IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2012-404-001833
[2012] NZHC 803

BETWEEN	NZF MONEY LIMITED (IN RECEIVERSHIP) Plaintiff
AND	PAT REDPATH O'CONNOR First Defendant
AND	MARK HUME THORNTON Second Defendant
AND	PETER KARL CHRISTOPHER HULJICH Third Defendant
AND	JOHN ALAN CALLAGHAN Fourth Defendant
AND	RICHARD ALAN WADDEL Fifth Defendant
AND	NZF GROUP LIMITED Sixth Defendant

Hearing: 27 April 2012

Counsel: R B Stewart QC and S M Hunter for Plaintiff
No appearance for First, Second, Third, Fourth and Fifth Defendants
P L Rice for Sixth Defendant

Judgment: 27 April 2012 at 2.15pm

ORAL JUDGMENT OF COLLINS J

Introduction

[1] The plaintiff (NZF Money) seeks continuation of a freezing order against the sixth defendant (NZF Group).

[2] On 5 April 2012 Peters J granted the plaintiff the following interlocutory orders:

> (a) until further order of the Court, NZF Group Limited is prohibited from dealing with, disposing of, or otherwise dissipating, any asset which would otherwise be available to meet the plaintiff's claim (being a sum not likely to be more than $3,000,000 plus interest and costs) owned directly, indirectly or beneficially by NZF Group Limited, or by any entity controlled directly or indirectly by NZF Group Limited, including but not limited to:
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> > (i) any monies forming an account in the name of NZF Group Limited or its nominees standing at any bank operating in New Zealand or elsewhere; and
> >
> > (ii) other assets not known to the plaintiff.
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> (b) the order in clause 3(a) does not prohibit NZF Group Limited from paying legal or other expenses that it incurs, such expenses not to exceed $100,000 pending agreement between the parties or order of the Court; ...

[3] Her Honour also made timetable orders which required the parties to file further affidavits and submissions so as to enable the Court to determine today whether or not the freezing orders made on 5 April 2012 should be maintained.

Background

[4] NZF Money is a finance company that was placed in receivership by its trustee, Covenant Trustee Company Ltd on 22 July 2011. At the date of receivership, investors in NZF Money were owed approximately $16.4 million.

[5] Prior to 20 October 2010 NZF Money owned NZF Homeloans Ltd (NZF Homeloans). NZF Money's 2010 prospectus referred to the profitability of NZF Homeloans as being one of the company's "key highlights". The prospectus states:

> The Home Loans Division operated by NZF Homeloans Limited achieved an unaudited profit before income tax of $4.150 million for the year ending 31 March 2010, representing a $6.524 million turnaround compared to the net loss before income tax of $2.374 million reported for the year ending 31March 2009.

[6] On 20 October 2010 NZF Money sold its total shareholding in NZF Homeloans to its parent company, NZF Group for $1,000. At this time, the directors of NZF Money were also directors of NZF Group and held a substantial number of shares in NZF Group.

[7] On 26 September 2011 NZF Group sold what was in effect 80 per cent of its Home Loans Division to RESIMAC Ltd (RESIMAC). NZF Homeloans was included in the sale. The evidence of Mr Gibson, a receiver of NZF Money was that:

> ... NZF Homeloans received not less than $3.03 million as a result of the transaction with RESIMAC which it then distributed to its shareholder, NZF Group.

Mr Gibson also explained that NZF Money received $0.9 million as a result of the sale in consideration for the sale of subordinated notes held by a trust. That payment is not related to the $3.03 million Mr Gibson has said was received by NZF Group as a result of the sale of NZF Homeloans to RESIMAC.

[8] On 4 April 2012 the receivers of NZF Money commenced its proceeding against the defendants. The gravamen of the claim is that the defendants grossly undersold NZF Homeloans to NZF Group. NZF Money pleads two causes of action:

(1) The first cause of action alleges that each of the directors of NZF Group owed NZF Money fiduciary duties, and duties under s 131 of the Companies Act 1993 to act in good faith and in the best interests of NZF Money and not to prefer NZF Group's interests or their own interests over NZF Money's interests. NZF Money seeks yet to be quantified damages against the director defendants.

(2) The second cause of action alleges that NZF Group holds the proceeds of the sale of the shares in NZF Homeloans to RESIMAC as a constructive trustee for NZF Money. NZF Money seeks declarations against NZF Group and equitable compensation in such sum as the Court thinks fit.

Relevant legal principles

[9] The arguments in this Court engaged two fundamental principles relating to the issuing of freezing orders:

(1) Before a Court can issue a freezing order it must be satisfied that the plaintiff has "a good arguable case against the defendant".[1] It is commonly accepted that this threshold is more stringent than the requirement for an interlocutory injunction but less rigorous than the requirement for summary judgment.[2]

(2) It is also a pre-requisite to the issuing of a freezing order that the Court is satisfied that there is a high risk that the defendant will dissipate its assets.[3]

Does NZF Money have a "good arguable case"?

[10] The case for NZF Money can be summarised in the following way:

(1) The directors of NZF Money owed fiduciary duties to act in good faith and in what the directors believed to be the best interests of NZF Money.[4]

(2) The directors of NZF Money breached this duty when they sold the shares of NZF Homeloans to NZF Group at a gross undervalue.

(3) The gross undervalue of the sale to NZF Group is demonstrated by NZF Group's sale of NZF Homeloans' shares a year later for over $3 million.

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1 *Rasu Maritima SA v Perusahaan Pertambangen Minyah Dan Gas Bumi Negara* [1978] QB 644 at 661; *Wilsons (NZ) Portland Cement Ltd v Gatx-Fuller Australasia Pty Ltd* [1985] 2 NZLR 11 (CA) at 21 and *Shaw v Narain* [1992] 2 NZLR 544 (CA) at 548.

2 *McGechan on Procedure* (looseleaf ed, Brookers) at [HR32.2.01].

3 *Third Chandriss Shipping Corp v Unimarine SA* [1979] 2 All ER 972 (QB) at 987; *Wilsons (NZ) Portland Cement Ltd v Gatx-Fuller Australasia Pty Ltd* [1985] 2 NZLR 11 (CA) at 22 and *Shaw v Narain* [1992] 2 NZLR 544 (CA) at 548.

4 Companies Act 1993, s 131.

(4) The sale proceeds were received by NZF Group with the knowledge of the breaches of fiduciary duty by the defendant directors. The proceeds should therefore be held by NZF Group subject to a constructive trust in favour of NZF Money.

[11] Mr Stewart QC, counsel for NZF Money referred to the judgment of Hoffman J (as he then was) in *Aveling Barford Ltd v Perion Ltd*.[5] The plaintiff in that case, Aveling Barford was at all material times owned and controlled by a Singaporean businessman called Dr Lee Kin Tat. The company was facing considerable financial difficulties. Prior to being placed in liquidation the company sold a property it owned for £350,000 notwithstanding the fact that prior to the sale the company obtained a report valuing the property at £650,000. The purchaser, Perion Ltd was a Jersey company which at all material times was also controlled by Dr Lee. Hoffman J held that as Dr Lee knew the property was worth £650,000 he breached his fiduciary duty to Aveling Barford Ltd when he arranged to sell the property for £350,000 and as Perion Ltd was aware of the facts concerning Dr Lee's breaches of fiduciary duty it was accountable as a constructive trustee.

[12] Mr Stewart submitted that *Aveling Barford* is indistinguishable from the claim brought by NZF Money. In his submission the sale by the directors of NZF Money to NZF Group of the shares in NZF Homeloans for a mere $1,000 in circumstances where, one year later NZF Group received a little over $3 million for the same shares is compelling evidence that:

(1) the director defendants breached their fiduciary duties and duties under s 131 of the Companies Act to NZF Money; and

(2) NZF Group knew of the directors' breaches of their fiduciary duties.

[13] Mr Stewart also relied upon the judgment of Kirby P (as he then was) in *Equiticorp Finance Ltd (in liq) v Bank of New Zealand*.[6] That was a decision of the New South Wales Court of Appeal. In his judgment Kirby P referred to the

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5 *Aveling Barford Ltd v Perion Ltd* [1989] BCLC 626 (Ch).

6 *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 11 ACSR 642 (NSWCA).

responsibilities of a director of one company, facing liquidity difficulties, and where that company formed part of a group of companies. His Honour said:[7]

> ... each company in a group "is a separate entity and the directors of a particular company are not entitled to sacrifice the interests of that company". In an *English Text Groups of Companies*, by C M Schmitthoff and F Woolridge (Sweet and Maxwell, London, 1991), the authors state, accurately in my understanding of the applicable law (at 59-60):
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> > It is trite that directors in exercising their powers must act bona fide in the interests of the company. In the context of groups, this requires the directors of each company in a group to consider whether a given transaction is in the interests of that company. Undoubtedly, it will often be the case that the interests of a company, which is a part of a group, will be so inextricably bound up with the welfare of the group, that what is in the interests of the group is in the interests of the company. This will almost invariably be the case with respect to a parent as regards its subsidiary. The subsidiary may not have the same compelling interest in preserving the other members of a group, but where a subsidiary is threatened by a failure of one of the members of a group then it will have an interest in preserving it.

[14] Mr Stewart also referred me to the judgment of Cooke J (as he then was) in *Nicholson v Permakraft (NZ) Ltd*, where his Honour said:[8]

> The duties of directors are owed to the company. On the facts of particular cases this may require the directors to consider inter alia the interests of creditors. For instance creditors are entitled to consideration, in my opinion, if the company is insolvent, or near-insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency.

[15] Mr Stewart argues on the basis of the evidence presented to me, and the authorities which he relies upon, that NZF Money has more than a "good arguable case" that NZF Group holds the proceeds of the sale of the shares in NZF Homeloans to RESIMAC as a constructive trustee for NZF Money.

[16] The case for NZF Group can be summarised in the following way:

(1) The consolidated balance sheet of NZF Group was not affected by the sale and transfer of the shares in NZF Homeloans to NZF Group. For this reason Mr Thornton, the Chief Executive Officer of NZF Group:

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7 At 683.

8 *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) at 249.

> unreservedly reject[ed] any suggestion that [he] or [his] fellow directors breached [their] duty to act in the best interests of NZF Money.

He explained that:

> the transfer of the shares to the parent company was simply for the purpose of improving the marketability of the homeloans business to potential investors thereby ensuring the long-term survival and profitability of the NZF Group of companies, including NZF Money.

(2) NZF Money could not have sold the shares of NZF Homeloans except as part of a sale of the Home Loans Division of the NZF Group. Accordingly the shares which NZF Money held in NZF Homeloans were of negligible value by themselves. This submission was supported by a report dated 26 April 2012 from a company with expertise in valuing shares. Its report concludes that as at the time NZF Money sold its shares in NZF Homeloans to NZF Group, the shares in question had negligible value.

(3) The shares in NZF Homeloans were charged in favour of the Westpac Bank. Even if the shares had been sold for a greater sum NZF Money would not have benefitted from this as the sale proceeds would have gone to Westpac.

(4) Even if NZF Money had sold its shares in NZF Homeloans for a greater sum, any benefit received by NZF Money from the sale would have been a realised profit that would have been distributed as a dividend to its sole shareholder, NZF Group.

[17] Mr Rice, counsel for NZF Group submitted that *Aveling Barford Ltd v Perion Ltd* was easily distinguishable from the present case. He submitted:

(1) The defendant directors relied upon professional advice when selling the NZF Homeloan shares to NZF Group.

(2) The requirement that the directors act in "good faith" in s 131 of the Companies Act merely required them to act honestly and with a proper motive. It was submitted that there was no evidence of the defendant directors acting dishonestly or for some improper motive.

(3) A director's belief that an action is in the best interests of the company does not need to be based on reasonable grounds. The test is subjective.[9]

(4) In *Aveling Barford Ltd v Perion Ltd*, Dr Lee was acting patently dishonestly when he sold the plaintiff's assets for close to half the valuation that he had already obtained prior to the sale of that property.

Analysis

[18] It is convenient to focus upon the factual arguments advanced by NZF Group.

The consolidated balance sheet

[19] In my view, NZF Money has a good arguable case when it submits that it is probably not relevant that the consolidated balance sheet of the NZF Group was unaffected by the sale of the NZF Homeloans shares to NZF Group. What is important is that:

(1) as a result of the sale of the NZF Homeloans shares to NZF Group. NZF Money has received just $1,000. NZF Money and its creditors have received comparatively little benefit from the sale of its shares in NZF Homeloans to NZF Group; and

(2) NZF Group has, on the other hand, apparently benefitted considerably from the sale of the same shares to RESIMAC.

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9 *Australia Growth Resources Corp Pty Ltd v Van Reesman* (1988) 13 ACLR 261 at 269.

The value of NZF Homeloans

[20] Mr Thornton may be correct when he says that the value of NZF Homeloans could only be maximised when those shares were sold as part of NZF Group's Home Loan Division. However, NZF Money has a "good arguable case" when it argues that the defendant directors appear to have not given any consideration as to how the benefits of the sale of NZF Homeloans shares to RESIMAC could have been used for the benefit of NZF Money. There is in my view, sound evidence to support the submission that the directors of NZF Money were focusing on the interests of NZF Group to the detriment of NZF Money. These actions of the directors support the plaintiff's case that the directors failed to fulfil their fiduciary and s 131 of the Companies Act 1993 duties to NZF Money.

[21] In reaching this conclusion I have given careful consideration to the report which was completed yesterday by Campbell MacPherson. That report has endeavoured to value NZF Homeloans as at 1 November 2010 using two methods of valuation:

(1) the net tangible asset method; and

(2) the discounted cashflow method.

[22] Mr Hunter, who appeared with Mr Stewart drew my attention to a number of qualifications in the report and submitted that there were a number of significant issues raised about the reliability of the author's conclusion that the shares in question had negligible value at the time they were sold to NZF Group. I cannot resolve those factual issues today. I can however say that NZF Money has satisfied me that there are significant facts that support its arguments. Most significantly, the fact that the shares in question were sold for $3.03 million ten months after they were sold for $1,000 constitutes compelling evidence that the directors of NZF Money may have failed to discharge their responsibilities to NZF Money.

The charge to Westpac

[23] Mr Thornton is also probably correct when he says that any sale of NZF Homeloans shares to NZF Money would have first been applied to the charge held by Westpac Bank. However, I accept that NZF Money has a good arguable case when it points out that Westpac must have consented to the release of its charge when the same shares were sold to RESIMAC in 2011. This provides a sound basis for NZF Money to argue that it might also have had the opportunity to benefit from the sales as NZF Group appears to have benefitted.

The possibility of a dividend

[24] Mr Thornton has said that any benefit NZF Money would have received from the sale of its shares in NZF Homeloans would have been distributed as a dividend to NZF Group.

[25] The suggestion that NZF Money would have paid a dividend to NZF Group is difficult to reconcile with the following evidence:

(1) As at October 2010 NZF Money appears to have been under considerable financial pressure.

(2) The receivers have concerns about the way NZF Money was managed during this period. Those concerns are reinforced by the fact that the Serious Fraud Office confirmed on 22 March 2012 that it is conducting an investigation into the NZF Group, NZF Money and their related companies. The Serious Fraud Office has also said that the Financial Market Authority and Serious Fraud Office have together begun investigating a series of allegations into the way NZF Money and other members of the NZF Group managed transactions between members of the NZF Group of companies.

(3) On 22 July 2011 NZF Money was placed into receivership owing $16.4 million to retail investors, and that the receivers provisionally

estimate that investors will receive a return of somewhere between 25 and 42 cents in the dollar.

[26] In summary, on the basis of the evidence currently before the Court, NZF Money has a good arguable case that:

(1) the defendant directors breached their fiduciary and s 131 Companies Act duties to NZF Money when selling NZF Homeloans to NZF Group; and

(2) that NZF Group holds the proceeds of the sale of the NZF Homeloans shares to RESIMAC as a constructive trustee in favour of NZF Money.

[27] I emphasise that this conclusion is based upon the evidence currently before me. It is possible that at the hearing of this proceeding other evidence will emerge and that ultimately the plaintiff may not succeed. However, at this juncture, I am of the view that the plaintiff has a "good arguable case".

Risk of dissipation

[28] NZF Money supports its concern that there is a risk of dissipation of the proceeds of the sale of the NZF Homeloans shares to RESIMAC by referring to a passage in Mr Thornton's affidavit. Mr Thornton explains the NZF Group will invest the money currently subject to the interlocutory freezing order in "two new joint venture projects: the first involves investment in a commercial vehicle securitisation programme and the second with a substantial kiwisaver investment group".

[29] In essence, NZF Money is concerned that if the freezing order is not continued, NZF Money will have to rely on NZF Group being much more successful with its future investment strategies than it has been to date. Mr Stewart submits this would invite the Court to prefer "hope over experience".

[30] NZF Group rejects these concerns and argues that there is no credible risk of dissipation. Mr Rice submitted:

(1) "There is clear evidence that there are ample assets to meet the plaintiff's claim should it ultimately be successful. In addition there are rights of recourse against five directors" and that

(2) The plaintiff's concerns about the value of certain NZF Group interests is misplaced.

Analysis

[31] NZF Money has satisfied me that there is a serious risk of dissipation. My reasons for reaching this conclusion can be succinctly stated:

(1) On 26 March 2012 NZF Group advised the New Zealand Stock Exchange that it has "an excess of liabilities ... over assets of circa $4 million".

(2) Mr Gibson explained:

> The current asset position of NZF Group as announced on 26 March 2012 represents a significant deterioration from the position as at 30 September 2011, as recorded in its interim results released to the NZX on 30 December 2011 ... At that stage NZF Group had an excess of liabilities over assets of $334,000 ... meaning its asset position has deteriorated by over $3.5 million over the last six months.

(3) In its announcement to the New Zealand Stock Exchange on 26 March 2012 NZF Group indicated that it was able to pay interest due on capital notes for the next 18 months but that it had started discussions with the trustee (Perpetual Trust Ltd) regarding the payment of interest and conversion to equity. In addition, NZF Group said it did not expect to have sufficient cash between March 2012 and the date the capital notes mature in 2016 to fully redeem them for cash, meaning that in all likelihood the notes would convert equity.

This statement to the New Zealand Stock Exchange signalled NZF Group is likely to face liquidity challenges.

(4) NZF Group is currently without a Company Secretary or a Chief Financial Officer. The person holding those roles resigned last week.

(5) The affairs of NZF Group are the subject of investigations by both the Serious Fraud Office and the Financial Markets Authority.

[32] In reaching my conclusions I am very mindful that freezing orders can be draconian. They involve the Court restraining a defendant from using their own assets pending resolution of a plaintiff's claim. In this case however, the factors which I have listed in [31] above cause me to have grave doubts about the ability of NZF Group to meet any judgment which NZF Money may in due course obtain for the ultimate benefit of those members of the public who invested in NZF Money.

Overall interests of justice

[33] Mr Rice has reminded me of the words of Kerr LJ in *Z Ltd v A* where his Lordship said:[10]

> the great value of [the freezing order] jurisdiction must not be debased by allowing it to become something which is invoked simply to obtain security for a judgment in advance, and still less as a means of pressurising defendants into settlements.

[34] A factor that I have taken into account as part of my overall assessment of the appropriateness of continuing the freezing order is that the receivers of NZF Money are acting in response to their obligations to those members of the public who invested in NZF Money. If the plaintiff succeeds then the receivers will receive an additional sum of approximately $3 million to repay investors. This would represent a boost of between 15 to 20 per cent in the funds available to investors in NZF Money.

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[10] *Z Ltd v A* [1982] 1 All ER 556 (CA) at 572.

[35] After weighing all matters that have been urged upon me by both parties I have concluded that it is in the overall interests of justice for the general terms of the freezing order made by Peters J on 5 April 2012 to remain in place until further order of this Court. It is however necessary to vary the terms of that order. The variations are that the orders I am making will not prevent NZF Group:

(1) paying legal expenses it has incurred in relation to the freezing orders; and

(2) making payments, in the ordinary course of its business, including business expenses incurred in good faith.[11]

The determination of what constitutes appropriate legal fees and payments in the ordinary course of NZF Group's business, including business expenses incurred in good faith will be determined by the Court once NZF Group complies with the disclosure order made by Peters J on 5 April 2012, and only if it becomes necessary for the Court to do so if the parties are unable to reach agreement.

[36] The orders which I have just announced are also conditional upon the plaintiff taking all possible steps to ensure that this proceeding is brought on for hearing at the earliest date that can be arranged.

[37] Costs are reserved.

D B Collins J

Solicitors:
Gilbert Walker, Auckland for Plaintiff
Duncan Cotterill, Auckland for Sixth Defendant

[11] High Court Rules, r 32.06.