IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA66/2018
[2018] NZCA 505

BETWEEN	COMMERCIAL FACTORS LIMITED Appellant
AND	JEFFREY PHILIP MELTZER, LLOYD JAMES HAYWARD AND ARRON LESLIE HEATH Respondents

Hearing:	26 September 2018
Court:	Miller, Clifford and Williams JJ
Counsel:	P J Dale and E Telle for Appellant A C Challis and D P Turnbull for Respondents
Judgment:	16 November 2018 at 2.30 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellant must pay the respondents costs for a standard appeal on a band A basis and usual disbursements.

REASONS OF THE COURT

(Given by Clifford J)

Introduction

[1] The appellant, Commercial Factors Ltd, agreed to fund the respondents, Messrs Meltzer, Hayward and Heath as the liquidators of Blue Chip New Zealand

Ltd,[1] to obtain a legal opinion as to the merits of commencing proceedings against Blue Chip's directors and auditors. Pursuant to the funding agreement between Commercial Factors, Blue Chip and the Liquidators recording those arrangements (the Agreement), Commercial Factors provided the agreed funding of $60,000 (excluding GST) and the Liquidators obtained the legal opinion.

[2] Proceedings were subsequently commenced by the Liquidators, but without litigation funding support. The proceedings were unsuccessful and were discontinued. The costs involved were ultimately funded by unexpected recoveries in Blue Chip's liquidation from unrelated litigation and from funds of the partners of Meltzer, Mason, Heath (including two of the Liquidators) paid into the Meltzer, Mason, Heath practice account.

[3] Commercial Factors then sued the Liquidators for monies it said were owing to it under the Agreement. In the High Court, Hinton J dismissed the claim.[2] Commercial Factors now appeals.

[4] Two issues arise: the first is whether, under the terms of the Agreement, the contractual circumstances which would entitle Commercial Factors to payment have arisen. If they have, the second is whether the Liquidators are themselves liable for that payment and, if they are, whether they can avoid that liability by showing they did not fail to act in good faith.

Background

Initial steps

[5] Blue Chip was put into liquidation by its Australian parent in 2008. It joined some 20 other related companies that had also been put into voluntary liquidation by their Australian owner. There were some 3,000 investors and creditors in New Zealand who together had lost sums in excess of $80 million. Many of the investors lost a significant proportion of their lifetime savings in Blue Chip's collapse.

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1 Messrs Meltzer and Heath were at all material times partners in Meltzer, Mason, Heath. Mr Hayward was a consultant.

2 *Commercial Factors Ltd v Meltzer* [2017] NZHC 3267.

[6] Few, if any, funds were available to the Liquidators to investigate possible avenues for recovery of creditors' funds. Third party funding would be required.

[7] With funding provided from the Liquidation Surplus Account, the Liquidators investigated possible claims under the Securities Act 1978. Those inquiries came to nothing.

[8] The Liquidators also considered the other option: suing the directors for reckless trading. By 2009 they had concluded they should obtain a legal opinion as to the prospects for such proceedings. Funding was required. Mr Meltzer approached Mr Haydon, a director and shareholder of Commercial Factors.

Commercial Factors funds an opinion

[9] Commercial Factors was not a traditional litigation funder. Nevertheless, it agreed to provide funding of $60,000 to enable the Liquidators to obtain such an opinion: $50,000 for the legal advice, $10,000 for the Liquidators' expenses. Mr Haydon wrote to the Liquidators, outlining the proposal, on 18 May 2009:

> 1) The advance to incur a fee of $15,000.00 as suggested by you and/or 24.00% pa until repaid, whichever is the highest in dollar terms.
>
> 2) The advance and interest to be treat [sic] as though it is a preferential creditors [sic] to the Liquidation regardless where receipts come from.
>
> 3) In consideration for funding the explanatory opinions that we share 2.5% of any recovery that is received from a claim against the Directors and/or Auditors.
>
> 4) That in considerate [sic] for funding this request [Commercial Factors] and/or its nominee be given the first right of refusal to any additional legal funding requirement for claims against the Directors and/or Auditors.
>
> 5) A legal agreement be prepared between the parties covering the above and other terms seen as legally basic to the agreement.
>
> 6) That if [Commercial Factors] declines or is unsuccessful in securing the offer as in 5) then the successful funder will repay [Commercial Factors] its advance and interest as in 1).

[10] Those proposals were reflected in the Agreement which was entered into, the Judge found, on 24 August 2009.[3]

[11] As relevant the Agreement provided:

> 3 ***Additional Sum and Repayment***
>
> 3.1 The Company (through the Liquidators) must pay [Commercial Factors] an additional amount of $18,000 or 24% per annum (calculated daily and compounding annually), whichever is greater, at the time of repayment of the Funding.
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> 3.2 If the Liquidators decide that as a result of the Advice they will endeavour to obtain funding for proceedings against the parties identified in the Advice as having liability to the Company, the Company and the Liquidators will give [Commercial Factors] the first option to provide that funding on terms determined by the Liquidators. If [Commercial Factors] within 10 days of receiving notice of the funding requirements chooses not to fund the proceeding or does not respond:
>
> 3.2.1 The Company will not enter a funding agreement with another party on any less favourable terms without first re-offering the funding opportunity to [Commercial Factors]; and
>
> 3.2.2 If another party agrees to fund the proceedings, the Company will procure the funder to repay to [Commercial Factors] the Funding and the Additional Sum before the proceedings are filed or any funding for the proceedings is made available to the Company or the Liquidators.
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> 3.3 If proceedings are commenced, whoever funds the proceedings, the Company will pay [Commercial Factors] 2.5% of net proceeds received from or on behalf of the defendants to those proceedings (whether those proceeds are received by way of settlement, by reason of a Court ordered judgment or otherwise) within 10 working days of receipt of the proceeds by the Company or the Liquidators.
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> 3.4 If proceedings are not commenced and the Company receives any amounts from other sources (other than funds directly obtained for the purposes of funding investigations, legal advice or Court or other proceedings), the Company will apply those amounts in the following order:
>
> 3.4.1 to meet the Company's obligations to any party who funded the obtaining of those amounts, and to reimburse the Liquidators' remuneration, costs and expenses in obtaining those amounts to the extent they were not funded;
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> 3.4.2 toward repayment to [Commercial Factors] of the Funding and Additional Sum;

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[3] *Commercial Factors Ltd*, above n 2, at [10].

3.4.3 to meet any other obligations of the Liquidators, and outstanding costs and expenses of the Liquidators, in connection with the liquidations of the Company and its subsidiaries (to the extent that no other funds are available for this purpose); and

3.5 For the avoidance of doubt, the Company's only obligation to repay to [Commercial Factors] the Funding and any Additional Sum are set out in clauses 3.1 to 3.5 inclusive. If following receipt of the Advice the Company (through the Liquidators) decides not to proceed further or the Company is unable to obtain funding to proceed further, the Company has no obligation to repay the Funding or make any other payment to [Commercial Factors] except as set out in cl 3.4 (specifically clause 3.4.2).

4 ***Liquidators' Decision Following Receipt of Advice and in Relation to any Proceedings***

4.1 [Commercial Factors] acknowledges that any decision to issue proceedings as a result of receipt of the Advice is that of the Liquidators in their absolute discretion. The Liquidators on behalf of the Company have the right to direct, conduct and conclude in such manner as they consider appropriate any proceedings that may be issued following receipt of the Advice.

4.2 The Liquidators agree to regularly consult with [Commercial Factors] as to progress of obtaining the Advice and, if proceedings are subsequently issued without funding from [Commercial Factors], to keep [Commercial Factors] informed as to the progress of the proceedings.

…

6 ***Exclusion of Personal Liability of the Liquidators***

6.1 The parties acknowledge that the Liquidators are entering into this Agreement in their capacity as joint and several liquidators of the Company. The Liquidators will have no personal liability under or in connection with this Agreement except in circumstances where they fail to act in good faith.

…

[12] As can be seen, the Agreement stipulated two sets of circumstances in which Commercial Factors would be entitled to be repaid the litigation funding it had provided to the Liquidators (the Funding), and to be paid its fee (the Fee). Those circumstances were:

(a) First (cl 3.2.2), where another party agreed to fund the proceedings, Blue Chip was to procure that party to repay the Funding and to pay the Fee.

(b) Second (cl 3.4), where proceedings were not commenced, but Blue Chip received recoveries from other sources, those funds were then to be applied to repay the Funding and to pay the Fee. As between the Liquidators and Commercial Factors, payment of those amounts would be made — subject to liquidation expenses incurred in their receipt — before the rest of the liquidation expenses generally.

[13] There was no provision for the repayment of the Funding or the payment of the Fee if Commercial Factors itself agreed to fund the substantive proceedings. It may be that matter was left for negotiation or it may be it was envisaged that Commercial Factors would look to its 2.5 per cent of the net proceeds (cl 3.3) in those circumstances.

[14] Neither does the Agreement explicitly address the situation that arose: namely the Liquidators themselves taking the proceedings and funding them, partly as liquidators' expenses payable from the liquidation and partly from funds the Meltzer, Mason, Heath partners (including two of the Liquidators) paid personally into the practice account.

[15] Mr Brian Keene QC eventually provided an opinion on the prospects of reckless trading and related proceedings against Blue Chip's directors and others on 8 September 2010.

[16] In an executive summary of his formal opinion Mr Keene stated his high-level conclusions in the following terms:

> 3. My view is that there is a good cause of action against the directors of various entities in the Blue Chip Group. They have breached their obligations under the Companies Act, such as to cause them to be personally responsible to the liquidators in respect of certain losses of the Group. These claims arise in the last quarter of 2004 and continue through to mid 2006.

> 4. I am of the further view that BDO Spicer Chartered Accountants, who were auditors of the Blue Chip Group, may have failed to meet their duty of care to Blue Chip which caused it to incur creditors and sustain losses which may be recoverable at law.

[17] Mr Keene recommended that the claim be filed in the High Court as soon as possible. He explained:

> 8. In the formal Opinion, I have suggested that a claim be filed in the High Court as soon as possible. In relation to claims under ss 131, 134, 135 and 136, of the Companies Act, losses relating to conduct by the directors that occurred more than six years prior to proceedings being issued will be barred by limitation. Effectively this means that deposits that are paid more than six years before the proceedings are issued will not be claimable as "losses". So the clock is ticking.

[18] Any claim should, he said, be filed before the end of 2010. Thereafter, the first step would be to collate and recreate the Blue Chip records. That would cost in the order of $250,000. The second stage would be to brief company personnel and expert witnesses. They were, however, only the first stages of what would be lengthy and difficult litigation. Mr Keene explained:

> It will be difficult because of the expected degree of opposition by the defendants (including the auditors). It will be lengthy because of the complex web of entities that form part of the Blue Chip Group and their interrelation with other companies that formed part of the Blue Chip Model of trading.

[19] But assessed overall, Mr Keene considered "there must be considerable optimism" the Court would find the directors liable.

Subsequent events

[20] On 23 September 2010, Commercial Factors formally declined the opportunity to fund the proceedings. It asked the Liquidators to "keep us posted as per clause 3.2.2".

[21] The Liquidators then looked for another litigation funder. On 7 October 2010 they advised Mr Haydon they had "met with two of the three funders (other than [Commercial Factors]) who expressed a possible interest in funding the Blue Chip litigation". Discussions were continuing.

[22] Commercial Factors paid Mr Keene's account directly on 3 November 2010. The Liquidators rendered their claim for $10,000, plus GST, in February 2011. Mr Haydon, acknowledging receipt of the invoice, asked for an update as to the likelihood of finding a funder and repayment to Commercial Factors. He asked if that was not going to happen when would the Liquidators draw the line so that cl 3.4 would "kick in" for Commercial Factors to be reimbursed. The Liquidators replied the search for a funder was ongoing; they had only received one definite "not interested" so far. They were reviewing the matter on a regular basis and if they felt no funder would be interested at that point they would "call it quits". Their view was that it was unlikely that funds would be "recovered for the benefit of funders … unless proceedings [could] be commenced".

[23] In response to a further inquiry from Commercial Factors they confirmed that they did not believe it likely that any other recoveries, that is beyond those that proceedings against the directors and auditors might generate, would be available as anticipated by cl 3.4.

[24] Commercial Factors paid the Liquidators' invoice directly to them on 21 March 2011.

[25] As events transpired, the Liquidators filed their statement of claim against the Blue Chip directors and auditors on 30 November 2011 in the High Court at Auckland. They had earlier provided a draft of that statement of claim to a number of the defendants, and had discussions with those parties as regards the foreshadowed proceedings. They took those steps, and subsequently filed the proceedings, to show the defendants that they were serious about the claim and optimistic as to its prospects. They had not, however, obtained litigation funding. In fact, between May and October 2011 the Meltzer, Mason, Heath partners had together provided funds of $49,500 which were used to pay the further legal fees incurred in commencing

the proceedings.[4] Those amounts were paid into the Meltzer, Mason, Heath practice account, and from there were disbursed directly to the legal advisers involved.

[26] From March 2012 onwards, and unexpectedly, proceeds began to be received in Blue Chip's liquidation as a result of the settlement of unrelated proceedings for the recovery of inter-company advances made by Blue Chip. By May 2012 a total of $307,961.19 had been received from that source. Those receipts were applied by the Liquidators to fund their expenses in the liquidation and the ongoing legal expenses they incurred in relation to their proceedings against the directors and auditors.

[27] All attempts to obtain third party litigation funding for the Liquidators' proceedings failed. The Liquidators announced publicly on 1 February 2013 that they were suspending the legal proceedings accordingly. In doing so, they noted they had "personally funded significant sums towards the investigations and legal proceedings".

[28] The Liquidators issued their final report on 10 October 2014. That report showed, amongst other things, the receipt by Blue Chip in the liquidation of the $307,961.19, the payment of Liquidators' remuneration of $253,199 and the payment of legal fees of $182,409.86.

[29] Commercial Factors subsequently sought payment by the Liquidators of the Funding and the Fee. It said payment was due to it as a priority pursuant to cl 3.4, and in particular out of the $307,961.19. That is, Commercial Factors contended that proceedings had not been commenced in the manner contemplated by the Agreement. The Liquidators did not agree and in mid-2016 Commercial Factors commenced proceedings for recovery of the monies. It pleaded the Liquidators were liable to it under either of cls 3.4 or 3.2, or under certain stipulated implied terms. The point of those implied terms was to strengthen Commercial Factors' assertion that, under the

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[4] The evidence as to when, and how much, the Meltzer, Mason, Heath partners funded the proceedings, both initially and over time, was not at all clear. In fact, Commercial Factors points to the lack of transparency in that area as a factor going to the Liquidators' liability. We have endeavoured to clarify those facts: we cannot always be confident, however, that the amounts we stipulate are completely accurate.

terms of cl 3.4, proceedings had not, in fact, been commenced. In the alternative, the Liquidators were liable pursuant to cl 6.1 of the Agreement, as they had failed to act in good faith by procuring Blue Chip to pay their and their legal advisers' expenses, and thereby failing to procure the payment of the Funding and the Fee as a priority as provided by cl 3.4.

[30] The Liquidators applied unsuccessfully for strike-out or summary judgment.[5] The matter came before Hinton J in the High Court in July 2017.

Judgment under appeal

[31] Hinton J did not accept that proceedings had not been commenced.[6] On a plain and ordinary meaning, a proceeding is commenced when it is filed (as here).[7] Nor in all the circumstances were the stipulated terms to be implied.

[32] However, cl 3.2 did apply. The Liquidators had — by virtue of their paying their own personal funds into the practice account to file the statement of claim — agreed to fund the proceeding.[8] It did not matter that the funding was not from an independent litigation funder.[9] All that mattered was that funding (partial or full) was provided by a party other than Commercial Factors.[10] Blue Chip was accordingly in breach of cl 3.2.2 by not procuring the Liquidators to pay Commercial Factors the Funding and the Fees before the reckless trading proceedings were commenced.[11]

[33] The question then was whether the Liquidators were personally liable. The Judge began by noting that decisions made by liquidators which are reasonable and made in good faith are generally unlikely to be overturned by the courts.[12] Here, there was a clause in the Agreement to that effect. The Judge considered relevant case law and held that, to find the Liquidators personally liable, the Court needed to "be satisfied either that the liquidators acted dishonestly or that they acted

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5 *Commercial Factors Ltd v Meltzer* [2017] NZHC 30, [2017] NZCCLR 7.
6 *Commercial Factors Ltd*, above n 2, at [37].
7 At [37].
8 At [41].
9 At [44].
10 At [43].
11 At [50].
12 At [64], citing *Young & Associates Ltd v Ruscoe* [2012] NZHC 1438, [2012] NZCCLR 23 at [8].

in a way no reasonable liquidator would have acted, for the liquidators to personally be liable for the breach of cl 3.2.2".[13] The Judge was satisfied that was not the case.

[34] In the circumstances as a whole, and whilst the Liquidators had not engaged in best practice, they were still entitled to the protection of cl 6.1 and were therefore not personally liable for the breach of cl 3.2.2.[14]

This appeal

Appellant's submissions

[35] There are essentially three strands to Commercial Factors' arguments in this appeal.

[36] First, Commercial Factors agrees with Hinton J that there has been a breach of cl 3.2.2 of the Agreement. The Liquidators funded the proceedings. Blue Chip, through the Liquidators as its agent, should have procured payment to Commercial Factors. That was Blue Chip's breach. As agents of Blue Chip, the Liquidators were not saved by cl 6.1. This is a new argument. Shortly before the hearing of the appeal, Commercial Factors applied to amended their pleaded grounds by including this agency argument. Although counsel for the Liquidators were not in a position to consent, the appeal as argued and responded to included the agency theory. Counsel for the Liquidators did not identify any prejudice from that approach. We therefore grant the application, although, as will be seen, in our view the agency argument is fundamentally flawed.

[37] Secondly, Commercial Factors maintains in the alternative that cl 3.4 applies. It challenges Hinton J's finding to the contrary. It says that the word "commenced" ought to be read as "commenced with sufficient funds to pursue the proceedings to determination or resolution". Proceedings were not "commenced" in that sense here. Without funding, the Liquidators did not have the means to take the proceedings further. Accordingly, cl 3.4 applies and, by virtue of the agreed priority, Blue Chip ought to have paid Commercial Factors once it recovered inter-company advances.

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13 At [77].
14 At [87].

[38] Thirdly, and if its new agency argument failed, Commercial Factors argued that the Liquidators were in breach of their good faith obligations and therefore personally liable for the breaches of cls 3.2.2 and 3.4. That is, the Liquidators misapplied or misappropriated funds which should have been paid to Commercial Factors. The Liquidators should have appreciated that they were obliged to procure Blue Chip to repay Commercial Factors (under cl 3.2.2) or alternatively recognised Commercial Factors' priority (under cl 3.4). Commercial Factors says the Liquidators' lack of good faith was evidenced by, in particular, their failure to act in a transparent manner — as between themselves and Commercial Factors — in respect of:

(a) the use of personal funds by the Meltzer, Mason, Heath partners to commence the proceedings;

(b) their subsequent use of the proceeds of the recovery of the inter-company advances — without advice to Commercial Factors — to meet their and their legal advisers' invoices;

(c) as regards the monies, some $112,500 the Meltzer, Mason, Heath partners paid personally in March and November 2013, and February 2014, to meet the then outstanding costs of their legal advisers, for which there were no funds available in the liquidation; and

(d) the "late disclosure of an advance of a further $150,000 by Mr Meltzer in cross-examination".

[39] There was also evidence of the irregular treatment of advances made by the Liquidators to Blue Chip. Mr Dale for Commercial Factors went so far as to submit that the Liquidators had misappropriated funds comprising the proceeds of the liquidation.

[40] Finally, and more generally, it is established that a liquidator must generally act impartially and must not allow a conflict of interest and duty.[15] By preferring their

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15 *Re Charterland Goldfields* (1909) 26 TLR 132.

own interests ahead of those of a legitimate creditor, the Liquidators were not acting in good faith.

Respondents' submissions

[41] The Liquidators agree with Hinton J that cl 3.4 does not apply. On a plain and ordinary reading of the clause, proceedings were commenced. There is no room to imply the terms suggested by Commercial Factors.

[42] However, the Liquidators maintain that Blue Chip (through the Liquidators) was never required to repay the Funding and the Fee because the obligation in cl 3.2 was never triggered. Clause 3.2.2 envisaged that the Liquidators would enter into a funding agreement with an independent third-party litigation funder. The parties' subsequent conduct was consistent with this.

[43] Furthermore, and in any event pursuant to cl 6.1, the Liquidators could only be personally liable if they failed to act in good faith. The Liquidators submit that they did not fail to act in good faith. They rely on Nation J's decision in *Heli Holdings Ltd v The Helicopter Line Ltd*.[16] As Hinton J found, the Liquidators' honest belief was that the obligation to pay the Funding and the Fee to Commercial Factors had not arisen.

[44] The Liquidators say Commercial Factors' agency argument is misconceived. While it was Blue Chip's obligation to repay Commercial Factors under the Agreement, any repayment had to be from the Liquidators as Blue Chip's agents. The parties contracted on the basis that the Liquidators would not assume personal liability for failing to do so, unless they did not act in good faith. Clause 6.1 would be rendered redundant if Commercial Factors' interpretation was correct.

Overview

[45] We will address the issues raised in this appeal in the following way.

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16 *Heli Holdings Ltd v The Helicopter Line Ltd* [2016] NZHC 976.

[46] We will first consider the challenges to Hinton J's findings as to breach. That is, whether she:

(a) erred in finding that cl 3.4 did not apply, because proceedings had been commenced; and

(b) erred in finding cl 3.2 did apply because the Liquidators were "another party" who had agreed to fund the proceedings.

[47] We uphold the Judge's decision as regards cl 3.4, but reach a different conclusion as regards cl 3.2.2. That is enough to dispose of the appeal. The Liquidators did not breach the Agreement. Given that both were argued before us, however, we go on to consider Commercial Factors' agency argument and whether the Liquidators would, in any event, be liable for failing to act in good faith. We reject both of these arguments.

[48] We therefore dismiss Commercial Factors' appeal.

[49] At the outset, we think it is helpful to record what we understand to be the principles of liability of liquidators to creditors for debts which arise in a liquidation.

[50] First, the basic proposition is that parties who contract with a liquidator as agent of a company in liquidation will be unsecured creditors of the company if the company's contractual obligations are not performed. The 1933 decision of the Kings Bench in *Stead Hazel & Co v Cooper* is a good example of the operation of that principle.[17] A liquidator, Mr Cooper, asked a supplier of a company that had been placed in liquidation to continue to supply. The supplier agreed. When Mr Cooper declined to accept delivery, the supplier sued him alleging personal liability. Referring to the letter Mr Cooper as liquidator had sent to the supplier requesting continued supply, with payment to be made after delivery, Lawrence J observed:[18]

> I see nothing in the letter of June 20, 1930, to suggest that the defendant intended to undertake a personal liability, and even if that letter and its acceptance by the plaintiffs constituted a new contract it was, in my judgment,

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17 *Stead Hazel & Co v Cooper* [1933] 1 KB 840.
18 At 842.

> a contract which purported to be a contract by the liquidator as agent for the company.

[51] Judgment was given in favour of the liquidator accordingly, with the supplier left as an unsecured creditor of the company.

[52] Secondly, a liquidator may agree that monies owing under a contract entered into by the liquidator as agent of the company in liquidation will be a liquidator's liability. In those circumstances the liquidator is, in effect, agreeing to treat any amount that becomes owing to the contracting party as an expense of the liquidation, and therefore claimable by the liquidator as a first priority payment pursuant to cl 1(1)(a) of sch 7 of the Companies Act 1993.[19] That is as part of "the Fees and Expenses properly incurred by the liquidator in carrying out the duties and exercising the powers of the liquidator". If issues arise, the High Court will determine whether the particular fees and expenses have been "properly incurred". The liquidator is an officer of the court[20] and explicitly subject to the court's jurisdiction pursuant to s 284 of the Companies Act.

[53] Were the court, in its supervisory jurisdiction, to conclude that particular expenses had not been properly incurred, and therefore — contrary to the contract made by the liquidator — not an expense of the liquidation, then the court may order the liquidator to repay the expenses pursuant to s 284 of the Companies Act.

[54] Thirdly, a liquidator could agree to be personally liable to a party with whom he contracted, notwithstanding that he did so in his capacity as liquidator. In that way, the liquidator would commit personal assets to discharge liabilities that arise. The possibility of such liability only has to be expressed to demonstrate that it would be an unusual liquidator indeed who accepted such a liability.

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19 Clause 1(1)–(5) of sch 7 establishes a range of creditor preferences in five descending categories. The first category, found in cl 1(1), applies generally to fees, expenses and costs incurred by various parties during the course of a liquidation. Where a creditor funds successful proceedings against a company in liquidation, cl 1(1)(e) gives that creditor a priority claim to amounts recovered. There was no suggestion that provision had any relevance here, Commercial Factors not being a creditor in the liquidation of Blue Chip and there being no recoveries.

20 *ANZ National Bank Ltd v Sheahan* [2012] NZHC 3037, [2013] 1 NZLR 674 at [122].

[55] As we have already mentioned, we think the better interpretation is that the obligations to pay the Funding and the Fee recorded in cl 3.4 would, if they eventuated, give rise to debts payable in the liquidation. That is, they would be expenses of the liquidation claimable by and payable to the Liquidators, and by them to Commercial Factors. Having said that, we agree with Hinton J that whilst cl 3.4 clearly indicates a sch 7, cl (1)(i)(a) priority claim, the same cannot be said for cl 3.2.2.

[56] We turn now to the issues for us to decide.

Breach

Clause 3.4

[57] Like Hinton J, we think that phrase "if proceedings are not commenced" means what it says. We adopt her following analysis:[21]

> [37] I do not agree with [Commercial Factors]'s interpretation of the word "commenced". Applying the ordinary sense of the word, a proceeding was commenced in this case when it was filed, and furthermore, it was not just simply filed. There were a number of other steps taken, including filing and service of statements of defence, filing of an amended claim, and filing of a request for particulars. I also find as a matter of fact that the liquidators did not issue the proceeding just as a formality. I accept their evidence that they hoped to continue on with it. There was no evidence to the contrary.
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> [38] To read the word "commenced" in clause 3.4 as meaning "commenced and followed through to an end", or "commenced and taken some distance" as [Commercial Factors] contends, would be to read a considerable amount into that clause, which I do not consider is correct or appropriate. At what point would a proceeding be "commenced" on that logic? …

[58] We do not need to add anything further.

Clause 3.2

[59] The Judge then found that under cl 3.2 another party had agreed to fund the proceeding: the three partners of Meltzer, Mason, Heath. The partners were another party.[22] Just as the Judge had been unwilling to read the words of cl 3.4 "up", in the

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21 *Commercial Factors Ltd*, above n 2.
22 At [43].

way Commercial Factors argued, so was she unwilling to read those words "down" in the way the Liquidators contended for.

[60] Whilst we see the force of the Judge's reasoning, in our view, and for one straightforward reason, we do not consider that to be the proper interpretation of the clause. Again, we can express our view succinctly. It is based on the structure of cl 3.2 as a whole.

[61] Remember, the Liquidators acted as agent of Blue Chip. Any reference in the Agreement to "the company" incurring an obligation of necessity includes a reference to the Liquidators as agent of the company, with the authority under sch 6 of the Companies Act to conduct the business of the company. In that context, we note that:

(a) it is "the company and [explicitly] the Liquidators" who are to give Commercial Factors the first option;

(b) it is the company, and hence implicitly the Liquidators, who agree not to enter a Funding Agreement "with another party" on any less favourable terms without first reoffering the funding opportunity to Commercial Factors; and

(c) it is the company, and hence implicitly the Liquidators, who contract to procure the funder to pay "before the proceedings are filed or any funding for the proceedings is made available to the company or the liquidators".

[62] In our view, therefore, when cl 3.2 refers to "another party" it is referring to a party other than the company or the Liquidators. We place particular reliance on the opening words of cl 3.2 in reaching that conclusion. That is, it is the Liquidators who will endeavour to obtain funding for proceedings and it is the Liquidators who, under s 301 of the Companies Act, actually take the proceedings. It would, in those circumstances, be unusual to regard the Liquidators as "another party" for the purposes of cl 3.2.2.

[63] We think that conclusion is also supported by what we see as the fundamental commercial proposition underlying the cl 3.2 arrangements. That is, it is an independent litigation funder who, by committing to fund the proceedings, in exchange for whatever share of the proceeds is agreed, ultimately, stands to benefit from the opinion that was initially obtained. The Liquidators, when they funded the commencement of the proceeding, were not and could not be in the equivalent position.

[64] We acknowledge that this does indeed leave "gap" in the Agreement. That "gap" can be seen as working unfairly as regards Commercial Factors: after all, it had paid the amounts due from it under the Agreement and, albeit after the commencement of the proceedings and unexpectedly, Blue Chip had received recoveries that, if used at the time, could have repaid the Funding and the Fees.

[65] We note Hinton J's point that the Liquidators were not identical to the three individuals who provided personal funds; two partners (Mr Meltzer and Mr Heath) were Liquidators, but the third partner (Ms Mason), was not. But in all the circumstances, and given the joint and several liability of partners for the debts of a firm, we would not place the reliance on that factor that the Judge did.

[66] Accordingly, we are satisfied that the Liquidators did not breach the Agreement. Given the way in which the appeal was brought, we go on to consider Commercial Factors' agency and bad faith arguments.

Agency

[67] For Commercial Factors, Mr Dale's argument was that if there was a breach of cl 3.2 or, for that matter, cl 3.4, then that was a breach by Blue Chip for which — as a matter of necessity as we understood the argument — the Liquidators were liable and, as sued, personally liable. Given our understanding of the basic principles, Mr Dale did not identify any legal basis for that personal liability. On the contrary, his submission appeared to take no account of the basic proposition that an agent is generally not liable for the obligations of the principal,[23] and the very obvious

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[23] *Montgomerie v United Kingdom Mutual Steamship Association Ltd* [1891] 1 QB 370.

significance of that principle in the case of a liquidator acting as agent of an insolvent company.

[68] Rather, it was Mr Dale's basic proposition that it was "the Liquidators as the company's agent" who were obliged to fulfil the obligations incurred under cls 3.2 and 3.4. That is:

(a) Blue Chip, through its liquidators as agents, should have procured payment to Commercial Factors;

(b) that was Blue Chip's breach; and

(c) as agents of Blue Chip, the liquidators are not saved by cl 6.1.

[69] We simply do not follow that argument. It would transfer liability from the principal to the agent. But the law attributes the agent's actions to the principal (here Blue Chip).

[70] As we have said, that is the fundamental basis upon which liquidators of insolvent companies contract. Here, any procurement of payment to Commercial Factors was necessarily going to be by the Liquidators as agents. It was in that context that cl 6.1 (which limits the Liquidators' liability unless they fail to act in good faith) was agreed. Clause 6.1 would be rendered meaningless if that agency theory prevailed.

[71] We are, for all those reasons, simply unable to accept the agency argument.

Good faith

[72] It was Mr Meltzer's evidence that cl 6.1 of the Agreement reflected standard liquidation practice. That is, liquidators contract on the basis that they are not personally liable unless, in the circumstances which lead to a creditor not receiving payment, the liquidators act other than in good faith. In our view, the reference in the Agreement to acting otherwise than in good faith is properly understood as a reference to circumstances which, as a matter of law, may give rise to personal liability

on the part of a liquidator. That is, a person who contracts with liquidators on such terms may by enforcing the contract obtain relief which, under the Companies Act, would require the exercise of the court's supervisory jurisdiction. As regards the exercise of the court's supervisory jurisdiction, it is well established that the courts will not interfere with matters of day-to-day administration, or hold a liquidator accountable for an error of judgement. Serious or obvious lapses in judgement on the part of a liquidator must be shown before the courts will interfere.[24]

[73] In arguing that in using the unexpected recovery of inter-company advances in the way they did the Liquidators had failed to act in good faith, Commercial Factors relied in part on a lack of transparency between the Liquidators and Commercial Factors over time as to how the Liquidators, in fact, funded the proceedings. We have outlined the specific points of evidence Commercial Factors relies on at [38]. We accept, as the Judge did,[25] that in recording and communicating those arrangements, the Liquidators did not act in accordance with best practice. For the appellants, Mr Dale was particularly critical of the inconsistencies in various accounts given by the Liquidators as to how their proceedings against the directors were funded. That is Mr Meltzer's explanation in his affidavit for summary judgment that Blue Chip received "some funds" to issue proceedings; the narrative disclosed by the Liquidators' report and their cashbook (including the personal advances); and, finally, and only at this point a complete picture, Mr Meltzer's evidence at trial as to the amount he personally had paid at the end of the liquidation to settle the debts of the lawyers involved. The Liquidators might also be said to have failed to keep Commercial Factors informed, as they had contracted to do under the Agreement.

[74] However, and essentially for the reasons the Judge found, we are satisfied that the Liquidators did not act otherwise than in good faith. That is:

(a) First, the Liquidators had not filed the proceedings in order to cut Commercial Factors out of cl 3.4 — rather, the Liquidators had filed proceedings in order to resolve the claim and generate funds for

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[24] Paul Heath and Michael Whale (eds) *Heath and Whale on Insolvency Law in New Zealand* (2nd ed, LexisNexis, Wellington, 2014) at [18.8].

[25] *Commercial Factors Ltd*, above n 2, at [84].

the creditors (including Commercial Factors).[26] At the time proceedings were issued, it was not known that the $307,961.19 would be forthcoming by way of the repayment of inter-company advances.[27]

(b) Second, the Liquidators had acted honestly and reasonably in thinking that by personally funding the proceeding, they would not fall afoul of cl 3.2. Mr Haydon did not suggest that cl 3.2.2 had been triggered and neither did Commercial Factors bring its claim in that way.[28] While the Liquidators ought to have reviewed the Agreement prior to issuing proceedings, that did not amount to a failure to act in good faith.[29]

(c) Third, it was not a breach of good faith for the Liquidators to disburse the funds received from the inter-company advances (including to themselves) and not pay Commercial Factors. Once proceedings were issued, Commercial Factors' recovery fell under cl 3.2 which did not give Commercial Factors priority ranking in all circumstances.[30]

[75] We make one final observation. From the outset, the Liquidators advised creditors that it was unlikely there would ever be a distribution. As Mr Keene advised, proceedings against directors and auditors would be complex, lengthy and expensive. Commercial Factors undertook the risk involved in funding the opinion in those circumstances. It could not be assured that, in the absence of litigation funding, it would receive payment under the Agreement. At the end of the day, the Liquidators were "out of pocket" as were their solicitors. Any perceived unfairness to Commercial Factors caused by the inadequacies of the Agreement is to be seen in that context. Moreover, and if the Liquidators had approached Commercial Factors with the proposal that in the circumstances they would fund the issue of the proceedings as an interim step it seems most unlikely that they would have done so on the basis they were, at that time, to pay Commercial Factors the Funding and the Fees. Whether or

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26 At [79].
27 At [80].
28 During the hearing of the appeal, counsel confirmed that the focus of the trial in the High Court had been the pleaded breach of cl 3.4, and not cl 3.2.
29 *Commercial Factors Ltd*, above n 2, at [82].
30 At [85].

not, in those circumstances, some amendment to the Agreement would have been made is a separate question.

Result

[76] The appeal is dismissed.

[77] The appellant must pay the respondents costs for a standard appeal on a band A basis and usual disbursements.

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