisions so if you would like any further information dated please call our Investor Service Team toll free on **0800 NATHANS** (0800 628 426).

We look forward to receiving your investment application. Thank you for considering Nathans.

...

1 The Secured Debenture Stock currently constitutes first ranking debt obligations of Nathans Finance NZ Limited secured over the assets of Nathans. The ranking of Secured Debenture Stock relates only to ranking among the securities offered by Nathans. Nathans may grant charges ranking prior to the Secured Debenture Stock to external lenders from whom Nathans borrows money. Any charges under legislation may take priority.

2 For full information, terms and conditions, which should be considered carefully prior to making a decision to invest, please refer to the Investment Statement dated 13 December 2006.

(my emphasis)

[244] The highlighted portions of the letter are alleged to be misleading. In addition, the Crown alleges that the letter omitted a material particular; namely, that Nathans had a liquidity profile that was "significantly deteriorating", with consequential risks to its solvency.

(ii) Analysis

[245] The focus is on either words actually contained in the letter[186] or contained in any document that is incorporated by reference or referred to in the advertisement.[187] There is a specific reference to the investment statement dated 13 December 2006, referring the notional investor to that document for "full information, terms and conditions, which should be considered carefully prior to making a decision to invest ....". The Crown put its case on the basis that the letter itself gave a misleading impression to investors on issues relevant to investment risk.

[246] The words used in the 14 May 2007 letter created an impression of a successful finance company that had never had any problems with impaired debt because of the strong level of corporate governance and robust credit assessment processes employed by it. The statement that Nathans did not lend into "higher risk" consumer areas was designed to reassure investors that the company was not engaging in speculative investments of a type that had led to the collapse of other companies in 2006. A strong inference available to be drawn from those statements was that any investment in Nathans would be safe, at least in comparison to other finance companies operating in the market.

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[186] Securities Act 1978, s 55(b)(i).
[187] Ibid, s 55(b)(iii).

[247] The notional investor was directed to the investment statement of 13 December 2006 and the accompanying application form to read before making an investment decision.

[248] The advertisement itself emphasises a strong level of corporate governance and robust credit assessment processes that have ensured an "unblemished no bad debts written off record". It also provides "comfort" to potential investors based on Nathans' "proven track record in commercial lending". No mention is made of any lending to VTL, IVL or AVS. As at 14 May 2007, no principal reductions had been made in respect of any of those debts and minimal interest had been paid.

[249] By this stage, it was inevitable that impairment of the three major loans would have required reconsideration as at the end of the 2007 financial year:[188]

(a) The VTL inter-company facility was due to come to an end on 31 July 2007, a little more than two months hence. There remained no realistic prospect either of payment in full or significant principal reduction of that loan by the date on which it fell due.

(b) At least $9.5 million of the IVL debt had fallen due for payment by 14 May 2007.[189] Without incorporation into a sale of other VTL businesses in the United States, there was no prospect of repayment or a significant reduction in that debt, in the foreseeable future.

(c) The AVS loans were, as at 14 May 2007, in default.[190] Mr Seymour did not sign an extension of the loan to AVS until 30 June 2007. As at 14 May 2007, AVS owed almost $AUD12 million to Nathans, with no reasonable prospect it could be paid in the foreseeable future.

[250] The emphasis on good corporate governance and robust credit management processes in a business focussed on commercial lending created a false impression of the nature of Nathans' business at that time. The statements that the Crown seeks to

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[188] The auditors reviewed impairment issues for VTL and IVL in 2006; see paras [380]-[387] below.
[189] See para [356](d) below.
[190] See paras [311]-[314] below.

impugn were, in my view, misleading. Similarly the omission of information about the state of the VTL business-related indebtedness, relevant to the "no bad debts" issue, was material to the statement. The omitted information was relevant to any investment decision to be made by a person receiving the letter.

[251] I hold that the Crown has proved beyond reasonable doubt that the statements were misleading and that omissions with regard to the state of the VTL business-related indebtedness was material. The directors have not proved on a balance of probabilities that the misleading statements were immaterial.

(b) Letter of 12 July 2007

[252] The letter of 12 July 2007 forms the basis of count 5 of the indictment. At the conclusion of the Crown case Mr Jones QC, for Mr Young, made an unsuccessful application under s 347 of the Crimes Act 1961 for an order discharging Mr Young on this count, on the grounds that the letter did not amount to an "advertisement", as defined. The legal submission was renewed in Mr Jones' closing address and, if correct, will operate for the benefit of all three accused.

[253] In a ruling given on 19 May 2011,[191] I held that the letter was *capable* of being interpreted in a manner that met the definition and dismissed the application on that basis. When I dismissed the s 347 application, I had not heard full argument on the appropriate way to interpret the letter. There was a question about the extent of contextual evidence that might be relevant.

[254] In closing, all counsel agreed with my preliminary view that the "public document" interpretation principles set out by the Privy Council in *Opua Ferries Ltd v Fullers Bay of Islands Ltd*[192] applied. They accepted that the letter must be viewed, objectively, through the lens of its recipient, without taking account of insider knowledge of the author.

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[191] *R v Moses (Ruling No 2)* HC Auckland CRI 2009-004-1388, 19 May 2011 at para [21].
[192] *Opua Ferries Ltd v Fullers Bay of Islands Ltd* [2003] 3 NZLR 740 (PC) at para [20].

[255] It is unnecessary to repeat the analysis undertaken in my ruling on the mid-trial application. The issue is whether, read in context, the letter serves to refer to the existing offer of securities and (implicitly) invites the reader to invest. The terms of the letter are set out in my earlier ruling.[193]

[256] In contrast to the letter of 14 May 2007,[194] the July letter contains no interest rate offer or options for the payment of interest. Nor does it identify any specific offer being made. Rather, at the outset, the reader is told that the purpose is "to confirm to [him or her] that it is very much business as usual at Nathans Finance". The need for reassurance stemmed from the receivership of another finance company, Bridgecorp Ltd, in the course of which concerns had been raised about alleged breaches of its trust deed and business practices.

[257] Mr Carruthers placed emphasis on the description of Nathans' business, information about recent performance and corporate governance assurances to suggest the real purpose was to solicit funds. He pointed out that footnotes to the letter referred specifically to the audited accounts for the period ended 30 June 2006 and the ranking of the secured debenture stock. Further, and while the point could not be determinative because of the way in which interpretation of the letter is approached,[195] Mr Carruthers referred to the fact that two directors of Nathans had signed a certificate under reg 17 of the Regulations in respect of the letter. Such a certificate is required whenever an advertisement is distributed.

[258] I accept Mr Jones' submission that the letter of 12 July 2007 does not fall within the definition of "advertisement" in s 2A of the Act. First, the letter does not explicitly solicit funds from the public. Its apparent purpose is to reassure investors that Nathans' business has not been affected by the receivership of Bridgecorp. Second, there is no reference to an investment statement or anything else that would necessarily strike an investor as an offer to subscribe for securities. Third, although the "Secured Debenture Stock" was referred to in a footnote, the letter cannot sensibly be interpreted using that information to make an offer of securities to the public.

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[193] *R v Moses (Ruling No 2)* HC Auckland CRI 2009-004-1388, 19 May 2011 at para [13].
[194] See para [243] above.
[195] See para [254] above.

[259] For the purposes of s 2A(1)(a)(i), the letter neither contains nor refers to an offer of securities to the public for subscription. In relation to s 2A(1)(a)(ii), I do not regard the content of the letter as being "reasonably likely to induce persons to subscribe for securities of an issuer" as there are no stated securities to which the communication relates. A passing reference to "Second Debenture Stock" does not, in my view, satisfy the requirement of relating to those "securities". Despite the broad definition given to the term "advertisement" by s 2A,[196] the statutory test is not met.

[260] If my view on interpretation were wrong, my decision can also be supported on the basis that the onus rests on the Crown to prove that the letter is an "advertisement" and it has failed to do so to the required standard.

(c) Letter of 6 August 2007

(i) Alleged misleading statements

[261] The letter of 6 August 2007 forms the basis of count 6 of the indictment. It was distributed about two weeks before receivership. The letter was sent to people who were on Nathans' database. It contained an offer to invest, at 10.25%. It is common ground that the letter is an "advertisement" as defined.

[262] The letter stated:

> **Exceptional rate offer – 10.25% p.a. for 14 months**
>
> **INVEST IN SECURITY, PERFORMANCE & PEACE OF MIND**
>
> Nathans continues to offer you quality investment opportunities on our Secured Debenture Stock.[1] *Nathans performance to date is built on a platform of robust credit assessment processes combined with a strong level of corporate governance. These factors have ensured that Nathans has retained its unblemished no bad debts written off record. Our investments are current 'First Ranking'[1] and have the added comfort that Nathans has a proven track record in commercial lending.*[2]
>
> *Nathans does not lend into the 'higher risk' consumer areas such as vehicle and retail consumer lending – that means no cars and no small retail loans.* Plus our professional and friendly team is committed to ensuring our

[196] See also *Orr v Martin* (1991) 5 NZCLC 67,383 (HC) at 67,390.

investment process is simple and smart, so that investing with Nathans is made easy!

Quality Lending Opportunities are Driving Demand

With quality lending opportunities continuing to present themselves, Nathans is delighted to present an exceptional rate offer of 10.25% p.a. for 14 months. This exclusive offer is only available on the enclosed application form and will close on 10 September 2007.

Choose to have Interest Paid Monthly

Our terms range from 3 months to 5 years and for new investments over $15,000 you can choose to have your net interest paid monthly directly into your bank account. For all other investments the minimum investment is $1,000 with interest paid quarterly.

Offer closes 10 September 2007

Before you invest please ensure you read the enclosed Investment Statement dated 13 December 2006[2] and simply complete the application form. Then make your cheque payable to Nathans Finance NZ Ltd (cross 'Not Transferable") and return in the reply paid envelope as provided.

At Nathans we understand the importance of investment decisions so if you would like any further information please call our Investor Service Team toll free on 0800 NATHANS (0800 628 426).

We look forward to receiving your Investment Application. Thank you for considering Nathans.

....

1. The Secured Debenture Stock currently constitutes first ranking debt obligations of Nathans Finance NZ Limited secured over the assets of Nathans. The ranking of the Secured Debenture Stock relates only to ranking among the securities offered by Nathans. Nathans may grant charges ranking prior to the Secured Debenture Stock to external lenders from whom Nathans borrows money. Any charges under legislation may take priority.

2. For full information, terms and conditions, which should be considered carefully prior to making a decision to invest, please refer to the Investment Statement dated 13 December 2006.

(my emphasis)

The highlighted parts of the letter provide the foundation for the Crown's allegation that the letter contains misleading statements.

[263] The Crown alleges that the statements with regard to involvement in commercial lending were untrue because they omitted a material particular: namely, the extent and nature of Nathans' lending to related parties and parties associated with Nathans' parent. It also asserted that there was a material omission in respect of

Nathans "significantly deteriorating" liquidity position and the consequential risks to its solvency.

(ii) Analysis

[264] The specific content of which the Crown complains repeats what was written in the letter of 14 May 2007. Nathans' financial position had deteriorated further. It is enough to refer to two specific points. For reasons that follow, I hold that the Crown has proved that the statements in the 6 August 2007 letter to be misleading. The directors have not established that the misleading aspects of it were immaterial to a prudent but non-expert investor.

[265] First, by 30 June 2007, the inter-company advances totalled over $100 million. That was more than the amount sought under the prospectus. Two of the IVL debts (totalling just over $10 million) had fallen into default.[197] The omission of those two material statements meant that the impression conveyed by the letter ("robust credit assessment processes combined with a strong level of corporate governance" and "unblemished no bad debts written off record") misrepresented the real situation to investors.

[266] The second issue concerns a deterioration in the liquidity position of Nathans. On 26 June 2007, the VTL board was supplied with a paper from Mr Bayer entitled "Working Paper on Intercompany Facilities". It is said to be an "update from 7th of April 2007" but I have not been able to locate the earlier document. Mr Bayer sounded warning bells. First, he was aware of a proposal that Nathans pay a dividend of $2 million to VTL. He said: "assuming a run rate of $2.6 million per month in drawdown this would allow for utilisation of $4.223 million of additional borrowing which at the current average rate is 1.62 months from the end of May 2007". Those comments did not take account of the balance of the share moneys held by VTL.[198] At the prevailing exchange rate at the date of Mr Bayer's memorandum those funds totalled $8.137 million. Mr Bayer advised the board that by using those funds "to ensure no further increase in the intercompany balance

[197] See para [356](d) below.
[198] See paras [238] and [293] above.

(except for the increase in the facility) would mean an additional 3.12 months". This memorandum seems to suggest strongly that Nathans might have only about five months of funds remaining. That was a serious liquidity issue that ought to have been disclosed.

20. Reasonable grounds for belief in truth of statements: Context

(a) Introductory comments

[267] The final issue is whether each director has proved on a balance of probabilities that he had grounds for an honest belief, based on reasonable grounds, that the statements in the prospectus (before and after the extension certificate), investment statement and advertisements of 14 May and 6 August 2007 were not misleading.[199] If the evidence were in a state of equipoise, the director will not have discharged the onus.

[268] The question has two components, one subjective and one objective. The first inquiry, into whether an actual belief was held, is viewed through the eyes of each director. The second arises if I were to find that an honest belief was held. At that stage, an objective assessment of whether there were reasonable grounds on which that actual belief could have been based is required. To explore those issues, it is necessary to understand the way in which the VTL-related businesses operated, how their situations were changing in the period up to 6 August 2007 and the nature of the relationship between Nathans and VTL.

(b) VTL's business - an overview

(i) Interests in the United States

[269] VTL's business interests in the United States were always the most likely means by which the growing inter-company debt could be repaid. IVL had had a promising start to its business life in 2003 and 2004. Its sole director, Mr Hyslop,

[199] Securities Act 1978, s 58(2) and (4); set out at para [23] above.

was acknowledged by all as an excellent salesman. However, IVL's business struck troubled waters in 2005, at a time when an interest subsidy from VTL was due to cease and its debt to Nathans had climbed to over $20 million.

[270] Mr Hyslop's initial efforts, in 2003, secured a number of operating franchisees. In some ways he was regarded as being "too successful" because, as Mr Hotchin acknowledged, VTL could not fit the technology to the machines as quickly as Mr Hyslop was selling the franchises. Another difficulty that Mr Hyslop encountered was the absence of available machine sites in California. The vending business was more mature in America and many site routes were owned by other business enterprises.

[271] This led to a change in VTL's strategy. It decided to acquire existing businesses so that their routes could be sold to operating franchisees. The acquisition process was, initially, gradual. In June 2004 a business called Adolphs Vending was acquired. It had 950 vending machines and was based in Dallas. A Californian company, MAB Services, Inc (MAB), was acquired in August 2004, unlocking a larger market into which IVL could tap to sell further franchises in that State. MAB had 2,600 sited machines and 500 in storage.

[272] The drivers who worked for MAB faced unemployment if alternative work in the same sector were not available. Strenuous efforts were made to market operating franchises to those drivers. They were of relatively modest means but, generally, had real property at a level sufficient to justify loans. Most of the loans were made by Nathans, as opposed to local banks.

[273] Many of the MAB drivers took up the option to acquire licences. But, when the time came for them to take delivery of the product, the software had not been "retrofitted" into the acquired machines, as promised. This situation appears to have enured over a long period of time, causing much angst in the relationship between Mr Hyslop and the VTL directors; particularly Mr Hotchin.

[274] An important strategic acquisition involved a shareholding in All Seasons in 2005. VTL acquired a 19% interest in All Seasons, with a prepaid put-option to

acquire up to 65% of its share capital. This particular acquisition was important for two reasons. First, it provided a base in California at a reasonable price, from which VTL could carry out its operations under the franchise model. Second, it established a linkage with two American businessmen, Messrs Halpern and Denny, that was seen as being vital to VTL's future business in the United States. They were existing shareholders in All Seasons. More of them later.

[275] Mr Hotchin resigned as chairman of Nathans in about September 2005. He became a director of All Seasons on acquisition of the shares. Mr Stevens also took a seat on All Seasons' board. Mr Hotchin was appointed as Chief Executive Officer of All Seasons.

[276] Mr Hotchin described his situation, after he became Chief Executive Officer of All Seasons, as an "unpaid director" of VTL and Nathans. He said that his executive role in Nathans diminished; up to that point he and Mr Doolan had been joint managing directors. Nevertheless, Mr Hotchin remained on the VTL and Nathans' boards, with primary responsibility for VTL's American operations.

[277] Messrs Halpern and Denny were described (in evidence) as "major financial players" in the United States, with experience in the vending industry and very high net worth. Both were said to be keen on the VTL technology and to see it expand throughout the United States. From the time VTL first acquired shares in All Seasons many of its directors' aspirations for the American business were dependent upon the extent to which Messrs Halpern and Denny were prepared to align their business interests with those of VTL.

[278] Reverting to IVL, Mr Hyslop was particularly critical of Mr Hotchin's role in the United States, saying that he always felt as though he was in a "battleground" with him. In turn, Mr Hotchin and Mr Doolan were less than complimentary about Mr Hyslop, believing that he had later extracted funds from his master franchising operation to VTL's detriment, at a time when he owed money to Nathans that he asserted could not be paid from income generated from the franchise business. Mr Hyslop's position, at trial, was that the money was used to repay a debt owed to his company, Woodfield Investments Ltd.

[279] Meetings took place in September and November 2005, the latter of which was a teleconference at which Mr Hyslop and Mr Hotchin clashed. Mr Hyslop believed that his contract had been terminated as a result of abusive comments made by Mr Hotchin during that conference, on 11 November 2005. Mr Hotchin was of the same view. Mr Doolan painted a different picture of those events.

[280] Like Mr Hotchin, Mr Doolan expressed concern when learning that a sum of approximately $US200,000 had been drawn out of the IVL business by Mr Hyslop, in preference to interest payments said to be due to Nathans. However, Mr Doolan recalls that he did most of the talking during this conference, in a moderate manner. Unlike both Mr Hotchin and Mr Hyslop, he does not believe the discussion was heated. He described himself as "disappointed" that Mr Hyslop would take money out of IVL for his own benefit before meeting obligations to IVL's creditors.

[281] By the end of 2005, Mr Hyslop had "departed" from the IVL business, without giving authority to any person to operate the business on its behalf. While the directors of Nathans maintained that Nathans held security over the master licence, they preferred not to treat the loan as in default but, rather, to carry on the licence business in an endeavour to preserve value. The board took the view that it was carrying on the master franchisee's licence business "on trust" for IVL, to maintain its value. While that was commercially sensible and prudent, it is unclear on what legal basis the business could be managed in that fashion. In the end, however, nothing turns on a nuanced legal analysis of this time.

[282] By mid-January 2006, Mr Hyslop was attempting to negotiate an exit payment, in the vicinity of $US5 million. VTL was not prepared to pay that amount. Whatever the rights and wrongs of the disputes between IVL and VTL, it is clear that, by the end of January 2006, relations had broken down irretrievably.

[283] The directors of VTL decided to appoint someone in the United States to "audit" the IVL accounts. Mr Hotchin arranged for Mr Treister, a colleague from All Seasons, to undertake that task and to trade the business of IVL on the "trust" basis, as if that company continued to operate the master franchise in California. Mr Doolan said that all directors of VTL agreed to proceed on that basis. As this

was a significant issue, the directors discussed it both among themselves and at a directors' meeting.

[284] As part of the arrangements in relation to the continuation of the IVL master franchise business, the payment of royalties by VTL to IVL was set off against interest owed on loans from IVL to Nathans. Mr Doolan deposed that no director dissented from that method of ensuring payment of some interest to Nathans, even though (again) the legal basis for doing that is unclear.

[285] The more important of the later acquisitions in the United States were Nor-Cal Beverage Co, Inc (NorCal) and Universal Vending Management, Inc (UVM). Both of these transactions were negotiated in 2006. NorCal was completed in November 2006, while UVM was settled in early 2007. Other acquisitions were completed in February 2007: the businesses of Phoenix Snack Attack, Artic Vending and Aramark.

[286] These acquisitions occurred at a time when it was clear that neither the IVL nor VTL debts to Nathans could be paid without VTL selling some or all of its American business units. They resulted in an outflow of cash from Nathans (to fund acquisitions) rather than an inflow from a divestment strategy, on which the VTL directors had previously agreed.[200]

[287] The UVM transaction was described by Mr Doolan as "extremely significant". UVM was a management company that carried on business throughout the United States, controlling $US62 million of vending machine revenue for 73 clients in 9,756 locations. In return for the acquisition of 17% of UVM's share capital, VTL considered it was guaranteed $US12.5 million in revenue from new business.

[288] Even though VTL was in "acquisition" mode, sales opportunities for US based businesses were also being progressed. Before any profits could be generated from either the NorCal or UVM acquisitions, two other transactions assumed greater importance. One, an offer by Catterton, Inc, involved the Shop24 business. The

[200] See para [335] below.

other provided the potential for a sale of other VTL-related businesses (including the master franchise operated through IVL) to a new company, to be known as Bacon Whitney Corporation (Bacon Whitney).

[289] Catterton made a proposal to buy the Shop24 franchises held in the United States. Its initial position was set out in a non-binding letter of intent dated 24 January 2007. A revised proposal was contained in a subsequent letter of 6 February 2007. While the latter was described as a "binding letter of intent", there were many aspects of the proposed transaction that remained open for further negotiation.

[290] On the face of it, the Catterton proposal involved payment of $US20 million in return for an (undefined) 60% stake in the "VTL group", whatever that expression meant. Through that mechanism, it was intended that Catterton would control the Shop24 business.

[291] This transaction did not proceed. At some point that I cannot define, it appears that Mr Stevens and/or Mr Hotchin was persuaded that a better sale price could be obtained through a greater alignment with the Halpern and Denny interests. None of the accused recall any board discussion on this point; nor is there any recorded VTL board decision to withdraw from the proposed Catterton deal.

[292] At a superficial level, the Shop24 business was discrete and the two proposed transactions could have sat side by side. It appears that Mr Stevens and/or Mr Hotchin acted unilaterally. I infer that Messrs Halpern and Denny put some pressure on either or both of them to ensure that a potential competitor did not cause difficulties to their desire to obtain the benefit of the VTL technology generally.

[293] Following negotiations in November and December 2006, Messrs Halpern and Denny agreed to acquire shares in VTL, representing 19.9% of its share capital.[201] Their acquisition of less than 20% meant that the provisions of the Takeovers Code were not triggered. Messrs Halpern and Denny acquired the shares personally, for a sum of $10.6 million. That money was paid to VTL on 19 January 2007 and was held in a US dollar denominated account. It seems

[201] See paras [342], [344] and [347] below.

reasonably clear that Messrs Halpern and Denny were, at that time, angling for more than just a minority interest in VTL. Consistent with my view on the reasons why the Catterton transaction did not proceed, their overall aim appeared to be acquisition of the technology for use in the American market.

[294] Messrs Halpern and Denny were also involved in the proposed Bacon Whitney transaction. A "non-binding" letter of intent dated 11 July 2007 was received by VTL from Bacon Whitney; a "binding" letter was forwarded on 26 July 2007. The assets to be acquired included the vending businesses operated by All Seasons (by then known as Service America Group (SAG)), as well as those of VTL's own Amrican companies. The IVL business appears to have been included in this proposed transaction. On the face of it, the purchase price was $US67.5 million.

[295] The $US67.5 million purchase price was to be met by a convertible note, payable to VTL in five years. Interest on the note was to become payable some seven months after settlement. The interest payable was to be 50% of the total, with the balance being capitalised. This meant that interest of 5% would have been payable (about $US3.5 million per annum) based on the 10% interest rate identified in the agreement.

[296] By this time, Mr Doolan had been made an offer to acquire shares held in VTL by a family trust associated with him, the Boston Trust. Also, Messrs Hotchin and Stevens were "interested" in the intended transaction through their involvement with SAG. It was necessary for Mr Moses and Mr Young as independent directors to deal with the proposal and to make decisions on it. After a telephone conference, lasting no more than 10-20 minutes, at 11pm on 12 July 2007 (while Mr Young was in England), the two of them resolved to authorise Mr Duggan to sign the non-binding letter of intent dated 11 July 2007, on behalf of VTL. As Mr Young was in England, there was no real opportunity for consideration to be given to the specific terms of the agreement before Mr Moses and Mr Young passed their board resolution.

[297] The terms of the letters of intent gave Messrs Halpern and Denny the option to require VTL to purchase some of their shares in Bacon Whitney in exchange for

5.5 million ordinary shares in VTL. That option could not be exercised before the end of a period of six months from the closing of the intended transaction. The other possibility was that Messrs Halpern and Denny could require conversion of the note into equity in Bacon Whitney. On either view, no cash would pass to VTL, other than the 5% interest payable six months after closure of the proposed transaction. The cards were all stacked in favour of Messrs Halpern and Denny.

[298] The Bacon Whitney transaction did not proceed further. A cynic might think that it never would have. It is possible that Messrs Halpern and Denny were biding their time until VTL collapsed and the technology could be acquired at low cost. However, having not heard from either Mr Halpern or Mr Denny, I make no finding one way or the other on that topic. In any event, receivership of Nathans intervened on 20 August 2007.

(ii) The Australian business

[299] The other major part of VTL's business was in Australia. The Australian business was conducted in a similar manner to the Californian one. AVS was granted master franchise rights, initially, for the eastern seaboard of Australia. For convenience, I describe AVS as the as the Australian master franchisee.

[300] AVS was operated by a New Zealander, Mr Seymour. In 2003, Nathans had advanced to AVS the sum of $AUD11.5 million so that the latter could acquire the master franchise rights from VTL. While attempts were made to acquire businesses in Australia to provide sites for operating franchisees, the problems with acquiring sites was not as acute in Australia as in California.

[301] In California, the vending business was more mature, meaning that many prime sites were already owned by other companies. To become successful in that market it was necessary to acquire businesses with those sites. In contrast, the Australian market was sufficiently new to allow vending sites to be acquired from other sources. Evidence was given about steps taken to acquire sites in buildings operated by large enterprises, such as Bunnings' stores, Qantas terminals and the Sydney University campus.

[302] Mr Seymour's view of his business tended to swing, with his mood. He sent contradictory emails, from time to time, to representatives of VTL in New Zealand that show, in close proximity to each other, despair about the prospects of ever repaying a loan of over $AUD12 million and enthusiasm at the prospect of growing the business for sale with others run by VTL in Australia.

[303] By mid 2006, it was clear that there would need to be a sale of AVS' business, probably in conjunction with VTL's Australian interests, in order to repay the debt, or even to pay interest. Mr Seymour says that he tried to make that point to VTL's and Nathans' auditor, Mr Hughes, at a dinner meeting in Sydney in mid to late 2006. Present at that meeting were Mr Seymour, his Sydney based accountant, Mr Banks, Mr Hughes and Mr Bridges, a partner of Staples Rodway who happened to be in Australia on other business at the time. Mr Seymour said that he imparted a gloomy picture of AVS' business. On the other hand, Mr Hughes recalls Mr Seymour being effusive about business prospects. Mr Bridges regarded the dinner as more of a social occasion. While he did not pay much attention to business discussions, Mr Bridges could recall that Mr Seymour raised some problems surrounding the installation of technology.

[304] This conflict in the evidence can be explained readily by the likelihood of Mr Seymour believing, in retrospect, that he placed much more emphasis on problems with the business and Mr Hughes hearing more about the positives; something which was consistent with information he had been provided by Mr Doolan. Nothing turns on the differences in the evidence.

[305] On 6 July 2006 Mr Seymour forwarded an email to both Mr Doolan and Mr Bayer about the state of AVS' cash flow. He said: "The business is insolvent". Mr Seymour made it clear that he had not misappropriated any funds, that his accounts had been subject to audit by a firm of accountants in Sydney and that Mr Banks could be contacted if there were any queries. Mr Seymour concluded by saying he would be in New Zealand on the following Monday to "discuss [his] exit arrangements". However, Mr Seymour did not press the "exit" option at that stage.

[306] A strategic planning meeting for the 24seven business in Australia was arranged for September 2006. Mr Seymour was one of the participants in that meeting; indeed, he played an active role. On the first day of the conference Mr Seymour led a discussion around two questions:

(a) What should a franchisee make out of a business?

(b) Can we sell a franchise with 100% finance?

[307] The agenda for the meeting demonstrates that considerable thought had gone into planning this meeting. The obvious intention was to strengthen the VTL business positions in Australia to maximise profitability, both for existing franchisees and VTL itself. Following the meeting a comprehensive list of "action points" was drawn up by Ms Short to give effect to decisions made at the meeting. An updated version of that document (together with a schedule of "action points" completed to that time) was forwarded by Ms Short, on 2 October 2006, to participants at the meeting. Mr Doolan and Mr Seymour were both recipients of that document.

[308] Two of Mr Hotchin's colleagues from SAG (Messrs John Davies and Mark Bruno) visited Australia and New Zealand, between 1 and 8 December 2006, to assess the VTL operating and franchise model in those countries. They reported, in somewhat gloomy terms, to a strategy meeting of the VTL board held on 19 December 2006.[202]

[309] Under the headings "Findings Overview", Mr Bruno reported:

> *The current business model is not working operationally, financially or organizationally. It is at best dysfunctional and at the worst case will eventually implode.* We spent time looking at why this is the case and have come to the conclusion that, amongst other issues, the master franchise model was built with the best intentions, but those intentions do not provide a value proposition for any of the stakeholders (VTL, AVS (the master franchisee), the operating franchisee or the vending client). Additionally, having VTL responsible for the operational execution is not working. There is not an adequate understanding of the issues or timely decision making, leading to the growing frustration and discontent with the master franchisee and the franchise operators. There is considerable frustration, distrust and unproductive energy spent between VTL and master franchisee's

[202] See paras [347] and [348] below.

> organization. This energy needs to be refocused to advance the business rather than to fight internal turf battles. The current organizational reporting is hurting the overall VTL offering and the ability to recruit new franchisees. Despite all of the issues that exist solutions are available. They require a complete restructuring of the business model and focus returned to providing a value and service to all stakeholders. Through the balance of this report I will refer to the stakeholders as Franchisor (VTL), Operator (operating franchisor) and the Franchisee (independent operator franchisee). (my emphasis)

[310] In an email sent on 3 March 2007, Mr Seymour identified some "key points" for the consideration of VTL personnel. At that stage, it became clear that Mr Seymour did not see any realistic prospect of the AVS debt being paid back. That triggered some concerns within Nathans about whether the AVS loan might fall into default. The loan was due to expire on 30 March 2007.

[311] On 27 April 2007, Mr Leong sent an email to Mr Davies (copying in Mr Seymour) wondering whether any progress had been made to resolve outstanding issues. Mr Leong noted that the loan for $AUD11.5 million had expired on 31 March 2007 and needed "to be rolled-over immediately". Mr Seymour responded on 1 May 2007 saying that there was "a genuine intent" on his part "to resolve issues surrounding" the roll-over. The main points that he raised were the "way forward" for AVS in respect of the master franchise model and the non-payment of machine licence income to AVS by VTL "due to an administrative blunder on VTL's part". Mr Seymour concluded his email by saying: "Under any of the current circumstances, I am unable to sign the roll over". It is interesting that the roll-over was being pressed by the lender, in a situation where it knew that the borrower had not (and could not) pay the debt when due.

[312] On 3 May 2007, Mr Leong sent an email to Mr Davies (copying in Mr Doolan) stressing the need for the issues to be "settled quickly" to enable the loan to be rolled-over. No progress was made. On 28 May 2007, Mr Bayer wrote to Mr Davies advising that the loan roll-over had still not been signed by Mr Seymour. He added:

> We have to report to the Trustee at the end of this month and this loan is currently in the overdue column due to Rob [Seymour] not signing.

[313] On 30 May 2007 Mr Davies sent an email to Mr Seymour stating:

> Can we get this done? I have not pushed it as I thought we would be further down the track with NewCo, but it seems we may have to keep things straight with Nathans in the interim.[203]

[314] Ultimately, Mr Seymour was prevailed upon to sign the roll-over documents, on or about 30 June 2007, the date on which Nathans' report to Perpetual was due.

(c) Strategic planning

(i) Nathans

[315] In June 2004, the month after the risk management policy was adopted, the then directors of Nathans (Messrs Hotchin, Doolan and Moses) developed a strategic plan. It was designed to cover the period to June 2006. The plan was recorded in a comprehensive document, running to some 26 pages.

[316] The purpose of the strategic plan was to:

(a) Assess the current position of Nathans;

(b) Propose a number of key targets for Nathans to have achieved no later than 30 June 2006; and

(c) Provide a formal plan for exactly how Nathans was going to achieve those targets.

[317] The rationale for the plan was to ensure that the board and management of Nathans created and maximised value for its ultimate shareholder, VTL. The document recorded that it was "the view of management" that maximisation of value would be achieved through building a "standalone and self-supporting finance company operation that produces a satisfactory level of maintainable earnings".

[318] It was recognised that due to "the high level of strategic importance of [Nathans] to its parent company [VTL] it [was] vitally important that in addition to

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[203] For a discussion of the "NewCo" concept see para [363] below.

any value considerations, that attention be paid to ensuring that Nathans [met] all of VTL's requirements ... in order that VTL's performance and value [was] also maximised". That statement reinforces the prevalent notion that what was good for VTL was good for Nathans, and *vice versa.*

[319] It was acknowledged that Nathans did not exhibit many of the characteristics of a "standalone finance business". Key areas of deficiency were identified:

(a) Nathans lacked established and continuing sources of new business and "origination" capacity. It was acknowledged that Nathans was "heavily reliant on VTL generated business and opportunities";

(b) Nathans was reliant on VTL to provide administration and finance functions;

(c) Nathans was perceived, both internally and externally, as a division of VTL rather than a business in its own right;

(d) Nathans' market risk was managed for it by VTL; and

(e) Nathans' credit risk, in terms of concentration of its loan book, lay almost entirely with VTL.

[320] The directors decided that enhancement of Nathans' value could be achieved by ensuring that it had a "diversified and high quality receivables book" and a "diversified and robust funding structure". In addition, it would need competent and experienced staff of its own, the ability to build new business and the ability to strong levels of earnings. Further, minimal direct or indirect reliance on VTL was desirable.

[321] From the plan, it is clear that Messrs Hotchin, Doolan and Moses knew that Nathans' exposure to parties related to or associated with VTL represented in excess of 90% of its receivables book. There was also a problem with an exposure to the Australian market that was not hedged, either naturally or artificially. In order to meet that latter problem it was intended to start fundraising activities in Australia.

[322] "Key strategic issues" were identified as:

(a) Agreement[204] between directors and management as to what type of lending Nathans would and would not engage in;

(b) Diversification of Nathans' receivables book and the concomitant reduction of concentration risk in respect of VTL;

(c) Managing lending operations in the country in which lending occurred, to minimise risks from exposure to movements in the dollar;

(d) Development of "best practice" credit risk management, so as to reduce Nathans' exposure to any form of default; and

(e) The recruitment and retention of "quality staff" to assist with the growth and management of the receivables book.

[323] In discussing liabilities, it was assumed that neither Nathans nor VTL were under any capital constraints. It was accepted, however, that Nathans had operated "in a benign economic environment over the [previous] two years" that had favoured issuers of fixed interest securities. Implicitly, it was acknowledged that position would not necessarily continue. Somewhat presciently, the plan added that:

> ... a default by any issuer of fixed interest securities, and in particular a finance company type entity, may in the future suppress demand for debenture stock such as that issued by [Nathans].

That statement acknowledged that financial planning should be undertaken on the basis that the market might move unexpectedly against a company's business.

[324] It was recognised that VTL's desire to expand its business through acquisition could impact on Nathans' ability to grow its own commercial receivables book, "depending on the quantum and nature of VTL's funding requirements with respect to these acquisitions". However, it was clear that Nathans could not develop a

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[204] I have taken this to mean that the directors would ensure that management acted in accordance with their plan.

reputation as a serious independent lender if inhibited by its parent's activities from lending to other entities:

> Until such time as [Nathans'] receivables book is diversified away from VTL and represents a more "arms length" and commercial risk profile the prospect of securing other cost effective sources of funding is very limited.

That is the context in which it was proposed that, by 30 June 2006, 66% of Nathans' lending would represent VTL related debt while the remainder would be commercial receivables.[205]

[325] Having developed that policy, it was for the directors of Nathans to require senior management to implement it and to supervise the implementation to ensure it was undertaken in accordance with the board's wishes.

[326] Just before Mr Young joined the Nathans board, a further business plan was prepared for the financial year ended 30 June 2006. Mr Young produced a copy of that plan. On his evidence it was prepared around August or September 2005. Important features were:

(a) For Nathans to lend "new quality commercial loans" during the 2006 financial year amounting to approximately $23.5 million. Taking into account other commercial loans it was estimated that the commercial loans on Nathans' books would total about $27.8 million by the end of June 2006.

(b) To increase the proportion of "commercial loans to total loans" from 8.84% as at June 2005 to 19.04% by the end of June 2006.

[327] The assumptions on which those strategies were based involved sufficient funds being available to Nathans to lend to commercial clients, "no additional drawings under the intercompany advances other than budgeted" and no major changes to the economic environment in which Nathans operated. The budget forecasted the following movements between July 2005 and June 2006:

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[205] See para [146] above.

(a) An increase in inter-company advances from $62.18 million to $70.70 million;[206]

(b) A minor decrease in loans to master franchisees from $38.16 million to $38.1 million;[207] and

(c) An increase in total loans from $122.8 million to $146.1 million.[208]

[328] The document records various strategies to achieve those aims. They included marketing, lending direction, credit application and management processes, management of arrears, staff (in particular the employment of a new commercial lending manager) and building and maintaining "a free cash float" of between $10 million to $12 million or 10% of total investments, whichever was the higher. In terms of the marketing strategy, the names of seven firms of brokers were identified to increase the pool of potential commercial borrowers.

[329] In April 2006, a strategic development paper was prepared for a board meeting to be held on 18 and 19 April 2006. The bulk of the paper deals with VTL issues. Under the heading "Equity and Debt", the paper recorded that the inter-company debt between Nathans and VTL had "reached a level where it is inhibiting the growth and profitability of both VTL and Nathans and creating Trustee issues". Concern was expressed that the "market cap" of VTL was such that it could not raise funds from the New Zealand market. Additional working capital for VTL was "urgently required".

[330] The proposed meeting was held on 20 and 21 April 2006. The notes indicate that they should be read in conjunction with "Board Minutes of same dates". The Nathans meeting was held on 18 April 2006; the VTL meeting on 20 and 21 April 2006. While Mr Young was present at the Nathans board meeting, he was not one of the participants at the strategy meeting. The VTL board minutes of 20 and 21 April 2006 record:

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[206] The amount outstanding at 30 June 2006 was $79.63 million: see para [154](d) above.
[207] The amounts owed by IVL and AVS as at 30 June 2006 was $36.42 million, to which a debt owed by the New Zealand master franchiser of about $2.5 million had to be added.
[208] $147.32 million, as at 30 June 2006.

10.6 Decisions arising out of Strategy Meeting:

10.6.1 Board Reporting Structure

Agreed that Board Agenda be restructured so that the essential reporting information is distilled and tabbed for easy reference by Directors. Also agreed that Nathans Board meetings/reporting will take place in conjunction with VTL Board meetings.

GS/DS to revise agenda.

10.6.2 Management Accountabilities:

Agreed that direct responsibility for the Group's business areas (24seven, Shop24 and finance company) by region be as follows:

Portfolios	***Manager***
USA (All Seasons; Texas; Ca./MAB)	***JH***
Belgium/EU	***JH***
Australasia	***MD***
Nathans – NZ, Aus., US (by jurisdiction)	***MD/JH***
Group – Finance, Legal, etc	***MD***

Each responsible Manager is to assume direct responsibility for financial and other controls, including reporting to the Board by business area and confirming the accuracy of financials for consolidation.

[331] From that time on, there appears to have been no serious attempt to implement the strategic plans formulated earlier by the Nathans directors. Rather, the ability for Nathans to be repaid or for a significant part of the VTL business-related business debts to be reduced, was wholly dependent on strategies adopted by VTL to deal with group assets in the United States and Australasia. At that stage, the directors of Nathans abdicated their responsibility for identifying and implementing Nathans' independent strategic aims to the VTL board.

(ii) VTL

[332] On 8 June 2006, Mr Doolan, Mr Moses and Mr Stevens met to discuss funding limits and processes for both Nathans and Chancery. There is no evidence that Mr Young knew of these discussions. Mr Doolan had sought approval from the directors of Chancery for an increase in its facility to VTL. Mr Stevens did not regard the proposal to increase the funding limit from $12 million to $20 million as supported by the information provided. The discussions that followed are relevant to VTL's relationship with both Chancery (of which Mr Moses was not a director) and Nathans.

[333] Those attending the meeting expressed concern about the continuing "creep" in the limits provided (initially) by Nathans and (then) by Chancery. It was accepted that the "creep" could not continue "because the cost of servicing the debt will become unsustainable". The three participants noted that interest on both loans was being compounded rather than paid from revenue. It was acknowledged that Perpetual was questioning the level of security for inter-company advances made by Nathans, in the context of two unrelated finance companies that had recently collapsed.

[334] Messrs Doolan, Moses and Stevens recognised that the "draw down of funds over recent months for working capital was due to the lack of franchising stock in California caused by delays in finalising documentation for the arrangement with [NorCal] and the slower than expected sales in Dallas and Australia". They recorded that "this could not continue". Budgets for the financial year ended 30 June 2007 had to "show that realistic and consistent sales will remedy the need for [Chancery] and Nathans to fund day-to-day working capital, including the servicing of debt". In that context, capital raising opportunities were identified. These included selling business interests in Australia, selling a partial interest in the United States businesses and business expansion opportunities in Germany, South East Asia, the United Kingdom and France.

[335] In consequence of those discussions, a paper (probably prepared by Mr Stevens) was circulated. It proposed a divestment policy for the period to 30 November 2006. The assumptions for that project included:

> ...
>
> 2. That the value of VTL of any arrangement to sell a full or part interest in one of its businesses is the consequent reduction in the net (to Group) cost of funds borrowed from Nathans Finance (estimate is 8-9% per annum).
>
> 3. That the respective individual franchise revenues cover the servicing of the [IVL] and [AVS] loans. The [New Zealand master franchisee] loan is a separate matter.
>
> 4. That Seymour should receive a net gain from the sale of his franchise after repayment of his loan from Nathans Finance.
>
> 5. That any sales fee (estimated at 4%) and estimated costs of presentation materials of (say) $100,000 (country of origin currency) will be deducted ahead of calculating the amount of any bonus.
>
> 6. That each or all of the following is (or can be) for sale:
>
>   a. A partial interest in VTL's US based 24seven businesses, and/or
>
>   b. A full interest in VTL's Australian based 24seven businesses, and/or
>
>   c. A partial interest in Shop24.

[336] The next VTL strategy meeting was held in Los Angeles, between 2 and 4 October 2006. It was attended by Messrs Stevens, Doolan, Hotchin and Moses. The meeting dealt with issues involving the whole of the VTL group. The main decision was to negotiate conditions to align VTL's interests with those of Messrs Halpern and Denny, "as requested by [Messrs Halpern and Denny]". A restructure of management was also contemplated, in order to co-ordinate international operations (for effectiveness and efficiency) and to release "senior resources" to address "significant strategic matters and corporate affairs".

[337] At this time, it was agreed that Mr Mark Bruno would undertake a detailed review of the Australasian market and its operations. His review was intended to

include consideration of the "master franchisee" model, both in respect of its effectiveness and performance.

[338] As far as Nathans was concerned, those present agreed that the reporting required improvement. Further emphasis was to be placed on the broadening of the profile of the lending book, to increase loans to parties unrelated to VTL interests. A profile for a new "CEO" position was to be prepared, for approval of the board and subsequent recruitment.

[339] Mr Doolan was asked to prepare a timetable for the listing of Nathans on either the New Zealand or Australian stock exchanges. That was to be done by December 2006. The initial concept was for the board to comprise Messrs Doolan, Moses and Young, with one or two additional independent directors. The intention was to sell 100% of the business for (say) $50 million plus oversubscriptions in order to repay debts and capitalise Nathans for growth. Nathans was intended to hold a "cornerstone interest" in VTL, to continue their existing synergies.

[340] Similar plans were to be made in respect of Chancery, which was to be restructured to a "full finance company profile". At that time a new name was sought: the company was then known as VTL Group Finance Ltd. The name chosen was Chancery. Mr Doolan was to prepare a report "showing [the] overlay of [Chancery/Nathans] books to assess match".

[341] On returning to New Zealand, Mr Doolan made an application to ASB Bank Ltd for a $5 million funding line, for Nathans. On 1 November 2006, ASB declined the application. After saying that the time taken to consider the request had been "due to the need to fully analyse the Nathans and VTL financial performances, due to their interdependence", two reasons were given for declining the application:

(a) The "significant intercompany advances from Nathans to VTL, with associated concentration and trading risks"; and

(b) VTL, while continuing to grow and to build profitability, had a "relatively weak balance sheet".

[342] Mr Doolan sought reconsideration of that decision, on the basis of VTL's intention to float Nathans. He told the bank that the intention was to sell all of VTL's holding in the company to repay inter-company advances to approximately $45 million.[209] On 2 November 2006, ASB declined that request stating that the "issues remain the same, ie substantial related party loans, which listing would not mitigate".

[343] Strategic issues were to be reconsidered at VTL's December 2006 meeting. That came to be held against the backdrop of an expression of interest, by Messrs Halpern and Denny, in acquiring shares in VTL.

[344] On 10 November 2006, Mr Stevens had written to Messrs Halpern and Denny declining an effective swap of a shareholding in VTL for the acquisition of Halpern and Denny's interests in SAG. By the time of VTL's November board meeting the Halpern and Denny proposals had developed further. Their status was recorded in the minutes of the VTL directors, held on 23 November 2006:

> 2. Expression of Interest in VTL Shares
>
> The Board recorded that it has received various correspondences from John Halpern and George Denny, expressing an interest in purchasing both newly issued shares and Treasury Stock in the Company.
>
> The Board confirms that the Company has not formally agreed to any sale of Company shares to Messrs Halpern and Denny.
>
> The Board records that it is prepared to receive a formal offer from Messrs Halpern and Denny on the basis that it will be considered by the Board and be subject to formal legal sign-off and shareholder approval as required.

[345] A strategy meeting was held in conjunction with the VTL board meeting of 19 December 2006. This was the first meeting of VTL that Mr Young attended. This was the meeting at which Mr Bruno presented his negative report about the Australasian operations.[210] Other issues discussed included involvement with SAG management options, review of potential acquisitions (UVM and SAG), the

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[209] The strategy agreed in October 2006, to list with the intention of obtaining subscriptions totalling $50 million, is consistent with the proposed repayment as, at that time, inter-company advances totalled about $95 million.

[210] See para [308] above.

possibility of acquiring Nationwide Finance Ltd (Nationwide), then part of the Hanover Group, the floating or trade sale of Nathans as a discrete business or the possibility of VTL listing on a secondary United Kingdom stock exchange board. The minutes of the board meeting of 19 December 2006 reveal that the strategic planning for the following three years, due to be updated in December 2006, had been deferred until the end of February 2007.

[346] At the end of Mr Young's evidence, I asked him some questions to help me to understand the apparent conflict between the divestment and acquisition strategies on which VTL was seemingly embarking. Mr Young responded that "they were both sort of in process before I'd really been part of the sort of strategic planning". He added that there was a "brief" strategy meeting at the first board meeting of VTL which he was present at the 19 December 2006 meeting. Mr Young deposed that "a lot of that [meeting] was consumed ... with the Australasian business and the Bruno report, so there wasn't a lot of, too much talk about some of the others".

[347] In relation to its own business activities, the minutes of VTL's board meeting of 19 December 2006 recorded:

(a) The first franchisee sales expected from NorCal were "on track" for January 2007. The evidence indicates that the NorCal business comprised 22 vending routes and was to be associated with IVL in California.

(b) An acquisition of the business operated by Artic Vending was scheduled "to close" on 31 December 2006, with about three franchise sales pending. This business was also to be operated in conjunction with IVL's master franchise in California.

(c) The acquisition of 17% of UVM was expected to be completed around 15 January 2007. It was described as a "management concept as opposed to acquisition [of] vending routes", with a "turnover platform" of $US62 million. Payment was to be spread over 18 months. This business interest would extend throughout the United

States. The VTL board approved this acquisition, subject to legal sign-off".

(d) There were continuing discussions with a company trading as Canteen, to secure some form of management arrangement for use of the franchise model in parts of the United States.

(e) A Special General Meeting was to be held on 12 January 2007 in relation to the proposed Halpern and Denny investment in VTL.

[348] The VTL board also approved a restructuring of the Australasian businesses which involved an amalgamation of all 24seven businesses throughout Australia and New Zealand. Surprisingly, in light of Mr Bruno's report, one of the principles of the restructuring was that "Australia is the growth focus". The proposed structure was to:

(a) Amalgamate the master franchisee and VTL businesses into a new entity. The identity of the new entity and its capital structure remained to be determined.

(b) Finalise this arrangement as soon as possible, while accepting that "full review" by the VTL board was required.

[349] Until those arrangements had been put into place, AVS was to assume specific responsibilities outside its master franchisee agreement and to be paid promptly for costs incurred, which were to be itemised and presented properly to VTL for reimbursement. Concerns about the way in which this arrangement operated were raised in early 2007 by Mr Seymour. A paper recording these arrangements was prepared by Mr Hotchin on or about 27 February 2007 for consideration at the board meeting of that date.[211]

[350] The Nathans board meeting was held on 21 December 2006, after the VTL strategy meeting. When the issue of the "inter-company debt" was raised by the

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[211] See para [355] below.

general manager's report, the board "recorded its recommendation to VTL to focus more on its own fund raising through Chancery Finance" and "its expectation that no more funds would be required from it by VTL for general operating expenses, and that any funds would be used for essential machines assets purchases only". It is surprising that the four members of the Nathans board who made up 80% of the membership of the VTL board should couch their views as "recommendations" and "expectations" if the situation was that dire. The way in which the views were expressed demonstrates graphically the subservient role of the Nathans board, at that time.

[351] In the context of "risk management", the Nathans board noted that "the directors have highlighted the potential issues regarding 24seven Master Loans, and that it is looking for guidance from VTL in this regard". Those observations also support the view that Nathans' future was being controlled by the VTL board. All of this was occurring only about two weeks after the prospectus and investment statement were distributed.

[352] It is also useful to view what was happening from VTL's side of the fence. VTL's annual report for the 12 months ended 30 June 2006 was published in early January 2007. As one of the "highlights", VTL reported that it had "invested significantly in a growth platform, that once converted will contribute an estimated 500% increase in annual revenue. That's from $48.5 million (as at 30 June 2006) to almost $300 million".

[353] Mr Stevens' review (as chairman of VTL) summarised benefits expected to flow from SAG's operations in the United States, those of IVL and AVS in California and Australia respectively, Shop24 (based in Europe) and Nathans. Describing Nathans as the "third pillar" of VTL's operations, Mr Stevens' continued:

> *Nathans Finance provides the funding that VTL Group needs to create its international growth platform, principally by financing new operators into the franchised businesses they are buying from us.*
>
> *In many cases this financing is of an interim nature only*, in that once these operators are established they can gain more standard bank financing. Nathans recently announced its intention to launch subsidiaries in Australia and the United States. In addition, Banco Popular, through its small business capital division, has agreed to refinance existing Nathans Finance United

> States loans and to finance qualifying franchisees, which are further supported by a guarantee from the federally-run small business administration.
>
> *Nathans Finance had no bad debts in the year under review, continuing an unblemished record. One of the main reasons for this is the high level of reporting provided by our technology, which automatically reports the performance of franchise holders business on a daily basis, right down to the profitability of individual vending machines*.
>
> Nathans Finance is also looking to widen its financing activities into other areas as it develops into a significant business in its own right, in addition to being one of the pillars supporting our wider growth strategy. (my emphasis)

[354] The proximity of the annual report to the issue of the Nathans' prospectus on 13 December 2006 is relevant, as is the different language in which Nathans' business interests were couched. The loans to VTL were described as "principally ... financing new operators into the franchised businesses", whereas those funds were being used to enable VTL to acquire new businesses in the United States. The operating franchisee funding was of much less significance than the loans to the master franchisees and VTL, to which no specific reference was made.

[355] The VTL papers for the meeting on 27 February 2007 included a paper, prepared by Mr Hotchin, proposing amalgamation of all current 24seven businesses operated in Australia and New Zealand, to be run out of Sydney. The paper again indicated that "Australia is the growth focus". If there were a coherent VTL strategy, this was a surprising development. As at mid February 2007, Catterton had made an offer for the Shop24 business[212] and Messrs Halpern and Denny had demonstrated a willingness to align their interests with VTL, at least to some degree.[213] Also, VTL had recently acquired interests in at least five businesses in the United States: NorCal, UVM, Phoenix Snack Attack, Artic and Aramark.

[356] In the summary of key legal issues, as at 21 February 2007, VTL directors were advised:

[212] See paras [289] above and [356] below.
[213] See para [293] above.

(a) A "letter of intent" had been received from Catterton, dated 6 February 2007. This was described as "a potential investment of US$20 million for a 60% interest in Shop24".

(b) A dispute had arisen with regard to the New Zealand master franchisee, Mr Canavan. A "potential audit issue" relating to the recovery of a $2.7 million loan was noted.

(c) Legal action in respect of a dispute involving MAB was highlighted. No details were provided. It was recorded that VTL was "confident" in its position ahead of a mediation scheduled for 15 March 2007.

(d) IVL was said not to be "an issue with" the debenture trustee at the time. However, it was noted that loans totalling $9.5 million and $697,000 were to fall due for payment on 22 April and 30 June 2007 respectively.

[357] The bulk of the financial information in the VTL board papers was based on consolidated accounts, to which all directors had access. The state of the inter-company account between Nathans and VTL was also available to all four directors of Nathans in a more transparent form: through monthly management accounts prepared for the Nathans board meetings.

[358] In the Nathans board papers for the month ended December 2006 (for a meeting held on 27 February 2007), the inter-company advances were said to be $95.28 million, with an increase of $2.66 million for the month that was partly used for capitalising inter-company interest, interest payments and subsidies of related parties. By that time, total VTL-related advances (including loans to master franchisees and machine lessors, but excluding All Seasons related advances) were $142.21 million and accounted for 90.1% of total finance receivables.[214]

[359] The minutes of the VTL board meeting held on 27 February 2007 record that:

[214] The basis for this calculation is set out at para [414](b).

(a) Chancery was responding to general information requests from the Registrar of Companies. Advice was being sought from a valuer and legal advisers to support a proposed loan restructuring to enable Chancery to continue to offer securities under its prospectus.[215]

(b) Catterton's indication to proceed with its proposal "subject to completion of due diligence" was noted.

(c) SAG was reported by Mr Hotchin to be "tight from a cash flow perspective, especially in light of IT and Shop24 costs".

(d) Options to deal with the IVL issue were to be discussed between Mr Hotchin and Mr Doolan on 1 March 2007.

[360] Another meeting of the VTL board was held on 11 April 2007. The agenda included reports on the operations of business units, including both Nathans and Chancery. Under "General Business" a structure was proposed and issues relating to the proposed Nationwide acquisition were discussed.

[361] This was the last formal meeting of the VTL board before Nathans was put into receivership. Mr Young explained that the various strategic activities underway meant that directors were (in my words) too busy to convene a board meeting. Also, there were problems with conflicts of interest faced by Messrs Stevens, Hotchin and Doolan in respect of the proposed transaction involving Bacon Whitney, which meant that a number of decisions on that issue had to be addressed by a committee of the board comprising only Mr Moses and Mr Young.

[362] The minutes of the meeting held on 11 April 2007 recorded that:

(a) VTL was instructing KPMG "to carry out peer review of Cole-Baker valuation [of Chancery] as requested by [the Registrar of Companies]". The scope of that review was subject to input from the Registrar. The issue concerning the Registrar was whether Chancery

[215] The discussion at the 27 February 2007 VTL board meeting post-dated receipt of the first of two Cole-Baker valuations addressed to Chancery and pre-dated the second: see paras [388]-[391] below.

was, in fact, engaging in commercial arm's length lending with members of the VTL group; in particular, the adequacy of a proposed subordinated guarantee to be given by VTL.

(b) While in the United States, Mr Stevens, as part of his role on the SAG board, had held a meeting with an investment banker to explore opportunities to "align interests under one umbrella". Mr Stevens reported that the meeting was "positively received ... with an indicative positive outcome to VTL in excess of its inter-company debt exposure". It was also recorded that VTL had been in discussions with KPMG concerning strategies to reduce the inter-company debt, for commercial lending and growth and diversification of Nathans' lending book.

(c) Mr Hotchin reported that Mr Davies was preparing a paper dealing with strategic issues for Australasian businesses; the proposed sale of an interest in Shop24 to Catterton was also "close to completion".

(d) The proposal to acquire Nationwide's business had foundered; it had been sold elsewhere.

[363] In an email dated 19 April 2007, Mr Stevens advised Mr Doolan, Mr Moses and Mr Young of a proposal made by Messrs Halpern and Denny in relation to the establishment of a new company (NewCo). This was the Bacon Whitney proposal in an embryonic form. The idea was for NewCo to be owned, initially, by investment vehicles (Funds) associated with Messrs Halpern and Denny with a convertible note to VTL for a sum of about $US12.5 million. A cash injection of $US6.5 million was proposed, to come from the Funds. NewCo was to contract with SAG to franchise existing routes with payments (to be negotiated) to SAG to cover expenses and repayment of bank debts. VTL would receive 65% of the shares in NewCo, the Funds 20% and Mr Hotchin 10%. It is unclear from that proposal how cash would flow to VTL to enable repayment of its debts to Nathans.

(d) Information available to Nathans' directors

(i) Nathans' board papers

[364] At each board meeting, directors of Nathans were supplied with comprehensive information about the company's financial position. The papers were circulated in advance of a meeting. None of the directors complained about the amount of time available to consider them before they met. Indeed, Mr Young's copies demonstrate that he had ample time to review and make notes about points of significance.

[365] The board papers were described for the "month ended ...". Thus, for example, the board papers for the "month ended June 2005" were for a meeting to be held on 4 August 2005 but included minutes of the previous meeting held on 22 June 2005. The reference to the "month ended" is to the financial information contained in the papers; in this case, for the month ended 30 June 2005. Other reports had been prepared in July 2005; examples include Mr Leong's report of 25 July 2005 (as general manager) and Ms Short's of 26 July 2005 (as marketing manager).

[366] Included among the board papers was a monthly certificate to the board from the chief financial officer. The certificate mirrors one that the directors were required to give to Perpetual, in terms of the trust deed. Mr Cunningham was responsible for signing the certificate of 26 July 2005. When he left the company that certificate was signed by Mr Doolan, as managing director, until Mr Bayer joined in May 2006. The directors say they relied on this certificate in respect of issues involving compliance with the trust deed, one of which dealt with broad questions of liquidity. The terms of any certificates to be given by the directors to the trustee were also included in those papers.

[367] Each set of board papers included a summary of "key legal issues" prepared by Mr Steytler. On a number of occasions, these dealt with issues involving the prospectus and investment statement.

[368] The monthly financial statements provided to the board consisted of:

(a) a statement of financial position;

(b) a statement of financial performance;

(c) a statement of cash flows;

(d) the debtors' aged trial balance; and

(e) secured debenture stock – in terms of maturities.

[369] The general manager's report included a summary of financial performance showing totals for revenue, cost of funds, trading margin, total overheads and operating surplus/deficit. These figures were provided on a forecasted and actual basis, with the previous month's figures available by way of comparison. The general manager then reported any material variations to the budgeted financial position.

[370] Under the heading "assets" the directors were given information about the three largest exposures and the percentages of advances, excluding inter-company advances, that had a maturity date in excess of 12 months. An example of the type of information presented to the board for each meeting is taken from Mr Leong's report of 25 July 2005:

> 2. Assets
>
> - Material changes to Commercial Clients:
>   - Boston and McConnochie Trusts – Loans of $1.115M each have been drawn down on 28 June 2005.
>   - SFS Limited – Loan of $770K has been rolled over
>   - Milford Way Trust – Loan of $75K was rolled over and increased to $125K.
> - [Nathans] currently has total advances (excluding inter company advances) of $71.25M to 74 third party clients

- *[Nathans'] three largest exposures are the $55.28M inter-company advance to VTL Group Limited, 24seven Vending (Australia) Limited and 24seven Vending (USA) Limited, $21.92m to Intelligent Vending and $13.54M to Advanced Vending. These 3 advances represent 71% of [Nathans'] book.*

- 66.3% of advances (excluding intercompany advances) have a maturity date of greater than 12 months. (my emphasis)

[371] The general manager's report also discussed risk management, in terms of market, credit and compliance risks. For example, in the June 2005 papers, Mr Leong reported that due to "the significant lending to VTL master franchisees and operators, we do remain exposed to a funding mismatch". Mr Leong tempered that observation by noting, as a "partial mitigating factor", the "historically high level of maturity roll-overs on the investment book".

[372] The "Investment Report" prepared by Ms Short provided the opening debenture balances, performance against budget, budget for the following quarter, financials, investment profile, maturity profile, key dates (including dates of official cash rate announcements, quarterly interest payment dates and expiry of the prospectus) and general. Helpfully, the information in the investment and maturity profiles were coupled with pie graphs.

(ii) VTL board papers

[373] Those directors of Nathans who were also members of the VTL board had additional information made available to them in the form of papers for the VTL board meetings.

[374] VTL directors received papers dealing with both VTL's individual position and the whole group. Among that information was monthly management accounts for both. Thus, the directors were able to see Nathans' financial position in the context of the overall group. Separate financial information was provided in respect of the group's interests in the United States and Australasia respectively. Summaries of the financial position of each subsidiary (including Nathans) were also made available. Mr Leong's report to the Nathans board was incorporated within the VTL papers.

(e) Valuation evidence

[375] Pursuant to a letter of engagement dated 14 November 2005, as part of its strategic planning, the VTL board obtained a valuation of the VTL group on a "Sum of the Parts" basis. MC Capital Ltd (Mr Clegg) was instructed for that purpose. The report is dated 26 May 2006 and was provided to the directors either on that day or shortly afterwards. Mr Clegg did not give evidence.

[376] The report purports to be an "indicative valuation analysis". The report refers to "estimating an indicative valuation for each of [the VTL group's] operating units". Mr Clegg stated that he had sought input from VTL's executive directors on the likely potential purchasers of each of the operating subsidiaries, in order to tailor the valuation methodology "to particular bidder types". As Mr Clegg said, "an existing Industry Player would value a subsidiary differently to that of a financial buyer (private equity fund)".

[377] A series of assumptions were set out in the report. The assumptions were specific to each component part of the group. In its report, MC Capital stated expressly that "it should not be construed, that it warrants [the] validity of the information" supplied. It added that "its investigations have not been designed to verify the accuracy or reliability of any information" supplied to it. The financial information on which the assumptions were based were provided by Mr Doolan, or (under his authority) Mr Bayer.

[378] The MC Capital report adopted a discounted cash flow analysis as the appropriate valuation methodology. Mr Clegg considered that appropriate because capitalisation of maintainable earnings did not reflect the "establishment phase" of businesses of this type. He recorded, based on information received from VTL, that the subsidiaries were "only now" beginning to realise the potential of the 24seven franchising model and VTL's market leading technology.

[379] The report states that MC Capital was not aware of any comparable listed vending companies to compare with VTL. A series of forecasts were provided to Mr Clegg so that he could calculate value based on those figures. The forecasts were

for periods ending in June 2010 and had been prepared by representatives of VTL. MC Capital reported a total value of $228 million for the sum of the parts of the VTL group.

[380] By March 2006, Perpetual was expressing concerns about the level of inter-company borrowing and the value to be ascribed to the IVL loan. Its concerns arose from the existence of capitalised interest that was likely to affect adversely the positive cash flow performance recorded in financial statements. A meeting with Perpetual was held on 24 April 2006 at which Mr Doolan attended, together with Mr Steytler, for Nathans. Mr Lancaster was one of Perpetual's representatives at that meeting. In answer to the concerns raised, Mr Doolan produced a draft of the MC Capital valuation.

[381] Perpetual was also concerned about the adequacy of securities for the loans. After receiving advice from Mr Graham of Ferrier Hodgson, it decided to seek a report from Nathans' auditors, Staples Rodway, under s 50(3) of the Act, for the purposes of assessing whether either the IVL and/or the inter-company debts should be impaired.

[382] Perpetual wrote to Mr Doolan on 27 April 2006 recording the outcome of the meeting of 24 April. One of the pieces of information given to Perpetual was that VTL would commence a mediation process with IVL once the audit of the latter had been completed. That did not take place and, indeed, was not seriously contemplated by the board of Nathans at that time.

[383] To enable the auditors to meet the trustee's s 50(3) request, VTL instructed Cole-Baker & Company Ltd to prepare a valuation of the IVL business. The report was to be addressed to the auditors. Mr Cole-Baker provided his report to the auditors on or about 24 August 2006. The auditors advised Perpetual that they would report under s 50(3) after completion of the audit. Perpetual was content with that. The audit was completed when the financial accounts for the year ended 30 June 2006 were signed by the directors, on 5 September 2006, with the unqualified audit opinion on those statements being provided on the same date.

[384] On the basis of the factual information and projections made available to him, Mr Cole-Baker derived a value for the Californian master franchise in excess of $US13.5 million, "based on growth projections provided by [VTL's] management". Mr Cole-Baker recorded the following sources of information on which IVL's business had been valued:

(a) A forecast of the expected trading for the next 20 years, prepared by management of VTL.

(b) Management accounts for IVL for the periods January to December 2004, January to June 2005 and January to October 2005.

(c) Advice from a business valuer in California.

(d) The Master Licence Agreement dated 30 June 2003, together with various addenda, the last of which was dated 22 April 2004.

(e) A letter of intent signed in February 2006 for the purchase of 22 vending routes from NorCal.

(f) Internally prepared evidence that IVL is achieving product sales of $130 per machine per week.

Mr Cole-Baker added that the information supplied and "the future of the business" had been discussed with both Mr Doolan and Mr Bayer.

[385] In addition to the description of information supplied to Mr Cole-Baker, Mr Doolan provided a representation letter dated 28 August 2006. The letter said:

> This representation letter is provided in connection with your valuation of the master franchise of Intelligent Vending LLC as at 30 June 2006.
>
> We confirm, to the best of our knowledge and belief, the following representations:
>
> 1. We acknowledge our responsibility for the accuracy of the financial statements supplied to you including the appropriate disclosure of all information required by statute.

2. There have been no irregularities involving management or employees that could have a material effect on the financial statements.

3. We have made available to you all information you have requested or that would be materially relevant to your assignment.

4. We have recorded or disclosed to you all liabilities, both actual and contingent.

5. We have disclosed all capital commitments.

6. There have been no events subsequent to the balance date, which would now require adjustment or disclosure in the financial statements.

7. We have reviewed the draft copy of the report supplied to us in particular the assumptions made and it is free, so far as we am aware, of any significant errors.

8. We confirm we do not have any information or knowledge, which could reasonably be expected to materially affect the business valuation conclusion in the report.

9. We confirm in our opinion that unaudited financial results and cash flow forecasts provided to you have been prepared on a consistent basis with those of previous years and the figures supplied to you are reasonable.

10. We confirm that the forecast Revenue Statements attached to your report, represent our expectations of future performance of the California franchise.

[386] Mr Hughes, the partner in charge of the audit, considered the figures and projections contained in the report, while Mr Bridges, a valuation expert within Staples Rodway, reviewed the methodology. Mr Bridges corresponded with Mr Cole-Baker on 4 September 2006 requesting certain information, to which Mr Cole-Baker responded on 5 September 2006, the date on which the audit opinion was actually given. Mr Bridges accepted that his assessment of the Cole-Baker valuation was done subject to time constraints.

[387] On 11 September 2006, the auditors reported to Perpetual that there was no need for any provision for either the inter-company or IVL debts. On the basis of the auditor's letter and unqualified audit opinion, Perpetual took no further action at that time.

[388] By early 2007, problems with renewal of the Chancery prospectus surfaced. On 9 February 2007, Mr Cole-Baker reported to the directors of Chancery (on instructions from Mr Bayer) to assess whether the terms on which Chancery lent money to members of the VTL group satisfied a specific provision of the Bonds Trust Deed, of which Covenant Trustee Company Ltd (Covenant) was trustee. The issue involved the extent to which a loan to a VTL company could be regarded as an arm's length commercial arrangement.

[389] Based on information provided by VTL, Mr Cole-Baker reported a "probable realisable value of the VTL Group businesses and investments" of between $292 million and $336 million". Mr Cole-Baker recorded that he had obtained, as sources of information:

(a) A budgeted forecast of the expected trading of the VTL group for the 12 months to December 2007;

(b) Management accounts for VTL group from July 2006 to November 2006; on a consolidated basis and for Nathans and Chancery;

(c) The MC Capital valuation; and

(d) Information about the future of the businesses obtained from Mr Doolan and Mr Bayer.

[390] Covenant sought further information from Mr Cole-Baker. Mr Cole-Baker reported on 16 February 2007. He stated the issue raised as the "commerciality of the lending by Chancery ... to subsidiaries of the VTL Group". Mr Cole-Baker considered that his earlier valuation (on 24 August 2006) of $224 million was conservative. He had, in effect, carried out a notional liquidation valuation for the VTL group showing that the company was solvent.

[391] Subsequently, Covenant requested an indication of the security available if the trading subsidiaries of VTL were placed in liquidation. A valuation on that basis was provided by Mr Cole-Baker on 14 March 2007 to Chancery. Even on a forced

liquidation, with business units ceasing to trade, Mr Cole-Baker assessed the value of the trading units as $133 million. Of that, a value of $22.5 million was put on Nathans.

[392] There are three further reports of relevance, all of which I will touch on when considering the beliefs of individual directors about the truth of statements in the offer documents that I have found to be misleading. They are:

(a) A report prepared by Fidelco Advisory Services, Inc (Fidelco) on the value of Bacon Whitney, dated August 2007. Fidelco is a business valuation specialist based in New Jersey.

(b) A draft report from Grant Samuel, chartered accountant, dated August 2007. This was prepared as an independent adviser's report under the Takeovers Code, in response to Messrs Halpern and Denny's intended purchase of a further 22.52% of VTL's share capital from the trustee of the Boston Trust. The report was never completed. The transaction was cancelled on 13 August 2008.

(c) A draft report to the Ministry of Economic Development provided by Mr Graham of Ferrier Hodgson on 17 August 2007. This report provided "interim findings" following a request from the Registrar of Companies. Mr Graham, in evidence, was at pains to make clear that his report was of an interim nature only and based on incomplete information; some of the information requested of VTL had not been provided.

21. Reasonable grounds for belief in truth of statements: Analysis

(a) Honest beliefs

[393] I accept that Mr Moses, Mr Doolan and Mr Young each held an honest belief that the statements in each offer document were not misleading. Each belief was

held from the time the relevant offer document was distributed and continued until Nathans' receivership; and in some cases to the present day.

[394] There are two reasons why I am satisfied that all three directors honestly believed the various statements were not misleading, notwithstanding my findings to the contrary:

(a) First, I find that they failed, on all material occasions, to give sufficient personal attention to the content of the relevant offer document. That meant that the directors were unable to form an independent view about whether there were or were not misleading statements in the offer documents. In part, their inability to form that view occurred because they wrongly left it to management to take professional advice and to confirm to them that the prospectus and investment statement were "compliant".[216] That was not a delegable duty. It was for them to read the contents of the offer documents and to determine for themselves whether they reflected the position of the company, as they knew it to be.

(b) Second (understandably) they have each attempted to reconstruct events as best they can from documentary and other evidence. In doing so, they have convinced themselves that a state of affairs existed which was consistent with their actions throughout.[217] In other words, their evidence was honest but mistaken.

(b) The differing responsibilities of the directors

[395] The position of each director was different.[218] Mr Moses had the responsibility of chairing the board. Mr Doolan had executive functions. For most of the time, he was one of two joint managing directors. Mr Young was the only director truly independent of VTL, until his appointment to that company's board in mid December 2006.

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[216] See paras [75]-[85], [184]-[185] above
[217] See para [112] above.
[218] See the discussion of their respective roles at paras [110] and [113]-[125] above.

[396] While Mr Moses, Mr Doolan and Mr Young, at various times, were in possession of different levels of information, the nature of their specific responsibilities is relevant to the inquiries each was required to make in order to clarify or understand information made available to them.

[397] Mr Moses' responsibilities must be assessed by reference to his position as chairman of Nathans and his role as a non-executive director. As a matter of law, no distinction is drawn between the roles performed in the boardroom by directors, whether labelled executive or non-executive. Every director is required to act in good faith, in what he or she believes to be the best interests of the company and to exercise the "care, diligence, and skill that a reasonable director would exercise in the same circumstances".[219] Use of the term "reasonable director" does not suggest different types of directors but is consistent with each having particular responsibilities within the board structure.

[398] The degree of care, diligence and skill required depends upon the nature of the company, the nature of the decision, the position of the director and the nature of the responsibilities undertaken by him or her.[220] In Mr Moses' case, those factors require consideration of the responsibilities undertaken by a non-executive director who is also the chairman of the board.

[399] A chairman is not just a figurehead. His or her role involves leadership. A chairman has the primary obligation of ensuring that the agenda for a meeting is properly formulated, guiding discussion and ensuring that the meeting is conducted efficiently and effectively. As s 128 of the Companies Act 1993 makes clear,[221] it would be wrong for the board to focus only on supervisory functions because it has the obligation of setting the policy that is to be implemented by management.

[400] A focus on supervision or monitoring "presupposes that the business drive comes from the managers of a company and that the board is there primarily to keep them on the rails", whereas it is "for the board, representing the interests of those who appoint them, to set the standards which they expect from managers and to set

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[219] Companies Act 1993, ss 131(1) and 137.
[220] Ibid, s 137.
[221] Section 128 is set out at para [75] above.

them high".[222] Those views are reinforced by the Institute of Directors' Code of Practice for Directors,[223] in which it is said that the chairman's role involves ensuring that all directors receive sufficient and timely information to enable them to be effective as board members;[224] including the need to ensure that adequate information is before the board on any major issue on which a decision is required.

[401] The term "non-executive director" is used to refer to a person who has no executive functions to fulfil, in relation to the company's day-to-day operations. Nevertheless, in carrying out his or her duties as a director, the non-executive must ensure that he or she has enough information on which to make an informed decision. It is not enough to rely on an executive director to bring something to the attention of the board, if it is clear that information on a particular point is relevant to a decision. Once sufficient information is available, the non-executive director's duty will be discharged through the provision of "independent judgement and outside experience and objectivity, not subordinated to operational considerations, on all issues which come before the board".[225]

[402] In the context of a finance company, a non-executive director is required to have the ability to read and understand the financial statements, the way in which such statements classify assets and liabilities as current or non-current, and to use that understanding when making decisions about such matters as solvency and liquidity.[226] Similar observations (with which I respectfully agree) were made by Miller J in *Davidson v Registrar of Companies*,[227] also in the context of a non-executive director of a finance company:

> [121] ... I accept that the standard of care required of a director depends on his or her position and responsibilities, but it also depends on the nature of the company and any given decision being made. A director must understand the fundamentals of the business, monitor performance and review financial statements regularly. It follows that a degree of financial literacy is required of any director of a finance company. Without it, Mr Davidson could scarcely understand the business, let alone contribute to policy decisions

[222] Sir Adrian Cadbury *The Company Chairman* (Cambridge, Director Books, 1990) at 14.
[223] The Institute of Directors in New Zealand (Inc), *Code of Practice for Directors* (2005). It was common ground that this version of the Code reflected the provisions that applied in both 2006 and 2007.
[224] Ibid, at para 3.15.
[225] Ibid, at para 3.7.
[226] See paras [83]-[85] above.
[227] *Davidson v Registrar of Companies* [2011] 1 NZLR 542 (HC) at para [121].

> affecting risk management and monitor the company's performance, yet his presence and reputation might encourage investors to believe that the group was well managed. Nor could he delegate performance monitoring to other directors, especially when he was one of only two who were independent. ... (footnotes omitted)

[403] Mr Doolan was intimately involved in the day-to-day business of Nathans. He had regular dealings with Nathans' management team, at least until early 2007. In late 2005 to nearly mid 2006, he was also acting as chief financial officer. Mr Doolan dealt with the audit partner at Staples Rodway and was also the director primarily responsible for liaising with Perpetual, as trustee. He gave instructions to valuers, such as MC Capital and Mr Cole-Baker, on the basis of which their valuations were compiled. Mr Doolan led the prospectus preparation team. He had responsibility for overseeing the Australasian operations of VTL for much of the period in question.

[404] Mr Young was also a non-executive director, though much further removed from operational issues than Mr Moses. He brought a significant degree of detachment from Nathans' operational considerations. His role required an inquiring mind, in relation to both company strategy and general administration. As the only Nathans director not on the VTL board (until late December 2006) Mr Young had a responsibility to make inquiries of his co-directors in relation to any of VTL's circumstances that had the potential to impact on Nathans' business activities and to challenge them or engage in debate about such matters, when necessary.

(c) The directors' grounds for believing misleading statements were true

[405] Messrs Moses, Doolan and Young advance one overarching reason for believing that the statements were not misleading, and others which are more specific to the individual findings. For the purpose of analysing whether the directors had reasonable grounds to believe the statements were true, it is possible to group the misleading statements[228] under five broad headings and to consider the directors' views in that context:

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[228] See paras [215]-[225] (investment statement and prospectus), [237]-[241] (extension certificate), [245]-[250] (letter of 14 May 2007) and [265]-[264] (letter of 6 August 2007).

(a) Lending to VTL and its subsidiaries was made on normal commercial terms, usually for periods of no more than 12 months. In making and managing such loans, VTL and its subsidiaries were treated no differently to third party borrowers dealing at arm's length with Nathans.

(b) A strong level of corporate governance and robust credit assessment processes meant that their unblemished record of "nil bad debts" had been maintained.

(c) The debts owing by VTL and its subsidiaries were expected to be repaid within a period of 12 months from the date of the financial statements for the year ended 30 June 2006.

(d) Nathans' receivables book was growing and diversifying as VTL and its subsidiaries were actively seeking to arrange repayment in the country in which the debts were incurred.

(e) VTL could financially support Nathans in the event of adverse financial circumstances.

These five groupings cover all of the types of misleading statements I have found to exist and are common to each of the times at which the knowledge of directors is to be assessed.

[406] While the position of individual directors must be separately considered, in relation to information available to them at relevant times, the bases for their respective beliefs that the impressions conveyed by their statements were true may be summarised as follows:

(a) In relation to the investment statement and the prospectus, the directors relied on management, the auditors, external professional advisers, the trustee and the Registrar of Companies (all of whom had input into the final form of those documents) in concluding that those

offer documents were compliant with regulatory requirements. Based largely on the "comfort" derived from those parties' input, the directors were confident in using the investment statement and prospectus as a firm base on which to build the extension certificate and subsequent advertisements, which, when they were distributed, were believed not to be misleading.

(b) Lending to VTL, its subsidiaries, IVL and AVS was literally undertaken on normal commercial terms, usually for periods not in excess of 12 months. The facilities granted took the form of a revolving credit contract incorporating terms on which third parties could borrow from Nathans', including the prevailing market interest rate. In the context of a "start-up" company, it was not unusual for interest to be capitalised and the fact that loans were consistently rolled over could be seen from the information contained in the "Material Contracts" section of the prospectus.[229] Adequate security had been provided for the loans.

(c) The description of corporate governance procedures as "strong" was accurate. There was no need for Nathans to have a board wholly (or substantially) independent of VTL. Further, "robust" credit application and management processes were used for loans to VTL, its subsidiaries, IVL and AVS. There was a credit policy in place and the directors were entitled to rely on management and staff to implement it.

(d) On the information provided to directors by management, there was no reason for concern in relation to Nathans' liquidity, at any of the material dates. In particular, directors relied on daily, weekly and monthly cash flow reporting through Mr Bult and the provision of liquidity certificates to the board by the chief financial officer.[230]

[229] See para [205] above.
[230] See para [366] above.

Further, the directors believed that the liquidity profile[231] had been completed on a "maturities" basis, in which case it was correct. The directors relied on the chief financial officer and the auditors to ensure correct disclosure of this aspect of the company's financial position.

(e) Nathans' board had, for some time, been exploring opportunities to lend to commercial entities operating in different sectors. While not expanding the lending book as quickly as might have been hoped, there was, nevertheless, both a growth in the number of third party commercial borrowers and diversification in respect of the sectors into which lending was carried out.

(d) Were the beliefs based on reasonable grounds?

(i) Overview

[407] Mr Doolan had been a director of Nathans since its incorporation on 23 July 2001. At that time he was already on the VTL board. From those early days, Mr Doolan accumulated knowledge about the affairs of both VTL and Nathans (as well as the wider group) from his role as an executive director, his involvement in overseeing the finance and accounting functions of each company, his involvement with the Australasian market from its inception, the reports available in board papers for each company, attendance at strategy and directors' meetings of both VTL and Nathans and interaction, both formally and informally, with co-directors and senior management. Even after Mr Doolan reduced his day-to-day involvement in early 2007, he maintained a significant interest in developments, to the extent that a family trust with which he was associated was engaged in negotiations to sell shares in VTL to Halpern and Denny interests around June to August 2007.

[408] Mr Moses had access to all board papers for Nathans from his appointment as a director of that company on 11 August 2003 and of VTL, after his appointment to the board of that company on 4 May 2004. Mr Moses had other sources of information; discussions with directors at board and strategy meetings (including

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[231] See para [201] above.

private sessions held after board meetings at which directors were free to raise issues of their choice with no minutes being kept), informal contact with co-directors (particularly Mr Stevens) and (generally email) correspondence from senior management and other directors.

[409] As a non-executive director Mr Moses had little contact with the day-to-day operations of either company, though as chairman of Nathans I am satisfied that he received much more informal information from people such as Mr Stevens, Mr Steytler and Mr Bayer than did Mr Young.

[410] Mr Young received board papers for Nathans from the time he was appointed to the board of that company on 19 September 2005. He did not have access to information generated for the benefit of the VTL board. There were occasions, such as receipt of the MC Capital valuation in May 2006, when although he was told by Mr Doolan of the general outcome of the report, he did not receive a copy. Mr Young had the opportunity to consider VTL documentation after joining that board on 13 December 2006, the day on which the Nathans' prospectus was issued.

[411] Mr Young had limited contact with other directors outside of formal board meetings and was rarely copied into correspondence from members of the management team; a significant exception being the email chain dealing with the risk section of the investment statement and prospectus in late November/early December 2006. In that sense, he could be regarded truly as an independent director of each company. Unlike others, he had no financial interest in either VTL or Nathans, whether as a shareholder or otherwise.

(ii) As at 13 December 2006: prospectus and investment statement

[412] It is true, as Mr Jones submitted, that Mr Young had considerably less knowledge about the overall activities of the VTL group in the period leading up to distribution of the investment statement and prospectus, on 13 December 2006. At that stage, Mr Young's information came, almost exclusively, from the Nathans board papers and discussions held at meetings of the directors, including the private sessions. Although Mr Young produced a business plan for Nathans that was

prepared around August or September 2005,[232] I find that he had little or no input into the content of that plan; the likelihood is that it was completed before he joined the Nathans' board on 12 September 2005 and was provided to him as preparatory information before he took up his seat.

[413] Having said that, my consideration of the evidence since the conclusion of the trial has led me to the view that the position of each director can be judged by reference to information available to him from the time that papers were presented to the Nathans board for its meeting on 20 November 2006, the last meeting held for registration of the offer documents on 13 December 2006. The papers for the November meeting contained month-end accounts for the periods to 31 August and 30 September 2006.

[414] The minutes of the 20 November 2006 meeting reveal that:

(a) There was a focus on the state of the inter-company debts. The board was advised that plans to reduce the inter-company debt were in place. While Mr Doolan and Mr Moses already knew this from their positions on the VTL board, the information is likely to have come to Mr Young's attention through the papers. The plans involved "divestiture of major assets" by VTL.[233] The board recorded "that it wished to consider details of factors contributing to" the increase in the inter-company indebtedness. Mr Bayer was asked to provide a breakdown of "capitalized intercompany interest" for circulation to the directors.

(b) Mr Leong's report of 1 November 2006 revealed that, as at 30 September 2006, the inter-company debts totalled $88.21 million and represented 58.2% of total finance receivables. There had been an increase of $3.45 million since 31 August 2006. The increase was said to be "partly due to capitalising inter-company interest, interest subsidies of related parties and machine lease payments". The board

[232] See para [326] above.
[233] See paras [335] and [336] above.

was also told that "VTL related advances" being defined as "inter-company advances and loans to its [master franchisees] and machine lessors (but excluding [All Seasons] related advances)"[234] accounted for 89.8% of total receivables. The September 2006 figure for inter-company advances represented an increase of $8.58 million in the three months from balance date, 30 June 2006.

[415] The next meeting of the Nathans' board was scheduled for 21 December 2006. The board papers for that meeting were not available to directors of Nathans before the exchanges leading to Mr Hotchin's "no cash will come in" email, of 1 December 2006.[235] They were circulated sometime in December. It appears likely that they were circulated before 13 December 2006, though on issues relating to the inter-company and VTL business-related advances, that may not matter.[236]

[416] The October board papers, for the December meeting, contained the minutes of the 20 November 2006 meeting and the following additional information:

(a) A request by Mr Bayer to Mr Doolan in a memorandum dated 7 December 2006, for an increase in the facility limits for either 24seven Vending (Australia) Ltd or 24seven Vending Pty Ltd, to fund "continued growth in this particular market". An increase of between $4 million and $5 million was sought. The then current facility was $10 million.

(b) The inter-company debt had increased from $79.63 million (as at 30 June 2006) to $90.13 million (as at 31 October 2006). The corresponding figure to 30 September 2006 was $88.21 million. Expressed as percentages of total receivables the September and October amounts were 58.2% and 58.8% respectively.

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[234] This calculation does not equate exactly (for definitional reasons) to the calculations I have made in respect of what I have defined as "VTL business-related debts" – though the figures are probably close enough for rough comparison.
[235] See paras [171]-[183] above.
[236] See paras [414](b), [416](b) and (c) below.

(c) The total of VTL business-related debts (excluding loans to operating franchisees) as at 31 October 2006 was $129.82 million, accounting for 84.7% of total finance receivables; this compares with $127.81 million and 84.4% as at 30 September 2006.

(d) The significant lending to VTL master franchisees and operators meant that Nathans remained exposed to a "funding mismatch".

(e) A loan of $750,000 to AVS had fallen due for repayment on 14 August 2006. While approval had been given for a fresh facility to be granted, none had been documented at the time the board papers were circulated.[237] The "NFL Loan Arrears Report" recorded that AVS loan as having expired.

[417] This information made it plain that not only could the existing inter-company debts not be repaid but that a further sum of between $4 million and $5 million was being sought to fund continued growth in Australia; something which, on the face of it, was inconsistent with the divestment strategy discussed at the 20 November 2006 meeting.[238] That was provided to the directors in the context both of information that part of the AVS loan had fallen into arrears and the marked increase in the VTL business-related indebtedness between 30 June 2006 and 31 October 2006.[239]

[418] Against that background, I consider whether the directors had reasonable grounds to believe the statements in the investment statement and prospectus were not misleading.

[419] The first issue is generic in nature. It concerns the ability of directors of an issuer to rely on others involved in the preparation of an investment statement and prospectus for the purpose of complying with their own statutory duties. While questions of degree arise and may result in more difficult judgments in other cases, I am satisfied that any "reliance" of the type advanced by the directors in this case

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[237] The broad thrust of the reasons why a renewed facility had not been granted are set out at paras [303]-[308] above.
[238] See para [414](a) above. See also para [355] above.
[239] See para [416](c) and (e) above.

cannot result in reasonable grounds to believe that the statements in the investment statement and prospectus were not misleading.

[420] The statutory duty for ensuring that offer documents go into the market without misleading statements rests on directors of the issuer.[240] Directors have a non-delegable duty to form their own opinions on that issue, in reliance on information provided by others that they have no reason to suspect may be wrong. The problem for the directors, in this particular case, is that they, in effect, purported to delegate to senior management the task of determining whether the investment statement and prospectus were "compliant" with regulatory requirements and failed to bring independent minds to bear on the topic. Their failure to do that was particularly surprising given the Securities Commission's earlier report on disclosure by finance companies and the subsequent correspondence with Nathans.[241]

[421] There was a fundamental failure, on the part of all directors, to review the content of the offer documents and to ask themselves whether the information conveyed presented, to a prudent but non-expert person, an accurate impression of Nathans' business and the associated risks. That exercise should have been undertaken by excluding their own insider knowledge. That is one of the reasons why a collective approach at a board meeting would likely have resulted in a different outcome. A discussion among the directors, properly led by the chairman, was likely to tease out a number of issues of concern.

[422] While it was fair for the directors to rely on the auditors to check aspects of the company's financial statements and to ensure that technical standards were fully met in relation to accounting policies, the accounts remained those of the directors and they had their own obligation to be satisfied of their content when signed.[242] By way of example, to which I shall refer in the context of the liquidity issue, it ought to have been obvious to Mr Moses, Mr Doolan and Mr Young that the classification of all or part of the inter-company indebtedness under "current assets" in the statement

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[240] Securities Act 1978, s 58(1) and (3); set out at para [23] above.

[241] See generally, paras [75]-[87] (directors' duties), [171]-[185] (email correspondence regarding risk section of investment statement and prospectus), and [395]-[404] (particular responsibilities of individual directors) above.

[242] See para [80] above.

of financial position was an error; irrespective of whether the auditors should take responsibility for the absence of a note making clear that the liquidity profile was prepared on a maturities basis.[243]

[423] It was not open to the directors to believe that Mr Steytler and the solicitors had an obligation to ensure "compliance". As recognised by Mr Hotchin, a decision on the extent of disclosure on risk was for the board to make, not management.

[424] Mr Moses, Mr Doolan and Mr Young have all emphasised that they did not receive the final advice provided by Minter Ellison, about the way in which the extent of the inter-company loans should be addressed in the risk section of the investment statement and prospectus. The solicitors had suggested that the directors may wish to describe the inter-company borrowings as "very significant" or "almost half".[244] The three directors say that they would have followed advice to that effect.

[425] On analysis, Mr Steytler's inadvertent failure to forward the final email in the sequence had no impact on the state of the directors' knowledge at the time they approved the risk section of each of those documents:

(a) Two days before the solicitors provided final advice at 2.05pm on 1 December 2006,[245] Mr Steytler had sent an email to all four Nathans directors, Mr Stevens, Ms Short, Mr Leong and Mr Bayer. He attached a version of the investment statement that contained a statement under the subheading "**VTL Insolvency**" in the proposed "Risk" section of the investment statement:

> [Nathans] provides financial accommodation to its parent company VTL and to VTL subsidiaries. As at 30 June 2006 these advances totalled $79,630,043 making up a significant portion of [Nathans'] current assets (46.2%) and are secured. Advances to VTL and its subsidiaries have been made on a commercial arms length basis, normally for terms no longer than 12 months.

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[243] See para [402] above.
[244] See para [183] above.
[245] See paras [182] and [183] above.

(b) From the information available to them from either the September or October 2006 board papers, the directors knew that the total inter-company debts was in the vicinity of $89 million, about 58.5% of total receivables. They also knew that the VTL business-related debts totalled around $128 million, representing about 84% of total finance receivables.[246] By way of comparison, the 30 June 2006 accounts, showed the inter-company debt at $79,630,043.

(c) If the directors had made inquiry to ascertain the amount outstanding at the end of November 2006, when approving the prospectus, they would have found that the total amount of inter-company debts had increased to $92.62 million; about 59.5% of Nathans' total finance receivables.

[426] From the information actually (or readily, on due enquiry) available to the Nathans' directors, any difference between Mr Steytler's suggestion of using the word "significant" to explain the extent of inter-company borrowing, compared with the expression "very significant" or "almost half" pales into insignificance. The expression in dollar (or percentage) terms as at 30 June 2006 bore little resemblance to the actual position as at December 2006.

[427] Mr Moses, Mr Doolan and Mr Young purported to place reliance on what they had been told by Mr Steytler and Minter Ellison on this issue. Any such reliance was misplaced. Minter Ellison, as the company's solicitors, provided advice based on primary facts given to them by the client. There is no evidence that Minter Ellison was ever given updated figures for the inter-company advances, whether as at 30 September, 31 October or 30 November 2006. That is evidenced by the suggestion that the words "almost half" be inserted into the "Risk" section of the two offer documents. Had updated figures been provided the percentage of inter-company advances to total finance receivables would have exceeded 50%.

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[246] See para [415](b) and (c) above.

[428] The role of the trustee and the Registrar was even more limited.[247] The limited review carried out by each of those parties for the purpose of complying with their particular statutory and contractual duties could not absolve the directors from compliance with their own.

[429] Even a cursory analysis of the narrative of the investment statement and prospectus should have led the directors to the view that the impression conveyed by it was at odds with the real position, as they knew it to be. There are no reasonable grounds on which the directors could have believed that the impression conveyed by the narrative of the prospectus was not misleading.

[430] I now deal with the specific grounds on which the directors contend that they had a rational basis for believing the statements were true.

[431] There were no reasonable grounds on which the directors could believe that lending to VTL and its subsidiaries were made on normal commercial terms, usually for periods of no more than 12 months. Nor were there such grounds for believing that the loans were managed in a manner consistent with those of third party borrowers.

[432] As at the date on which the investment statement and prospectus were distributed, the directors of Nathans knew there was no reasonable prospect that inter-company debts could be repaid without VTL selling all or some of its business units. Nor was there any possibility of IVL or AVS repaying their debts without their businesses being sold in conjunction with VTL business units.[248] The directors were aware of inconsistent strategies being undertaken by VTL to obtain repayment of the debt. Leaving the Australian market to one side (as it was discussed in greater detail just before Christmas 2006) the directors were aware both of the "divestment" policy and the various acquisitions of interests in businesses in the United States. They were also aware of a significant increase in the inter-company debt since 30 June 2006.

[247] See paras [92]-[96] (trustee) and [97] and [98] (Registrar of Companies) above.
[248] See paras [216] and [217] above.

[433] It was disingenuous for the directors to place weight on the suggestion that the impugned statements were literally true. The directors were aware that the money received would be used primarily as working capital for VTL and that was not disclosed.[249] Save in rare circumstances, a commercially driven lender is unlikely to capitalise the interest or extend the amount or term of a loan to an arm's length third party, when it knows that the borrower cannot afford to pay either interest or principal from existing business revenue. At the least, it would be necessary to disclose in unequivocal terms that that state of affairs existed.[250]

[434] Generic statements about good governance and credit management processes fall into the same category. Strong corporate governance does not involve the delegation of strategic decisions about a company's future to its parent, particularly when the subsidiary is soliciting funds from the public for the ostensible purpose of developing its business as a finance company. So far as "robust credit management" was concerned, the directors were aware of the cursory basis on which applications for finance and/or roll-overs were made in cases involving VTL, IVL and AVS. The degree of scrutiny given to third party borrowers far exceeded those relating to VTL, IVL and AVS, notwithstanding that the extant credit policy did not differentiate between different types of borrowers.[251]

[435] I am prepared to assume (without deciding the point) that the directors were entitled, at least so far as the liquidity profile was concerned, to rely on the auditors review of the accounting policies and the absence of any indication from them that a note should be added to deal with the "maturity date" basis on which the liquidity profile had been prepared. I am not prepared to make an unequivocal finding in favour of the directors on this point because of my concerns that the directors were on notice as a result of the way in which part or all of the inter-company advances were classified as a "current asset" in the statement of financial position. In light of other findings, a detailed consideration of this issue is rendered otiose.

[436] So far as the suggestion that VTL supported Nathans was concerned, the directors had no reasonable basis to believe that VTL, as at the date on which the

[249] See para [219] above.
[250] See para [218] above.
[251] See paras [220]-[222] above.

prospectus and investment statement was registered or in the foreseeable future, would have sufficient funds to support Nathans in the event of financial adversity. As previously indicated, Nathans supported VTL.[252] The directors' assessment of VTL's prospects of receiving sufficient funds to make any significant impact on the amounts owing to Nathans in respect of inter-company debts (leaving to one side the IVL and AVS debts) was hopelessly optimistic.

[437] Because the "growth and diversification" of the commercial lending book point is no more than the other side of the coin involving failure to disclose the true extent of the VTL business-related indebtedness, I see no reason to address that issue independently.

(iii) As at 29 March 2007

[438] By the time the extension certificate was signed there had been one important development that could have effected payment of about 10% of the inter-company debt. That development arose out of the sale of shares in VTL to Messrs Halpern and Denny that was settled on or about 19 January 2007.[253] The relevance of receipt of the Halpern and Denny purchase moneys lay in the ability that directors of VTL (now including Mr Young) had to provide some financial support to Nathans if circumstances so required. The question is whether receipt of those moneys could form a reasonable basis for the directors to believe that VTL was in a position to support Nathans if necessary, thereby rendering a previously misleading statement true.

[439] I do not accept that receipt of the moneys provides a reasonable belief for the view that the earlier statements about VTL's ability to support Nathans were no longer misleading. First, the moneys were not "earmarked" for Nathans, in a legal sense. Indeed, while not relevant for present purposes, they were never used for Nathans' benefit until after receivership. Second, while a relatively large sum, it was, as at January 2007, about 10% of the total inter-company debt and a much lesser

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[252] See para [224] above.
[253] See para [293] above.

percentage of the VTL business-related debts. If Nathans struck troubled waters the sum of $10.6 million would not go far in alleviating its financial situation.

[440] At the time the extension certificate was registered, the misleading statements arising out of the original prospectus remained. My findings on the lack of reasonable grounds for belief that those statements were not misleading as at 13 December 2006 apply equally as at 29 March 2007. The obligation to monitor the position to ensure a prospectus and investment statement portray the real position of the company applies.[254] No reasonable efforts were made to comply with that obligation.

[441] I have held that there were two additional misleading statements, arising out of the two points certified by both Mr Doolan and Mr Hotchin.[255] To determine the grounds for any belief that those statements were true, as at 29 March 2007, it is necessary to consider what occurred at board meetings prior to that date.

[442] Mr Young attended his first meeting of the VTL board on 19 December 2006. On the same day a strategy meeting was held at which, among other things, Nathans' future was discussed. The content of the board papers and the discussion at those two meetings has already been summarised.[256]

[443] In addition to the matters discussed at those meetings, VTL had made three further acquisitions in the United States, all of which had required funding from Nathans: Phoenix Snack Attack, Artic Vending and Aramark. These were said to have been generating sales of $1.5 million, $1.1 million and $200,000 respectively. The Nationwide acquisition was not far advanced. The possibility of listing Nathans in either New Zealand or Australia had not been progressed.

[444] A further meeting of the Nathans' board was also held on 27 February 2007. The papers for that meeting indicated that a paper on the topic of establishing subsidiaries of Nathans in Australia and the United States for circulation to directors had been put "on hold".

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[254] *R v Steigrad* [2011] NZCA 304 at para [114].
[255] See paras [238]-[241] above.
[256] See paras [345] and [347] above.

[445] Directors were told that IVL loans were about to mature: $9.5 million on 22 April 2007, $697,000 on 30 June 2007, $US5.4 million on 1 September 2007 and $2.4 million on 30 September 2007. Mr Young's notes of that meeting indicate that a management meeting was to be held on 1 March 2007 to consider this issue, with Mr Doolan to review the possibility of a roll-over. By this time, IVL was trading at the behest of VTL and had no independent management to make decisions on issues of that type.

[446] In addition, Mr Leong reported that the loan of $AUD750,000 to AVS had expired on 14 August 2006, some six months earlier. Though the loan had "been approved for roll-over", that was "currently being documented". On that issue, Mr Young noted that Mr Leong advised that initially Mr Seymour had wanted interest support before signing any roll-over document, but that issue had since been resolved between Mr Davies and Mr Seymour.

[447] After the 27 February 2007 board meeting, the next meeting of the VTL board was scheduled for 29 March 2007. However, it was deferred until 11 April 2007. Therefore, the VTL board did not meet between 27 February and the date on which the extension certificate was signed. I have been unable to locate any evidence suggesting that the directors made a considered decision about whether the extension certificate should be signed.

[448] I found that the extension certificate itself was misleading in two respects:

(a) It stated that there had been no material and adverse change in the financial position of Nathans since the audited accounts for the year ended 30 June 2006, when that was not the case.[257]

(b) There was no reference to a significant decrease in net cash flow that was known to the directors at the time the extension certificate was registered.[258]

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[257] See para [240] above.
[258] See para [241] above.

[449] The two aspects in which I have held the extension certificate to be misleading arise from information actually before the board at the time the certificate was signed. All directors knew of the true position or, with reasonable diligence, could have ascertained it. As there was no reasonable attempt to ascertain the true position, there can be no reasonable grounds for believing that those material omissions did not misrepresent the true state of Nathans' financial position.

[450] In any event, by the end of January 2007, the inter-company advances had increased to about $98 million. As at 31 March 2007 they stood at about $104 million. Irrespective of the precise figures available to directors as at 29 March 2007, the difference between those two sums was immaterial.

(iv) As at 14 May 2007

[451] The minutes of VTL's meeting of 11 April 2007 record that representatives of the Companies Office were inquiring into Chancery's situation and a peer review of the Cole-Baker valuations of February and March 2007 was to be undertaken by KPMG. Other correspondence produced in evidence reveals that the issue raised by the Registrar of Companies related to the question whether a proposed transaction involving a loan to NZ Vending Investments Ltd (another VTL company) in a sum of over $16 million had been made on commercial arm's length terms and, if not, whether a subordinated guarantee by VTL of bond holders' debts would solve the problem. There had earlier been a difficulty in relation to Chancery's ability to pay debts as they fell due, evidenced by the quarterly payments made by Nathans in late 2006.

[452] While it is apparent, from reports given by Mr Stevens and Mr Hotchin to the VTL board, that many discussions were underway in an endeavour to sell parts of the VTL business to generate cash, from an objective standpoint, none of those projects had reached such a state of maturity that directors could safely rely on substantial proceeds flowing to VTL in the foreseeable future as a result of any sales. The contradictory strategies reported in advance of the 27 February 2007 VTL meeting made it clear that there was no coherent approach being taken. By that time, the

term "strategy" was a misnomer.[259] Although two reports had been received from Mr Cole-Baker in relation to inquiries from Chancery's trustee, on balance they could not have been given any real weight given the real position known to the directors at that stage.[260]

[453] The words used in the 14 May 2007 letter created a false impression of a successful finance company that had never had any problems with impaired debt because of the strong level of corporate governance and robust credit assessment processes employed by it. In addition, the notion that Nathans was not lending in "higher risk" markets was hidden by the restriction of that statement to "consumer areas".[261] It was inevitable that impairment of the three major loans would have required reconsideration as at the end of the 2007 financial year.[262] In those circumstances, there was no reasonable basis on which the directors could have formed a belief that the statements in the 14 May 2007 letter were not misleading.

(v) As at 6 August 2007

[454] During this period the Bacon Whitney transaction[263] was moving from an embryonic stage to a formal offer. In my view, the directors were pinning their hopes on this transaction as a "saviour" for both VTL and Nathans. There was no reasonable basis for that view. There were no realistic prospects of a significant cash injection in the foreseeable future and the structure of the transaction was more likely to benefit the Halpern and Denny interests. In addition, in June 2007, Mr Bayer had advised the board that liquid funds were diminishing relatively quickly.[264] By this stage the directors actions were closer to blind faith as opposed to hopeless optimism.

[455] The directors' beliefs that the 6 August 2007 letter was not misleading had two bases. The first was founded on the (favourable to the directors) proposition that the transaction could have promptly proceeded in the form in which it was couched

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[259] See para [355] above.
[260] Compare with paras [388]-[390] above.
[261] See para [246] and [248] above.
[262] See para [249] above.
[263] See paras [294]-[298] above.
[264] See para [266] above.

in the "binding letter of intent" of 26 July 2007. The Fidelco report was said to give credence to this view.[265] But, as mentioned earlier,[266] there was no immediate cash payable to VTL. The purchase price was to be met by way of convertible note. Only 5% of the convertible note would be paid each year (about $US3.5 million per annum) based on the entitlement to 50% of the total interest that became payable after six months. In addition, the options to require VTL to purchase some of the shares in Bacon Whitney owned by Halpern and Denny interests were not favourable to VTL.

[456] The second is referable to the value of the transaction to VTL. Mr Graham was instructed to obtain information and to prepare a report for the Ministry of Economic Development. The purpose was to provide a financial assessment of VTL, on the basis of which the Registrar of Companies could make decisions about any steps he may wish to take, whether under the Corporations (Investigation and Management) Act 1989, or otherwise. The critical issue involved the VTL groups' "actual" EBITDA[267] that had been calculated in the Fidelco valuation. Mr Graham was unable to verify the calculation and was concerned that it was based on forecasts rather than historical data. The Grant Samuel report[268] was also pessimistic about this transaction.

[457] It is clear that EBITDA information was not conveyed to Mr Graham, although Mr Tappet, of Fidelco, appears to have provided some data to Mr Hotchin by email dated 6 August 2007. Mr Hotchin sent that information to Mr Doolan the following day and he passed it on to Mr Bayer. Irrespective of the fault in not providing the information to Mr Graham, it is clear from Mr Tappet's email that the franchising sales summaries and revenue figures had been supplied through VTL and SAG. Mr Tappet held no independently verified information.

[458] The Bacon Whitney transaction had problematic features of the type already outlined. As at 6 August 2007, there is no evidence that the three accused had dug any deeper into the transaction or to the valuation obtained from Fidelco. Without

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[265] See para [392](a) above.
[266] See paras [295] and [297] above.
[267] Earnings Before Income Tax Depreciation and Amortization.
[268] See para [392](b) above.

having enquired further about the benefits said to flow to VTL from the proposed transactions, there was no reasonable basis for the directors to believe that this transaction would save Nathans by providing funds to repay or substantially reduce the inter-company debt within a short time.

[459] The directors had no reasonable grounds to believe that the statements made in the 6 August 2007 letter, with regard to involvement in commercial lending were true. It is plain that they omitted a material particular, namely the extent and nature of Nathans' lending to related parties and parties associated with Nathans' parent. By August 2007, the inter-company indebtedness was approximately $108 million. Those were facts known to the directors or readily available to them. The liquidity position was also deteriorating significantly, as had been reported in June by Mr Bayer.

22. Conclusion

[460] For those reasons, I returned the verdicts set out in para [4] above on 8 July 2011.

P R Heath J

Delivered at 10.00am on 8 July 2011