IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV-2016-404-000057
[2021] NZHC 1922

BETWEEN	ADAM DAVID BANKS Plaintiff
AND	WILLIAM ROBERT FARMER First Defendant
AND	SIMON MATHEW GAMBLE Second Defendant
AND	CHRISTOPHER JAMES MASSAM Third Defendant
AND	DOUGLAS LEROY FREDERICK Fourth Defendant

Hearing:	1 to 24 July 2019, 11 December 2019 and 5 and 6 October 2020
Appearances:	Jeremy Johnson, Gregory Simms and William Porter for the Plaintiff Robert Hollyman QC, Alec Steel, Lance Green and Ana Lenard for the First Defendant Second Defendant in Person Third Defendant in Person No appearance for the Fourth Defendant
Judgment:	28 July 2021

JUDGMENT OF MOORE J

This judgment was delivered me on 28 July 2021 at 2:00 pm
pursuant to Rule 11.5 of the High Court Rules.

Registrar/ Deputy Registrar

Date:

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INTRODUCTION

"Whāia te pae tawhiti kia tata, ko te pae tata whakamaua kia tina!"

[1] This case is about the rise and fall of a technology company which held so much promise but which ended up in failure. It is also about a young man who invested part of his family inheritance and lost it.

[2] The company was called Mako. It was established by two enthusiasts with information technology ("IT") skills and a vision. They saw a gap in the emerging technology security market and they developed a technological solution to meet that gap. The system they developed was innovative and world-leading. Mako grew rapidly, initially locally and then globally.

[3] Revenue projections were estimated to reach tens, if not hundreds of millions of dollars. But Mako had an Achilles' heel; it lacked the capital to fully realise its potential. It looked for and found investors. One of those was the plaintiff. Between 2011 and 2014 he invested over $3.2 million in the form of unsecured loans. He lost his money when Mako went into liquidation and receivership owing creditors around $34.5 million.

[4] The plaintiff sues the four defendants who were directors of Mako. He says they took his money in circumstances where there was a significant information asymmetry; the defendants knew many important and relevant facts about the company's performance and the plaintiff did not. The plaintiff says that if the defendants had acted as they should have as directors of Mako, consistent with their legal obligations, he would not have lost his money.

[5] In particular, the plaintiff says the defendants breached their obligations by taking investments from him as a member of the public without a registered prospectus, making misrepresentations about Mako's state and prospects which had no reasonable foundation, failing to disclose critical information about the company before the plaintiff made his investments and continuing to trade the company in circumstances where it was insolvent, under-capitalised and, with no realistic prospect

of receiving further capital, allowed Mako to continue to trade to the detriment of its creditors, including the plaintiff.

[6] These alleged defaults are reflected in the four causes of actions the plaintiff brings against the defendants.

[7] The defendants respond that the failure of Mako was not due to any actionable failure on their part. Mako, despite its promise, never realised its potential and the plaintiff lost his investment as did every other investor, including the defendants and their families. The defendants point out that some companies succeed. Most do not. The nature and purpose of corporate limited liability is to allow individuals, such as the plaintiff, the defendants, and the other investors, to limit the amount of money which they place at risk.

[8] The defendants say that the closer the evidence is examined the clearer it becomes that the actions of the defendants were commercially responsible when judged in the context of the particular circumstances which faced them and Mako at all relevant times.

THE CLAIM

[9] In this judgment,[1] the four causes of action are not addressed in the order pleaded, but rather in the same order both counsel addressed them in submissions. I consider this to be a logical approach which I shall also adopt.

[10] In summary, the plaintiff's claim is that:

(a) in breach of the Securities Act 1978 ("the Securities Act"):

(i) *First cause of action:* Mako offered an allotment of a debt security to Mr Banks without having a registered prospectus. Under s 37 of the Securities Act, Mr Banks is entitled to be repaid the subscription amount and, as the company is unable to repay, the directors are liable; and

(ii) *Fourth cause of action:* Mr Banks was induced to subscribe for securities on the basis of advertisements that included untrue statements. Under ss 55G and 56 of the Securities Act, the directors are liable to compensate Mr Banks for loss and damage he sustained as a result;

(b) *Second cause of action:* in breach of the Fair Trading Act 1986 ("the FTA"), the defendants engaged in misleading and deceptive conduct which induced Mr Banks to invest and keep his money invested in

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1 The substantive hearing occupied 18 sitting days. I reserved my decision on 24 July 2019. On 27 September 2019, the defendants filed an interlocutory application seeking orders that the plaintiff deliver up certain electronic devices on the grounds that it appeared the plaintiff may have forged certain documents he produced in evidence. That application was heard on 11 December 2019 and granted. The devices were delivered, inspected and analysed by experts retained by the plaintiff and the defendants. COVID-19 intervened. The forensic examination took until July 2020 to complete. On 16 July 2020, I made timetabling orders for the filing of evidence and the common bundle. A two day fixture on 5 and 6 October 2020 was allocated, that being the earliest available date given the scheduling pressures imposed by COVID-19. I heard evidence from witnesses and received oral and written submissions from counsel. On 31 March 2021, the Court of Appeal delivered its judgment in *Yan v Mainzeal Property & Construction Limited (In liq)* [2021] NZCA 99. Given the significance of that judgment to these proceedings, on 14 April 2021 I invited counsel to make supplementary submissions. These were received from the plaintiff and the first defendant on 29 April 2021 and 14 May 2021 respectively and from the plaintiff in reply on 17 May 2021.

Mako. Under s 43 of the FTA, the defendants are liable to compensate Mr Banks for the loss and damage he suffered as a result; and

(c) *Third cause of action:* in breach of the Companies Act 1993 ("the Companies Act") the defendants:

(i) failed to act in good faith and in the best interests of the company (s 131 of the Companies Act);

(ii) carried on business in a manner that was likely to create a substantial risk of serious loss to creditors (s 135 of the Companies Act);

(iii) agreed to the company incurring obligations that it was not able to perform (s 136 of the Companies Act); and

(iv) failed to exercise the care, diligence and skill that a reasonable director would exercise in the circumstances (s 137 of the Companies Act).

Under s 301 of the Companies Act, the directors are liable to compensate Mr Banks for the loss and damage he suffered as a result.

[11] Mr Banks seeks compensation for the sums he invested, plus interest and costs.

BACKGROUND

[12] Mako operated for 13 years between 2002 and 2015. In the course of the hearing, the primary focus was on the four-and-a-half (or so) years from December 2010 when the prospect of the plaintiff investing funds in the company was first raised, until August 2015 when Mako went into liquidation. The fortunes of Mako, the actions of the directors and the involvement of the plaintiff were examined in minute and painstaking detail. For that, there can be no criticism of any party. That course was necessary for the trier of fact to properly understand and evaluate the actions of the parties and the context within which those actions took place.

[13] However, given the level of detail engaged, it is necessary to set out in far greater detail than would usually be the case, the factual background.

The beginnings of YellowTuna and Mako

[14] In the late 1990s the second and third defendants, Messrs Gamble and Massam,[2] were both working on the help desk at Telecom's then new internet service provider, Xtra. These responsibilities evolved into operational roles at Telecom with a focus on IT. Mr Gamble, particularly, was interested in IT solutions designed to protect Xtra's servers from intrusion and hacking.

[15] It was about this time that Mr Farmer, the first defendant, who Mr Gamble had known for some years, approached Mr Gamble about joining his business, E-Force, as its IT Manager. Although Mr Gamble was excited by this prospect, he was not confident that he could deliver all that Mr Farmer hoped for. He thus introduced Mr Massam who, with Mr Gamble, joined Mr Farmer at E-Force. Together they built networks and introduced various technologies. Despite their efforts, E-Force failed towards the end of 2000.

[16] This proved to be the impetus for Messrs Massam and Gamble to set out on their own. They decided to start a business together focusing on networking technology. It was a timely initiative because, at the time, New Zealand's small

[2] Messrs Gamble and Massam represented themselves. They each filed a brief of evidence but were led by Mr Hollyman QC, acting for Mr Farmer, the first defendant.

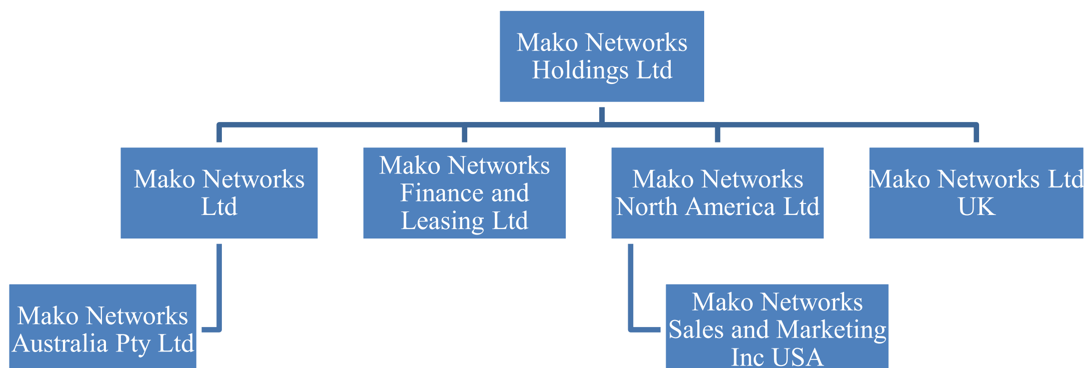
business sector was just starting to embrace computer networks, broadband and the internet.

[17] Throughout the trial the names of the companies involved were used interchangeably. It appears that in 2001 Messrs Massam and Gamble, with another, Mr Dennis Monks, set up YellowTuna Networks Ltd ("YellowTuna"), later renamed Mako Networks Ltd ("Mako Networks").

[18] Messrs Massam and Gamble maintained contact with Mr Farmer. They sought out his advice on various financial and strategic matters. Mr Farmer indicated an interest in getting involved in the YellowTuna business and in 2002 joined YellowTuna as its Chief Executive Officer ("CEO"). YellowTuna Holdings Ltd ("YellowTuna Holdings") was formed in September 2002 as a holding company and was later renamed to Mako Networks Holdings Ltd ("Mako Holdings"). Messrs Massam, Gamble, Monks and Farmer each took a 25 per cent share in YellowTuna Holdings. Mr Farmer was appointed a director of YellowTuna Holdings in September 2002 and of YellowTuna in May 2004.

Corporate structure

[19] To avoid later confusion, it may be helpful to explain the corporate structure of YellowTuna and its relationship with Mako. The following corporate structure diagram and explanatory notes (with some additions and deletions which reflect changes in the company names) are taken from the Private Placement Memorandum which is discussed later in this judgment.



Mako Networks Holdings Ltd (formerly YellowTuna Holdings Ltd)
Owner of all Intellectual Property – Proprietary Software, Patents and Trademarks

<u>100% Owned Subsidiaries</u>

Mako Networks Ltd
Fully Operatonal Sales, Marketing, Administration, for New Zealand, Research and Development contractor to YTH. Network Operations worldwide. Owner of and administrator for PCI compliance Certification.

Mako Networks Finance and Leasing Ltd
Hardware Specification, Procurement and Supply worldwide

Mako Networks Ltd – UK
Fully Operational Sales and Marketing for the United Kingdom and South Africa

Mako Networks Australia Pty Ltd
Research and Development contractor to YTH through MNL

Mako Networks Sales and Marketing Inc – USA
Non-operatoinal Sales and Marketing for USA structured for tax efficiency

Mako Networks North America Ltd
Non-operatoinal US Licence holder for future operations

[20] Mako Holdings (which until 2013 was known as YellowTuna Holdings), is recorded as the "holding company" in the group's financial statements. It not only held shares in the subsidiary companies but also owned the business' core asset, its intellectual property. It made that property available to its subsidiaries to exploit in the marketplace. Mako Networks was the New Zealand arm of the business and the research and development contractor to Mako Holdings. It owned the Mako PCI-DSS compliance certification which is discussed more fully later. Mako Networks Finance and Leasing Ltd ("Mako Finance & Leasing") was the worldwide hardware specification, procurement and supply arm of the business. There were also other Mako companies, both operational and non-operational, set up for the primary international markets in North America, the United Kingdom and Australia.

[21] As is evident from the minutes of the Board of Directors ("the Board"), the directors tended to treat the various companies as a single business enterprise or group, including preparing the financial statements on a consolidated basis. For the purposes of this judgment, references to "Mako", without further specificity, relate to the Mako businesses generally, including the period during which the business was run under the YellowTuna banner.

Growth and development of Mako

[22] The new business grew and the technology the defendants developed with YellowTuna would later provide the foundation for Mako's innovative business.

[23] Mako's commercial focus narrowed from the provision of general IT services to specialising in internet connectivity, protection and control. The platform developed by Mako was unique and world leading. It was an automated network security system which enabled computers to update firewalls, a task previously undertaken by technicians. These technological advances led to the development of the "Mako system" which was comprised of hardware connecting business sites to the internet and a cloud-based, centrally-managed server platform. The innovative aspect of the Mako system was (and remains) such that it cut through the technical complexities of firewalls and network security. The technology also had the advantage of being capable of being installed and maintained cheaply. The Mako system became an industry leader in cloud-based network management systems.

[24] Initially, the company's marketing and sales energies were directed at persuading either TelstraClear or Telecom to purchase the Mako system because each had large numbers of customers connected to the internet, operating small businesses and distribution enterprises which reflected Mako's business targets.

[25] It was something of a strategic triumph when, on 25 October 2005, Mako entered into its first supply agreement with Telecom. Under this agreement, Telecom adopted the Mako system which it marketed to its customers as SecureME. The product remains a successful one today, now under the ownership of Spark New Zealand.[3] Shortly afterwards the Mako system was purchased by the Ministry of Health under the name SecureME for Health. Through its association with Telecom, Mako also secured a number of key customers including Fonterra, Z-Energy, St Johns, Mobil New Zealand, Lotto New Zealand and the New Zealand Racing Board.

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[3] Telecom was rebranded as Spark on 8 August 2014.

[26] In 2006, Mako successfully completed its first security audit with ICSA Labs[4] which opened up markets further afield.

Mako in 2007 to 2009 and PCI-DSS certification

[27] In 2007, Mako established a relationship with NetComm, an Australian technology manufacturer and distributor. Mako gave NetComm exclusive rights to the Mako system in Australia which NetComm rebranded in the Australian market as NetAssure.

[28] In 2009, apparently at the request of Telecom, which wished to roll out the Mako system to its large corporate customers, the directors of Mako investigated what appeared to be a gap in the credit card security market. This required Payment Card Industry Data Security Standard ("PCI-DSS") accreditation of the Mako system. The PCI-DSS standard was developed in 2006 by the five major western credit card companies as a means to improve cardholder data protection and reduce instances of fraud. If accreditation was obtained it would differentiate Mako as a unique provider and market leader in the industry and thus open up access to large global businesses which accept payment by credit card. On 3 February 2010, after months of work to secure accreditation, the Mako system was certified as PCI-DSS compliant. Later that month Mako launched its PCI-DSS compliant management system, the first of its type in the world. This was a commercial coup which differentiated Mako from any of its competitors. It was common ground at the hearing that Mako's achievements in this regard were massive. From this point, the company looked to expand globally, particularly into the United States.

Telecom funding

[29] From 2009, Mako primarily funded its business through one of Telecom's subsidiary companies, Telecom Rentals Ltd ("Telecom Rentals"). Telecom Rental's core business was providing IT and telecommunications equipment leasing services. Essentially, Telecom Rentals provided Mako with a working capital facility using its equipment leases and committed future business as security for advances. Despite

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[4] ICSA Labs is a US-based agency specialising in security hosting and certification network and computing systems.

normally offering sale and lease back services, Telecom Rentals agreed to release funds as working capital to Mako to support the upfront costs of developing its business, particularly internationally. This agreement was formally governed by a series of rental agreements and an associated general security deed ("GSD") between Mako Finance & Leasing and Telecom Rentals. The agreement was executed on 26 October 2010. The GSD had a priority limit of $5 million.

[30] The agreement was varied in August 2011 with Mako Networks agreeing to guarantee 30 per cent of the debt owed by Mako Finance & Leasing to Telecom Rentals. This variation, in part, was to allow equipment financed by Telecom Rentals to be used offshore without breaching the agreement. This arrangement remained in place until early 2013 when the limit was increased from $5 million to $35 million. There were further variations to the arrangements between Mako and Telecom Rentals, the latest of which was when the debt arrangements were restructured in early 2014. These variations are discussed more fully later.

The Private Placement Memorandum (2010)

[31] Through 2010, Mako began looking to raise capital from wealthy investors. In September 2010, Mr Farmer and Mr Gamble started work on a draft information memorandum for capital raising purposes. It would come to be known as the Private Placement Memorandum ("PPM"). Mr Farmer said that the PPM was specifically aimed at investors who were not members of the public in order to avoid the obligations and strictures imposed by the Securities Act. He received legal advice from internal and external providers on the definition of "members of the public" under the Securities Act and in particular, the various exclusions.

[32] This approach is reflected in the opening parts of the PPM which are reproduced below:

> "**Mako Networks**
>
> Private Placement Memorandum
>
> This Private Placement Memorandum ("Memorandum") has been prepared by Mako Networks Ltd (Mako) its related companies and its directors and shareholders. This Memorandum is not an Investment Statement nor

Prospectus and does not constitute an offer of securities to the public for the purposes of the Securities Act 1978 (“the Act”).

No offer of securities is made to any person except such persons excluded from being members of the public under s 3(2)(a) of the Act, (together being “Qualified Investors”). These include persons:

A. WHO ARE RELATIVES OR CLOSE BUSINESS ASSOCIATES OF MAKO OR A DIRECTOR OF MAKO;

B. WHOSE PRINCIPLE (sic) BUSINESS IS THE INVESTMENT OF MONEY OR WHO, IN THE COURSE OF AND FOR THE PURPOSE OF THEIR BUSINESS, HABITUALLY INVEST MONEY;

C. ANY OTHER PERSON WHO IN ALL THE CIRCUMSTANCES CAN PROPERLY BE REGARDED AS HAVING BEEN SELECTED OTHERWISE THAN AS A MEMBER OF THE PUBLIC.

Provision of Memorandum

This Memorandum is provided to Qualified Investors in New Zealand who have expressed an interest in investing in Common Stock (“the Shares”) offered by YellowTuna Holdings Limited (“Mako” or “the Company”) (“the Opportunity”). The sole purpose of the Memorandum is to provide information to Qualified Investors and is not intended to form the basis of any investment decision or any decision in connection with the Opportunity.”

[33] The PPM also contained extensive exclusions:

“**No Representations or Warranty**

No information contained in this Memorandum has been independently verified by any person and no representation or warranty, express or implied, is made nor is any responsibility accepted by Mako with respect to the completeness or accuracy of any information contained in this Memorandum or any further information supplied in connection with the Opportunity.

This Memorandum and specifically the financials have been prepared on the basis of numerous assumptions, projections and best estimates. Because projections involve risk and uncertainties actual results are likely to vary and such variations could be material. No representations are made by the Company, its directors or its management that the results set out in this Memorandum will be achieved.

Independent Review

This Memorandum does not purport to contain all of the information that may be required to evaluate the Opportunity. Any intending Qualified Investor and their respective advisors should conduct their own independent review, investigations and analysis of the operations and affairs of Mako and the information contained or referred to in this Memorandum.

…

Limitation of Liability

Except insofar as liability under any law cannot be excluded, Mako shall not have any responsibility or liability arising in respect of the information contained in this Memorandum or in any way for errors or omissions (including responsibility to any person by reason of negligence).

No Guarantee

No party is guaranteeing the Opportunity or the future performance of Mako.

If these conditions are not acceptable, this Memorandum should be returned immediately to Mako."

[34] A footer appeared at the bottom of each of the 24 pages, stating:

> "This document is strictly confidential and circulation is restricted to Qualified Investors as outlined on pages 3 and 4 of this Private Placement Memorandum. All copies should be returned immediately to Mako Networks and copies destroyed if the conditions outlined are not acceptable."

[35] The PPM also set out the company's plans for expansion and the development of the Mako system with its PCI-DSS compliance. Under the heading, "Mako Opportunities", it described its markets in Australia, the United Kingdom and the United States, prefaced by the following:

> "The following information is included as an outline to demonstrate the quality and quantum of business opportunities that Mako is actively working on. All PCI-DSS opportunities are subject to Commercial In-Confidence Non-Disclosure Agreements and/or Letters of Engagement and as such cannot be elaborated upon."

[36] Towards the end of the document, the revenue projections for the period 2011 to 2015 were set out. The predicted revenue in 2011 was $17,036,707, in 2012 it was $41,575,828, in 2013 it was $63,034,008, in 2014 it was $97,588,393 and in 2015 it was $133,967,197.

[37] The document concluded:

"**Investment Proposal**

Capital Raising

The company seeks to raise NZD$7.5m from an invitation-only private placement of its Common Stock. The offer will open on 1st November and

> close on 30th November 2010. The Company expects to increase its share plan to 25 million shares of which 3.75 million will be allocated in the capital raising…"

Mr Banks meets Mr Farmer

[38] It was about this time, in late 2010, that the plaintiff, Mr Adam Banks ("Mr Banks"), first met Mr Farmer. At the time Mr Farmer was living in a rural lifestyle complex in Albany, Auckland. Amongst his neighbours was a Mr David Winslade ("Mr Winslade"). At the time Mr Winslade's partner was Mr Banks' mother, Ms Caroline Banks ("Ms Banks").[5] There is some disagreement between the parties as to how the question of Mr Banks investing in Mako first arose and what was said. This is covered in more detail later in relation to the first cause of action.

[39] According to Mr Farmer, investing in Mako was first raised when Mr Winslade mentioned to him that Ms Banks could be interested in an investment. Sometime later Mr Winslade told him Ms Banks was interested and Mr Farmer gave him a copy of the PPM, saying Ms Banks should contact him if she was interested. Mr Farmer said Ms Banks later made contact and over the course of two meetings, they discussed a possible investment. Mr Farmer said that from their discussions, it was obvious to him that Ms Banks was "well versed in the business world" and that a Mako investment would represent a small part of her total investment portfolio. He said that he told Ms Banks that Mako was a high-risk technology investment and nothing like any of her previous investments. He claimed he told her that if she could not afford to lose the money, then she should not invest in Mako. Later she emailed him, confirmed that she would like to proceed with the investment and advised Mr Farmer that her son, Mr Banks, would "take it from here".

[40] In contrast, Ms Banks' evidence was that it was Mr Farmer who first raised the question of investing in Mako. He raised it directly with her and talked about investing in Mako at a good rate of return. Ms Banks said she told Mr Farmer that Mr Banks might be interested and gave him her son's contact details. She believed Mr Banks would be interested in the opportunity to help the family financially because,

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5 In the course of her evidence Ms Banks indicated that "Ms" was her preferred honorific.

according to her, "he was keen to learn about New Zealand laws and cultural norms and to generate money via employment or investment". Ms Banks was adamant that she did not initiate the approach to Mr Farmer herself, that Mr Winslade never spoke to her about an investment in Mako, and that she did not have any business or investment meetings with Mr Farmer apart from a much later occasion on 18 February 2015. She said that other than assisting Mr Banks with some of the international money transfers to Mako, she had very little to do with the loans although, occasionally, she said she was copied in on correspondence between Mr Banks and Mr Farmer or she would discuss, in general terms only, Mr Banks' investment when she saw Mr Farmer socially. She claimed that she had no real involvement or knowledge of any detail around the loans.

[41] The funds which Mr Banks would later lend to Mako across all three advances originated from accounts controlled by Ms Banks and trusts associated with her. The original source was derived from inheritance and residential property lending undertaken by Ms Banks in England before she emigrated to New Zealand in 2007.

[42] However they were introduced, it is common ground that Mr Farmer and Mr Banks first met in late December 2010. Mr Farmer claimed they spoke about Mr Banks' UK investment experience and his knowledge of the New Zealand technology investment landscape. He said that Mr Banks presented as many high wealth individuals do. These discussions led to more detailed correspondence. Mr Farmer claimed that throughout, Mr Banks presented as a financially astute and experienced investor. He said his belief was that Mr Banks' involvement was to oversee the investment for his mother.

[43] Mr Banks' evidence was that he was interested in investing in Mako because it involved IT and provided an opportunity to learn about technology. He said that Mr Farmer told him that Mako would be carrying out capital raisings of tens or hundreds of millions of dollars, that the company had no secured debts and that his investment would be safe. He said Mr Farmer explained that the loans would be made to Mako Holdings, a company which did not trade but simply received and distributed its income. According to Mr Banks, Mr Farmer said that Mako was obliged to take

"several solvency steps per year" and that any investment by Mr Banks would rank equally with all other unsecured creditors.

[44] On 22 December 2010, Mr Farmer emailed Mr Banks a copy of the PPM. Later the same day, Mr Banks responded to Mr Farmer with a series of questions regarding the potential investment. Amongst the various questions he asked, was whether the offer expired on 30 November 2010 or whether the expiry date on the PPM was meant to be 2011. He asked how often the solvency tests were taken and who regulated them. He asked whether his investment ranked ahead of wages and he made some suggestions as to how any investment might be structured.

[45] A few days later, Mr Banks asked Mr Farmer if the company would consider providing a personal, limited guarantee to "give us confidence". By email, Mr Farmer flatly rejected that option. Mr Banks then emailed Mr Farmer a proposal; a loan of £1.05 million in return for quarterly interest payments. He said he would be the lender. He commented:

> "It isn't always convenient to have my name on bank accounts and in this deal we will be using accounts that are owned by related entities which often handle money for my benefit. The UK accounts are owned by Caroline and the NZ account is owned by a trust of which I am a beneficiary and an administrator. A copy of a bill and the passport of me and Caroline isn't a problem…"

[46] He advised that he was treating the investment as a UK deal on his books. The Inland Revenue Department had given him a tax exemption on foreign income and he said he wanted to receive as much interest as possible before the exemption expired.

[47] Between this time and the end of January 2011, Mr Farmer and Mr Banks exchanged numerous emails and spoke on the telephone. Mr Farmer also met with Ms Banks. He said this was because he needed to satisfy himself that she was content with the proposed investment.

[48] By the end of January 2011, the agreement was starting to take shape. The parties' legal advisors were working on the documentation and exchanging drafts. One matter, which was creating some difficulties, was the structure of the proposed loan; a simple loan or a loan-to-equity conversion. On 1 February 2011, Mr Farmer received

an updated draft of the agreement from Mako's lawyers. They, or possibly Mr Farmer, had a query regarding the equitisation of the debt. Mr Farmer's email to Mr Banks is reproduced below:

> "You mentioned on Thursday evening that it would be unlikely that you would want to convert any of the loans to equity. As this is the area that is giving me the greatest difficulty with complying with securities requirements, should we just delete the option and leave it as a straight loan with repayment due as prescribed?
>
> I would be happy to talk through if you called."

[49] Mr Banks responded almost immediately advising that he was happy to delete the equity option because he did not wish to delay matters further.

Agreement 1

[50] On 4 February 2011, Mr Banks executed the loan agreement with Mako ("Agreement 1"). He agreed to lend Mako £1,177,000 in three tranches as follows;

(a) the first tranche would be £130,000 for a minimum term of two years with a minimum notice period of six months in the event Mr Banks wished to call it up ("Tranche 1");

(b) the second tranche would be £547,000 for a minimum term of two years with a notice period of six months ("Tranche 2"); and

(c) the third tranche would be £500,000 for a minimum term of three months with a notice period of three months ("Tranche 3").

[51] Other key terms of the agreement included:

(a) Mako would not make any external bank borrowings or give security (other than in the ordinary course of business where the secured assets were not more than 15 per cent of the net value of the borrower) over any of Mako's assets without first obtaining Mr Banks' consent or giving Mr Banks the option to demand repayment of all tranches prior to Mako entering into any financing;

(b) Mr Banks acknowledged that the loan was unsecured and not guaranteed by any person;

(c) Mr Banks would provide both financial and capital raising advice to Mako; and

(d) both parties acknowledged that the loan was the entire agreement between them and superseded all prior agreements, negotiations and representations. Mr Banks confirmed that he had entered into the agreement on his own judgement and had not relied on any representation by Mako, its agents, officers and personnel.

[52] Although Mr Banks and his mother experienced some difficulties in extracting the funds from the United Kingdom, the final payment was made by mid-April 2011.

[53] It is common ground, supported by the contemporaneous documentary record, that over the next two years or so Mr Farmer and Mr Banks corresponded by email and from time to time met in person. There is also evidence of the same between Ms Banks and Mr Farmer. Over this period Mr Farmer accepted that he portrayed Mako as a company which was doing well with growing investor and customer interest and strong financial projections. As will be discussed, there was some reasonable basis for those expressions of confidence.

Mako in 2011 and 2012

Customers and marketing

[54] In 2010 and 2011 Messrs Massam and Gamble travelled widely through Asia, the United States and the United Kingdom promoting the Mako system and its PCI-DSS certification. The target markets were banks, payment processors and credit card companies. They also attended international trade shows.

[55] In May 2011 Messrs Massam and Gamble attended a technology trade show in Las Vegas. They were joined by the fourth defendant, Mr Frederick, who at that time was providing consultancy services to the company. It seems it was here that they

all gained a fuller appreciation of just how ground-breaking and attractive the Mako system and its PCI-DSS accreditation was to potential customers. The unique technology piqued the interest of large organisations, including Chevron, which invited Mako to "pitch their product" against other competitors for a request for proposal ("RFP") at Chevron's headquarters in California. At the time, Chevron was the third largest listed company in the world with approximately 7,000 internet-connected petrol stations. The presentation resulted in Chevron entering into an agreement with Mako which led to it successfully rolling out over 4,000 Mako systems to its sites.

[56] Other large potential customers began to show an interest, particularly because the incidence of credit card fraud was increasing globally.

[57] At about the same time the company was engaged in discussions with Heartland Payment Systems and Alon Brands. The former is one of the United States' largest payment processors with revenues of the order of USD 2 billion. Alon is a mid-sized petroleum company with approximately 1,500 sites and revenues of approximately USD 1 billion.

[58] In December 2011, Mako signed a non-exclusive distribution agreement with UK-based Phoenix Managed Networks ("Phoenix") for North America and Europe. This required Phoenix to pre-purchase 10,000 Mako licences and 4,000 appliances.

[59] The same year, Mako received a $4.2 million technology development grant from the then Ministry of Science and Innovation ("MSI"). Unsurprisingly, that process required MSI to undertake a thorough review of Mako's business operation including its financials and the testing of its components before Mako could draw down the grant. That scrutiny continued beyond the receipt of the grant.

[60] In early 2012, the Board conducted a two day strategic planning exercise. An internal target, regarded as achievable, of $100 million of earnings before interest, taxes, depreciation and amortisation by June 2015 was set.

[61] The monthly Board minutes over 2012 reveal the Board undertook regular reviews of the cashflow position and customer prospects in the pipeline. Some of the larger projects in the pipeline included Metcash and Phoenix, both of which led to contracts.

[62] Market penetration reports were considered by the Board which indicated a target of 150,000 licences by 2015 was achievable. Promising marketing initiatives included Heartland Payment Systems, Bullseye Telecom ("Bullseye"), Earthlink and Phoenix.

[63] Live trials at a limited number of Chevron sites were underway. The full roll out was expected to start in mid-2013.

[64] At the end of 2012, the Phoenix contract was amended to 10,000 units by the end of 2015. The Phoenix pipeline had very significant revenue potential.

[65] In late 2012, Mako commenced a trial with Bullseye, a business-to-business telecommunications company operating out of Michigan. This led to a reseller agreement entered into in May 2013 to deliver a combined solution to Bullseye customers. Under this agreement the Mako product was on-sold to major United States businesses including Triton Management, Fisher Auto Parts and Title Max. By April 2014 the system had been installed at many of their sites.

Mr Frederick and Mr Frawley join the Board and Mr Gamble moves to the United States

[66] In December 2011, Messrs Michael Frawley and Douglas Frederick were invited to join the Board as independent, non-executive directors.

[67] Mr Frederick is a citizen of the United States and is resident there.[6] His background is in software technology and technology services having been involved in that field in various offshore markets, most notably, in the United States. He worked for the Boeing Company as a research analyst before joining the software technology

6 Mr Frederick's evidence was received in the form of an affidavit. He did not attend the trial, did not give viva voce evidence and did not file written submissions.

company BAAN as Executive Vice President in 1997. He served on the boards for BAAN subsidiaries in Israel and Japan. In 1999 he joined Electronic Data Systems ("EDS"), one of the United States' largest technology companies, where he was Executive Vice President responsible for some 80,000 staff and annual revenues of approximately USD 15 billion.

[68] Mr Frederick first met Mr Farmer in London in late 2009 after Mako had successfully obtained PCI-DSS certification. In the course of his discussions with Mr Farmer, he indicated that although he knew nothing about networking specifically, he could help facilitate the company's entry into the United States market through his contacts and experience in technology and IT. Initially, he provided consulting services to the company and later joined the Board of Mako Networks in June 2010. In December 2012 he was invited to join the YellowTuna board as its non-executive chairman and was elected to that position at the company's AGM in April the following year.

[69] Mr Frawley joined the YellowTuna Holdings board at the same time as Mr Frederick. He did so after returning from the United Kingdom having worked in the legal profession there for 25 years, notably as managing partner in a leading London law firm.

[70] In addition to Mr Frederick's influence in the lucrative United States market, it was decided that Mr Gamble should join him by relocating there to promote the Mako technology to other Silicon Valley technology firms. Mr Gamble and his family moved to the United States in March 2012.

Finances and cashflow

[71] The potential success of the initiatives discussed above, were not reflected in the company's balance sheet. In November 2011, the Mako group's income, as recorded in its financial statement for the year ended 30 June 2011, showed revenue of $4,780,446 against the previous year of $5,176,317 and a loss of $3,220,804, figures which starkly contrasted with the PPM's total revenue projection for that year of over $17 million.

[72] The Board minutes of April 2012 reflect the directors' understanding and consideration of Mako's cashflow position. The following are extracts:

> "**6. Current Cash Flow Forecast.**
>
> Paul [CFO] explained the workings of the current cashflow forecast for the Group to July 2012. It was noted that only sales confirmed and billed were included. It was noted that the Group had sufficient cash to the end of May 2012 but needed to close further sales by then to fund outgoings in June, July and beyond. [Mr Farmer] then discussed the sales pipeline below.
>
> **7. Current Sales Pipeline.**
>
> …
>
> The Board noted that [Mr Farmer] as CEO was reasonably confident that the sales pipeline was sufficient to enable the company to trade through August 2012. Subsequent larger sales will then be needed to enable the company to trade beyond this point. [Mr Farmer] emphasised that the business was still relatively high risk and large expected sales had to be realised by the end of May and beyond. The Board agreed it was a very fluid situation that required close management. It was agreed another Board meeting would occur on 29 May 2012 at 9:00 am NZ time to review the Group's solvency and cash flow position. In the interim [Mr Farmer] would send to the Directors a weekly summary of sales activity following Monday's management meetings."

[73] However, by the time the Board met in May 2012, the cash position was little improved as the following extract from the minutes reveals:

> "…[Mr Farmer] advised the Board that this Metcash contract was expected to be finalised on May 31st and funds expected to be received from either buy upfront volumes or leases will be used to repay the [Telecom Rentals] loan for this deal. A further discussion took place on the status of the Phoenix contract and possible timing of their next orders and receipts. The Board were reminded that the company had already borrowed under leasing contracts with [Telecom Rentals] for the entire 10,000 licences Phoenix have agreed to in their contract (4000) and subsequent purchase orders issued for the remaining 6000 licences that had been copied to the Board. [The CFO] advised the Board that current debt due to [Telecom Rentals] was approx $10.2m by [Mako Finance].
>
> [The CFO] advised the Board that the cashflow projection now showed sufficient funds through to late July 2012 but new receipts would be required from then onwards and this needed to be looked at in conjunction with the sales pipeline."

[74] Two months later the position had still not improved. The Board minutes for July 2012 reveal similar themes. These record that Mr Paul McGregor, the CFO:

> "…emphasised the monthly minimum cash requirements to meet salaries and opex was $700K and debt repayments to Telecom Rentals were building shortly to $500K. Without cash inflows from sales or other means, the group had insufficient cash to meet outgoings from early August and this built to a need for $5m of cash by the end of October to meet known outgoings growing by an additional $1.2m per month…
>
> …
>
> [Mr Farmer] emphasised to the board how tight cash flow was and that the best case was contracts would be closed and revenue received from customers…but the likely case was that further funding would be needed from Telecom Rentals
>
> …
>
> It was agreed for the record that the company was currently meeting its debts as they fell due but the next three to four weeks would need to be monitored carefully in the light of the payments that were coming up."

[75] The Board minutes for August 2012 record the Board's view that Mako had sufficient funds to meet expenses until the end of September. Mr Farmer expressed confidence that there were sufficient sales in the pipeline to cover any ongoing costs beyond that.

[76] The minutes for September 2012 record that Mr Farmer presented an updated cashflow analysis which showed that after additional funding arranged with Telecom Rentals, Mako had sufficient funds through to the end of October 2012. The directors then examined the likely short term cash receipts from Phoenix, the BullsEye trials, Telecom and BankServ/InfoGuard.

[77] The minutes for December 2012 record that Mr Farmer advised that Mako had sufficient cash to cover the period through to the end of January 2013. He expected another draw down from Telecom Rentals to carry the company through to February. Final negotiations with Phoenix over their next draw down of the inventory were underway and it was anticipated they would take 500 units with licences by the end of December 2012 and would formalise an increase in the contracted commitment to 10,000 as provided for in the purchase orders.

[78] The question of undertaking an Initial Public Offering ("IPO") was also discussed at the December meeting. The possibility of an IPO had been in the wings since the global significance of PCI-DSS certification first became apparent. Mr Farmer told the Board that information had been collected over the previous two months from merchant banks. He sought and obtained Board approval to proceed to the next stage which would likely include an independent market analysis by Mr Sidorenko, of Norcal Growth Partners ("Norcal") and the engagement of investment bankers, Cameron Partners.

Mako in 2013

Telecom Rentals

[79] Through to the middle of 2013 Telecom Rentals continued to assure Mako of its ongoing financial support. By email on 11 April 2013 Telecom Rentals confirmed that with an exposure to Mako of about $23 million it was prepared to provide an agreed "ceiling" of $35 million for the short to medium term.

[80] The Board minutes for June 2013 record the discussion around increasing the limit on the Telecom Rentals debt. The Board resolved to capitalise Mr Banks' loan to equity. The Board also resolved to enter into discussions with Telecom Rentals relative to the loan agreement.

[81] What no one on the Board appears to have appreciated at the time, is that any purported grant of security in favour of Telecom Rentals would be in breach of Mr Banks' rights under Agreement 1.

[82] On 28 June 2013 Mako Finance & Leasing, Mako Networks and Telecom Rentals executed a deed of assignment under which Mako Finance & Leasing assigned the Telecom Rentals rental agreements to Mako Networks, and Mako Finance & Leasing assigned the GSD between Mako Finance and Leasing and Telecom Rentals to Mako Holdings.

[83] On the evidence it seems that the agreement of 28 June 2013 was not the end of discussions between Mako and Telecom Rentals because, at a special meeting on

3 July 2013, the Board met to review and approve recommendations for the Deeds of Assignment relating to the funding restructure between Mako and Telecom Rentals. The minutes record:

> "Mr Farmer provided a summary to the Directors, explaining that a thorough review had been performed on the account. [Telecom Rentals] had a concern that the shareholder equity invested in the business was disproportionate to [Telecom Rentals'] risk exposure. The proposed lease construct would solve this matter with the assignment of the General Security Deed (GSD) from an operating company to the ultimate Holding company.
>
> …
>
> The Directors had a general discussion on the risks, business implications including cash flow, alternative financiers, the cost of the transaction and execution of forecast sales.
>
> Mr Farmer read out to the directors, Mr Frawley's email support for the resolutions…"

[84] Mr Frawley's email which had been sent earlier the same day to Mr Farmer and copied to the other directors said of this arrangement:

> "Good morning Bill
>
> As per our conversation I confirm that the proposed transaction is in my view "a no brainer".
>
> The transaction:
>
> 1.Rationalises and simplifies the arrangements between Telecom Rentals and Mako.
>
> 2.Gives Telecom Rental additional and identifiable security;
>
> 3.Improves in the short to mid term Mako's cashflow by substantially reducing its interest payments to Telecom Rentals. It will also hopefully result in an additional advance of $3m which will help with the expansion of Mako's business in the US.
>
> …
>
> So in short I support the resolutions.
>
> Regards
>
> Michael Frawley"

Agreement 2

[85] On 30 June 2013, Mr Banks and Mako entered into Agreement 2. The background to this follows.

[86] On 9 March 2013, Mr Banks emailed Mr Farmer indicating he would like to invest more funds with Mako. He suggested certain terms. Mr Farmer responded two days later. This led to an agreement in April which was superseded when Mr Banks found himself in a position to advance a greater sum. In May 2013, in performing his obligations under Agreement 2, Mr Banks advanced funds in two separate tranches; £237,722.43 on 15 May 2013 and £24,779.14 on 31 May 2013.[7]

[87] A month later, on 30 June 2013, Agreement 2 was recorded in writing. Mr Banks used the trading name Leopard Investments. He said he did this because he valued his privacy and did not want his real name recorded amongst Mako's creditors.

[88] The terms of Agreement 2 supplemented those in Agreement 1, additionally provided that all Mr Banks' advances (plus interest) due as at the date of the agreement would convert to equity in Mako on completion of Mako's listing on the New Zealand Stock Exchange ("NZX"). At the subsequent June Board meeting Mako's directors resolved to capitalise Mr Banks' loan, although noting that the shares would not be issued until any IPO.

[89] In his evidence Mr Farmer accepted that cashflow throughout this time was tight. However, it seems that two aspects of Mako's business gave the directors a sufficient level of comfort that the company would be able to continue to trade. The first were the various business opportunities sitting in the pipeline of which some, such as Chevron, were expected to be highly lucrative when realised. The other was the $35 million Telecom Rentals' loan facility which was being used as working capital.

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[7] Mr Banks actioned these two transfers on 14 and 30 May 2013 respectively but Mako did not receive the funds until each of the following days.

Initial Public Offering ("IPO")

[90] As noted, the possibility of an IPO had been under consideration from the early days. The minutes record its discussion from time to time. It was a topic of discussion between Mr Farmer and Mr Banks prior to Agreement 1 being entered into.

[91] In March 2013, Mr Farmer approached investment bankers, Cameron Partners, to advise the directors on the logistics of a potential IPO to raise capital of up to $25 million with a view to launching an IPO in the second half of 2013. On 22 March 2013 Cameron Partners provided the directors with a comprehensive nine page proposal which detailed a four step process towards Mako achieving an IPO. Cameron Partners' advice was that it was not appropriate for Mako to list on the NZX with any debt on its balance sheet, including the Telecom Rentals' debt. They thus recommended that as a first step, Mako should address that debt and where possible, capitalise it.

The Norcal Reports

Norcal Marketing Report (15 March 2013)

[92] In January 2013, Mr Farmer engaged Mr Paul Sidorenko ("Mr Sidorenko") of Norcal to carry out market research to ascertain Mako's long term prospects in the United States and other global markets.

[93] Mr Farmer and Mr Gamble had met Mr Sidorenko in the United States. He was, according to Mr Farmer, someone with an "in-depth knowledge of the specific market sector Mako operated in". In cross-examination Mr Farmer described Mr Sidorenko as "a talented salesperson and general sales consultant…a lawyer…[who] is very good at writing documents".[8]

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[8] Mr Sidorenko described himself in a second and later report as "…a business executive and attorney with over 20 years of sale & alliance management, business development and corporate development experience in the technology industry. As the former Vice President of Corporate Development for Clearpath Networks, Mr Sidorenko has had extensive experience with the market for cloud-based networks security, monitoring and management solutions and has engaged with many of the sales channels listed in Mako's pipeline. Mr Sidorenko was provided with unrestricted access to the Mako sales organisation, the Mako sales channel and supporting services."

[94] The resulting document dated 15 March 2013 ("the Norcal Marketing Report") is very detailed. It runs to nearly 40 pages. Mr Sidorenko undertook a comprehensive market analysis of the United States and other global markets for Mako products and solutions in network security, management and monitoring. Because Mako was anticipating further expansion into the United States market, Mr Sidorenko focused on Mako's potential in that region. The report which followed did not analyse the likely sales in the pipeline nor was it a formal valuation of the business.

[95] Notwithstanding, the Norcal Marketing Report concluded that the company was worth a multiple of eight to 10 times its revenue. Set out below are extracts taken from the executive summary:

> "**Competitive Landscape Summary** – Mako's competition ranges from small niche players to large, Fortune 50 companies. The competitive landscape can be segregated vertically in terms of customer size and horizontally in terms of solutions set. In the vertical realm, competitors are large enterprise players in the managed services and Unified Threat Management ("UTM") space that focused predominantly on the large enterprise market. These vendors offer bespoke security and network management solutions delivered by third parties. Due to their "up-market" focus, total costs of purchase, management, support and ownership for these vendors are uniformly not competitive with Mako. In the horizontal realm, competitors are primarily niche players specialising in managed security services, security appliances and software. While some of these competitors focus to varying degrees on Payment Card Industry-Data Security Standard (PCI), none have attained PCI certification and provide only partial coverage for the total requirements of PCI. In all cases, competitors are seeking to expand their ability to deliver a comprehensive suite of cloud-based storage, security and networking services and related business analytics that can leverage the services due to a growing consolidation trend favouring "one stop" solutions.
>
> **Valuation Analysis Summary** – As a rough guideline, valuations and/or market capitalisation for companies in the Network Management, Network Security and Financial Technology space range from 4 to 6 times revenue to 8 to 12 times revenue with Financial Technology companies historically valued at the lower end of this range. However, recent valuations for strategic players have considered booking run rates in addition to revenues and been edging upward for companies that have healthy bookings, demonstrated innovative solutions and have seen accelerated adoption by customers. A guideline of 10 times revenue can be justified for companies that are (1) growing quickly, (2) in an active sector, (3) with solid growth and defensible IP that is relevant to its differentiation. By this measure, an 8-10x revenue multiple for Mako appears justified based on its revenue growth, current pipeline, focus on sales operations, continued vitality of its core market, renewed investor focus on cloud management solutions and its protected intellectual property. Recent acquisition activity with companies in the cloud networking, management and security areas also support this multiple."

[96] Mr Sidorenko also undertook a SWOT analysis. Introducing this topic, he noted that the market analysis he had undertaken revealed that no single player dominated the market and that innovation was accelerating at an extremely rapid pace. Thus, he observed, it was imperative that Mako leverage its unique technology, IP and PCI certification to take advantage of the current market void of a "clear brand leader in this space".

[97] In terms of Mako's strengths, he referred to the unique and exclusive technological strengths the product had. As for weaknesses, he referred to a limited number of issues which included public IP address requirements, maintaining PCI compliance, remote access limitations and the fact that there was no current long term evolution ("LTE") certification. As for opportunities, he listed many, particularly in relation to potential markets. Of the threats, he noted market innovation from competitors, Mako's lack of recognition in the commercial market and Mako's inability to control the pipeline as the market evolved.

The Norcal Pipeline Report (1 July 2013)

[98] In April 2013, Mako retained Norcal to undertake further research, this time to conduct an independent analysis of the work pipeline identified in the Norcal Marketing Report. This was the "Norcal Pipeline Report".

[99] The Norcal Pipeline Report, dated 1 July 2013, recorded that it was prepared on the directors' instructions as part of Mako's continuing market due diligence. Its stated purpose was to provide an "objective and realistic assessment of opportunities being currently pursued by Mako's business development…teams in light of current sales activities, market conditions and end user buying preferences."

[100] The report was compiled from various sources; the pipeline considerations published in January 2013, interviews with business development managers in the sales regions, research into the opportunities listed in the pipeline reports, the development of a common assessment framework capturing the priorities identified by various industry business development managers, sales operations, and a scoring analysis which calculated the likelihood of success of each business endeavour as measured against objective criteria.

[101] The report summarised Mako's business and client pipeline as follows:

> "Overall, the pipeline reviewed for this report appears to be reasonably constructed with a high level of engagement in partner channels and a realistic approach to specific regional challenges. This overall assessment is bolstered by the accelerated sale progress that Mako has seen in 2013 in general and some specific customer wins that will enhance Mako's brand recognition in the future.
>
> …
>
> On balance, sales support resources that need to be expanded are pre-sales technical support, partner programs to encourage the inclusion of smaller channel partners…and improved marketing and sales execution collateral…Overall, demand generation activity, market profiling research and channel modelling needs to be expanded in order to proactively pursue additional sales opportunities and partner channels…"

Solvency test paper

[102] On 30 June 2013, an internally generated Board paper reviewed Mako's solvency. It seems the primary purpose of this exercise was to provide a going concern confirmation for Mako's auditors, Deloitte, for the purposes of the IPO. The report, prepared by management, applied the two-limbed test under s 4 of the Companies Act; the first being the cash flow test, namely whether the company is able to pay its debts as they become due in the normal course of business and the second, the balance sheet test, that is whether the value of the company's assets is greater than its liabilities, including contingent liabilities. The report noted that as at 30 June 2013 Mako's unaudited consolidated financial accounts reported an equity deficit of $8,667,000 and total liabilities exceeding assets by the same amount. The working capital deficit was $3.5 million. The Mako group had recorded a loss before tax for the year ended 30 June 2013 of $7,397,000 compared with the previous year's loss of $6,274,000.

[103] The two primary stated objectives of the paper were;

(a) "to demonstrate to the directors that the company had sufficient cash resources to meet its obligations in the normal course of business"; and

(b) "to provide the directors with adequate information to determine a "true and fair" view as to the value of [Mako] on a going concern basis, and

that this value exceeds the equity deficit and could potentially settle the outstanding liabilities of the Company…”.

[104] The paper concluded that Mako was solvent on the basis of the value of the work in the pipeline and the value of the business. It forecast revenue for 2014 at over three times the revenue of the preceding financial year.

Deloitte Planning Report

[105] On 6 August 2013, Deloitte prepared a planning report at the directors’ request for the year ended 30 June 2013 for the purpose of reviewing Mako’s accounts for a possible IPO. Deloitte listed the key areas of audit risk which were considered appropriate to bring to the attention of the Board for that purpose.

[106] Identified as an area of focus was whether Mako could continue as a going concern. The relevant part is reproduced in full below.

Focus area	Response
Going concern As at 30 June 2013 the (unaudited) consolidated financial accounts of Mako Networks Holdings Limited has an equity deficit of approximately $8.667 million and a working capital deficit of $3.476 million.	Consider and perform appropriate tests on the documentation prepared by the company to evidence and support the entity having the ability to continue as a going-concern. (We understand the business has adequate cash surplus ($3.9 million) as at 30 June 2013, plus additional liquidity via access to $35 million financing facility with TRL, currently drawn to $24.5 million as at 30 June 2013). Deloitte will review managements discounted cash flow model, including assumptions used in the model including support for the cash flows and the supporting contracts. Disclosure has been made in the notes to the financial statements and the audit report in relation to assumptions supporting the going concern basis and that Mako will require funding by way of securing future contracts and successful capital raising) to continue as a going concern.

Restated accounts for year ended 30 June 2012

[107] As part of Deloitte’s audit, it was discovered that Mako’s accountants, Duns Accounts Ltd had wrongly included anticipated forward sales from Phoenix as

revenue. The original accounts recorded Mako's positive equity position of $1,873,896 for the period ended 30 June 2012. As a result of Deloitte's intervention, the revenue was restated from $10.3 million to $4.6 million. Assets were restated from $17.1 million to $8.9 million.

Bell Gully instructions

[108] The same month Mako instructed solicitors, Bell Gully to provide legal advice and support in relation to Mako's proposed IPO. It was anticipated the work would involve due diligence, preparing and reviewing all relevant documents, assisting Mako and its investment bankers and providing general liaison services involving the NZX and the Financial Markets Authority.

The Weldon Report

[109] In mid-2013 Cameron Partners introduced Mr Farmer to Mr Mark Weldon, formerly the CEO of the NZX. The directors engaged Mr Weldon to undertake a review of Mako's organisational structure. In July 2013 Mr Weldon wrote to Mr Farmer setting out his proposal for a six-week project. As part of that plan he anticipated joining the Board. He also indicated he would personally invest between $1 million and $3 million in Mako.

[110] The resultant 37-page report was dated 7 October 2013. It described the purpose of the review as twofold:

> "1. Undertake for the Board an organisational assessment, including identifying current organisational strengths, weaknesses, opportunities and risks for the company; and
>
> 2. Develop a set of recommendation that will ensure Mako can manage its growth profitability (sic) and effectively, with the goal of creating the maximum shareholder value."

[111] In summary, the report's authors recognised that while Mako had one or two areas of "true distinctiveness (product and sales)" and was a "market disruptor" there were issues around its supply chain, capital and operations. The report stated that Mako's capital structure was highly risky with both current debt levels and the projected debt track being too high. This, the report stated, created two significant

risks; first Mako's ability to control its own destiny and secondly, how Mako could fund near term growth at an acceptable cost. Contributing to the working capital issues was what the report described as:

> "…an ad hoc organisation approach in the areas of inventory supply, customer delivery, contractual terms, pricing, internal budgeting and key operational metrics".

[112] It stated that while that situation might be appropriate for a small, simple business, it was not adequate for an international and complex business. The report noted that if Mako's debt was not kept under control, the company, despite its promising sales and pipeline could "grow bust". The report concluded that Mako was a company with some:

> "extremely world class aspects, and some aspects that are counter to that. What this means in practical terms is that the balance of the organization is critical to address. If addressed, the value realization potential will become realizable, tangible, and potentially quite large …"

[113] Mr Farmer gave evidence that the Weldon Report was tabled at Mako's AGM in October 2013. The minutes for the meeting record Mr Weldon's attendance.

Telecom Rentals raises concerns

[114] On 13 October 2013 Telcom Rentals' General Manager wrote to Mr Farmer expressing concerns over Mako's viability and warning that without a cash injection Telecom Rentals would have to consider halting further funding. In summary the advice from Telecom Rentals was:

(a) without Telecom Rentals' continued support Mako was technically insolvent;

(b) Mako's negative equity provided challenges when justifying further lending;

(c) the anticipated growth in Mako's revenue was unlikely to cover the loan repayments to Telecom Rentals let alone the company's overheads and working capital requirements;

(d) the likelihood of repayment of the sums owed to Telecom Rentals without restructuring or further equity was low;

(e) a cash/equity injection of $20 million to $50 million was needed by March 2014 to cover Mako's losses and working capital requirements; and

(f) without such an injection, Telecom Rentals might halt further funding leading to potential insolvency and/or conversion or sale of Telecom Rentals' debt.

[115] A few weeks later Telecom Rentals clarified its position. Mr Farmer was told that the reference to $20 million to $50 million of cash/equity by March 2014 was not a requirement to repay the debt by March 2014. Mr Farmer took this to mean that Telecom Rentals would continue to fund Mako until at least March the following year.

[116] However, that optimism appears to have been misplaced because shortly afterwards, in November 2013, Telecom Rentals refused to advance the $5 million Mako expected to receive that month, apparently because it wished to undertake an independent review of Mako's business. On the evidence, this came as a surprise to the directors. It materially changed the working capital position for Mako and a cashflow deficit was expected by January 2014.

Customers and marketing

[117] Despite the cashflow difficulties which Mako was experiencing in 2013, there were a number of positive trading aspects. Of these, the most notable was Chevron. The Chevron trials had successfully concluded and, as a result, in November 2013 Mako and Chevron entered into an agreement under which Mako would provide services to Chevron sites throughout the United States, initially 600 and forecast to reach 6,000. Further, British Telecom exceeded Mako's expectations with the Mako system being used for their Cardnet product.

[118] In his evidence Mr Gamble referred to other emerging, albeit less prominent customers. These included three major United States carparking companies.

[119] In a report to the Board in September 2013, the recently executed United States contracts were listed with forecasts for gross revenue. The report contained a table showing the link between sales forecast, inventory ordering and the working capital impact for cash payments to the supplier and the purchase receipt from the customer.

[120] The teaming agreement with Sprint Corporation ("Sprint"), a United States telecommunications giant and mobile network operator, had been executed which, based on the pipeline assessment, was expected to be worth $20 million over three years. The Sprint productisation agreement, which is discussed later, was also being advanced.

Mr Frawley raises concerns

[121] On 23 October 2013, before the latest advice from Telecom Rentals but after it had registered its concerns about Mako's solvency position, Mr Frawley wrote to the other directors raising concerns over the draft representation letter prepared by Mako's auditors, Deloitte. He pointed out that the draft required the directors to confirm that Mako had adequate resources to continue operating as a going concern for the foreseeable future. Mr Frawley questioned whether such a confirmation was possible in the light of Telecom Rental's indications. He concluded by saying:

> "I have seen nothing at this stage that would give me the requisite level of comfort to sign the letter as currently drafted but there may of course be a number of things going on behind the scene that I am unaware of."

[122] Mr Farmer responded the following day in a letter copied to all directors. Under the heading, "Going Concern", he said:

> "Even if [Telecom Rentals] stopped any further funding, current orders on hand or indicated will cover any short term cash requirements. Current deployments are strengthening improving the company's recurring revenue stream. Alternate funding of CPE and installations will materially benefit the Company's cash burn. Progress with three node sales is advanced and has been positively received with affirmations by each of the prospective customers that the catalyst for transition to that purchasing method is proof of business model.
>
> My assessment of the Company's position is that the going concern basis is appropriate albeit not without risk. My interpretation of the representation we are making is we have considered matters properly and that we have articulated that those risks exist and should not be discounted."

[123] It seems that these comments did not assuage Mr Frawley's concerns. The Board minutes of 30 October 2013 record:

> "Mr Frawley commented that the current forecasts didn't outline what would happen, it was the directors judgement at that particular point of time of what could be reasonably expected to happen based on their understanding of the business. The directors' judgement needed to be supported by good processes and relevant information. [Telecom Rentals'] email of 13th of October introduced uncertainty, which was clarified in their subsequent email of 27 October. The subsequent email confirmed that it was [Telecom Rentals'] intention to support Mako and any repayment of debt was at Mako boards discretion."

[124] Mr Frawley also commented that the Weldon Report identified issues which were not a surprise. It highlighted the need to concentrate on the structural and implementation issues.

[125] The minutes also record that all directors agreed, at that time, they had reasonable grounds to believe Mako could continue on a going concern basis until October 2014, but that the position would require close monitoring. Despite Mr Frawley's observations, the Board unanimously resolved to approve the audited financial statements of Mako Networks and approve the directors' representation letter. Mr Frawley seconded the latter motion.

[126] The following day, 31 October 2013, the auditors formally recorded:

> "Without qualifying our opinion, we draw attention to Note 12 in the financial statements, which indicates that the Group and [Mako Networks] incurred a net deficit of $7,683,000 and $137,000 respectively during the year ended 30 June 2013 and the Group has an overall net deficit in equity of $13,906,000. These conditions, along with other matters set out in Note 12, indicate the existence of a material uncertainty that may cast significant doubt about [Mako Networks] and the Group's ability to continue as a going concern."

Mr Frawley resigns

[127] Mr Frawley resigned on 29 December 2013. The events leading up to this are of some relevance. On 18 December 2013 Mr Frawley wrote to the directors observing that "realistic and resilient cash flow" projections were required. This was followed three days later by a further email in which he commented that he did not believe Telecom Rentals was "setting up [Mako] for a cheap takeover". He pointed out that

the accounts and cashflows provided by Mako showed that the company was technically insolvent in that its liabilities exceeded the value of its assets and that it would be unable to pay its debts in January 2014 if further funds were not received. He concluded by stating:

> "It is fairly clear to me that [Telecom Rentals] are facing a substantial loss and their best option will be to work with us on finding a solution. This means that it is in everyone's interest for us to cooperate with them and if we fail to do so they will have no option but to assume that we have something to hide."

[128] On 25 December 2013, Mr Frawley emailed the directors noting, amongst other comments:

> "The cash flow that is presented to [Telecom Rentals] should be limited to transactions that we know are going to actually happen. It should not include the Highwire scenario, third party investors or sales where a binding contract is not in place."

[129] Four days later Mr Frawley formally tendered his resignation. He cited his reasons as two-fold; first, the concerns outlined in his letter and secondly, the amount of time he was spending on Mako matters. In summary, Mr Frawley said that his primary concern was that the credit line from Telecom Rentals kept increasing and effectively funded the company's working capital. He said Telecom withdrew the facility because it had concerns over its security. Mr Frawley said that he suspected Telecom Rentals did not have a proper appreciation of how Mako was using the facility, a position aggravated by the company's inadequate systems and procedures. Mr Frawley observed that because Telecom Rentals was Mako's biggest creditor, the Board and the directors had a duty to ensure that Mako's trading did not cause them or other creditors serious loss. Telecom Rentals' exposure was significantly more than the value of the assets they had purchased and rented back. He observed that they were facing a large shortfall. He suggested that Telcom Rentals and KordaMentha be given copies of the Weldon and Norcal reports "…because those documents provide a good insight into the challenges faced by the company and its potential especially in the US market". Mr Frawley's concluding comments were:

> "I would like to conclude by saying that none of my comments are aimed at anyone personally and I hold all the Board members and in particular [Mr Farmer] in the highest regard. I also think that the company has huge potential and with the right partner(s), strategy and structures it should achieve it."

Telecom Rentals restructures debt

[130] According to Mr Farmer, the first indication Telecom Rentals was wavering in its commitment to Mako and that it would not advance further funds until and/or unless Mako provided it with a cashflow forecast and financial statements was at a meeting on 26 September 2013. This was followed up by the 13 October 2013 email. Mako had been relying on Telecom Rentals' continued support and assurance that it had a debt ceiling of $35 million.

[131] Telecom Rentals decided all further advances would be suspended until KordaMentha had undertaken an independent review of Mako's business, a position which Mako's directors and legal advisors regarded as unlawful. As a consequence, in late December 2013 Mr Farmer and Mr Frederick together injected approximately $1.1 million of their own funds into Mako to meet its immediate cashflow requirements.

[132] Throughout January 2014, negotiations continued. Mako took professional advice from accountants Lynch & Associates and solicitors, Bell Gully, on whether it could continue to trade.

[133] In late January 2014, Telecom Rentals and Mako reached agreement on a new loan restructure to convert the outstanding debt into a table loan with a five year-term and a two-year repayment holiday. The restructure was formalised on 7 February 2014. Mako agreed to sell Telecom it's New Zealand business (SecureME) for $3 million and Telecom Rentals agreed to a two-year repayment holiday with repayment, including interest, to be paid from 2016 over a three year term. Telecom also agreed to advance Mako a further $2 million.

[134] However, before the agreement could be executed by Mako, it required ratification by the shareholders.

[135] On 5 February 2014, Mr Farmer sent an email letter to all shareholders, including Mr Banks, inviting them to a special general meeting ("SGM") by Skype.

The letter attached a copy of the agreement and a draft resolution. The relevant parts of Mr Farmer's explanatory letter are set out below:

> "Dear Shareholders
>
> As you will see from the attached documents the last six weeks have been a challenging time for the Board and Management of the Company as we have dealt with the severance of funding to support the business from Telecom Rentals. Circumstances have changed on literally a daily basis from one where the Directors have had to consider various options as cash reserves have been depleted.
>
> Ultimately we have come to an arrangement with Telecom Corporate for a Sale of the SecureMe business to Gen-i and a complete restructuring of our current debt arrangement. This agreement was finally reached on Monday and full Documentation received last evening.
>
> Further to this, the Management have completed a comprehensive review of all expenses in the business and initiated a major restructuring of the same. This will result in a significant reduction in personnel in research and development and absolute alignment of sales resources to take advantage of the opportunities in the US and Australia with the UK being covered by Phoenix Managed Networks.
>
> To complete the arrangements agreed with Telecom I am requesting an urgent Special Meeting is convened to discuss and if agreed approve the transaction as outlined in the Draft Resolution attached. I realise this is very short notice but time is of the essence with funds depleted.
>
> …
>
> Should you not be available for a call and wish to vote on the Resolution could you please reply to this email with a note in the subject line – VOTE IN FAVOUR, VOTE AGAINST or ABSTAIN.
>
> …
>
> Many thanks for your urgent attention. I look forward to closing this chapter and moving forward to take advantage of the opportunities in front of us.
>
> Kind regards
>
> Bill"

[136] The resolution was ratified by the shareholders. Although the arrangement with Telecom Rentals provided a two year breathing space before repayments commenced, the cost to Mako was significant. Mr Farmer described it as "gut-wrenching". Mako's staffing complement was slashed by 55 per cent; half the

research and development team as well as administrative and operational staff were made redundant.

Agreement 3

[137] As Mako was negotiating with Telecom Rentals over late 2013/early 2014, Mr Banks indicated to Mr Farmer that he had more funds to invest. A description of the events leading up to Agreement 3 follows.

[138] On 15 November 2013, by email, Mr Banks responded to what appears to have been an earlier approach by Mr Farmer to meet up. He said:

> "If [the IPO] happens, great, if not, I'll simply assume that I'll have big smile post-float.
>
> I don't have any mortgages but if you ever needed me to apply for one and provide Mako with liquidity I'd be happy to. I know you said you don't need this but I just wanted to remind you that I'm here to do whatever little I can for Mako."

[139] Mr Farmer responded:

> "Adam
>
> With the opportunities building in Oz and the US we may look to list earlier and require extra capital to ramp up as quickly as we can. This could also play a little better into your hands with a more robust story and greater opportunity of uplift.
>
> Could I ask you if you were to provide further capital what level you feel comfortable with.
>
> Many thanks
>
> Bill"

[140] The Board minutes of 24 December 2013 record undertakings from Mr Banks and another creditor, Mr C,[9] for cash injections of $500,000 and $200,000 respectively, conditional on Mako undertaking an IPO in the near term. Mr Farmer noted that any potential investors would need to be advised of the Telecom Rentals' situation and he

[9] The investor's name has been anonymised for privacy reasons.

would thus need to advise both Mr Banks and Mr C not to advance the monies they had pledged due to the change in circumstances. The minutes record:

> "Mr Frawley supported this position and added that any investor with knowledge of a distressed financial position would heavily discount the value of the company. Further, there was a substantial risk that the discussions with these investors could expose the Board and the company to a claim if it was found to be misleading."

[141] Mr Farmer emailed Mr Banks later that day advising him to "…hold off on transferring funds to Mako at this time" and promising to get back to him when "…we are all clear to accept the same."

[142] Approximately a month later, on 21 January 2014, Mr Farmer emailed Mr Banks asking him how he was placed to catch up, adding that there were "Some real challenges at the moment but will talk through".

[143] The following day, 22 January 2014, Mr Farmer advised Mr Banks by email that:

> "Things are really challenging at the moment with [Telecom Rentals] suspending our funding facility just before Christmas. We have been working day and night for solutions and whilst there are options it is not certain at the moment."

[144] Mr Banks had not attended the Skype SGM. Nor did he respond in any way to Mr Farmer's explanatory letter of 5 February 2014. It was not for another fortnight, on 9 February 2014, that he responded. Mr Farmer suggested they meet the following week. Mr Banks replied:

> "It's a shame that we had to panic-sell that business chunk. Will the IPO cash eliminate the reliance on a credit provider?
>
> I hope that you have put out the fire and things have changed such that if I put my $500K in now it would be as safe as my existing money was 6m ago."

[145] He made no comment on the issue of Mako giving security to Telecom Rentals.

[146] Mr Farmer met with Mr Banks on 4 March 2014 and the following day, sent him the shareholder's agreement. He told Mr Banks that he felt the best option for Mako would be for Mr Banks or his nominee to become a Mako shareholder. This

advice was consistent with the observations of Mako's professional advisors, particularly Cameron Partners and Mr Weldon, that debt should, where possible, be equitised. He asked Mr Banks to review the attached shareholder agreement.

[147] On 8 March 2014, Mr Banks responded that:

> "The agreement looks good. Let's do this when you're ready".

[148] However, a week later, on 16 March 2014, Mr Banks wrote:

> "I've had some 2nd thoughts. Our arrangement was that I'm a creditor and the debt increases by 10%/y. We then entered into an agreement that stated that the debt would cease to increase and I'd get a share price discount. I was looking forward to things happening as per that agreement and am used to agreements being adhered to unless both agree to dissolve them. Unfortunately that agreement has been effectively dissolved without my say. Circumstances have changed so I guess I'm okay with that. One would imagine that we would revert to how things were before but it seems we are keeping just one part of the agreement: the part re the debt ceasing to increase. If you can find the time I'd like to sort this out before handling the below."

[149] Mr Farmer responded the following day with:

> "Just so we are on the same page the public offer shareholding was $100m less the discount whereas the current proposal is at $50m with the expectation of a better upside."

[150] On 18 March 2014, Mr Banks replied:

> "I was happy not having my money grow in exchange for a discount. I now have the option of buying in @ $50m but it seems that that is something that any investor has the option of doing for a while: on 29.11.13 we chatted about the then latest capital raising of $5m. You said that we would use the same valuation as was used in the capital raising before that: $50m.
>
> If I have misunderstood sure perhaps we should chat. Maybe there's a simpler way of looking at it: you've already done some leg work re the IPO and ascertain that the market was prepared to buy in @ $100m. If that's true then I'm getting a great discount and I'd be happy to buy in (to keep things simple we'll forget about the extra $500k)."

[151] On 24 April 2014, Mr Banks advanced $500,000 to Mako. No written agreement was ever executed.

[152] Following this, Mr Farmer updated Mako's share allocation to reflect that Mr Banks was a shareholder although no shares were ever actually issued to him and the debt of accession was never executed.

Mako in 2014

[153] By February 2014, with the Telecom Rentals debt restructured, the immediate pressure on the directors was, to some extent, relieved. The company had received $5 million in cash from Telecom Rentals and no repayments of the debt or interest were due for another two years. Additionally, there were a number of promising and, potentially, highly lucrative deals on the horizon.

[154] In the Board minutes for March 2014, Mr Farmer reported that a statutory demand for USD 271,365.30 served by GPC Electronics, one of Mako's suppliers, was no longer being pursued by the creditor. He also referred to a meeting he and Mr Frederick had with Telecom's CEO, Mr Simon Moutter. This was to the effect that Telecom's original intention had been to place Mako into receivership but the potential disruption of the SecureME business had dissuaded Telecom from adopting that course. Telecom advised that the restructure was a "one time deal" and if Mako came back "with no money receivership is the only option". The Board meeting then went on to consider various capital raising options before Mr Gamble gave a sales update for the United States market.

Sprint

[155] One of the most promising prospects identified in the pipeline at this time was Sprint. The detail of this opportunity is discussed later, but in summary, in September 2013, Mako entered into the teaming agreement under which Sprint was to make the Mako system available to its customers and promote the product. The expected value to Mako over three years was approximately $20 million. The product agreement referred to in the minutes would have the Mako system rolled out to tens of thousands of sites. That deal was estimated to be worth approximately USD 42 million over two years. Negotiations continued well into May 2014 before Sprint unexpectedly withdrew.

D&S Communications

[156] There were, however, other business opportunities being considered by the directors around this time. In July 2014 discussions with D&S Communications ("D&S") led to the execution of a distribution and supply agreement under which D&S contracted to provide all logistics for the supply, installation and servicing of Mako's hardware at Chevron's sites. Under this arrangement Mako could receive much needed cash in advance for the business it secured from Chevron.

Goldman Sachs

[157] In the meantime, the directors were actively exploring options for the recapitalisation of the company. A private equity firm was engaged to assist. Through them the directors were introduced to Goldman Sachs. Due diligence was commenced. On 25 September 2014 Goldman Sachs put a proposal to the directors which was that the Telecom Rentals' debt should be equitised with equity splits of 10 to 15 per cent for management, 5 per cent for existing equity investors and 60 to 70 per cent for a new investor. Over the following weeks there were discussions between the parties, but in late October the Board rejected the offer although agreeing to maintain contact with Goldman Sachs.

BP North America

[158] In September 2014 Mako was approached by BP Products North America Inc ("BP") to install the Mako system in all its retail sites throughout North America. The potential for Mako was massive. In October 2014 Mako was advised it was the preferred provider and was invited to enter a Master Services contract. At the time it was expected contractual negotiations would be completed by late November, with trialling in January 2015 and roll-out to 7,200 sites in April 2015. The likely gross revenue for Mako generated over three years was expected to be in the order of $8 million to $16 million. D&S would pre-purchase the hardware and licences from Mako to provide the working capital to fund the roll-out.

[159] Discussions about a possible merger with D&S continued. A business continuity agreement was entered into to give BP some assurance Mako could deliver its system if the contract went ahead.

Mako in 2015

[160] Despite the earlier indications, the contract with BP was not formalised until 10 June 2015. In his evidence, Mr Farmer expressed how frustrating it was to him and the other directors at what seemed to be inexplicable delays on the part of BP over the first part of 2015 in getting the contracts executed. These delays had consequential practical effects. In particular, it delayed Mako's ability to roll out the product to thousands of BP sites.

[161] In the meantime, the merger discussions with D&S continued. As part of that process D&S also discussed with Telecom, albeit ultimately unsuccessfully, the possibility of it buying out Mako's debt to Telecom Rentals for $5 million.

[162] By August 2015 the chronic cashflow issues which had plagued Mako again came to the fore. D&S advised that due to their own financial constraints they could no longer pre-purchase the hardware and licenses. This effectively frustrated Mako's ability to perform its obligations to BP. Without working capital the roll-out was impossible.

[163] At a Board meeting on 19 August 2015 the directors determined that without further sources of funds the company's cash position was such that it was not viable to continue to trade. Mako was placed in liquidation and the directors invited Telecom to appoint receivers.

Post-receivership events

[164] KordaMentha were appointed receivers on 21 August 2015. The Mako business, which was essentially its IT, was ultimately sold to D&S for approximately $2.5 million.

[165] D&S has gone on to successfully roll out the Mako system to BP. The Chevron contract was successfully renegotiated. The business, still trading as Mako, now operates out of Chicago. Mr Gamble is its president. It has been highly successful. Discussions are underway for Mako's technology to be rolled out to BP globally. According to Mr Gamble, Mako continues to increase its market share to the detriment of its much larger competitors.

DEFENCE APPLICATIONS FOR POST-TRIAL PRODUCTION ORDERS AND TO RECALL MR BANKS

Introduction

[166] This section of my judgment relates to post-trial applications filed by the defendants seeking the delivery up of certain electronic devices in Mr Banks' possession and the defendants' consequent application to recall Mr Banks and adduce further evidence after the close of evidence.

[167] It is dealt with at this point because my findings on this issue and, in particular, my findings on Mr Banks' credibility, assume relevance to my determinations on certain aspects of the causes of action, particularly those under the Securities Act and the FTA.

Background

[168] On 27 September 2019, two months after I had heard final submissions and reserved my judgment, Mr Hollyman filed an interlocutory application. He sought orders that Mr Banks deliver up to an independent expert any and all electronic devices which might have stored emails sent to or received from the account chris1astro@zoho.com, ("the Zoho address"), operated by Zoho, an email service provider based in Austin, Texas.

[169] The emails in question had attracted a modest level of prominence in the trial, particularly in the context of the defendants' affirmative defence that Mr Banks was a habitual investor or a person whose principal business involved the investment of

money, thereby ousting the application of the Securities Act.[10] The evidence disclosed that Mr Banks had deposited sums exceeding $500,000 in trading accounts with CMC Markets ("CMC") and Vantage FX Pty Ltd ("Vantage FX") in September 2011 and March 2012. His explanation for these deposits was that they were not actually investments, but rather they were made in connection with a research project operating out of the University of Auckland's Business School.

[170] The existence of these emails was first disclosed by Mr Banks to the defence when his evidence was served in advance of the trial. In his brief, Mr Banks specifically addressed these deposits. He said he was approached by a Mr Chris Nuves ("Mr Nuves") on 16 August 2011. Mr Nuves asked him if he wanted to be part of a group researching the utility of software relating to "…people, money and/or online shopping". Mr Banks claimed the project was not about share trading. He said he did not use the software. His involvement was limited to crediting money to those accounts to enable the research group to analyse the software features. According to Mr Banks he deposited the money and was later repaid together with a small amount of interest earned in the CMC account. He said that he felt safe contributing the money because he had previously vetted Mr Nuves and "…he seemed like a respectable person".

[171] The 20 or so emails were produced to support his claim. All are relatively brief and their content generally banal. Taken at face value they do, however, confirm the existence of Mr Nuves' and Mr Banks' involvement in a research project of the sort he claimed.

[172] It was not until some weeks after the trial had finished that questions around the provenance and authenticity of the emails and the Zoho address first surfaced. The emails were originally discovered in PDF format with Mr Banks' brief of evidence. Shortly before the trial started, Mr Farmer's solicitors requested "native" electronic versions of the emails. Mr Banks' solicitors responded the same day by attaching a Zip folder which contained .msg files of the emails.

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10 Statement of Defence dated 17 June 2019 at [117(3)] to Amended Statement of Claim dated 18 April 2019, relying on the affirmative defence in s 3(2)(a)(ii) of the Securities Act 1978.

[173] On receiving these, Messrs Gamble and Massam undertook a simple, presumptive test to see if the Zoho email address existed. This they did on 2 July 2019 by running a "recipient" test against Zoho's mail servers. They issued a command to the mail server indicating they wished to send an email to a particular address. The way the server responds will indicate whether or not the email address actually exists. Mr Massam issued a command that he wanted to send an email to chris1astro@zoho.com. The mail server replied that there was no such email address in use. Messrs Gamble and Massam then examined the emails more closely. They observed features which they regarded as "very strange".

[174] They then made enquiries with Zoho's helpdesk to ascertain whether the Zoho address existed in August 2011. Zoho replied that it had no records of any such account and suggested that a personal account be set up with that email address to see if it was available. Mr Massam followed this advice. He received a "welcome" email from Zoho which also indicated that the Zoho address did not exist. Enquiries were then made with the technical support engineer at Zoho, Mr Eric Nogelmeier. He reviewed Zoho's records and confirmed there was no record of the Zoho address existing between August 2011 and March 2012, being the date range of the emails. The defence then engaged Mr Willem Cronje, an expert in forensic computer investigations, to examine the emails. Mr Cronje's initial opinion was that the emails' authenticity was questionable. This was because there was standard content missing from the header sections and the time stamps did not reflect the change to daylight saving time.

[175] The defence's application to produce was opposed by Mr Banks, first on the ground of want of jurisdiction and secondly, whether any evidence derived from an examination of the devices would materially add to the evidence or assist the Court on any question in issue.

[176] I allowed the application and made orders requiring Mr Banks to deliver up the devices and password. I also made orders that the computer forensic experts engaged

by Mr Banks and the defendants were to provide reports and made associated timetabling orders.[11]

The evidence

[177] A joint statement was filed by the respective experts, Mr Campbell McKenzie for the defendants and Mr David Harris for Mr Banks, in which they agreed on the following:

(a) no email containing the Zoho address for 2011 to 2012 was located in either the hardware or Mr Banks' Gmail account;

(b) no contact record with the name Nuves, Nooves or Noovs was located for the entire Google account nor was the Zoho address attached to any contact; and

(c) the Zoho emails had very little header information and were missing much of what would be expected in standard email header data. There is no means to verify the authenticity of these emails.

[178] Mr Banks made two affidavits[12] and later served a brief of evidence. Affidavits were also filed by Mr Nogelmeier, Mr Cronje, Ms Banks, Mr Ben Castelow (who is Mr Banks' sister's partner), Mr McKenzie and Mr Harris.

[179] On 5 and 6 October 2020, the trial was re-opened for the purpose of receiving further evidence and submissions on the question of the authenticity of the emails and related issues. Oral evidence was given by Mr Nogelmeier,[13] Mr Harris, Mr McKenzie, Mr Castelow, Ms Banks and Mr Banks. I also received oral submissions from both counsel.

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[11] *Banks v Farmer & Ors* [2019] NZHC 3415.
[12] 1 November 2019 and 15 November 2019.
[13] Via AVL link.

Discussion and findings

[180] It is not necessary for the purposes of this judgment to traverse the evidence and submissions in detail. I have come to the conclusion that I do not accept Mr Banks' explanations that the funds he advanced to CMC and Vantage FX were to support the research project as he claims. I am satisfied, having regard to all the circumstances, that the emails were created by Mr Banks at some point after these proceedings were commenced for the purpose of supporting his false explanation for the CMC and Vantage FX deposits. My reasons follow.

[181] First, there is Mr Nogelmeier's evidence which first led Messrs Massam and Gamble to suspect the authenticity of the emails. This was that Zoho could find no record of the Zoho address existing between August 2011 and March 2012. Furthermore, had there been such an address, Zoho would have had a record of it. Zoho's records show that the address was first created in July 2019 by Mr Massam in the course of his preliminary enquiries. Mr Nogelmeier maintained this position under cross-examination, confirming that Zoho kept a log of accounts which had been opened and closed and that he had personally checked those records.

[182] Secondly, the experts' evidence was that the only versions of the emails they could locate in Mr Banks' Gmail account were attachments to emails created in 2019, presumably for the purposes of the litigation. They could not locate any of the emails dated either 2011 or 2012. Furthermore, despite searching Mr Banks' entire Google account, they discovered no contact record with the name Nuves or similar. The Zoho address was not attached to any contact. The experts were agreed that there was no means to verify the emails' authenticity.

[183] Mr Harris, a software expert in the production and processing of electronic mail, analysed the emails and concluded that the lack of detail in the headers is such that they could have been created in any number of ways and at any time. He said they had no probative value as evidence of communications between Mr Banks and Mr Nuves at the times claimed and everything which may have permitted such a confirmation is missing. Furthermore, there is no valid reason why an extractor programme would remove message ID headers. The messages contain aspects which

are specific to the Microsoft mail environment which is unusual because Gmail does not use Microsoft hosting infrastructure. Mr Banks was unable to explain this. Also of significance, is that several of the messages contain a header which refers to Microsoft Outlook, which did not exist until 2012. I place less weight on Mr Harris' evidence that it was unusual that all of the .eml files contained a time zone stamp of +0000. Mr Harris observed that unless the messages were sent from London, he would not expect to see such a time zone stamp. As Mr McKenzie observed, the time stamps were displayed differently across different versions of the files and might simply reflect the tools which the experts used.

[184] Mr Harris also placed some reliance on the fact that three of the 28 messages have different dates but exactly the same time, literally to the second. He said that while this might be theoretically possible, he believed it to be an extremely unlikely coincidence given the small sample set. Despite Mr Johnson's submission that this evidence should not be afforded the emphasis Mr Harris gave it because it is unknown how many emails Mr Nuves sent or what time of the day he sent them, I am of the view there is force in Mr Harris' observation on this point.

[185] Thirdly, in their joint expert report, Messrs Harris and McKenzie agreed on the following:

(a) the emails are not in the format they would consider to be "original" emails; rather they contain text that resembles an email message;

(b) the emails could have been extracted using add-ons and scripts; and

(c) even if Mr Banks extracted the emails as he claims, it would also have been possible to edit them at a later stage.

[186] Fourth, and independent of the expert evidence, Mr Banks' account of how he became associated with Mr Nuves and the research project is inherently implausible. While I accept Mr Johnson's submission that Mr Banks has "an unusual personality" I do not accept that he is naïve or that he lacks "the guile to forge emails and then attempt to keep the evidence of that hidden" as was submitted. To advance more than

$500,000 to support research into the utility of software to assist a man who is virtually unknown to him stretches credulity even when generous allowances are given on account of Mr Banks' unusual presentation.

[187] Fifth and relatedly, while there is no onus on Mr Banks to prove Mr Nuves' existence, it is most surprising that there is such a dearth of evidence beyond the emails themselves and Mr Banks' evidence, of Mr Nuves. Mr Banks, in an affidavit filed in opposition to the defendants' application for production orders, stated:

> "Over a period of months I've tried to find Chris Nuves but I have not been able to. I think one difficulty is that "Chris Nuves" may not be his legal name."

[188] This statement is most surprising for at least two reasons. First, in his evidence at the trial Mr Banks had said he felt comfortable lending such a large sum to Mr Nuves' research project because he had vetted Mr Nuves and he seemed "like a respectable person". And yet when undertaking a similar exercise for the purpose of the recall application, he was unable to find him or, it seems, any reference to him. Secondly, on the face of the emails, Mr Nuves held more than three teaching positions and more than six treasury positions. He apparently handled donations from the public and worked in a Hobson Street office. Some of the emails bear what appears to be his mobile phone number. The fact that in late 2020 Mr Nuves apparently had no internet presence and could not be located despite his apparent prominence in university circles, simply compounds the difficulty in accepting Mr Banks' account.

[189] Sixth, I do not accept that Mr Banks did not, at the relevant time, possess the necessary electronic skills to create the emails as he claimed. In his brief of evidence, he stated that he had studied papers in computing. In the context of the Nuves emails he said he participated in the research programme because he was interested in software and its usability and wanted to increase his experience in software analysis. He also described himself as "…good at identifying faults and things that could be improved in software". These observations, together with other aspects of his evidence, reveal not only an interest and apparent competence in software and IT systems, but also a practical ability to apply those skills. It cannot be said that Mr Banks lacks skills in this area.

[190] Seventh, I consider that the circumstances in which the emails were disclosed assumes some relevance when viewed in the overall context of this case. Mr Banks said he located the emails in a box "of old academic materials" in the course of locating documents in response to Associate Judge Smith's discovery order. Quite apart from the question as to why he would have printed off and separately stored hard copy versions of such innocuous correspondence, I regard it as significant that the existence of the emails was first brought to the attention of the defence when Mr Banks' brief of evidence was served, shortly before the trial commenced. When asked why his affidavit of documents did not include the emails, Mr Banks appeared to suggest that the relevant discovery orders related to shareholdings and investments and had nothing to do with the software research project or the Nuves emails. In this regard I also consider it significant that Mr Banks claimed he deleted Mr Nuves as a "frequent contact" in his gmail account when he discovered it on 24 September 2019, that is after he had notice that the authenticity of the emails was being questioned. The inherent implausibility of his explanation is apparent from this extract taken from his affidavit:

> "**Inquiries I made since this issue was raised**
>
> 25 After Mr Farmer indicated that he was planning on filing this application, on 3 September 2019 I decided to check the flash drive's functionality. I did this by moving a few files on and off the drive.
>
> 26 On 24 September 2019 I was looking through my Gmail account for anything relating to Chris and noticed and that his email address appeared in my 'Frequently contacted' list. A screenshot showing this is annexed…
>
> 27 After I took this screenshot, I decided to add Chris' name to the entry (thinking that this might reveal more information about the email address).
>
> 28 When I did this, Google automatically moved the entry to the "Contacts" list. I did not want to have disturbed the original entry, so I deleted it from the "Contacts" list, thinking that it would reappear on the "Frequently contacted" list. It did not."

Credibility findings

[191] For the reasons listed above I simply do not believe Mr Banks' account relating to the existence of Mr Nuves, the research project and the explanation for his substantial investments in CMC and Vantage FX. However, the effect of this finding

extends beyond the relatively narrow issue of Mr Nuves' existence and the habitual investor category exception. It is directly relevant to wider credibility determinations relative to both Mr Banks and Ms Banks. My reasons follow.

[192] First, Mr Banks. Mr Johnson submits Mr Banks was a nervous witness who was attempting to be helpful but has a precise and literal approach to the use of language. Having seen and heard him giving evidence over several days, both during the trial and the recall hearing, I cannot agree.

[193] Far from striking me as nervous, Mr Banks was, throughout much of his evidence, evasive, defensive and unco-operative. He exhibited no sense of nervousness or deference to opposing counsel. I found him to be a most unimpressive witness whose lengthy and often circular responses, even to the most straightforward of propositions, did him no credit. He made few, if any, concessions, even when such a course was plainly called for. At times during his cross-examination, it was evident he was highly suspicious of the line of questioning and pre-empted his answers in anticipation of where he believed Mr Hollyman was heading. At other times, his responses to Mr Hollyman's questions were conveyed in an artificially literal fashion. It was clear he understood the gravamen of the question but was determined to obstruct counsel's ability to obtain an answer to the proposition posed. On occasions he challenged the relevance of lines of questioning or otherwise attempted to evade answering. There are examples too numerous to list. I shall refer to just a few.

[194] In the course of cross-examination Mr Banks was asked if he knew anyone called Isabel Fish. He said he knew an Isabel Fish but it was spelled differently and that person did not have a dance studio business.[14] It was put to him that Isabel Fish was his partner at the time. He denied this before adding that he had never met an Isabel Fish with a dance studio. He said "I'm very confused by this…I'm trying to grasp at some reality here, I'm not seeing any reality". Mr Hollyman referred him to

[14] The reference to a dance studio arose from a passage in Mr Farmer's evidence which Mr Hollyman had earlier referred to Mr Banks where Mr Farmer had said that Mr Banks had told him he spent most of his time researching investments and assisting his partner, Isabel Fish, with her dance studio business.

an email he had sent to Mr Farmer from an email address in the name Isabel Fish. Mr Banks replied:

> "A …Well actually, if you want to be pedantic, which I think you are, the label in the "From" field says "Isabel Fish", there's no email address there and, of course, anyone can type in any label but I don't think that's relevant. Do you want to talk about the body of the email?
>
> Q No, I want to talk about Isabel Fish.
>
> A Okay, sure
>
> Q Mr Banks, because are you denying Isabel Fish was at the time your partner who ran the dance study (sic)?
>
> A So, I am not sure how much I can repeat myself for a fifth time…"

[195] This tortuous exchange prefaced the next two-and-a-half pages of the notes of evidence during which Mr Banks did all he could to evade and frustrate Mr Hollyman's questioning. He challenged the relevance of the questions to such an extent I was required to intervene and direct him to answer. He attempted to obfuscate by focussing on differences in the spelling of the name being "Isabel" or "Isabelle" and suggested more than once he knew no one of that name who ran a dance studio. Finally, after some 23 question and answer sequences, Mr Banks accepted his former partner was called Isabel Fish and she had run a "drama academy".

[196] Another example of Mr Banks' less than frank assertions emerge through his communications with Mr Farmer during the negotiations which preceded Agreement 1. This relates to the legal advice he claimed he was receiving. On 17 January 2011, having received the draft loan documents from Mr Farmer, he emailed Mr Farmer saying that his lawyer, "Grant", had reviewed the contracts, adding that he had expected him to have only some minor adjustments but, unfortunately he had:

> "…a lot of reservations but I hope we can find a compromise. He thinks that there is inadequate creditor protection and is hoping that you will offer more. I have drafted the below which I expect will make him happier."

[197] He then set out the suggested amendments before adding that Grant thought he should ask for a personal guarantee and that once the parties had agreed on the terms "…Grant would like to convert the contracts to deeds of debt". He suggested that Grant would probably also want security. Then, on 25 January 2011, Mr Banks sent

Mr Farmer an email including further, suggested, amendments to the agreement adding that "Once we are happy I'll show it to my lawyer who hopefully will consider it to be as good as the deed of debt that he recommended then your lawyers can take it from there". This was followed by an email on 28 January 2011 in which Mr Banks set out what he claimed were comments from his lawyer. In fact, Mr Banks did not have a lawyer. In cross-examination, he accepted that Grant, who he named as his lawyer, was in fact a law student by a different name whom he had spoken to at three parties. From Mr Farmer's perspective the emails conveyed the wholly false impression that Mr Banks was working closely with his solicitors. While the motive for this subterfuge is unclear, it is an example of Mr Banks' facility for bending the truth.

[198] There were also other, miscellaneous aspects to Mr Banks' evidence where his explanations were prolix and unconvincing. These include his description of his main occupation being "property landlord in the UK" in an Immigration New Zealand ("INZ") residence permit application. His explanations for this were illogical and implausible even extending to the suggestion that an INZ officer had been complicit in misleading INZ.

[199] Another example was his self-description as a student. When that was explored in cross-examination, it became apparent he was not a student as that term is commonly understood, in the sense of being enrolled in a course of study, but rather someone who studies topics which interest him.

[200] While none of these examples is determinative of a particular issue in contest, combined they serve to bolster my adverse findings as to Mr Banks' credibility. Later in this judgment I shall return to more specific and relevant examples of where I am satisfied Mr Banks has lied.

[201] In rejecting Mr Banks' account on the Nuves emails, I do not overlook the evidence of Ms Banks and Mr Castelow who both gave evidence that they had driven Mr Banks to meetings at which they both met a man called "Chris". I agree with

Mr Hollyman's submission that their evidence should be viewed with circumspection for the following reasons:

(a) it was Mr Banks who approached them and initiated the enquiry about Mr Nuves;

(b) both affidavits bear a high degree of resemblance and the unavoidable risk of cross contamination, particularly given they both live at the same address;

(c) the events occurred some eight to nine years before the witnesses were asked to recall events which at the time they occurred, would have been routine and unremarkable events;

(d) the witnesses were unable to recall matters beyond that contained in their affidavits; and

(e) Mr Castelow was able to provide surprising detail, purportedly unprompted, in relation to both CMC and Mr Nuves.

[202] I am not prepared to accept their evidence when it is considered against the substantial body of circumstantial evidence pointing in the opposite direction.

[203] Mr Johnson rightly submits that given the seriousness of the allegation, compelling evidence is required and that the party making the allegation is required to prove it. As previously observed, it is not for Mr Banks to prove that he did not forge the emails.

[204] As noted, I am satisfied on the evidence set out above, that Mr Banks forged the emails for the purpose of providing an in-Court explanation for the significant advances he made to CMC and Vantage FX. While I accept that each of the evidential strands does not, on its own, support such a conclusion, it is the combination of

independent evidence from multiple sources which compels the making of that inference.[15]

[205] The next question is, having made this determination, what are the consequences?

[206] Mr Hollyman submits that if I was to find the emails had been fabricated, the proper inference to draw is that in 2011 and 2012 Mr Banks was trading with significant sums of money on at least two share trading platforms. This finding, combined with Mr Banks' less than frank disclosure, his other extensive investments and his lack of employment would necessarily lead the Court to conclude that he was a habitual investor at the time he invested in Mako.

[207] Mr Johnson submits that even if the Court was to find that Mr Banks' use of CMC and Vantage FX was his personal trading, this would be of little consequence under the Securities Act cause of action. The period of trading was so limited that the habitual investor exception does not apply.

[208] As for the other causes of action, Mr Johnson accepts Mr Banks' credibility may assume some relevance when the Court is considering the alleged misrepresentations under the FTA cause of action and various claims made by Mr Farmer for example that at a meeting in November 2013 he told Mr Banks that "we might lose all our money". However, he submits that Mr Banks' case relies primarily on the contemporaneous documentary record. Furthermore, and relatedly, the assessment of liability under the Companies Act claims involves, primarily, objective assessments of the defendants' conduct.

[209] The second and fourth causes of action both relate to the accuracy of information given to Mr Banks by Mr Farmer and the failure to provide Mr Banks with material information. Given that a significant number of the pleaded misrepresentations engage a direct credibility contest between Mr Banks and Mr Farmer, I cannot agree that the effect of my credibility findings are so limited.

15 *Thomas v R* [1972] NZLR 34 (CA); *Commissioner of Police v De Wys* [2016] NZCA 634; and *Attorney-General v Strathboss Kiwifruit Ltd* [2020] NZCA 98, [2020] 3 NZLR 247 at [469]-[471].

Neither do I agree that Mr Bank’s credibility on the first cause of action under s 37 of the Securities Act is all but irrelevant.

FIRST CAUSE OF ACTION – S 37 OF THE SECURITIES ACT

[210] Section 37 of the Securities Act provides:

> "**37 Void irregular allotments**
>
> (1) No allotment of a security offered to the public for subscription shall be made unless at the time of the subscription for the security there was a registered prospectus relating to the security.
>
> …"

The parties' positions

[211] The plaintiff's claim under this cause of action is that there was a void allotment of securities to Mr Banks by Mako. Mr Johnson submits that an allotment of securities was made to Mr Banks as a member of the public, in circumstances where no registered prospectus was ever issued by Mako. The consequence of that conduct is that the allotment was invalid, and of no effect. As such, Mr Banks must be repaid. Mako is not in a position to make the repayment and so the directors are jointly and severally liable to repay the subscriptions plus interest to Mr Banks under s 37 of the Securities Act. Mr Johnson submits "just and equitable" discretionary relief under s 37AH of the Securities Act is not available to the directors. The onus is on the directors to prove that the default in repayment was not due to any misconduct or negligence on their part and they cannot and have not done that.

[212] The defendants submit that the plaintiff's claim does not fit within the framework of the Securities Act and that relief is unavailable as a result. If the Court considers the Securities Act is applicable, the defendants' position is that there were three allotments, corresponding to each of the three Agreements. Even if the Agreements could constitute allotments of security, Mr Hollyman submits there was no relevant offer of securities made to Mr Banks as a member of the public, or as part of a section of the public, or as an individual member of the public selected at random. Additionally, Mr Banks is excluded from being a member of the public on the grounds under s 3(2)(a) of the Securities Act. If the Court found any allotment to be void, it would be just and equitable for the Court to grant the directors relief from liability under s 37AH of the Securities Act.

What is the correct approach for this cause of action?

[213] The parties adopt different approaches to how this cause of action should be viewed and determined.

[214] The plaintiff views the funds Mr Banks transferred to Mako, being the entire $3.2 million, as a single allotment of security. Mr Johnson adopts a global approach, grouping together all three Agreements and referring to the "allotment of a debt security" in the singular. As a consequence, he makes few submissions on the Agreements as individual allotments and does not detail, relative to each advance, the circumstances said to constitute an offer of securities to the public.

[215] In contrast, the defendants submit such an approach is incorrect. Mr Hollyman says it illustrates that the first cause of action is misconceived. He submits that the correct approach requires each of the three Agreements to be assessed individually when determining whether they fit within the definition of allotments of security, and whether they stemmed from offers of securities to the public.

[216] Thus, the first issue to determine is which is the correct approach?

[217] The term "allot" is defined in the Securities Act to include "sell, issue, assign, and convey". Allotment has a corresponding meaning. I adopt a common sense approach in applying the terms to the present circumstances. The terms "sell, issue, assign, and convey" carry the ordinary connotation of singular events. In other words, each speaks to a specific instance or transaction. To "allot" security, in my view, means to enter into a transaction where an allotment of securities is made on a particular occasion. I favour this interpretation because it would not make sense for an individual who has, for example, accepted offers for securities by a company on multiple, separate occasions, perhaps over the course of several years, to be treated as having made a single allotment of securities. Such an interpretation would prevent the Court from examining each transaction separately, despite the fact the circumstances surrounding a particular transaction may have been quite different and lead to different conclusions under the Securities Act. The consequences of such an approach would be to prevent the scrutiny of individual transactions. Repayment would be "all or nothing". This cannot be right.

[218] In the present case, to roll all three Agreements into a single allotment (if indeed they are found to be allotments) also fails to recognise their essential differences. These include not only the different circumstances in which they were entered, but also the financial state of the company at the time, and the differing terms between the Agreements, specifically between Agreement 1 and Agreements 2 and 3. I thus favour and adopt Mr Hollyman's approach.

Can the Agreements be considered security allotments?

[219] The next part of my analysis involves determining what a security allotment is in order to determine whether the funds advanced by Mr Banks may be considered allotments.

[220] The meaning of security under the Securities Act is defined in s 2D:

> "**2D Meaning of security**
>
> (1) In this Act, unless the context otherwise requires, the term security means any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person; and includes—
>
> …
>
> (b) a debt security;
>
> …
>
> but does not include any such interest or right…that is declared by regulations not to be a security for the purposes of this Act."

[221] A "debt security is defined under s 2(1):

> "**2 Interpretation**
>
> In this Act, unless the context otherwise requires,—
>
> …
>
> **debt security** means any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property); and includes;—
>
> (a) a debenture, debenture stock, bond, note, certificate of deposit, and convertible note; and
>
> (b) an interest or right that is declared by regulations to be a debt security for the purposes of this Act; and
>
> (c) a renewal or variation of the terms or conditions of any such interest or right or of a security referred to in paragraph (a) or paragraph (b);—

> but does not include—
>
> (d) an interest in contributory mortgage where the interest is offered by a contributory mortgage broker; or
>
> (e) any such interest or right or a security referred to in paragraph (a) or paragraph (c) that is declared by regulations not to be a debt security for the purposes of this Act."

[222] I accept that these provisions provide a broad and encompassing definition. The Supreme Court in *Hickman v Turner & Waverley Ltd*[16] observed that the definition of 'debt security' under s 2 should be afforded "a purposeful, but non-technical, construction".[17] A key part of the Supreme Court's reasoning in *Hickman* involves asking whether that which is being offered should be considered an investment. If what is being offered is an investment, and there is an "interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person", then the investment will meet the definition of a debt security.

[223] Mr Hollyman submits that the Agreements are "quite apart" from instruments that might generally be understood to constitute securities. It is the defendants' position that all three Agreements were privately negotiated loan arrangements which should not be considered security allotments. Mr Johnson submits that the broad legislative definitions and the Supreme Court's approach means that the Agreements do amount to securities. Further, he submits that Mr Hollyman's approach narrows the enquiry and is unrealistic given that the relevant sections of the Securities Act are designed to protect investors comprehensively. Against that background, I consider each agreement in turn.

Agreement 1

[224] Agreement 1 takes the form of a loan arrangement, recorded in writing on 4 February 2011, under which Mr Banks advanced funds to Mako, with a right to repayment and interest. The statutory definition of debt securities includes "an interest in or right to be paid money that is…lent". I am satisfied the funds advanced under Agreement 1 meet the definition of debt security.

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16 *Hickman v Turner & Waverley Ltd* [2012] NZSC 72, [2013] 1 NZLR 741.

17 At [58].

Agreements 2 and 3

[225] Agreement 2 is a written loan agreement, dated 30 June 2013. The terms and conditions of Agreement 2 are the same as those contained in Agreement 1 (as per para 2 of Agreement 2).[18] Agreement 2 includes an additional right of conversion to equity which Agreement 1 did not confer. This provision was included on the advice of Cameron Partners. Mako was advised to convert debt to equity where possible in anticipation of listing on the NZX. This right is set out under para 3 of Agreement 2. It provides:

> "3. Equitisation
>
> The Lender and Borrower wish to amend the Debt Letter Agreement subject to clause 4(h)(i) as follows:
>
> The Borrower has indicated to the Lender that it has initiated a further capitisation program and is likely to list on the New Zealand Stock exchange ('NZX'). The Borrower has engaged the services of Cameron Partners ("Cameron") to assist with the capital raising Cameron have strongly recommended that any debt currently on the Borrowers Balance Sheet is either repaid or transferred to equity prior to the NZX listing and agreed prior to the close of the Borrowers financial year end. The Borrowers financial year end is 30th June 2013.
>
> The Lender has agreed to transfer the total of advances and interest dues as at 30 June 2013 in New Zealand dollars to equity in Mako upon completion of the NZX listing. As compensation for agreeing the transfer at the current stage of planning and foregoing interest until the listing the Lender will receive a discount on issue of 15%. For clarification (sic) sake, if the Prospectus share value is $1.00, the Lender will buy shares at 85c each."

[226] I am satisfied that the presence of this clause further qualifies Agreement 2 as a debt security. There can be no doubt that a transaction exchanging money for a right to equity or shares in a company is an allotment of security.

[227] Although Agreement 3 was not recorded in writing, it is accepted it was entered into on the same terms as Agreement 2. It thus follows Agreement 3 was also a debt security.

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[18] There is some uncertainty as to what the correct term under Agreement 2 is. This is because there are two different terms relating to the advances under Agreement 1. This is discussed later in the judgment.

Were there offers of securities made to the public?

Legal principles

[228] There are two parts to the analysis under this section; first, whether an offer was made, and secondly, whether that offer was made to the public. I shall set out the legal principles before applying them to, and forming conclusions on, each Agreement/allotment.

[229] The definitions of both "offer" and "public" are broad and inclusive. An "offer" is defined under s 2 of the Act as including "an invitation, and any proposal or invitation to make an offer". After considering this definition, Anderson J in *Orr v Martin* said:[19]

> "Thus for the purposes of the Securities Act 1978 the term 'offer' has a far broader meaning than such term has in, for example, contractual law. It encompasses concepts which in the law of contract amount to invitations to treat, and such extended meaning is entirely consistent with the consumer protection nature of the Act itself."

[230] The meaning of "public" is not defined in the legislation. Section 3 provides both inclusive and exclusive guidelines for categorising the public.[20] Its text provides some guidance as to "what is and [what] is not an offer to the public".[21] Necessarily, determining whether an offer of a security was made to the public is a factual issue to be determined on the circumstances of the particular case, rather than by reference to fixed criteria.[22]

[231] Section 3 provides:

> "**3 Construction of references to offering securities to the public**
>
> (1) Any reference in this Act to an **offer of securities to the public** shall be construed as including—
>
> (a) a reference to offering the securities to any section of the public, however selected; and

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19 *Orr v Martin* (1991) 5 NZCLC 67,383 (HC) at 67,390. Affirmed in *Robert Jones Investments Ltd v Gardner (No 2)* (1993) 6 NZCLC 68,514 at 68,529.

20 Cathy Quinn and Peter Ratner "The Definition of the 'Public'" in *Morison's Company and Securities Law New Zealand* (online loose-leaf ed, LexisNexis) at [7.1].

21 *Lawrence v Registrar of Companies* [2004] 3 NZLR 37 (CA) at [30].

22 At [35].

(b) a reference to offering the securities to individual members of the public selected at random; and

(c) a reference to offering the securities to a person if the person became known to the offeror as a result of any advertisement made by or on behalf of the offeror and that was intended or likely to result in the public seeking further information or advice about any investment opportunity or services,—

whether or not any such offer is calculated to result in the securities becoming available for subscription by persons other than those receiving the offer.

(2) None of the following offers shall constitute an offer of securities to the public:

(a) an offer of securities made to any or all of the following persons only:

(i) relatives or close business associates of the issuer or of a director of the issuer:

(ii) persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money:

(iia) persons who are each required to pay a minimum subscription price of at least $500,000 for the securities before the allotment of those securities:

(iib) persons who have each previously paid a minimum subscription price of at least $500,000 for securities (the **initial securities**) in a single transaction before the allotment of the initial securities, provided that—

(A) the offer of the securities is made by the issuer of the initial securities; and

(B) the offer of the securities is made within 18 months of the date of the first allotment of the initial securities:

(iii) any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public:

(b) an invitation to a person to enter into a bona fide underwriting or sub-underwriting agreement with respect to an offer of securities.

…"

[232] Thus, under s 3(1), an offer of securities to the public can include an offer to:

(a) a section of the public, however selected;

(b) individual members of the public, selected at random; and

(c) a person who became known to the offeror as a result of an advertisement by the offeror that was intended to result in the public seeking further information about investment opportunities.

[233] Section 3(1)(a) is intended to make clear that an offer to the public need not be one that is open to every member of the public. A section of the public, however selected, will be sufficient to be included in the definition. In *Robert Jones Investments Ltd v Gardner (No 2)* John Hansen J said:[23]

> "It is quite clear that the wording of sec 3(1)(a) is extremely wide, and it is hard to envisage any offer that is not prima facie an offer to the public on the wording of the section. Perhaps if an offer was limited to institutions and directors, it may fall outside the term public, but, clearly, the term itself is very wide."

[234] However, he went on to sound a note of caution:[24]

> "Any consideration of this section must be viewed against the overall statutory aim of the Act. This is to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for security. It is aimed at the protection of investors, and is consumer orientated legislation."

[235] Section 3(1)(b) is self-explanatory. It requires individuals to have been selected at random.

[236] Section 3(1)(c) requires an advertisement. Although advertisement is defined in the Securities Act, its meaning does not apply to the term under this particular section.[25] Instead, the ordinary meaning of advertisement is retained.[26]

[237] The relevant exceptions to the "public" are set out under ss 3(2)(a)(i)-(iia).

[238] Section 3(2)(a)(i) excludes "relatives or close business associates of the issuer or of a director of the issuer". In *Lawrence v Registrar of Companies*,[27] the Court

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23 *Robert Jones Investments Ltd v Gardner (No 2)* (1993) 6 NZCLC 68,514 at 68,529.
24 At 68,529 citing *Re AIC Merchant Finances Ltd* [1990] 2 NZLR 385 at 391.
25 Securities Act 1978, s 2A(5).
26 *Orr v Martin* (1991) 5 NZCLC 67,383 (HC).
27 *Lawrence v Registrar of Companies* [2004] 3 NZLR 37 (CA).

referred to and approved the approach taken in *Securities Commission v Kiwi Co-operative Dairies Ltd*[28] when discussing the identity of those captured by the words:[29]

> "The Judge observed that in *Kiwi Cooperative Dairies* this Court had held that there had to be a degree of intimacy or business friendship in the relationship between issuer and offeree that was sufficient to overcome any inequality that might otherwise be present in the relationship. To be "close business associates" persons had to be sufficiently closely connected on a personal basis with the issuer that it could be assumed that they had either sufficient knowledge of the issuer's affairs or the means of readily obtaining it."

[239] In *Society of Lloyds & Oxford Members Agency Ltd v Hyslop* ("*Society of Lloyds*"), the Court considered the conduct of a Mr Langdale, who recruited "Names" for Lloyds. Mr Langdale's usual practice was to be approached by parties interested in becoming a Lloyds Name. That practice did not contravene the Securities Act because there was no offer on the part of Mr Langdale. However, in relation to Ms Hyslop, it was Mr Langdale who approached her and some five other longstanding friends. He invited them to become Lloyds Names.[30] The Court held this did not constitute an offer to the public because Ms Hyslop fitted within the exception under s 3(2)(a)(i).

[240] Section 3(2)(a)(ii) excludes those "whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money". This exception splits naturally into two categories. First, those whose principal business is investing, and secondly, those who are habitual investors. Again, there are no legislative definitions for these categories. Ordinary meanings are to be used.

[241] In *Lawrence v Registrar of Companies* the Court explained the rationale for the s 3(2)(a)(ii) exclusion as such people being "presumed by the legislature to be a category of persons able to protect themselves, because of their expertise."[31] In practice, they may rightly be expected to have the necessary experience and expertise to understand and interpret the documentation, know what, if any, further enquiries

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28 *Securities Commission v Kiwi Co-operative Dairies Ltd* [1995] 3 NZLR 26 at 31 and 32.
29 *Lawrence v Registrar of Companies* [2004] 3 NZLR 37 (CA) at [16].
30 *Society of Lloyds & Oxford Members Agency Ltd v Hyslop* [1993] 3 NZLR 135 (CA) at 7 and 8.
31 *Lawrence v Registrar of Companies* [2004] 3 NZLR 37 (CA) at [32].

are necessary and thus be in a position to make a fully informed and reflective investment judgement.

[242] In *Robert Jones Investments Ltd v Gardner* it was held that Mr Gardner was a habitual investor due to the large number of share purchases he had made, and his own statements regarding his status as a share market trader and dealer. There the investment activity spanned a period of more than two years.[32]

[243] Mr Johnson referred me to the District Court's decision in *Ministry of Economic Development v Stakeholder Finance Ltd*.[33] There the Judge held that an individual who had entered into eight property transactions over a four to five year period was not a habitual investor. Mr Hollyman submits this test is too onerous. It is also inconsistent with the approach taken by John Hansen J in *Robert Jones Investments Ltd v Gardner* where this Court held that investment activity over a two year period was sufficient to qualify someone as a habitual investor.[34]

[244] Mr Hollyman also referred me to the observations of Shelley Griffiths in *Company and Security Law in New Zealand*, with which I agree:[35]

> "…the word 'habitual' qualifies "investor" and in that context it is arguable that "constant" and "continual" do not capture what was intended by the expression. Certainly some regularity, some pattern of recurrent activity of investment is intended, but constant and continual seem to set the benchmark that is neither related to the idea of what investment entails nor linked to the underlying purpose of the section…It can be inferred that knowing what questions to ask and knowing how to ask them is what being a habitual investor gives a person."

[245] With respect, I agree with those observations. They are common sense. Plainly what amounts to habitual will be fact dependent, but relevant considerations are likely to include the number of investments, the time over which the investments were made, the nature of the investments, the frequency of investments and, perhaps, the measure of the investor's success. Any attempt at greater prescription is likely to be fraught.

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32 *Robert Jones Investments Ltd v Gardner (No 2)* (1993) 6 NZCLC 68,514 (HC) at 68,532.

33 *Ministry of Economic Development v Stakeholder Finance Ltd* DC Auckland CRI-2007-004-028150, -028160 and 028102, 9 December 2008 at [68] and [69].

34 *Robert Jones Investments Ltd v Gardner (No 2)* (1993) 6 NZCLC 68,514 (HC) at 68,532.

35 Shelley Griffiths "The Primary Market" in J Farrar and S Watson (ed) *Company and Securities Law in New Zealand* (Brookers, Wellington, 2013) at 1053.

[246] The exception under s 3(2)(a)(iia) excludes persons "who are each required to pay a minimum subscription price of at least $500,000 for the securities before the allotment of those securities". Unlike the other two exceptions, this exception is aimed at the nature of the offer and is not concerned with the investor themselves.

[247] Finally, the exception under s 3(2)(a)(iii) relates to "any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public". This exception is to be read with the preceding inclusive provisions such that even if the offerees fit within those definitions, they might, nonetheless, be excluded. In *Society of Lloyds* the investors who may have qualified for exclusion under the s 3(2)(a)(i) exception for relatives and business associates, might also have met the exclusory definition under s 3(2)(a)(iii). As Richardson J said:[36]

> "Even if, contrary to my assessment, the six old friends of Mr Langdale could be regarded as a section of the public, I would hold that they were selected otherwise than as members of the public."

What is the effect of the chosen approach?

[248] My conclusion that each Agreement needs to be considered individually, and that each constitutes a separate allotment of a security requires me to consider the circumstances of each Agreement/allotment to determine whether each amounted to an offer of securities made to the public.

Was there an offer to the public?

Agreement 1

(a) Factual circumstances

[249] Answering this question requires reference back to the factual circumstances which preceded Agreement 1. As set out beginning at [38] above, Mr Farmer and Ms Banks have differing accounts as to how Agreement 1 came into existence. This is a determinative issue in my view. Ultimately, I am required to make factual findings.

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[36] *Society of Lloyds & Oxford Members Agency Ltd v Hyslop* [1993] 3 NZLR 135 (CA) at 8.

[250] I accept Mr Farmer's evidence on this point and I reject the evidence of both Mr Banks and his mother. My reasons for not accepting the latters' evidence are based both on my earlier credibility findings against them on the so-called "Nuves" evidence, as well as certain contemporary documentary evidence which tends to independently support Mr Farmer's account of the events, and, in parts, contradict Mr and Ms Banks in material respects. Examples with my reasons follow.

[251] I am satisfied that Mr Farmer's and Ms Banks' business relationship commenced through Mr Winslade at a social event in connection with the Albany rural lifestyle estate where Mr Farmer and Mr Winslade lived. Mr Farmer and Mr Winslade had been discussing Mako, specifically talking about its capital raising plans, when Mr Winslade mentioned that Ms Banks had some leftover money from the sale of properties in the United Kingdom. Mr Farmer said Mr Winslade left their discussion, presumably to speak to Ms Banks, before returning to Mr Farmer and advising there was some interest on her behalf. He asked whether Mr Farmer had any information or documentation and Mr Farmer provided a copy of Mako's PPM, saying that Ms Banks should contact him if she was still interested.

[252] In contrast, Ms Banks claimed that Mr Winslade never raised the possibility of an investment in Mako with her. She said she heard about Mako from Mr Farmer directly:

> "At some point in late 2010 during a conversation with [Mr Farmer] he talked about people who had lent money to his company called Mako at a good interest rate. He asked if I would be interested. This is the first time Mr Farmer asked if I would be interested in investing in Mako."

[253] It is unclear whether the meeting Ms Banks referred to occurred at one of the estate's social functions or in a different setting. This is because Ms Banks said she visited Mr Farmer "a few times socially at [his Albany estate home] and the subsequent one in Coatesville with Dave". This suggests the property in Albany was different to the Coatesville address. If Ms Banks' evidence on this point is to be accepted, the following exchange in cross-examination between Mr Hollyman and Ms Banks makes a conversation occurring at a social function seem unlikely:

> "Q At [39] Mr Farmer refers to social functions, I'll read that paragraph out, 'The residents of the complex would regularly come together for

social functions. At these functions we talked about among other things our various business ventures and projects. The people who live in the estate and attended these functions were typically successful business people and high net worth individuals.' Had you attended some of those functions Ms Banks?

A I attended a few functions not regularly.

Q Would that be a fair description of your experience of those functions?

A No, the functions I attended was like a quiz night, or they had Guy Fawkes night, or for Christmas like social functions, like with a meal.

Q And would it be right to say that at those functions your experience of them was that you talked about among other things your various business ventures and projects?

A No.

Q Would you agree that the people who lived in the estate were typically successful business people and high net worth individuals?

A I don't know because I didn't talk to them about business."

[254] The alternative is that Ms Banks had the conversation about Mako in a different setting. However, there is no evidence to support this. Mr Winslade appears to have been the common link between Mr Farmer and Ms Banks, even in circumstances removed from any business dealings. Mr Farmer said:

> "Dave lived next door to me in Albany… I refer to 'Dave' living next door to me rather than 'Dave and Caroline' because Caroline rarely stayed at the house…"

[255] It was put to Ms Banks in cross-examination that she rarely stayed at the Albany property. She responded:

> "I stayed at the house but also stayed at [a property on] Great North Road where Leila lived and Adam lived next door, they were recent immigrants and I was doing my best to settle them in especially as Leila didn't drive."

[256] She later described being "next door to [Mr Banks] a lot". Mr Banks also confirmed this when he said "[Ms Banks] was spending a lot of time with my sister who lived next door to me. So, a lot of the time she was physically close."

[257] On this evidence it seems unlikely that Ms Banks during these early days, who on both Mr Farmer's and Mr Banks' accounts was not permanently living at the Albany

property, would nonetheless have had a private conversation with Mr Farmer about Mako in circumstances where Mr Winslade was not present.

[258] Also, independently supportive of Mr Farmer's account is a contemporaneous email from Mr Banks to Mr Farmer on 22 December 2010, in which Mr Banks wrote:

> "I'm sure that it won't be an issue but I don't want Dave to be involved."

[259] In the circumstances it seems unlikely that Mr Banks would have said this if he believed Mr Winslade had been uninvolved in the initial introductions or conversations. Plainly, he did not want him involved in the negotiations.

[260] Based on my earlier credibility findings and on the contemporaneous evidence, I favour Mr Farmer's account. I am thus satisfied Mr Winslade played some role or had some initial involvement in introducing the business relationship between Mr Farmer and the Banks family.

[261] Mr Farmer said that after he gave Mr Winslade the PPM, Ms Banks contacted him to discuss the possibility of investing. Ms Banks denied this. Mr Farmer said Ms Banks made a special trip out to meet him to understand Mako's business. He said he met with Ms Banks and they spoke, broadly, about what Mako's business involved. Mr Farmer said that from these discussions, it was obvious to him that Ms Banks was "well versed in the business world" and that a Mako investment would represent a small part of her total investment portfolio. Mr Farmer said that his understanding was that any investment would be with Ms Banks' money.

[262] At some point following these events, Mr Farmer said Ms Banks sent him an email saying that she would like to proceed, and that Mr Banks would "take it from here". Mr Farmer has been unable to locate that email. Ms Banks denied she ever sent such an email. Ms Banks says she gave Mr Farmer her son's contact details and suggested Mr Farmer get in touch with him. Regardless, at some point, Ms Banks involved Mr Banks in the process.

[263] Mr Banks and Mr Farmer met on 22 December 2010. Mr Farmer gave him a copy of the PPM. By this time it had expired. The offer closed on 30 November 2010.

[264] Later the same day Mr Banks emailed Mr Farmer with a series of questions around the mechanics of the investment. On 24 December 2010 Mr Banks asked Mr Farmer whether a personal guarantee might be possible. Mr Farmer responded in the negative the following day. On 27 December 2010 Mr Banks proposed a loan of £1.05 million in return for quarterly interest payments. Between this time and the end of January 2011, Mr Farmer and Mr Banks exchanged numerous emails and spoke on the telephone. Mr Farmer said he believed Mr Banks was acting as Ms Banks' agent:

> "I perceived [Mr Banks] to be [Ms Banks'] representative, and that he was involved to oversee the investment on her behalf."

[265] This perception is supported by an email Mr Banks sent on 12 January 2011 in which he referred to Ms Banks as a stakeholder:

> "...Once we have polished them I'll run them past Caroline (a stakeholder as she will eventually benefit from my returns)."

[266] When asked in cross-examination what he had meant by the term "stakeholder" his explanation was:

> "…stakeholder, that's very simple. My mother and sister are family members and I absolutely intended that if I had gotten a return from the investment I would have shared it with them. I didn't, of course, have to share it with anybody, but they are my family, they are the only family I have, and I would have taken pleasure from sharing my financial returns with them."

[267] Ms Banks was cross-examined on this subject. She said, "I never had any beneficial interest in Adam's loans to Mako, and I'm not a stakeholder in the traditional sense." Ms Banks said she did not know why Mr Banks would have used the term "stakeholder" but assumed he did so because she was a member of his family, who gave him the funds to invest, and who he wanted to benefit from any returns.

[268] I do not accept Mr Banks would have used the term "stakeholder" out of context. He is plainly an intelligent man. He is articulate. I have already commented on the precision, almost to obsessive levels, of his use of language. He is not someone who would have used a term like "stakeholder" loosely or without understanding its proper meaning, and intending to use it in its correct context. I am satisfied that when he described Ms Banks as a stakeholder that is how he saw her. This conclusion is supported by later correspondence which I shall refer to.

[269] Ms Banks steadfastly denied that Mr Banks was her representative. Her evidence was "that is simply not the case" and that her involvement in "Adam's loans" was limited. I do not accept that was the position, nor was it conveyed to Mr Farmer or Mako. I am satisfied Ms Banks remained involved in the process leading up to and including the finalising of Agreement 1 and even beyond. My reasons follow.

[270] First, on more than one occasion during the period leading up to Agreement 2, Mr Banks referred to Ms Banks in a way connotative of her having a level of expectation or authority inconsistent with her claim she had relinquished all effective control to Mr Banks. For example, in an email to Mr Farmer on 22 December 2010, Mr Banks noted that, as part of the terms of any agreement, interest when generated would be transferred to himself, his sister Leila or Ms Banks.

[271] There is also his email of 12 January 2011 in which he said he would run the details "past Caroline". If Ms Banks had, in fact, no effective involvement after giving Mr Farmer her son's contact details some time in mid-December 2010, it begs the question as to why her son felt the need to involve her in the details a month or so later.

[272] Secondly, Ms Banks maintained an operative role during the transfer of the funds. Both Mr Banks and Ms Banks claim that Ms Banks' involvement in the money transfers was because she operated the UK bank accounts. Any transfer required her to facilitate it. However, the email exchanges between Ms Banks and Mr Farmer during the two month period between February and March 2011 convey the impression of a much closer involvement in the transaction by Ms Banks than simply facilitating money transfers.

[273] There are numerous email communications between Mr Farmer, Ms Banks and Mr Banks throughout this period. They relate to the logistics and frustrations of the international transfers. They express embarrassment on the part of Ms Banks. Aspects of this correspondence deserve particular mention. The correspondence is warm and friendly, consistent with both a personal and business relationship. Additionally, if this investment was one which Ms Banks had left entirely to her son to manage, why was she corresponding directly with Mr Farmer over this period? I accept that her

personal involvement was required to release the funds, but the mechanics of the transfer to Mako did not require her assistance to the level she was, in fact, involved nor her direct involvement with Mr Farmer.

[274] Thirdly, in the correspondence, particularly around 1 April 2011, the day the funds were released, Ms Banks asked Mr Farmer if, in lieu of £25,000, he would accept "25k GBP/NZD mid-market +200 (as compensation)". This correspondence goes well beyond facilitating the transfer of funds. It amounts to a request to vary terms.

[275] Similarly, Ms Banks' language to Mr Farmer in the email of 12 February 2011 is personal and singular. For example, she said "So *I* am asking you if you would kindly allow *me* to pay you from NZ funds the equivalent of 25,000 pounds" (emphasis added). It is clear she is referring to herself, rather than Mr Banks. This exchange is not simply about transferring funds. Again, it is indicative of her being actively involved in the ongoing negotiations.

[276] Fourth, Ms Banks used the first person plural "we" on multiple occasions in this correspondence in contexts where the inference is that she was referring to herself and her son. Ms Banks' explanation for her use of "we" was:

> "In some e-mails I use the word 'we' when describing Adam's loans to Mako. This is my mistake and I understand how it can be misinterpreted to mean I was party to the loans. However, I was not involved in Adam's negotiations or agreements to loan Mako money. I simply helped him facilitate the payment of money. I used the word 'we' sometimes because even though the money was Adam's to invest, it had been given to him by me and the New Life Family Trust, I had been occasionally involved and I assumed he would use it to benefit our family. I was also trying to speak casually to appeal to Mr Farmer's moral compass to treat Adam fairly."

[277] Fifth, I find that Ms Banks and Mr Farmer met on at least one, but probably more, occasions where Mako's business and investment options were discussed. One meeting occurred on 3 January 2011. Mr Farmer said this meeting was for the purpose of satisfying himself that Ms Banks "was happy with the investment". Ms Banks denied such a meeting ever took place. However, that denial is contradicted by an email from Mr Farmer to Ms Banks on 6 January 2011, in which Mr Farmer said, "it was good to catch up on Monday, please excuse my rushing off". Monday of that week was 3 January 2011. It is implausible that Mr Farmer would have sent this email

had he not met Ms Banks as he described. It is also significant in my view that this meeting occurred *after* Mr Banks had been involved in the process and following the detailed discussions between Mr Farmer and Mr Banks. It also runs contrary to Ms Banks' assertion she met Mr Farmer only once, on 18 February 2015 with her son, when she was his support person. This suggests to me that despite Mr Banks being engaged in much of the detail of the discussions and negotiations, Ms Banks was also actively involved.

[278] Sixth, in support of her claim that her involvement was limited to facilitating the international money transfers, Ms Banks pointed to an email sent to her by Mr Banks on 12 February 2011 in which he sent instructions for a cheque, and requested she email the bank with instructions for the transfer of £1 million to Mako as soon as possible. On this issue, Mr Banks said in evidence:

> "In this phase of the project the task was transferring money and the people at my end doing the thinking and managing, if you will, were Caroline and I."

[279] Evidently, Mr Banks did not consider that his mother's role was confined to acting on instructions he gave her relative to the transfers. He considered her to be involved in the "thinking and management" of the dealings around Agreement 1.

[280] Finally, if there was any doubt as to Ms Banks involvement in Agreement 1, this is dispelled by continuing correspondence between Mr Farmer and Mr Banks after the conclusion of Agreement 1.

[281] Around October 2011 Mr Farmer's evidence was that he offered to repay some of Mako's debt back to Ms Banks. On 10 October 2011, Mr Banks emailed Mr Farmer:

> "Caroline told me about your chat re Mako. Thank you for the offer of making a payment however I thought we had discussed the issue a while ago. Here is my understanding of the arrangement:
>
> 1 interest is capitalised (this occurs with every transaction row (see table))
>
> 2 we have a transaction row every time there is an anniversary that's not in the min period or a transaction (I expect these to be infrequent)"

[282] Later the same day Mr Farmer replied saying "I'm happy with how things are but want to be sure that Caroline and yourself do not think we are taking unfair advantage".

[283] Mr Banks responded:

> "Please let me know if I am missing anything but the deal sounds fair to me. *We are both happy* with the tables and formulae and, I currently have no need for the money."
>
> (emphasis added)

[284] From this it is apparent that even after Agreement 1 was completed Ms Banks continued to be involved in the investment decisions with her son.

[285] There are other examples of Ms Banks' continued involvement. On 3 September 2012 Mr Banks emailed Mr Farmer in response to being sent a copy of the YellowTuna Holdings accounts. He expressed concern about being named in the accounts and wrote:

> "Ages ago I talked to Caroline about this exact issue and I believe she said that you said that my name would not appear in such documents; did she talk to you?"

[286] Mr Farmer replied the following day saying that although he could not recall such a discussion, the document could easily be changed. He invited Mr Banks to call him.

[287] On 14 March 2013, a month after Agreement 1 had been concluded and three months before Agreement 2 was entered into, Ms Banks sent Mr Farmer an email which is set out in full below:

> "Hi Bill
>
> I hope you and all the family are well. Your house seems to be progressing well.
>
> Adam told me he had meet (sic) you. *I am happy we are doing further business with you*. It sounds very exciting how you are expanding the business. I wish you well with the launch on the Stockmarket.
>
> We are getting on well. Leila came back from Japan last month. Her eye condition has improved and she is slowly getting a better sleep pattern.

> I have recently been to Golden Bay where I did a Permaculture Design course. I learnt a lot although it was very intense.
>
> Please give my love to Jennie.
>
> Love
>
> Caroline"
>
> (emphasis added)

[288] It is the cumulative and combined effect of this evidence, coming as it does from disparate sources over an extended period which leads me to conclude that it was through Ms Banks and her personal connection with Mr Farmer that her son advanced the funds to Mako. That Ms Banks maintained a close and continuing involvement in the investment both before and after the first advance is consistent with Mr Farmer's understanding of her role and position. Against the backdrop of that finding that I turn now to consider whether there was an offer of securities to the public.

(b) Analysis on Agreement 1

[289] Mr Hollyman submits that *Society of Lloyds* is factually on "all-fours". He says that as a matter of common sense, circumstances where individuals approach the offeror cannot constitute an offer within the meaning of the Act. Like Mr Langdale in *Society of Lloyds*, Ms Banks knew through Mr Winslade that Mako was seeking investors. It was Ms Banks who approached Mr Farmer seeking to invest in Mako. I accept Mr Farmer's account that Ms Banks approached him having been appraised of the investment opportunity through Mr Winslade. She then combined her energies with her son's to bring about the investment. It was, thus, not an offer and I agree that *Society of Lloyds* is generally on point.

[290] Even if I am wrong and, in fact, what occurred constituted an offer, I am not satisfied it was an offer to the public. My reasons follow.

[291] First, it is necessary to consider the context. Mako never intended to engage with the public. I accept Mr Farmer told Ms Banks that any investment in Mako was a high risk technology investment and quite unlike any of her other investments. Mako did not want to be subject to the requirements of the Securities Act. That intention is plainly apparent from the wording of the PPM which was drafted following advice

from both in-house and external legal advisors. Ms Keenan, providing legal advice to Mako sent Mr Farmer an amended draft of the PPM on 8 November 2010. In her covering note she said she had:

> "…reworded the qualifying paragraphs at the beginning of the Private Placement Memorandum so that the document specifically targets investors that are excluded from being "members of the public" under s 3(2)(1) of the Securities Act 1978."

[292] I accept the wording was deliberate and for the express purpose of avoiding the PPM's classification as an offer of securities to the public.

[293] I also note this position is supported by contemporary correspondence between Mr Farmer and Mr Banks. In an email dated 1 February 2011, Mr Farmer specifically noted the difficulties in complying with Securities Act requirements and requested that the original proposal to equitise be deleted. Mr Banks responded on 3 February 2011 saying he was happy to delete the equity option.

[294] Secondly, although a "section of the public" had in some ways been selected, that is being the kind of investors Mako wanted to attract (high net worth individuals with investing experience), any members of that section of the public would be excluded from the definition of "public" by s 3(2)(a)(ii). It would be an odd result if I was to find that an offer was given to a section of the public on these criteria, only for the members of that section of the public to be excluded by the legislative exception.

[295] Section 3(2)(a)(iii) states as an exception to "the public" "any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public". Such was the position in *Society of Lloyds* where, as previously discussed, investors who could have been considered a section of the public, were also excluded by the s 3(2)(a)(i) exception for relatives and business associates.

[296] I consider such a position exists here. Even if Ms Banks, along with the other investors at the time, could be considered a section of the public, I would find that they were selected otherwise.

[297] Thirdly, I cannot accept that a single individual, engaged with privately in the circumstances of this case as I have found them, could conceivably be described as a section of the public. While I accept Mr Johnson's submission that the definition of an offer to the public may include an offer to just one person, if the offer is not made to someone as a member of the public, then regardless of the number of offerees, there will still not be an offer to a section of the public.[37] Furthermore, that a single individual is involved, while not determinative, does tend to support the inference the offer was not one made to the public.

[298] Fourth, there is no doubt an offer of securities was not made to individual members of the public selected at random in terms of s 3(1)(b). Mako had specific criteria for the kind of investors it was looking for. These were set out in full at the start of the PPM and repeated in various forms throughout the document. There is nothing random about who they were attempting to attract.

[299] Fifth, no advertisement was made by or on behalf of Mako that was "intended or likely to result in the public seeking further information or advice about any investment opportunity or services" in terms of s 3(1)(c).

(c) Conclusion

[300] I am satisfied there was no offer of securities to the public which can be linked to Agreement 1 or the first allotment of debt security. It follows Mr Banks' claim under the Securities Act in relation to Agreement 1 must fail.

(d) Was Mr Banks a habitual investor?

[301] I have found that there was no offer of securities to the public. In part, that finding relies on the correctness of my conclusion that any offer that might have been made was between Mr Farmer and Ms Banks. However, even if I am wrong and any such offer was to Mr Banks, I am satisfied that at least one of the exceptions in s 3(2) of the Securities Act applies. In particular, I am satisfied that Mr Banks was a person whose principal business was the investment of money or who, in the course of and

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[37] Cathy Quinn and Peter Ratner "The Definition of 'The Public'" in *Morison's Company and Securities Law* (online loose-leaf ed, LexisNexis) at [7.5].

for the purpose of their business, habitually invest money.[38] My reasons for so concluding may be briefly stated.

[302] First, Mr Banks, throughout his dealings with Mr Farmer, held himself out as both sophisticated and knowledgeable in business and investment matters. There are numerous examples of this throughout the email exchanges, particularly in those between Mr Banks and Mr Farmer in the months preceding the execution of Agreement 1. The clear impression given by this correspondence when read in its totality is that Mr Farmer and Mr Banks were corresponding as equals. Both exhibited a comfort in and familiarity with the use of the technical investment language and terms.

[303] Secondly, and relatedly, as has been discussed, Mr Banks did not use the services of a qualified lawyer. Despite this, his correspondence on the legal aspects of protecting his position when negotiating Agreement 1 were relevant and to the point. He plainly understood his legal rights and the various options available to him during the negotiations. In his correspondence with Mr Farmer he covered the relevant points with an ability and insight consistent with one well used to and experienced in investing.

[304] Thirdly, Mr Banks' reference to the investment as being "a UK deal on my books" infers the Mako investment was one of a number. Other examples include his statements about the exemptions given by the Inland Revenue Department and his knowledge of mechanisms to deal with exchange rate fluctuations.

[305] Fourthly, Mr Banks lives off investment income. He has no other visible means of support. He described himself as self-employed. He spoke of administering the trusts from which his substantial investment funds appear to have been derived. Certainly, at the relevant periods, he was in control of significant funds.

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[38] Securities Act 1978, s 3(2)(a)(ii).

[306] In a document which bears an NZIS stamp dated 15 July 2010, which appears to have been filed in support of Mr Banks' immigration application, the following appears:

> "3 Employment. I have not undertaken any employment in NZ. However I do perform a lot of work in connection with the business affairs of [redacted] and my family….
>
> 4 I have been computer literate since the age of 8. I have had advanced computer skills since 16…
>
> 5 Business experience. Between 2000 and 2008 I helped manage a property letting company business: the amount of work I did depended largely on whether I was studying. I dealt with advertising, tax, preparing spreadsheets for the accountant, restructuring the business, court proceedings as a result of bad tenants*, profit analysis, research (including investments and financial products)… and editing legal documents*."
>
> (emphasis added)

[307] In cross-examination Mr Banks attempted, albeit unconvincingly, to distance himself from the document's authorship suggesting, as I understood him, it was a document prepared by an immigration officer when plainly, having regard to other personal information it contains which only Mr Banks could have known, and the repeated use of the first person singular, "I", it was not.

[308] Fifthly, Mako was not Mr Banks' only significant investment during the period in question. The very significant funds he invested on the CMC and Vantage FX share trading platforms support this conclusion. On that topic, his attempts to falsely explain away those investments as part of the Nuves research project by producing false emails permits an adverse inference to be drawn.

[309] Sixth, cl 4(a) in Agreement 1 specifies:

> "The Lender shall provide advice to the Borrower regarding capital raising of the Borrower and shall provide financial advice to the Borrower as agreed between the Lender and the Borrower."

[310] On its face, the inclusion of that clause indicates that Mr Banks believed that he had relevant investment expertise he could share with Mako and Mako believed that the receipt of such advice would operate to its benefit.

[311] Seventh, in July 2010 Mr Banks invested over $1 million in debenture stock in Marac Finance Ltd. This was just seven months before Agreement 1. That Mr Banks' memory in cross-examination was so vague in relation to this substantial deposit supports the inference that this was simply another large, but otherwise unremarkable, investment in Mr Banks' business life.

Agreement 2

(a) Factual circumstances

[312] The circumstances preceding Agreement 2 are quite different to those which preceded Agreement 1. After the successful transfer of funds under Agreement 1, contact between Mr Banks and Mako reduced. Mr Banks explained that a collection of meetings, telephone calls and emails occurred over the intervening period of a little over two years between Agreement 1 and Agreement 2. He says that Mr Farmer's reports were always positive, containing "good news" which made him feel confident about his investment.

[313] Mr Banks and Mr Farmer met on 8 March 2013. The following day Mr Banks emailed Mr Farmer, indicating he would like to invest more funds in Mako, and suggested terms for the second Agreement:

> "I would like to invest more in Mako (see attached). How would you feel about the below conditions?
>
> -New money will become debt tranches with similar terms to the existing ones. Differing term: I won't have the ability to withdraw the money.
>
> -On a date chosen by you all tranches will have the latest magnitudes calculated by one of us (using your formula, as discussed re the existing tranches), any GBP will be converted to NZD at the mid-market rate and sum will be used to purchase discounted (if I was to commit very early would I be able to get 20%?) shares.
>
> …"

[314] Mr Farmer responded on 11 March 2013 providing provisional views on Mr Banks' proposed terms and setting out the plan for the future in terms of documenting confirmation of the conversion, putting the share transfer to the existing shareholders for ratification, listing the company and issuing the new public shares.

[315] Ms Banks' contact with Mr Farmer and her involvement in the Mako loans and agreements also reduced after Agreement 1 had been concluded. I accept Mr Banks assumed a leading role during the period between the conclusion of Agreement 1 and the initial discussions regarding Agreement 2. However, as discussed, Ms Banks still maintained some influential presence.

[316] On 15 and 31 May 2013, Mr Banks performed his part of Agreement 2 and advanced two tranches of funds, £237,722.43 and £24,779.14 respectively.

[317] A month later on 30 June 2013 Agreement 2 was executed in writing.

(b) Analysis on Agreement 2

[318] The circumstances clearly reveal that no offer of securities to the public was made by Mako prior to the second allotment under Agreement 2. Agreement 2 was concluded as a direct result of the pre-existing relationship between Mr and Ms Banks and Mr Farmer.

[319] I accept that Mako was still looking to raise capital and attract investors at this stage, but this was very much an ongoing activity. There was no updated PPM, and there is no evidence to suggest that Mako had changed its investment strategy to engage with members of the public. The conclusion is thus that the kind of investors Mako was interested in remained the same; high net worth individuals with investing experience.

[320] However, I do note that there was a shift in Mako's attitude toward equitisation. Previously, equitisation was not a favoured option for Mako. Mr Farmer had suggested to Mr Banks that the proposed equitisation clause (originally considered as part of Agreement 1) be deleted because of the challenging Securities Act obligations it created for Mako. However, Cameron Partners had advised Mako to equitise its debt as a pre-requisite for any public listing. This position is reflected in the addition of the equitisation clause in Agreement 2.

[321] Regardless, Agreement 2 came about through Ms Banks' and Mr Banks' existing business relationship with Mr Farmer and Mako. Mr Banks was the party

who suggested a further investment; he was not approached by Mako or by Mr Farmer. My findings in relation to Ms Banks and Mr Banks not being members of the public for the purposes of Agreement 1 also apply here.

[322] I find that no offer of securities was made to the public prior to the allotment of securities by Agreement 2. Mr Banks' claim under this allotment must also fail.

Agreement 3

(a) Factual circumstances

[323] As already discussed, the months preceding this third and final transfer had been challenging for Mako. Mako's situation was set out by Mr Farmer on 5 February 2014 in his email to all of Mako's shareholders.

[324] Prior to this advice, Mr Farmer had told Mr Banks on two occasions not to advance any further funds due to the difficulties Mako was then experiencing. In evidence Mr Farmer said that in December 2013:

> "Adam Banks and [Mr C] had offered to advance further sums, but given the position that the company was in in December 2013, I contacted both of them and advised them not to advance any money whatsoever…"

[325] Against this background, and in fact, despite of it, by April 2014 Mr Banks wished to transfer more funds to Mako. Agreement 3 involved an advance of $500,000 on the same terms as Agreement 2. Agreement 3 was not put in writing. On 4 April 2014 Mr Farmer emailed Mr Banks, providing him with bank account details for Mako's New Zealand account. The final transfer of $500,000 to Mako was made on 24 April 2014 from the New Life Family Trust Account, confirmed in an email by Mr Farmer thanking Mr Banks for the transfer.

(b) Analysis on Agreement 3

[326] I do not accept that in late 2013, given Mako's precarious financial position, the refusal to accept additional funds from investors and the lack of evidence to suggest anything else, Mako would have made, or indeed did make, an offer of securities to the public.

[327] In relation to Agreement 3, the evidence is silent on who approached who first. If Mr Banks approached Mr Farmer, as he did prior to Agreement 2, then no offer could have been made by Mako. If Mr Farmer approached Mr Banks seeking further investment, he did so because of the pre-existing relationship with Mr Banks. Either way the investment was not made as a result of an offer to the public.

[328] For these reasons I find no offer of securities was made to the public prior to the allotment of securities by Agreement 3. Mr Banks' claim under this allotment must also fail.

Liability and relief?

[329] The plaintiff seeks orders under s 37(6) of the Securities Act that the defendants as directors are jointly and severally liable to repay the allotments to the plaintiff in full with interest from the date of each advance.

[330] Given my findings, none of the defendants is liable and no relief is available to Mr Banks.

[331] It is thus not necessary for me to separately determine Mr Frederick's liability in respect of Agreement 1 under this cause of action.[39]

Conclusion on Securities Act claims

[332] For the reasons set out above, I do not accept any offers of securities to the public were made prior to and in connection with the three individual allotments of securities, being Agreements 1, 2 and 3.

[333] It follows that the first cause of action under s 37 of the Securities Act must fail.

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[39] This question arose because as at 4 February 2011, when Agreement 1 was executed, Mr Frederick was not registered as a director. However, given his role as Board chairman and other functions within Mako Holdings at that time, I would have found he was a director pursuant to s 126(1) of the Companies Act as at 4 February 2011.

THIRD CAUSE OF ACTION – BREACH OF DIRECTORS' DUTIES CLAIMS (COMPANIES ACT CLAIM)

Introduction

[334] The third cause of action is brought under s 301 of the Companies Act 1993. The plaintiff alleges that the defendants breached various directors' duties under that Act. Mr Banks seeks an order under s 301(1)(c) requiring the defendants to pay him by way of compensation a sum equal to the total amount he advanced to Mako. That sum, including interest, is in the order of $5 million. Alternatively, Mr Banks seeks an order under s 301(1)(b) requiring the defendants to restore or contribute $29,897,000[40] to Mako. A banning order under s 383(c)(iii) of the Companies Act is also sought.

[335] Specifically, Mr Banks claims that the following duties were breached by the directors:

(a) s 135 (reckless trading), that is not to agree, cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to creditors;

(b) s 136 (improperly incurring obligations), that is not to agree to incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when required to do so; and

(c) s 137 (failing to exercise skill and care), that is failing to exercise the care, diligence and skill a reasonable director in the same circumstances would when exercising powers or performing duties.

[336] Although Mr Banks pleaded that the defendants breached their duty to act in good faith and in the best interests of the company in terms of s 131(1) of the Companies Act,[41] this was not pursued by the time of closing submissions.

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[40] At [201] of Mr Farmer's closing submissions.
[41] Amended statement of Claim of 18 April 2019, at [111] and [112].

Notwithstanding, Mr Johnson submits that aspects of the particulars under this head remain relevant and applicable to the other alleged breaches. These include the following:

(a) misrepresenting the financial position of Mako;

(b) allowing Mako to incur significant debt obligations which created a substantial risk of serious loss to creditors;

(c) restructuring the Telecom liability in 2013; and

(d) failing to put Mako's interests ahead of their personal interests as directors and shareholders.

[337] These are all allegations which are central issues engaged in and relevant to the other duties particularly those under ss 135 and 137.

[338] I address the third cause of action under the following headings:

(a) setting out a summary of the plaintiff's case;

(b) providing background context regarding the Board and its decision-making processes;

(c) addressing the extent to which the defendants may rely on professional and other advice under s 138;

(d) explaining the policy rationale for director's duties in an insolvency context;

(e) assessing each of the alleged breaches of duty in turn; and

(f) determining whether relief is available under s 301.

The plaintiff's case in summary

[339] Mr Johnson summarises the plaintiff's position under the Companies Act cause of action in the following way:

(a) the defendants should have caused Mako to cease trading in June 2013, at the very latest. After that date, they traded recklessly. In doing so, they breached s 135 of the Companies Act;

(b) the defendants entered into contractual obligations with Mr Banks when, at the time each agreement was entered into, they had no reasonable grounds to believe Mako could repay Mr Banks when required to do so. In doing so, they breached s 136 of the Companies Act;

(c) the defendants' conduct in various respects breached s 137 of the Companies Act;

(d) the defendants did not follow the advice that they received from advisors, nor did they call their advisors to give evidence, meaning that in terms of s 138 they cannot rely on that advice as a defence. An adverse inference should be drawn as to what their advisors would have said had they been called as witnesses; and

(e) the above breaches should be remedied by ordering the defendants to compensate Mr Banks directly.

[340] Before I turn to consider each of the alleged statutory breaches, it is necessary to make some preliminary factual findings and observations.

The Board and its decision-making processes

The Board

[341] In discussing whether the directors of Mako were in breach of their duties, it is helpful to preface this with some observations about the company, its Board and how

it operated. In my view, given the nature of the company and its business, the Board, while relatively small in number, was comprised of an appropriate and complementary mix of skill sets and experience.

[342] The Board consisted of five members. Three, Messrs Farmer, Gamble and Massam were executive directors who had been connected to the business from its inception in or around 2002. The other two, Messrs Frawley and Frederick, were appointed in mid-2010 as independent, non-executive directors.

[343] Mr Farmer was appointed executive director and CEO. As earlier discussed, his commercial experience is what led Messrs Gamble, Massam and Monk to invite him to join Mako and take a shareholding. Mr Farmer was responsible for the day-to-day management of the business. He negotiated contracts, obtained and implemented professional advice, sourced investors and liaised with shareholders and investors.

[344] Mr Gamble was a co-founder and executive director of Mako. With extensive IT experience and following his move to the United States, he was predominantly involved in Mako's marketing and sales, particularly in North America. He provided something of a bridge between the technical side of the business and sales and marketing.

[345] Mr Massam was also a co-founder and executive director of Mako. Originally a software developer, Mr Massam's role was to manage the Mako system, oversee PCI-DSS compliance and report to the Board on technical matters impacting the business.

[346] The qualifications and experience of Messrs Frawley and Frederick have also been discussed at [66] to [70].

[347] It was suggested in evidence and submissions that Mr Frederick was not an independent director.[42] However, until Mr Frawley resigned in late December 2013, neither he nor Mr Frederick held shares nor were they involved in any active way in

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42 Mr Killick, an expert called by the plaintiff, suggested that Mr Frederick was not independent because he was a shareholder.

Mako's day-to-day operations. After Mr Frawley resigned, Mr Frederick advanced his own funds to support Mako over the period of its negotiations with Telecom Rentals. The loan was equitised. Thus, at least until the end of 2013, the Board included two non-executive, independent directors.

Board discussions at meetings

[348] Meetings of the Board were monthly, usually by way of telephone conference given that Messrs Frederick and Gamble were resident in the United States. The CFO was also usually in attendance. Minutes were maintained and circulated.

[349] The Board discussions, as recorded in the minutes, broadly reflected the responsibilities and skill sets of the individual directors. Thus, for example, Mr Farmer tended to report on strategic and financial issues, Mr Gamble on marketing and sales and Mr Massam on technical and compliance issues. The independent directors were also active in Board discussions. The minutes are peppered with interjections and observations from Messrs Frederick and Frawley which, to a considerable extent, reflect their particular backgrounds and experience. For example, Mr Frederick frequently tested the basis for the marketing and pipeline assessments while Mr Frawley tended to focus on issues of compliance. There are numerous examples of both throughout the minutes.

[350] Board resolutions were carried unanimously. Although competing views were exchanged, occasionally robustly, decisions tended to be reached by consensus. In perusing the minutes, I did not encounter any resolution which was not subscribed to by all directors.

[351] Although the minutes, from time to time, referred to Mr Banks and his investments, only Mr Farmer ever had direct dealings with him.

[352] I next address the extent to which the defendants might access the affirmative defence of reliance on advice under s 138 of the Companies Act in relation to all the claims for breach of statutory duty.

Adverse inferences and the affirmative defence of reliance on advice

[353] Section 138 of the Companies Act recognises that directors, in undertaking their duties, are entitled to rely on professional advice. The section provides an affirmative defence to a claim of breach of statutory duty by excusing a director who relies on information provided or advice given by an employee, professional advisor or fellow director and who acts in good faith, makes proper enquiries and has no knowledge that such reliance is unwarranted. It is for the director to establish the defence. Thus, a director seeking to rely on the defence is required to adduce evidence establishing the nature and scope of the advice and the circumstances justifying the directors' reliance on the advice.[43]

[354] Mr Johnson submits that because the defendants did not call evidence from their professional advisors, I should draw an adverse inference that had they done so, their evidence would not have assisted them.

[355] An adverse inference of the sort Mr Johnson submits I should draw, may be made where such a witness is in the "camp" of one party such that it would have been natural for that party to call the witness.[44]

[356] The defendants have pleaded s 138 as an affirmative defence to the third cause of action.[45] Specifically, they claim they are entitled to rely on the expert advice given by Mako's employees, professional advisors, experts and other directors. They also claim reliance on the advice of their accountants and auditors, legal advisors, investment bankers and other financial advisors.

[357] Mr Johnson lists the advisors he submits the defendants ought to have called as including Mr McGregor (the CFO), Mr Frawley, Cameron Partners, Deloitte, Bell Gully (including Mr Tingey), McLean Law, Mr Weldon and Mr Sidorenko.

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43 *Morgenstern v Jeffreys* [2014] NZCA 449, (2014) 11 NZCLC 98-024 at [76].
44 At [78].
45 Statement of defence to amended statement of claim dated 18 April 2019, dated 17 June 2019 at [152]-[154].

[358] I am not prepared to reject the defence, to the limited extent it was relied upon, nor draw any adverse inferences against the defendants. My reasons follow.

[359] Mr Johnson refers me to the Court of Appeal's observations in *Morgenstern v Jeffreys*.[46] However, the present case is very different. Mr Morgenstern claimed that he relied on the advice he received from his accountants to repay his overdrawn current account by selling his shares on the basis of a feasibility study. In doing so, Mr Morgenstern gave oral hearsay evidence that he relied on what he claimed his advisors told him to that effect. At first instance, Rodney Hansen J, held that if Mr Morgenstern wished to rely on the advice as a defence, he was required to call evidence from those advisors and in the absence of doing so, the Court was entitled to draw an adverse inference. The Court of Appeal agreed.

[360] In contrast, the contemporaneous documentary record relied on by all parties in this case, including professional advice, has been produced and commented upon by the relevant witnesses, not only Messrs Banks, Farmer, Gamble and Massam, but also the expert witnesses. The documentary record speaks for itself. In material respects, the documents and the statements contained within them were relied on by the plaintiff to support his case, particularly in relation to the third cause of action. Others, both internally and externally, form part of the essential narrative. Some, such as Mr Tingey's advice, were admissible on a limited basis; not as the truth of their contents, but rather as evidence of statements which informed or otherwise caused the defendants to act in a particular way.

[361] I accept that the two Norcal reports authored by Mr Sidorenko were heavily relied on by the directors and thus fall into a different category. However, even the plaintiff's own expert, Mr Fisk, described the Norcal Pipeline Assessment as a very thorough appraisal of the market, a description which Mr Bridgman also agreed with. Indeed, it was the detail of Mr Sidorenko's reasons and methodology which permitted the plaintiff's experts to comment on the reliability of the information the defendants relied on. Finally, and relatedly, I do not detect any material prejudice to the plaintiff's case caused by the defendants' advisors not being available for cross-examination.

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[46] *Morgenstern v Jeffreys* [2014] NZCA 449, (2014) 11 NZCLC 98-024.

Indeed, Mr Johnson did not point me to any aspect of the plaintiff's case which has been compromised by his inability to test the defendants' advisors' evidence. Mr Johnson was able to, and did, make effective and cogent submissions in support of Mr Banks' case on the face of the documents themselves.

[362] I have come to a similar conclusion in respect of Mr Frawley. There was some suggestion that Mr Frawley had been summonsed by the plaintiff, but was, apparently, unavailable to attend the hearing due to a pre-existing commitment. Despite this, Mr Johnson says the defendants should have called him. Again, this is not the sort of situation where the Court's comments in *Morgenstern* apply. As I set out earlier in this judgment, Mr Frawley's views and opinions are captured in the contemporaneous documentary record, mostly in the form of emails and Board minutes. It is difficult to imagine what additional advantage there would have been to either party had he been called as a witness. For the plaintiff, Mr Frawley was portrayed by experts and counsel alike as reflecting the standard required by the Companies Act of the reasonable and prudent director in the circumstances. The defendants' response is that if that is the case, Mr Frawley was a party to the actions of his fellow directors up to the moment of his resignation in December 2013. Thus up to that point, at the earliest, and on the plaintiff's own case, the actions of the directors cannot be faulted on the plaintiff's own case. It is thus difficult to see what prejudice there was to either party arising from the fact that Mr Frawley was not called as a witness.

[363] I next turn to address the policy rationale for directors' duties in an insolvency context, and the application of those duties to the present.

Policy rationale for directors' duties in an insolvency context

[364] Before determining whether the defendants were in breach of any of the ss 135 to 137 duties, I first set out the policy rationale for directors' duties under the Companies Act in an insolvency context. This background is instructive when considering the application of the relevant duties in this case.

[365] Directors' duties were codified in the Companies Act to draw together the various duties found in the common law and scattered throughout disparate parts of

the Companies Act 1955.[47] The purpose of imposing on directors duties, is to constrain for the benefit of shareholders, creditors, and the company entity itself what would otherwise be directors' unfettered control of the company.

[366] The long title to the Companies Act states, *inter alia*, that the Companies Act reaffirms the value of the company as a means of achieving economic and social benefits through the aggregation of capital for productive purposes, the spreading of economic risk, and the taking of business risks; and encourages the efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgement while at the same time providing protection for shareholders and creditors against the abuse of management power. Directors' duties are not intended to prevent the taking of legitimate business risks or constrain genuine business judgement,[48] but rather to protect shareholders and creditors against illegitimate abuses of directors' powers.

[367] Prior to the enactment of the Companies Act, the Law Commission referred to the need for companies to take business risks (in the context of the duty to avoid reckless trading):[49]

> "In the course of restating the liability of directors for reckless trading as part of their general duties during a company's life, we have concluded that section 320 goes too far towards inhibiting the use of the company form as the vehicle for the taking of business risk. A company may be legitimately formed to embark on a speculative or very risky venture, or may undertake such a venture later. The chance of failure —and the prize for success —may be high. Indeed success may greatly benefit the community. Section 2 of the draft Act recognises this as an important function of the limited liability company."

[368] The policy rationale for the duties under ss 135 and 136 overlap to the extent that they both protect against directors taking illegitimate risks at the expense of

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47 Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) at [504].

48 See for example *Madsen Ries v Cooper* [2020] NZSC 100, (2020) 29 NZTC 24-088 at [69] per Glazebrook J commenting that "[t]here has been much criticism of the current wording of s 135 and its deviation from the wording recommended by the Law Commission. One of the main concerns is the extent to which s 135 may inhibit taking ordinary and legitimate business risks. This is particularly acute for businesses that might be high risk but have the potential for high return commensurate with the risk. Another issue arises with regard to companies that might be having temporary financial difficulties and whether in such circumstances it is legitimate to continue trading and, if so, for how long." I consider that Mako is the kind of company contemplated in this passage.

49 Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) at [516].

shareholders and creditors. Sections 135 and 136 are calculated to encourage directors not to exacerbate the indebtedness of their company once it becomes insolvent and, at the same time, to provide some compensation for the body of creditors where this occurs.[50]

[369] Unlike shareholders who have some control over the degree of risk they will permit directors to take with their funds, creditors have no such control. They do not appoint the directors. As the Court of Appeal recently observed in *Yan v Mainzeal Property and Construction Ltd (in liq)* ("*Mainzeal*"), there are "significant information asymmetries between the directors of a company and its creditors".[51]

[370] The directors of an insolvent company or one which is on the threshold of insolvency, may face "perverse incentives" in relation to risk taking.[52] Once the shareholders' funds are depleted, the downside of business risk will be borne by the creditors, not the shareholders. But the upside, if the risk pays off and the company makes gains which bring it back into positive territory, will be enjoyed by the shareholders. So, the worse the position of the company, the greater the incentive for the directors and shareholders to "gamble on the doorstep of insolvency".[53]

[371] The Court of Appeal in *Mainzeal* observed that from the perspective of creditors, there are two broad types of harm that may be caused by a directors' decision to continue trading while a company is insolvent or near insolvency. These are:[54]

> "(a) *Harm to existing creditors:* where a company trades on, but shareholder funds are exhausted, the company is in effect trading on capital provided by the company's existing creditors. If the company makes losses, these losses will be borne by the existing creditors who would otherwise have received a higher dividend in the company's liquidation, had it stopped earlier. The loss they suffer is the difference between the payment they would have received in an earlier liquidation, and the payment they receive in the eventual liquidation;
>
> (b) *Harm to new creditors:* new creditors, who would not have been exposed to the company if the company went into liquidation at an earlier date, may deal with the company and suffer losses in the eventual liquidation. And existing creditors may extend further credit,

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50 Peter Watts *Directors' Powers and Duties* (2nd ed, LexisNexis, Wellington, 2015) at [10.2.1].
51 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [230].
52 At [21].
53 At [231].
54 At [233].

> increasing their exposure to the company. For these creditors, the loss caused by the company trading on is the whole of their new exposure to the company, less any payments received before liquidation or in the eventual liquidation."

[372] Existing creditors may object to the directors' decision to continue trading on the basis that the assets of the company are, in effect, the assets of the creditors.[55] Continued trading in these circumstances may risk depleting those assets at the creditors' expense.[56]

[373] The policy concern for new creditors is that the directors have permitted the company to obtain funds from new creditors where dealing with the insolvent company involved a significant risk for those creditors.[57] If the company is already insolvent and the directors know this, but the creditors do not, extending credit to the company falls outside the normal range of risks the creditors accept when they deal with limited liability companies.[58]

[374] The Court of Appeal considered that there was no policy reason for concern about the position of a creditor who had been provided adequate information about the company's financial position which accurately portrayed the risk of extending credit, and bargained for terms reflecting that risk.[59] The policy concern arises if the risk faced by creditors is outside the normal and acceptable range, and the relevant creditors are not aware of this.[60]

[375] I must also pay heed to William Young J's comments in *Re South Pacific Shipping Ltd (in liq)*, where he said in relation to s 135 that:[61]

> "As drafted the section is capable of misapplication by commercially inexperienced but cautious Judges bringing hindsight judgment to bear in circumstances very different from those which confronted the directors whose actions are challenged."

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55 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [236].
56 At [236].
57 At [236].
58 At [236].
59 At [237].
60 At [237].
61 *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 (HC) at [128(4)].

[376] Against that background, I turn now to consider each of the alleged statutory breaches.

Section 135 – Reckless trading

Legal principles

[377] Section 135 provides as follows:

> "**135 Reckless trading**
>
> A director of a company must not—
>
> (a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors."

[378] In *Mainzeal*, the Court of Appeal set out the obligations of a director under the s 135 duty. The two questions raised by s 135 are:[62]

(a) whether the business of the company was being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; and

(b) if so, whether the directors agreed or allowed the business of the company to be carried out in that manner.

[379] The Court of Appeal elaborated that a creditors' exposure to loss must be a serious one.[63] The risk of that loss eventuating must be substantial, which in this context means "large".[64] Furthermore, it must be the way in which the business of the company is being carried on that is likely to create that large risk of loss. "Likely" in the context of s 135 means "more likely than not".[65]

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62 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [258].
63 At [259(a)].
64 At [259(b)].
65 At [259(c)].

[380] In other words, the question is whether the business of the company is being carried out in a manner that is more likely than not to create a large or significant risk of a serious (rather than minor) loss to the company's creditors.[66]

[381] What is expected of a reasonable director was described by the Court in the following terms:[67]

> "[262] …We consider that s 135 sets an objective boundary, beyond which the scope for directors take business risks is significantly curtailed. Whether that boundary has been crossed should be assessed by reference to the information that was available or should have been available to the director, acting reasonably. A failure to make enquiries that a reasonable director would have made, or seek advice that a reasonable director would have sought, will not protect a director from liability for breach of s 135. This approach leaves proper scope for the exercise of business judgement by directors who are acting reasonably in the performance of their responsibilities.
>
> [263] Thus, as this Court said in *Mason v Lewis*, what is required when a company enters troubled financial waters is a "sober assessment" by the directors, of an on-going character, as to the company's likely future income and prospects.
>
> [264] …If continued trading is expected to result in a deficit, it is not open to directors to trade on in the hope that the deficit will be reduced."
>
> (footnotes omitted)

[382] The Court of Appeal referred to the observations of O'Regan J in *Fatupaito v Bates*, where his Honour said:[68]

> "[67] …I think that the position in relation to s 135, when read together with s 301 is as follows:
>
> - Section 135 imposes a duty which is owed by a director to the company rather than to any particular creditor;
> - The test is an objective one;
> - Although the law reform process makes it difficult to illicit any legislative intent in relation to the wording of s 135, it appears to impose a stringent duty on directors to avoid substantial risks of serious loss to creditors and does not appear to allow for such risks to be incurred, even in circumstances where the potential for great reward exists;
> - In situations where a company has little or no equity (as is the case here), the directors will need to consider very carefully whether continuing to

[66] At [260].
[67] At [262].
[68] *Fatupaito v Bates* [2001] 3 NZLR 386 (HC) at [67].

trade has realistic prospects of generating cash which will allow for the servicing of pre-existing debt and the meeting of commitments which such trading will inevitably attract. As Anderson J said, the reference to "substantial risk" and "serious loss" does appear to set a higher standard than simply any risk at all to creditors which must be inevitable where a company is operating at a loss and has few, if any, realisable assets;

- Where a breach of the duty is found, the assessment of the amount to be paid by a director under s 301 should be "neither more nor less than that [directors] just deserts" (sic)."

[383] Recognising that the decision whether or not to trade on is "difficult and complex",[69] the Court of Appeal referred to the dictum of William Young J in *Re South Pacific Shipping Ltd (in liq)*, when he stated:[70]

> "No-one suggests that a company must cease trading the moment it becomes insolvent (in a balance sheet sense). Such cessation of business may inflict serious loss on creditors and, where there is a probability of salvage, such loss may fairly be regarded as unnecessary. The cases, however, make it perfectly clear that there are limits to the extent to which directors can trade companies while they are insolvent (in a balance sheet sense…) in the hope that things will improve. In most of the cases, the time allowance has been limited, a matter of months."

[384] Drawing these threads together, the Court of Appeal observed that where a company is in a precarious financial position, the following principles apply:[71]

> "[269] …it seems to us that where a company is in a precarious financial position:
>
> (a) The directors must squarely face up to that financial situation and assess the risk of a serious loss to creditors.
>
> (b) If continuing to trade in a "business as usual" manner is likely to create a significant risk of serious loss to creditors, trading on in that manner is not permitted.
>
> (c) A decision to trade on should be made only after undertaking a sober assessment of the likely consequences of doing so. Unfounded optimism is not enough.
>
> (d) A decision to trade on, rather than take immediate steps to cease trading, is likely to breach s 135 unless the manner in which the directors chose to trade on has realistic prospects of enabling the company both to service pre-existing debt and to meet the new commitments which such trading will inevitably attract. It is not enough that there is a realistic prospect that

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69 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [266].

70 *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 (HC) at [125(3)].

71 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 [269].

> existing creditors will be paid by substituting new creditors, who in turn will face a substantial risk of serious loss. Section 135 does not condone a policy of robbing Peter to pay Paul, on the condition that Peter's losses are exceeded by Paul's gains.
>
> [270] If, following a sober assessment of the likely consequences of trading on, it appears that a return to solvency is unlikely, it is not open to the directors of a company to trade on while attempting to rescue all or part of the business. They must either cease trading or take steps to appoint an administrator under pt 15A of the Act to seek to rescue all or part of the company's business."

[385] In order to apply the section in a sensible way, it has generally been accepted that s 135 must be interpreted in a way which penalises only illegitimate risk taking.[72] There are several relevant factors in determining whether a business risk is legitimate or illegitimate, including:

(a) the nature of a company's trading operations and its state of maturity;

(b) the preparedness of directors to introduce their own funds as capital into the business to ensure it continues to trade;[73] and

(c) creditors' knowledge and support for the focal risk. William Young J phrased the question as, "Was the risk understood by those whose funds were in peril?"[74] His Honour further commented that it would be contrary to the principles of limited liability to find directors liable where risks which were recognised by creditors have crystallised.[75]

[386] The Court of Appeal in *Cooper v Debut Homes Ltd (in liq)* affirmed the principle that directors do not become liable under s 135 simply because they continue to trade after a company becomes insolvent.[76] A Court is not to assess the risk of a particular transaction ignoring the upside to the business.[77] It is the risk and loss to the company as a whole.[78] The risk must be considered with the potential advantage

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72 *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 (HC) at [127] and [130].

73 *Jordan v O'Sullivan* HC Wellington CIV-2004-485-2611, 13 May 2008 at [254].

74 *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 (HC) at [125].

75 At [125]. See also *Petros Development Ltd (in liq); Re Advanced Plastics Ltd v Harnett* HC Auckland CIV-2003-404-0633, 15 December 2004; and *Cool Cars (Wholesale) Ltd (in liq) v Sharma (aka Kumar)* [2014] NZHC 583.

76 *Cooper v Debut Homes Ltd (in liq)* [2019] NZCA 39, [2019] 3 NZLR 57 at [31]-[33].

77 At [31].

78 At [31].

of the proposed action to the company and an assessment of how likely it is that the advantage will be enjoyed.[79] Potential downsides must be considered against potential upsides "…otherwise the purpose of encouraging efficient and responsible management of companies in leaving directors a wide discretion in matters of business judgement will be defeated".[80] The Court of Appeal observed that this section must be interpreted in light of its purpose, that is consistent with the long title expressly recognising, as appropriate in the management of a company, the taking of business risks by allowing directors a wide discretion in matters of business judgment.[81] Caution must be exercised to avoid bringing hindsight judgement to bear in circumstances which do not fully and realistically comprehend the difficult commercial choices facing directors.[82]

[387] Relatedly, Tompkins J, speaking extra-judicially, noted that if the risk of loss is reasonably balanced by the prospect of gain, the risk could not be characterised as substantial.[83] In assessing the degree of risk, the Courts are likely to take an attitude which is commercially realistic. The two words of emphasis in the phrase "a substantial risk of serious loss" support the view that a Court is unlikely to consider a director in breach of that duty if the risk of loss created is commensurate with the likelihood of profit.

Plaintiff's submissions

[388] Mr Johnson, while accepting that there can be no dispute that Mako's product had potential, submits the directors failed to put Mako in a position in which it could realise that potential. They overburdened the company with very high levels of debt which prevented it from accessing adequate capital to support growth. Despite being advised by various professionals that this was the case, the directors continued to trade and accumulate further debt while never being able to obtain the necessary levels of capital. Instead, the directors continued to trade in the hope that Mako could bring in new business. They failed to carry out a robust and ongoing analysis of whether

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79 At [33].
80 At [33].
81 At [33].
82 At [33].
83 D Tompkins "Directing the Directors: The Duties of Directors under the Companies Act 1993" (1994) 2 Wai L Rev 13 at [27].

potential sales opportunities were, in fact, likely to be obtained on favourable terms within acceptable timeframes and whether they would deliver sufficient returns. They did not properly consider whether Mako could, in fact, deliver on these opportunities profitably within realistic timeframes given the company's working capital constraints and accumulating losses and debts.

[389] Mr Johnson submits that this is a typical case of reckless trading evidenced by the following:

(a) that Mako, as a group, was balance sheet insolvent from 30 June 2012 at the latest. The directors knew this and to remedy it, decided to book future revenue on Mako's contract with Phoenix. They knew that the business was under-capitalised and were constantly looking for funds to meet the shortfall. Assessing that on a group basis, the directors traded in circumstances where there was a serious risk of substantial loss to creditors from this point. If the Mako companies were liquidated, there would be a significant deficit of assets. There was, clearly, a systemic policy to "trade while insolvent"; and

(b) there is no evidence that the defendants made any sober assessment of Mako's prospects when viewed against the group's insolvency.

[390] I thus turn to the first question which is whether Mako was insolvent and, if so, when. The relevance of solvency is that defendants will be in breach of the s 135 duty if they continued to trade too far beyond the point of Mako becoming insolvent and thereby created the likelihood of a significant risk of serious loss to creditors.

Was Mako insolvent at any point during its trading history?

[391] As discussed, the solvency test under s 4(1) of the Companies Act has two limbs. A company must satisfy both to be solvent. The first limb is cashflow solvency, which requires the company to be able to pay its debts as they fall due in the normal course of business.[84] The second limb is balance sheet solvency, which requires the

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84 Companies Act 1993, s 4(1)(a).

value of the company's assets to be greater than the value of its liabilities, including contingent liabilities.[85] I shall first discuss the question of balance sheet insolvency before examining the issue of cashflow insolvency.

(a) Was Mako ever balance sheet insolvent and, if so, when?

[392] Section 4(1)(b) of the Companies Act provides that to be balance sheet solvent, the value of a company's assets must be greater than the value of its liabilities, including contingent liabilities. When determining the value of a contingent liability, account may be taken of the likelihood of a contingency occurring.[86]

[393] Mr Fisk,[87] one of three experts called for Mr Banks, expressed the view that the Mako group was balance sheet insolvent from June 2012 and that Mako Holdings was insolvent from June 2013. Mr Hussey,[88] called for the defendants, criticised Mr Fisk's approach on the basis it did not consider whether the value of the Mako business might have been such that the group, and thus Mako Holdings, was not balance sheet insolvent. In particular, he stressed the need to include the value of the intangible assets. Interestingly Mr Fisk in cross-examination accepted that if Mako had gone into liquidation at this point, Mr Banks may well have lost everything.

[394] Mr Hussey further explained that the valuation process takes revenues (either historical or future) and multiplies it by a factor (normally calculated by comparison with other businesses operating in a similar market) to derive an enterprise value. The enterprise value is the value of the core business assets net of trade creditors. Equity value is debt subtracted from the enterprise value (exclusive of trade creditors).

[395] In a joint expert statement prepared by Mr Fisk and Mr Hussey before the trial, Mr Fisk stated that balance sheet solvency was better addressed by another expert retained by the plaintiff, Mr Bridgman.[89] Mr Bridgman concluded that the equity value of Mako as at June 2013 was most unlikely to exceed the deficiency in the

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85 Section 4(1)(b).
86 Section 4(4)(a).
87 Mr Fisk is a chartered accountant and Wellington Managing Partner of PwC.
88 Mr Hussey is a chartered accountant and principal and sole director of Hussey & Associates Ltd (a charted accounting practice trading as Hussey & Co).
89 Mr Bridgman is a chartered accountant and Auckland Partner of PwC specialising in corporate finance and restructuring.

group's net tangible assets and that consequently, there was no value attributable to the shareholders' equity. The group would therefore be unable to satisfy the balance sheet limb of the solvency test.

[396] Mr Bridgman's principal reason for this divergence of view with Mr Hussey is that he could not see how Mr Sidorenko in his Norcal Marketing Report of 15 March 2013 could assign Mako a value of between eight and 10 times its revenue when calculating the enterprise value, given the modest size of Mako's business and its steadily declining revenue trajectory.

[397] Despite this, Mr Bridgman did not, himself, carry out a valuation of Mako. His focus was on the multiples adopted in the Norcal Marketing Report and the solvency paper. Mr Bridgman accepted in cross-examination that the likelihood of Mako realising business prospects at the relevant times was relevant to an assessment of value, but he had not carried out the necessary analysis to determine the effect of Mako's prospects on its valuation.

[398] It is helpful in this part of the discussion to remember the purpose for which Mr Sidorenko was instructed by the directors. At the time, in early 2013, Mako was contemplating the possibility of an IPO. As previously noted, Mr Farmer and Mr Gamble had met Mr Sidorenko in the United States. His qualifications for the task are set out at footnote 7 above. Mr Sidorenko undertook a comprehensive market analysis of the United States and global markets for Mako products and solutions in network security, management and monitoring. In explaining the approach to his analysis to Mr Farmer, Mr Sidorenko said that because Mako was anticipating expanding into the United States market over the following three to five years he had focused on Mako's potential in that region, but as Mako also had a global footprint and expected to expand its business globally, he had made "…every effort to include a global perspective where possible".

[399] The multiples required to find that the Mako group was balance sheet solvent during the relevant period are significantly lower than those assessed by Mr Sidorenko.

[400] Properly and responsibly, Mr Bridgman accepted during cross-examination that:

(a) it was not possible to infer with any degree of precision the value of Mako's international business by reference to the sale of its New Zealand-based business operations to Telecom in February 2014;

(b) the Norcal Pipeline Report of 1 July 2013 represented a very thorough appraisal of the relevant market and pipeline;

(c) the purchaser of a business pays for future revenue rather than historic earnings and that a company's value comes from its future prospects;

(d) smaller companies are able to grow more than larger companies which might justify higher forward multiples for the former, reflecting their growth prospects; and

(e) the average revenue multiple of the companies he reviewed almost perfectly matched those calculated in the Norcal Marketing Report.

[401] Mr Bridgman's responses in cross-examination were consistent with applying a multiple of at least five to Mako's historical revenues and 2.5 to Mako's future projected revenues. This is broadly consistent with Mr Hussey's calculations. It follows that Mako was balance sheet solvent during its trading history.

(b) Was Mako cashflow insolvent and, if so, when?

[402] Section 4(1)(a) of the Companies Act provides that a company is cashflow solvent where it is "able to pay its debts as they become due in the normal course of business".

[403] Both Mr Fisk and Mr Hussey agreed that Mako was cashflow insolvent from the point that Telecom Rentals withdrew its funding facility in December 2013. The difference between them is that Mr Fisk was of the view that Mako never returned to cashflow solvency after that point. In contrast, Mr Hussey expressed the opinion that

Mako Holdings returned to solvency after the Telecom Rentals debt was restructured in February 2014. Mr Hussey was of the view that the new business which had been won by Mako was sufficiently significant to affect the assessment of cashflow solvency. Mr Fisk disagreed with this because, in his view, cashflow solvency is the ability of a company to meet its debts as they fall due and future, potential new business will not change a company's solvency, but may carry weight in determining the reasonableness of a director's decision to continue to trade while insolvent.

[404] Mr Hollyman is critical of Mr Fisk's approach. He submits that his interpretation of the cashflow limb of the solvency test is "extreme and would render many successful businesses cashflow insolvent". He suggested it was a commercially unrealistic interpretation and in his cross-examination of Mr Fisk, pointed to various examples of businesses which rely on forward, but unconfirmed, contracts to satisfy the business owner that their enterprise is able to pay its debts as they fall due.

[405] In my view, little turns on this distinction. The question in this case is whether the directors had reasonable grounds to believe they would be able to meet future debts as they fell due through future revenue. Because the fortunes and prospects of any commercial enterprise will fluctuate over time, as they did with Mako, it is necessary to consider Mako's cashflow solvency across its trading history.

[406] As set out earlier, throughout much of 2013, the directors undertook a going concern analysis as part of each monthly meeting. Mr Frawley was actively involved in these discussions, as were his fellow directors. At the December 2013 meeting, which Mr Frawley attended, the question of whether Mako could continue to trade was discussed:

> "Mr Farmer indicated that if the company was placed into any form of insolvency the company's contracts would be void and infrastructure support would not be able to continue operating which would in turn lead [to a] system failure and risk operation at SecureMe. It will also effectively destroy any value the company had.
>
> Directors considered alternatives to accelerate business cash in flows and to reduce costs. Mr Farmer would review non-essential employee costs in an effort to reduce cost."

[407] The Telecom Rentals debt restructure is a critical point in Mako's trading history because it provided Mako with a two year debt holiday. The plaintiff alleges that Mako was insolvent prior to the debt restructure and should have ceased trading before reaching that point. I therefore propose to consider solvency both prior to and following the Telecom Rentals debt restructure.

(i) From Telecom Rentals' withdrawal of funding to the February 2014 debt restructure

[408] The first relevant period is between December 2013 and 7 February 2014. The significance of this period is that it was in December 2013 that Telecom Rentals refused to advance Mako the $5 million it expected to receive that month. The period ends on 7 February 2014, which is the date the parties executed the agreement to restructure Mako's debt.

[409] As already noted, Mr Fisk and Mr Hussey agreed that Mako Holdings was cashflow insolvent once Telecom Rentals withdrew its funding facility. The question is whether the defendants acted in breach of s 135 by continuing to trade while they sought to negotiate an arrangement with Telecom Rentals. This period was some two years and 10 months after Agreement 1 and six months after Agreement 2. The restructuring agreement with Telecom Rentals was concluded approximately two-and-a-half months before Agreement 3.

[410] The experts disagreed on whether Mako should have continued to trade during this period. Mr Fisk opined that Mako never returned to solvency after December 2013 as a result of its contingent liability to Telecom Rentals. He considered that the group was likely to run out of money by the end of January 2014.

[411] On this point I prefer Mr Hussey's evidence over that of Mr Fisk. I consider Mr Hussey's evidence more commercially realistic and consistent with the approach the Courts have previously taken on the issue. Mr Hussey said that it was appropriate for the directors to continue to trade while they considered the company's position and entered into negotiations with Telecom Rentals with a view to reaching an agreement with Mako's largest creditor. That agreement would permit it to continue to trade in what Telecom Rentals itself described as the "short to medium term". Telecom Rentals

had the option of exercising its rights under the debt security. It elected not to and, instead, entered negotiations.

[412] The decision of the directors to trade on must be viewed in that context. Mr Johnson is correct the Weldon Report gave little comfort. It recognised that although Mako had areas of true distinctiveness there were real issues around debt and the ability to fund growth. However, as Mr Frawley observed to his fellow directors, none of this was a surprise and neither could it have been. On the other hand, the two Norcal reports of March 2013 and July 2013 provided an independent basis for the directors to reasonably believe the company was viable and the prospective work in the pipeline, and other global opportunities, were positive. Mr Johnson was critical of Mr Sidorenko and the reports. He submitted limited weight should be given to this evidence because Mr Sidorenko was an employee of Mako. However, the evidence is that this occurred some time after the reports had been completed. The payment of Mr Sidorenko's fee was converted, in full or in part, to equity as Mako's advisors had suggested. Mr Gamble's evidence was that Mr Sidorenko first indicated an interest in becoming involved in Mako after he had completed his reports. An employment agreement dated April 2015 tends to support that claim.

[413] There were other criticisms of the report and its methodology by the plaintiff's experts. However, to some extent these criticisms tend to miss the point. Unless the shortcomings were sufficiently gross and thus obvious to the directors, which I do not accept they were, the commissioning of both these reports is instructive. It is relevant to each of the duties in question. That the Board turned to an independent and, from all accounts, highly qualified expert in the field to advise on the company's value and undertake an in-depth analysis of the market and strength of Mako's pipeline, tends to undermine the suggestion that the defendants were commercially irresponsible, unrealistic and trapped in their own bubble of unfounded optimism.

[414] It is also noteworthy that the directors took a number of strategic and commercial steps during this period of negotiation:

(a) Mako's staffing complement was reduced by 55 per cent;

(b) both Mr Farmer and Mr Frederick personally advanced just under $1.5 million to the company in December 2013 to ensure its survival in the interim;

(c) following indications from Mr Banks in November 2013 that he wished to advance further sums, Mr Farmer was frank about Mako's position. On 24 December 2013, he told Mr Banks to hold off any investment and promised to get back to him when Mako was able to accept his offer. Then, a month later on 21 January 2014, while negotiations with Telecom Rentals were still in train, he told Mr Banks that there were some real challenges with Telecom Rentals suspending Mako's funding facility and that although there were options, the situation was uncertain;

(d) on 5 February 2014 Mr Farmer sent all shareholders, including Mr Banks, an email inviting them to a SGM to ratify the solution to accept the agreement Mako had negotiated with Telecom Rentals. The adverse consequences to Mako of accepting the arrangement were expressly stated in that communication as was Telecom Rentals' proposal to take security over Mako's assets;

(e) the directors actively sought investment from wealthy investors (excluding Mr Banks) and explained the reasons for the urgency; and

(f) the directors received legal and insolvency advice from professionals.

[415] Thus, the question is whether continuing to trade during this period could be described as illegitimate risk taking. In addition to adopting the measures discussed above, the defendants carefully reviewed both the downsides and upsides of continuing. They appropriately assessed the future prospects of the company. An example of this may be seen in the Board minutes of January 2014. This meeting was devoted to whether the Board should accept Telecom Rentals' offer of a possible restructure although, at that point, it seems no details of what Telecom Rentals would propose were known to the Board.

[416] Mr Farmer advised the Board that he had been in discussions with Mr Tingey of Bell Gully. The legal advice was that Mako was not in default, meaning that Telecom Rentals could not appoint a receiver. Mr Farmer listed some 22 potential investors including four who had apparently been introduced by Mr Tingey and who had expressed an interest in investing in Mako. He proposed to invite investors to participate in a one-off round of immediate cash injections to be converted to heavily discounted equity at the time of capital raising activity. The objective was to offer an emergency funding round to bridge the business until an IPO. As part of this discussion, Mr Farmer asked Mr Gamble to report on sales. Mr Gamble noted that the Sprint deal, would, when signed, return US$42 million of revenue over two years. The discussions then moved to whether Mako should continue to operate while it was insolvent. At this point Mr Tingey joined the meeting by telephone. The minutes record that Mr Tingey explained that when a company is in financial trouble, the directors could be personally liable for the incremental liabilities incurred should the company have ceased trading. The minutes record, *inter alia*:

> "The liability in question is not the total debt of the company it is the incremental liabilities incurred from the time the company should have ceased trading. Incurring debt is entering an obligation (with knowledge the company should have ceased trading) not the date when it is due. The courts would typically judge the degree of risk taken by continuing trading for a few days, if it is considered in the creditors' best interest this is a possible defence. Directors would need to form a view on the likelihood of any deal succeeding."

[417] After Mr Tingey left the meeting, the Board turned its mind to the issues raised by Mr Tingey. The minutes record:

> "The proposed actions were considered in the best interests of the creditors as immediately ceasing trading would be destructive to value and could potentially disrupt Telecoms SecureMe service (without a satisfactory plan of action).
>
> The investment proposal if successful would clearly be the best result for the company and its creditors.
>
> Directors considered the prospects of the investment proposal succeeding, the outcome was highly uncertain however, if successful the solution could potentially see the business achieve its potential targets and be in a position to eventually settle [Telecom Rentals'] debt.
>
> The Chairman tabled a resolution to proceed with the investment proposal. Directors unanimously agreed to the investment proposal outlined by Mr Farmer."

[418] Given all these circumstances, I do not consider that the directors can be criticised. They knew that they were in troubled financial waters. They undertook a sober assessment of the company's future prospects. They invested personally. They warned future creditors and investors and they took active steps to reduce their overheads. Furthermore, if Mako had ceased trading at this time Mr Banks would have received nothing. The decision to trade on could only have operated to enhance his prospects of recovery whether through loan repayments or equitisation on favourable terms.

[419] Accordingly, I am satisfied the defendants were not in breach of the s 135 duty in continuing to trade in the period after Telecom Rentals withdrew funding until the consequent debt restructure.

(ii) From the Telecom Rentals debt restructure to the failure of the Sprint deal

[420] The second relevant period begins on 7 February 2014 when, following intensive negotiations, the directors of Mako signed the restructuring agreement with Telecom Rentals. The restructure had an immediately beneficial effect on Mako Holdings and the Mako group. There were, of course, also adverse consequences to Mako. The arrangement resulted in the sale of the SecureME business for $3 million resulting in an annual loss of revenue to Mako of approximately $750,000. It also led to the shedding of employees, including research and development staff, a serious consequence for an IT development business. But the arrangement did permit Mako to continue to trade. In addition to the funds released from the sale of the SecureME product, Telecom Rentals agreed to advance a further $2 million to Mako with repayments suspended for two years until 29 February 2016. Mako's debt, then sitting at $26.8 million was required to be repaid over 36 months but with those repayments not commencing until 29 February 2016.

[421] Mr Fisk considered that the Telecom Rentals debt restructure did not solve Mako's cashflow difficulties. He acknowledged that it provided the group with some reprieve from repaying the debt obligation. The restructure did not, however, provide an alternative source of funding that would enable Mako to pay its debts as they fell due.

[422] Mr Fisk's interpretation of Telecom Rentals' actions was that Telecom Rentals found itself in a position where it had already advanced significant funds to Mako and was significantly exposed through lack of security. Had it taken steps to enforce its security, it would likely have suffered a significant shortfall. Accordingly, in Mr Fisk's view, Telecom Rentals had nothing to lose by giving Mako more time to try to get back on its feet and meet the potential which the directors saw in it. Mr Hussey agreed with this assessment in cross-examination. In other words, it should not be inferred that Telecom Rentals' decision to restructure the debt rather than wind Mako up reflected a significant degree of confidence in Mako's ability to trade out of its difficulties.

[423] Another positive development during this period was that the statutory demand served by GPC, a United States-based product supplier to Mako, was pursued. Instead, a repayment arrangement had been entered into to reduce the debt which at that time stood at US$1.25 million.

[424] Thus two of Mako's principal creditors, Telecom Rentals and GPC, were aware of Mako's position and supported the decision to continue trading. Mr Banks had indicated some second thoughts about a third investment. Mako agreed to restore him to being a creditor. He was aware of the consequences of the Telecom Rentals debt restructure and despite this, maintained his investment.

[425] Mr Hollyman asks the question, why then would the directors put the company into liquidation at this time? Liquidation would guarantee substantial loss to all creditors. Continuing to trade had the real potential to deliver up substantial value to the company and its creditors. He notes that Mr Hussey supported such an analysis given that the Telecom Rentals debt had been restructured and Mako had a two year debt holiday. At that time, it was expected the Sprint deal would be signed in mid-2014.

[426] I agree with Mr Hollyman. From the directors' point of view, Mako now had $5 million in cash in hand and no repayments due for another two years. GPC was sorted. This placed Mako in a position to pursue the sales and other business opportunities which the directors, particularly Mr Gamble in the United States, had

been working on in the previous months, including throughout the period the company was negotiating with Telecom Rentals.

[427] Of these, the negotiations with Sprint were the most promising. According to Mr Hussey, Sprint was the third largest telecommunications provider in the United States with a capital value of $40 billion as at early 2014. Plainly, on its face, it had ample financial capacity to fund the purchase of product and services from Mako with sales estimated at approximately US$42 million.

[428] Negotiations on the Sprint deal had begun well before the debt restructure. In September 2013, Mako and Sprint had entered into the "teaming agreement". This recorded that Mako had developed a commercially available software which utilised Sprint's systems and devices. The agreement authorised Sprint to provide Mako's system to Sprint's users and for Sprint and Mako to exchange information and explore potential co-marketing opportunities.

[429] On 21 January 2014, Sprint made a two-year commitment to purchase 50,000 units from Mako. The Board minutes of January 2014 record Mr Gamble advising the Board that the Sprint deal, when signed represented "$42 million of revenue over 2 years (minimum commitment)".

[430] According to Mr Gamble, he met with Sprint's senior sales leadership team at their global headquarters in Kansas City on multiple occasions. Mr Gamble's evidence was that Sprint had committed internally to getting Mako "productized" by the end of March 2014 and selling 1,500 Mako units in the following nine months. In an email to Mr Farmer on 14 January 2014, Mr Gamble reported on his discussions with senior Sprint personnel. He said that at the beginning of December 2013, he had met with the Vice President of "Emerging Products" and other senior figures in the retail and marketing teams. He said that it was clear that Sprint was taking Mako extremely seriously:

> "[T]hey told us they had committed internally to getting Mako productised by the end of March and selling 15,000 Mako's in the following nine months. They also told us that Sprint is not used to purchasing in bulk but rather prefers contracted term and volume commitments…

> On January, 8 [Sprint] called Mako to confirm that Sprint found the pricing acceptable and that they were likely going to move forward with the 50,000 unit commitment over two years. The next step is for them to present Mako with a contract and they expect some negotiation to take place between Mako and Sprint. Part of this negotiation with (sic) include Sprint's internal stocking order which I anticipate will be 5,000 Mako appliances and associated licences. [Sprint] confirmed that they are still on track and have the desire to complete this process before the end of March.
>
> [Former Sprint staff] tell me that for Sprint to move so quickly from teaming to productisation is very rare. From our discussions with Sprint's senior management and their sales teams, it is obvious that there is a lot of optimism and opportunity for Mako within Sprint. We even had Mako personnel and hardware on display at Sprint's booth at this week's National Retail Federation show in New York City. Anecdotally, Sprint will only commit to 50% of what they believe they can sell in a given period. I believe this bodes well for Mako."

[431] Contracts had been sent to Sprint. Pricing was submitted. However, an obstacle emerged. Sprint was refusing to prepay and Mako did not have the financial capability to manufacture the necessary hardware to supply Sprint. On 3 April 2014, Mr Gamble emailed Mr Callendar at Sprint:

> "Further to our discussions last week there are matters that Mako need to be sure of as we go into the contract finalization stage.
>
> As previously discussed, Mako is a hi-growth new US market entrant and as such, does not have the balance sheet to fund financing of Sprint's requirements. The pricing that we have submitted reflects this and Sprint performing that obligation. Should you require us to introduce a financier, we have identified a few that have indicated an interest in performing this function but they will need to be a party to the negotiations as they will be financing Sprint not Mako. Can you please confirm for me which paths Sprint will be pursuing so I can make any necessary arrangements.
>
> Further to this, your sharing of projections last week is really appreciated. In fact, this will be an essential element of ensuring ongoing timely supply of the hardware given the management of long lead-time components. We are currently preparing to gear up for the original 5,000 unit order and the earlier we can confirm this the better we will be placed to ensure the product arrives in an appropriate time frame. Given all the sales opportunities, it seems prudent to have product sooner rather than later.
>
> I am very much looking forward to getting through the contract phase and into the exciting time that awaits."

[432] Three weeks later on 26 April 2014, Mr Gamble emailed Mr Farmer with a draft of an email he proposed to send to the Board. It confirmed that Sprint was not

willing to meet the costs of supplying the hardware. Relevant portions of the email are reproduced below:

> "Dear Mako Board Members,
>
> I wanted to update you on recent happenings regarding Sprint commercialization and third party financing to Sprint for the Mako system.
>
> Last week on a call with Christopher Callender and Scott Smeltzer of Sprint, I felt there had been a change in how commercialization was progressing. It felt as if there was a lot of push back on Sprint purchasing our solution in bulk and providing support and other services required of our partners.
>
> …
>
> On Monday of this week [21 April 2014] I had quite a long conversation with Christopher regarding my concerns. It turns out that they were correct. He confirmed that Sprint is unwilling/unable to buy product in bulk up front or warehouse & stage. They are happy to provide tier one support and warm hand shake calls requiring Mako assistance to our help desk.
>
> When I reminded Christopher that in December he had indicated Sprint was most interested in the 50k term and volume commitment and associated pricing, I was told that they are not willing/able to make such a commitment…
>
> I had a follow up conversation with Christopher and Scott yesterday where I asked them to provide me in writing what deal is actually on the table. I reminded them that since January they have had our contract provided at their request which outlines how things were to be constructed from our perspective and have had no such documentation from them. I asked them to specify what is likely to be different from our existing teaming agreement as well as how they would promote the solution, incent (sic) their sales people, sales projections etc. I was promised this by COB today. During this call they reinforced their desire to make this a successful relationship, how their help desk would work and that they were unlikely to be able to make any volume commitment.
>
> In return, they asked that I help Sprint with some of their due diligence by providing them with some information on the history, success and current status of our carrier partners…
>
> I have also been working on financing for Sprint so they could bulk purchase Mako hardware and licences at an MRC while Mako gets paid upfront (a solution that now seems redundant). Much of this work has been through Wells Fargo through an intro from Financial Technology Ventures. Wells have been trying to identify which group is best to provide such financing…
>
> They came back to me within four days stating they are unable to fund Sprint but would be interested in working on us on other deals.
>
> Today I spoke with my contact at Wells about the reasons why Var Resources couldn't fund Sprint;…They do not have issue with Mako's product. They had concern over financing Sprint over a three year term. They indicated that

> other customers such as Chevron would be fine to finance. Sprint's current reporting and the junk status of its bonds influenced their decision…
>
> I wanted to provide this information to you in a factual manner without my personal interpretation.
>
> Warm regards
>
> Simon"

[433] I accept that at around this time there were other promising opportunities which are recorded in the Board minutes, particularly the 11 March 2014 meeting. Bullseye had ordered a further 50 units for Fisher Auto Parts and had brought another two deals to the table. Phoenix had registered a new opportunity through WorldPay, for a 1,300 store sandwich chain. There was also a new sales initiative with Birch Telecom, and positive negotiations with Telstra.

[434] The Sprint negotiations were reported on. It was noted that a decision was still pending from Sprint on the particular type of contract; a Master Service Agreement or Master Product Agreement. It was reported that final negotiations would start once that issue had been determined. Mr Gamble reported that Sprint continued to promote Mako financing the business, and that he had been in discussions with Wells Fargo, Hi Wire and Brightstar in relation to this.

[435] This combination of evidence leads me to conclude that in the minds of the directors, particularly Mr Gamble who was on the ground in the United States and was actively involved in negotiations with senior Sprint executives, that until 26 April 2014 there was a reasonable and legitimate expectation a binding agreement with Sprint on the terms discussed was imminent. All Mako was waiting for was confirmation from Sprint as to which form the contract would take and how the upfront costs of producing the hardware would be financed. Mr Gamble was having discussions with other parties on how that would be achieved.

[436] Negotiations with Sprint continued. In evidence Mr Gamble said that Sprint's stance amounted to a material change in their position and so he "swung into action to salvage the Sprint deal in the best way we could". He decided that he and Mr Farmer should meet with a Mr Nasser, Mr Callender's senior. The meeting took place in early May 2014 following which Mr Gamble sent Mr Nasser an email confirming aspects

of their discussion. The email notes that the contract between Mako and Sprint would ostensibly be a resale agreement. Sprint would contract and bill all end users. Initially, Mako would provide the hardware on consignment and be paid for it as it was drawn down and installed.

[437] Mr Nasser responded on 17 May 2014 by indicating that the parties were not perfectly aligned in terms of their respective understanding.

[438] The meeting with Mr Nasser was discussed by Mr Farmer when the Board met on 16 May 2014. He referred to the refusal by Sprint to pre-purchase Mako inventory as part of their supply agreement. Mr Farmer reported that Mr Nasser was very keen to have Mako as their only PCI-DSS compliant service but could not agree to "upfront" the purchase. He said that the pricing had not been agreed, but the supply agreement was intended to be a resale agreement with pricing mutually agreed.

[439] While it is difficult to pinpoint precisely when the directors knew or ought to have known the Sprint agreement was unlikely to be concluded, I am satisfied that a sober and objective appraisal of all the circumstances in late April to mid-May 2014 at the earliest would have led the directors to conclude that it was unlikely an agreement with Sprint acceptable to Mako would be obtained. Certainly, by mid-2014, the satisfactory conclusion of the Sprint deal was seen as a forlorn hope, as is apparent in Mr Farmer's email to the Board members on 6 July 2014. He described the position with Sprint in the following way:

> "Sprint is at best a mess. Even if the end user pays for the hardware it now appears that they have no capability for delivery and logistics and will not provide any comfort on-going payment of services. We could use D&S but will have to have a separate SOW that they will not be able to fund and as such we will not receive any up front cash benefits. Certainly does not seem like a deal we should be chasing. Are we going to be able to continue with the Teaming Agreement? If so how are we going to get the sales personnel motivated to recommend Mako?"

[440] I consider the earliest point at which Mako could be cashflow insolvent is at the point where the Sprint deal, objectively assessed, looked unlikely.

[441] I therefore turn to consider at what point after the Sprint deal looked unlikely the directors were in breach of the s 135 duty.

At what point after the failure of the Sprint deal were the directors in breach of s 135?

[442] I preface this discussion by noting, as Mr Hollyman submitted, that Mako's corporate identity is a relevant contextual factor in determining whether the defendants breached s 135. After Mako obtained its PCI-DSS certification in 2010, it was a high growth company seeking to establish itself in lucrative global markets. This can be contrasted with Mainzeal from *Mainzeal*, which was a well-established company chaired by a former Prime Minister. Mako's inherent risk profile was clearly much greater than that for an established company with a settled market presence.[90]

[443] Mr Hollyman points out that in the period April to June 2014, while trading was admittedly difficult for Mako, it still had sufficient funds to pay all wages and other outgoings through to the first week of June 2014. He submits that despite the difficulties of the Sprint negotiations and Sprint's change in stance, there were other market opportunities which justified optimism. Mako was working hard to conclude its financing and distribution agreement with D&S. The Norcal Pipeline Assessment Report had identified a very substantial potential market, particularly in the United States, and there were other business opportunities discussed as identified in the Board minutes of 11 March 2014.

[444] There is some force in Mr Hollyman's submission. While the Sprint deal had not progressed as planned, Mako still had other business opportunities from which it expected substantial financial returns. These were available due to the debt holiday offered by Telecom Rentals. For those few months, the commercially realistic option was to pursue available opportunities while continuing to negotiate with Sprint in the hope of reviving the deal. The counterfactual of Mako simply cutting its losses in April offered no realistic prospect of generating a return which could be used to repay creditors. If Mako ceased trading at this point, it was inevitable that all creditors would have suffered substantial losses. While trading on necessarily meant that debt would

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90 See *Mainzeal Property and Construction Ltd v Yan* [2019] NZHC 255 at [276] per Cooke J commenting that "From the creditors' perspective, failure would have been seen as a low risk. This was a well-established company, chaired by a former New Zealand Prime Minister. It was not a new company in start-up mode. These are relevant considerations in identifying the dividing line between the risk to creditors subsumed within the normal trading risks of a company, and the substantial risk of serious loss to the creditors with which s 135 is concerned."

be incurred, the upside was the securing of imminent contracts worth millions of dollars and the consequent reduction of risk to creditors.

[445] Mr Hollyman notes that in June 2014, Mr Farmer loaned Mako funds to cover its PAYE obligations. In July 2014, Mr Gamble loaned $150,000 to Mako using money he had borrowed from his mother. The Sprint negotiations continued and Mako was in discussions with D&S which eventually led to the signing of an agreement on 21 July 2014 to assist, in part, with the roll out of the Mako System to Chevron and otherwise to assist Mako in funding its business. This unlocked immediate cashflow for Mako and allowed it to continue to trade.

[446] Mr Hollyman submits that similarly, in the period August to December 2014, it was appropriate for the directors to continue to trade despite the tight cashflow. By this time, they were negotiating with Goldman Sachs. In September 2014, BP indicated it intended to conclude the contract documents by the end of November 2014 and expected to carry out a non-competitive trial in January 2015 with the roll out intended for April 2015. Mako was advised it was the exclusive provider frontrunner for BP.

[447] Mr Hollyman submits that the directors' decision to keep trading was vindicated when, in December 2014 and January 2015, Mako received oral and then written confirmation it had been selected to provide BP with secure transaction facilities. This justified the directors' decision to continue trading, with D&S continuing to financially support Mako while it sought to finalise the contract with BP.

[448] In June 2015, the contract with BP was finally executed and Mako was set to sign up as many BP fuel service stations as possible. One thousand service stations had indicated they would sign up with the expectation that the final number would be the order of some 4,000 sites.

[449] Ultimately, the delays in rolling out the Mako solution to the BP sites combined with the fact that D&S could no longer financially support Mako, led to the directors, responsibly so in Mr Hollyman's submission, resolving to put the company into liquidation in August 2015. Mr Hollyman submits it was appropriate for the directors

to continue trading until this point because they reasonably believed the BP contract would begin to generate revenue shortly after it was executed and because they believed D&S could continue to provide funding in the interim.

[450] When it became clear that was no longer the case, Mr Hollyman submits the directors took the responsible step in terms of their duty under s 135. Until that point, Mr Hollyman submits, it was entirely appropriate for the directors to permit Mako to continue to trade. Until then, the directors had not exposed the creditors to any risk of serious loss.

[451] In all the circumstances and while being conscious that 20/20 hindsight may have the effect of distorting an assessment, which the Courts have consistently acknowledged is often a difficult, complex and finely balanced one for directors to make, I do not accept that Mako should have continued to trade beyond the point when it became likely the Sprint deal would fail. While the directors' decision to keep trading may have been vindicated by subsequent events at the end of 2014 or early 2015, particularly when Mako received confirmation it had been selected to provide its services to BP, that does not change my assessment that from about the time that a successful conclusion of the Sprint deal became unlikely, the creation of a substantial risk of serious loss became more likely than not. That assessment needs to be made by reference to the information available to the directors at the relevant time, which in my view was the period of a few months following the Telecom Rentals debt restructure. That hindsight might now reveal later circumstances which could justify extending the period of trading is not a legitimate consideration when assessing whether, at a particular point, the s 135 duty was breached.

[452] In my view the totality of the information available to the directors at about the time successfully concluding the Sprint deal looked unlikely was when Mako should have stopped trading. This was late April to mid-May 2014. Had the Sprint deal materialised, the funds available to Mako under the contract would have been sufficient to meet not only Mako's indebtedness to Telecom Rentals but also its liability to Mr Banks. It would have provided sufficient cashflow over the ensuing two years to return Mako to a fully solvent position. The company would have secured breathing space and a source of working capital to pursue other potentially lucrative

commercial opportunities such as Chevron and BP without relying on others, such as D&S, to fund the shortfalls. Without the Sprint deal, however, there was no objective or realistic hope of returning to cashflow solvency. Makos other deals never could have brought it back from insolvency, and the company would have had to trade while insolvent for an extended period to complete them.

[453] The decision to trade on was not one, as the Court of Appeal in *Mainzeal* put it,[91] that had realistic prospects of enabling the company both to service pre-existing debt and meet the new commitments which such trading would inevitably attract. It was apparent that a return to solvency was unlikely, and it was not open to the directors to trade on while attempting to rescue all or part of the business.

Conclusion as to breach

[454] As noted, the earliest point at which there could have been a breach of the s 135 duty was therefore after the failure of the Sprint deal at the end of April to mid-May 2014.

[455] However, the effect of this finding provides no room for relief for Mr Banks. By late April he had already advanced his funds under Agreement 3. That Mako continued to trade for another 14 months after that does not affect the conclusion. Mr Banks was not at risk of further loss resulting from Mako continuing to trade beyond the end of April to mid-May 2014.

[456] His claim for compensation for a breach under s 135 must fail.

Section 136 – Improperly incurring obligations

Legal principles

[457] Section 136 provides as follows:

> “**136 Duty in relation to obligations**

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[91] *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [265] citing *Fatupaito v Bates* [2001] 3 NZLR 386 (HC).

> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so."

[458] Section 136 claims may relate to specific obligations, an identified class of obligations, or all obligations and occurred by the company after a given point.[92] The director must have agreed to the company incurring the focal obligation.[93]

[459] In *Fatupaito v Bates*, O'Regan J noted that s 136 has both subjective and objective elements.[94] It requires the plaintiff to establish that:[95]

> "[the director] agreed to the company incurring an obligation at a time when [they] did not believe (the subjective test) on reasonable grounds (an objective test) that the company would be able to perform that obligation when required to do so."

[460] There are two ways of satisfying this test. The first is to establish that at the time the obligations were entered into, the director did not believe the company would be able to perform them. The time at which the required belief is to be proved is the time when the obligation is incurred.[96]

[461] The second is to show, if the director did subjectively believe the company would be capable of performing the obligation, such a belief was unreasonable. Here the focus is on what the director knew or would have known had they made the inquiries a reasonable director would have made.[97] A director cannot rely on matters known to them which suggest the obligations will be met if a reasonable director would have made further inquiries, and those further inquiries would have revealed that there was a substantial risk that the company would not be able to perform the obligation in question when it fell due.[98]

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92 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [283].
93 At [284].
94 *Fatupaito v Bates* [2001] 3 NZLR 386 (HC) at [80].
95 At [80].
96 *Jordan v O'Sullivan*, HC Wellington CIV-2004-485-2611, 13 May 2008 at [60].
97 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [285(b)].
98 At [285(b)].

[462] Both counsel referred me to the following observations of Clifford J in *Jordan v O'Sullivan*:[99]

> "[58] Where the ability to meet the obligation is dependent on anticipated income, the reasonableness of expecting this income to eventuate is highly relevant. In *Re Wait Investments Ltd (In Liquidation)* [1997] 3 NZLR 36 for example, Barker J concluded (at 103) that the directors were in breach of s 320(1)(a) in circumstances where their expectation that the company would be able to raise finance and thus pay the debt in question was "unduly optimistic and without proper foundation".
>
> [59] Section 136 does not appear to require that the company's ability to meet the obligation arises from the company's separate resources, as long as the director believes on reasonable grounds that the company will be able to do so. Therefore, it would appear that a director who believes, on reasonable grounds, that the obligation will be met by means of shareholder or director contributions will not breach the duty. That s 136 will not be breached if director contributions are reasonably anticipated is implicit in the judgment of Paterson J in *Ocean Boulevard Properties Ltd v Everest* (2000) 8 NZCLC 262,289. In concluding that s 136 has been breached, Paterson J noted at [10] that "[i]t must be inferred that the directors did not have the intention or the capacity to contribute funds for the conduct of a business"."

[463] Clifford J also considered that an illegitimate risks test could be useful in the application of s 136 as with s 135:[100]

> "[61] In terms of the relationship between s 135 and s 136, it has been noted (see, for example, *Goatlands Ltd (in liq) & Ors v Borrell & Anor* (2007) 23 NZTC 21,107 at [113]), that s 136 may be the more apposite section where the challenged conduct relates to the incurring of specific liabilities, rather than a course of conduct over an extended period of time.
>
> …
>
> [63] It would, in my view, be surprising in these circumstances if a director's behaviour was to be assessed against the materially different standard depending on whether a particular obligation was incurred as part of a continuing series of transactions, or where it was incurred as part of a stand-alone transaction. Both situations can properly, in my judgment, be assessed according to whether the decisions taken by the defendants evidenced the taking of a "legitimate" or "illegitimate" risk, with that question being assessed on the basis of the type of consideration outlined by the Court of Appeal in *Mason v Lewis*."

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[99] *Jordan v O'Sullivan* HC Wellington CIV-2004-485-2611, 13 May 2008 at [58] and [59].

[100] At [61]-[63].

[464] In *Mainzeal*, the Court of Appeal commented that the two stage inquiry under s 136 requires some specificity in relation to the obligations or class of obligations in issue.[101] It is necessary to identify:[102]

(a) when the relevant obligations were incurred;

(b) when those obligations would fall due;

(c) what the director believed, at the time the obligations were incurred, as to the ability of the company to meet the obligations at a future time when they would fall due; and

(d) the grounds for the director's beliefs.

[465] It thus follows that in this case, I must examine the circumstances at the times the obligations were incurred by Mako. In other words, at the time at which each of the three agreements was entered into.

Plaintiff's submissions

[466] Mr Banks pleads that the defendants breached s 136 by incurring obligations to Mr Banks and to Telecom in circumstances where the defendants could not have believed on reasonable grounds that Mako would be able to perform its obligations when required to do so, having regard to:

(a) Mako's mounting debt levels;

(b) Mako's failure to meet projected revenue forecasts;

(c) Mako's lack of confirmed future revenue/sales; and

(d) various other "red flags".

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101 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [286].
102 At [286].

[467] I turn now to consider each of the three agreements in turn.

Agreement 1 – 4 February 2011

[468] Under Agreement 1, Mr Banks advanced three tranches. Tranches 1 and 2, for £130,000 and £547,000 respectively, had two-year terms with a notice period of six months. Mr Johnson concedes that the directors would have had reasonable grounds to believe that Mako would be in a position to repay Tranches 1 and 2 at the time the obligations under Agreement 1 were incurred.

[469] However, Mr Johnson takes a different position in respect of Tranche 3. He submits there is no evidence to suggest that Mako could repay Mr Banks the £500,000 principal plus interest on three months' notice. That is particularly so, he submits, given that the directors knew or ought to have known that Mako would significantly undershoot its revenue forecast for the year, resulting in less cash than expected. He submits that the directors were aware that Mako Holdings would become responsible for the Telecom Rentals debt, an important factor that was discussed at the Board meeting on 20 June 2013. The directors knew this would result in Mako Holdings breaching its agreement with Mr Banks. To this Mr Johnson adds that the directors' belief needs to be viewed in the context of Mako consistently missing its revenue forecasts. They knew an IPO was unlikely. They knew that the company was facing a significant cash outflow over the next 12 months. Assuming the Telecom Rentals facility could be drawn down to meet Mako's commitments, the ability to meet those and repay Mr Banks within three months if required must be, Mr Johnson submits, a very open question.

(a) Subjective belief

[470] The first inquiry is to ask whether, at the time the obligation was incurred, the defendants subjectively believed Mako would be able to perform the obligation when it fell due. Although the agreement recorded the date of the third advance as 10 March 2011, the obligation to repay, that is when Mr Banks could first demand repayment, was three months after Agreement 1 was executed, that is 4 May 2011.

[471] On this issue there can be little doubt that the defendants subjectively believed the company would be able to repay Mr Banks the sum of £500,000 from 4 May 2011.

(b) Reasonable grounds for that belief

[472] The second inquiry, and the central question under this heading, is whether the defendants had reasonable grounds for that belief.

[473] I agree with Mr Hollyman that the defendants' belief was reasonably held for the reasons he advances. First, Mako already had substantial reserves accruing from its New Zealand-based operations and had trading revenues of over $3.7 million in the financial year ending 30 June 2010. Secondly, it had only relatively recently become the first company in the world to achieve PCI-DSS certification. Thirdly, the defendants had determined that they would sell 300 licences in New Zealand based on forecast meetings with Telecom. Fourthly, the defendants had been told by Gen-i, Australia, that it would purchase 10,000 licences to deliver Mako PCI services to the National Australia Bank and Commonwealth Bank of Australia. Fifth, Mako was conducting concept trials at major trading banks in the United Kingdom, including Royal Bank of Scotland and, finally, while the agreement provided that Mr Banks could call up £500,000 of his loan after three months (on three months' notice), the remainder of the loan could not be called upon for a period of at least two years.

[474] It follows that for these reasons I am satisfied that as at 4 February 2011, the directors reasonably believed Mako would be able to meet its obligations under Agreement 1 to Mr Banks when they fell due.

Agreement 2 – 30 June 2013

[475] Under Agreement 2, Mr Banks advanced two tranches, £237,722.43 on 15 May 2013 and £24,779.14 on 31 May 2013. Approximately a month later, on 30 June 2013, Agreement 2 was formalised in writing. The terms of Agreement 2 supplemented those in Agreement 1, additionally providing that all Mr Banks' advances (plus interest) due as at the date of the agreement would convert to equity in Mako on completion of Mako's listing on the NZX.

[476] Mr Johnson submits that the directors knew (or ought to have known) that Mako Holdings would become responsible for the Telecom Rentals debt, which would:

(a) place considerable financial stress on Mako Holdings; and

(b) result in Mako Holdings:

(i) breaching its newly signed Agreement 2; and

(ii) misrepresenting to Mr Banks that Mako Holdings had not given additional securities since Agreement 1.

[477] Further, he submits, at this time:

(a) Mako had consistently missed its revenue forecasts;

(b) the directors were aware that the accounts for the preceding year needed restatement, fundamentally changing the financial position of Mako;

(c) the directors (or their advisors) felt as though they needed detailed analysis to be conducted to determine whether the company could continue as a going concern; and

(d) the directors were aware that Mako could not successfully list on the NZX without Telecom Rentals equitising its debt.

[478] For these reasons, Mr Johnson submits, the directors had no reasonable grounds to believe that Mako could repay Mr Banks when required to do so.

(a) Subjective belief

[479] While Mr Johnson's submissions focussed on the reasonableness of the directors' belief that Mako could meet its obligations under Agreement 2, rather than whether the directors subjectively believed that fact, he did note, however, that it is

questionable whether the directors even turned their minds to repaying Mr Banks given that they anticipated him converting his debt into equity.

[480] I do not doubt that the defendants subjectively believed that Mako would be able to meet its obligations to Mr Banks under Agreement 2. As at 30 June 2013 they remained enthusiastic about the possibility of an IPO, and had not yet encountered the difficulties they would face four or so months later with the Telecom Rentals debt. The directors would have believed that the IPO would go ahead, and in any event the very positive prospects represented by the Sprint deal would generate more than sufficient funds to repay Mr Banks.

[481] I thus turn to whether the defendants had reasonable grounds for that belief.

(b) Reasonable grounds for that belief

[482] In assessing the reasonableness of the defendants' belief that Mako could meet its obligations under Agreement 2, Mr Fisk observed that:

> "Based on the information I have reviewed and available evidence it is difficult to say exactly when the Directors' should have realised that continuing to incur obligations was not reasonable. It may well have been before the difficulties suffered with [Telecom Rentals] in October to December 2013, but it was certainly once the Group and the Company were clearly insolvent with no clear direction forward.
>
> …
>
> Although not as clear as the February 2011 advance I am of the opinion that, at the time money was advanced by the Company by [Mr Banks], there are more factors in favour of the Directors being reasonable in accepting those monies and legitimately believing the Company would be able to perform the obligations in relation to them than factors against. Of particularly (sic) significance was the fact that [Mr Banks] had indicated his intention to capitalise his debt on the IPO of the Company, the real progress being made towards an IPO and the fact the Company was not liable for the [Telecom Rentals] debt at this time. Again, the realisable value of the IP would have been key at this time."

[483] As already noted, Mr Hussey considered that Mako Holdings and the Mako Group were not insolvent before November 2013 when Telecom Rentals advised it would make no further advances. Up until that point, I accept that the defendants did

have reasonable grounds for believing Mako would be able to perform its obligation to Mr Banks.

[484] The time at which the reasonableness of the directors' belief under s 136 is to be assessed is when Mr Banks transferred each tranche of funds to Mako. This is because it was the payment of the funds which triggered Mako's obligation to repay on the terms discussed, not the execution of the agreement.

[485] Even if I am wrong and the correct date at which to assess the directors' belief is 30 June 2013, I am satisfied the defendants had reasonable grounds for their belief.

[486] There is, however, some uncertainty as to when the obligations under Agreement 2 would fall due. That is because Agreement 2 provided that its terms and conditions "remain the same as recorded in the Debt Letter Agreement executed between the parties [on] 4 February 2011." However, the terms of the three loans vary. Under Agreement 1, Tranches 1 and 2 were for two years and Tranche 3 for three months. This seems to mean that the terms under Agreement 2 are either three months or two years running from one of the three following starting dates:

(a) 15 May 2013 (Tranche 1);

(b) 31 May 2013 (Tranche 2); or

(c) 30 June 2013 (the execution of Agreement 2).

[487] Despite this, whatever the correct point at which to assess the defendants' belief is, the result is the same and for the same reasons, which follow.

[488] First, Telecom Rentals had confirmed in writing that the agreed debt ceiling in the short to medium term was $35 million. Consistent with that confirmation, the funding was formally increased from $5 million to $35 million. At that point the debt to Telecom Rentals was $21 million, giving Mako head room of some $14 million.

[489] Secondly, in June 2013, Mako's business prospects were promising. Mako had passed the testing period with Chevron and would begin installing its product in

Chevron's sites. This arrangement was likely to lead to further, significant business opportunities including not only Chevron, but other large global customers.

[490] Thirdly, Mr Banks had agreed to convert his debt to equity on an IPO. As at 30 June 2013, an IPO was certainly a reasonable prospect.

[491] For these reasons I am satisfied that during the period from 15 May 2013 to 30 June 2013, the directors reasonably believed Mako would be able to meet its obligations under Agreement 2 to Mr Banks when they fell due whether that was just three months later around August 2013/September 2013 or in June 2015.

Agreement 3 – 24 April 2014

[492] Agreement 3 involved Mr Banks transferring $500,000 on the same terms and conditions as Agreement 2. On 4 April 2014 Mr Farmer emailed Mr Banks, providing him with Mako's bank account details. The final transfer of $500,000 to Mako was made on 24 April 2014, confirmed in an email from Mr Farmer thanking Mr Banks for the transfer.

(a) Subjective belief

[493] As with Agreement 2, Mr Johnson submits that the directors did not subjectively believe that Mako could perform its obligations under Agreement 3 because they considered that Mr Banks would equitise his debt instead of seeking repayment.

[494] I am of the view that the defendants subjectively believed that Mako could perform its obligations under Agreement 3. The Telecom Rentals debt restructure had recently been finalised. It provided an opportunity for the directors to pursue the Sprint deal (and others). The directors remained optimistic about the Sprint deal, in the knowledge that if it succeeded, Mako's cashflow and debt issues would be solved. They thus believed that Mako would be able to repay Mr Banks following the success of the Sprint deal.

(b) Reasonable grounds for that belief

[495] Under this heading, the crucial question is, however, whether the defendants had reasonable grounds for that belief.

[496] There is a direct conflict between the experts as to whether, when Agreement 3 was entered into, the directors knew or ought to have known that Mako could not repay Mr Banks. In distinguishing his opinion from that in relation to Agreement 2, Mr Fisk said this about Agreement 3:

> "The same cannot be said in relation to the $500,000 advanced by [Mr Banks] in April 2014, which I note does not appear to have documentation evidencing the agreement finalised, despite the Group continuing to trade for another 18 months.
>
> As discussed through my brief I consider that by this time both the Group and the Company were insolvent on both a balance sheet and cash flow basis and the Directors should have known that at the time the money was received.
>
> Additionally, by this time [Telecom Rentals'] significant debt had been escalated to secured and the value of the [Telecom Rentals] debts significantly outweighed the reported value of the Assets and the Directors were unsure how much longer the Group would be able to trade.
>
> The plan remained to proceed to IPO but given the performance of the Group at that time and the real prospect that the Group would not be able to continue at all I do not believe it was reasonable to think that pursuing an IPO at that time was a realistic option.
>
> On this basis I consider the directors could not have reasonably believed that they would be able to meet any obligation to repay [Mr Banks] the $500,000 advanced in April 2014."

[497] I have discussed Mr Hussey's position. His evidence was that for so long as the Sprint deal remained a realistic option, which in his view it did as at 24 April 2014, there were reasonable grounds for the directors to believe that Mako had the ability to meet its obligations when they materialised under Agreement 3.

[498] Mr Banks agreed to advance the $500,000 on 18 March 2014. This commitment represented the culmination of a number of communications involving Mr Banks and Mr Farmer. In early March 2014, Mr Farmer sent Mr Banks a shareholder agreement noting that he did so "in anticipation of going down that track". Mr Banks replied on 8 March 2014 and stated, "The agreement looks good. Let's do this when you're ready."

[499] As earlier discussed, between 16 March 2014 and 18 March 2014, there was further dialogue between Mr Banks and Mr Farmer in which Mr Banks expressed some concerns. Despite this, he agreed to advance the funds which were received by Mako some six weeks later on 24 April 2014.

[500] While the terms were discussed prior to the advance, had Mr Banks not advanced the funds, Mako would not have been under any obligation to repay those funds. Nor was Mako under an obligation to convert Mr Banks' funds to equity until those funds were transferred, and the IPO occurred. It follows that the latest possible time at which Mako Holdings could have incurred the relevant obligation was when Mr Banks advanced the funds on 24 April 2014. I propose to consider the reasonableness of the directors' belief as at that time.

[501] I have already discussed the Sprint deal and its prospects in some detail. I have determined that until late April to mid-May 2014 it was reasonable for the directors to believe that the Sprint deal would proceed to the completion of contracts. It was not reasonably practicable for the directors to immediately contact Mr Banks and stop him from advancing the funds when only Mr Gamble was aware prior to 24 April 2014 that negotiations were becoming more difficult. Even then it was apparent to Mr Gamble that the deal was still likely to be successfully completed. Some deference to Mr Gamble's view at that time should be allowed given he was "on the ground" and dealing with senior Sprint executives face-to-face. Mr Farmer first learned of Sprint's changing stance when he received Mr Gamble's email of 26 April 2014, two days after Mr Banks had transferred the funds. Further, it was not until around this time that Wells Fargo first communicated it was unwilling to fund the Sprint deal and its reasons for that.

[502] The directors then considered other avenues to pursue in order to save the deal. They engaged with more senior executives within Sprint's management hierarchy. They spoke with Mr Nasser. He only informed them that the parties were misaligned in his email of 17 May 2014. The directors then investigated other funding options recognising the problem lay not with the product, but rather sourcing the funding to produce the hardware.

[503] Objectively assessed, as at the time the obligation under Agreement 3 was incurred, that is 24 April 2014, the Sprint deal was still a realistic prospect and likely to lead to binding contracts. In balancing the risk of loss to creditors against the real potential for gain and thus the ability of Mako to meet its obligations as they fell due, whether that was just a few months later or two years later, I am satisfied the directors reasonably believed Mako would be able to meet its obligations under Agreement 3 when they fell due.

[504] In that context, sight should also not be lost of the other significant business negotiations which were then in train also, especially D&S and Chevron.

Conclusion as to breach

[505] The defendants did not breach the s 136 duty in respect of Agreement 1, 2 or 3. They subjectively believed on reasonable grounds that Mako would be able to meet its obligations to Mr Banks under the agreements when those obligations fell due.

Section 137 – Duty to exercise skill and care

Legal principles

[506] Section 137 provides:

> "**137 Director's duty of care**
>
> A director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,—
>
> (a) the nature of the company; and
>
> (b) the nature of the decision; and
>
> (c) the position of the director and the nature of the responsibilities undertaken by him or her."

[507] Section 137 makes clear that the standard to assess directors' skill and care is the objective standard of a "reasonable director". The particular knowledge and experience of a director is not relevant to the s 137 enquiry.[103]

[103] *Delegat v Norman* [2012] NZHC 2358 at [110].

[508] However, as Woolford J observed in *Delegat v Norman*, some element of subjectivity is introduced by the words in s 137(c) which refer to the position of the director and the nature of the responsibilities undertaken by him or her. This, the Judge observed, seems to allow "differentiation between executive and non-executive directors".[104]

Plaintiff's submissions

[509] Mr Banks has pleaded that the defendants breached s 137 having regard to:

(a) Mako's liabilities to Telecom and Mr Banks;

(b) Mako's general financial position;

(c) the position of the defendants also being shareholders and not wanting to dilute their shareholding interests; and

(d) the matters referred to and relied on in relation to the other claims under s 301 of the Companies Act.

[510] More particularly, Mr Johnson submits that if the defendants repeatedly placed reliance on the solvency report without properly considering changes in circumstances, such as missed revenue forecasts, that would be a breach of s 137. To that list, Mr Johnson adds that the defendants did not reconsider solvency in light of the Weldon Report. They failed to stress test or consider worse case scenarios. They went to the market with documents that, at best, contained errors and at worst, were misleading. They entered into the Telecom Rentals' debt restructuring negotiations without considering the full implications or seeking the consent of Mr Banks. Mr Johnson said that while Mr Farmer admitted this was a mistake, it was a culpable error given the size of Mr Banks' loans and their proportion to the annual revenue. He referred to the "pre-booking of revenue in April 2012". I understand this to be a reference to the incorrect treatment in Mako's accounts of Phoenix.

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[104] At [110].

[511] I turn now to deal with each of Mr Banks' claims under s 137.

Did the defendants fail to exercise the skill and care that a reasonable director would in the same circumstances?

[512] Mr Johnson makes two specific criticisms of the directors' conduct which he submits breached the s 137 duty. I deal with these before turning to consider his submission that the other alleged breaches of duty under ss 135 and 136 also necessarily constitute a breach of s 137.

(a) Mako's financial position, including liabilities to Telecom and Mr Banks

[513] First, Mr Johnson points to Mako's general financial position, specifically its liabilities to Telecom and Mr Banks. The liability to Telecom arose from the agreement in late June 2013 to increase Telecom Rentals' loan facility to Mako from $5 million to $35 million.

[514] It is difficult to see how the directors may be criticised for entering into this arrangement. Mr Frawley described it as "a no brainer" to rationalise and simplify the arrangements between Telecom Rentals and Mako. It gave Telecom Rentals an additional and identifiable security and it improved, as it was intended to, the short to medium term cashflow position of Mako.

[515] It is correct that the Telecom agreement with Mako Holdings breached Mako's agreement with Mr Banks. Mr Farmer accepted that it was a mistake. Mr Banks' consent should have been obtained and it was not.

[516] I am satisfied, however, it was an unintentional breach which, in my view, would have been waived by Mr Banks had his consent been sought in any event. This is because he advanced a further $500,000 under Agreement 3 when he plainly knew of and understood the ramifications of the later Telecom Rentals agreement, under which their debt took priority. By the time he advanced the funds under Agreement 3, he had already received the papers from Mr Farmer on 5 February 2014 calling for the SGM to ratify the restructuring proposal. That Mr Banks must have read and understood the significance of this material, even if he did not attend the SGM, is

evident from his email to Mr Farmer of 19 February 2014 when he observed that it was a shame “we had to panic-sell that business chunk”.

(b) Prioritising interests as shareholders over the company’s interests

[517] This is a convenient point at which to deal with Mr Banks’ claim that the defendants, as shareholders wishing to avoid diluting their own shareholdings, acted or omitted to act in a manner contrary to the company’s best interests. As I understood Mr Johnson, this complaint is founded on two issues:

(a) the taking of excessive director salaries; and

(b) failing to engage further with the indicative offer from Goldman Sachs.

[518] Later in this section I shall discuss the issue of directors’ salaries when discussing Mr Killick’s evidence. Three additional points may be made. The first is that the directors’ salaries were approved unanimously at AGMs. The resolutions approving these entitlements were recorded in the AGM minutes which were sent to all interested parties, including Mr Banks. Secondly, the directors, particularly Mr Farmer, were paid primarily in shares rather than cash. Thirdly, at least three of the directors loaned the company money when an urgent injection of cash was needed.

[519] As for the Goldman Sachs proposal, Mr Frederick prepared a “pros and cons” analysis and forwarded it to the directors to discuss at the Board meeting. The “cons” are listed as follows:

> “• Tied up with [Goldman Sachs] until Dec 31, 2014
>
> • No option out for Mako under current wording of agreement until time passes or [Goldman Sachs] declares deal dead
>
> • Mako must make a internal commitment to proceeding along “gross level” terms of agreement
>
> • We will not be able to have… [incomplete]”

[520] This was then discussed at the Board meeting of 23 October 2014, which was recorded as follows:

> "Doug Frederick then went on to outline to the meeting interactions between himself and Tobin Whamond of Goldman Sachs. Doug had followed up on the letter forwarded to Tobin by telephone to ensure it had been received and seek any reaction to it. Tobin advised that he was following up with internal attorneys with their response but that it would not be favourable. He further outlined how [Goldman Sachs] needed to follow a specific business process and that using warranties was not acceptable to them and that they would need to speak to Telecom NZ before they would entertain any offer. Doug had responded outlining again how the Mako Board needed to have some indication of an offer and the current proposal pitched would not receive shareholder approval. Furthermore, the feeling of the Board was allowing a discussion with Telecom without having an offer could seriously undermine the company's position with Telecom and lead to an even more distressed offer."

[521] Mako's rejections of Goldman Sachs' proposal is unsurprising. It is most unlikely that Telecom Rentals would have relinquished its priority debt for a 10 to 15 per cent shareholding when the new investor would receive 60 to 70 per cent for a similar level of investment. The directors were correct in concluding that the deal would all but wipe out the value held by all existing shareholders. Despite this, the directors continued to engage with Goldman Sachs and proposed alternative terms which were rejected. I accept that the decision made by the directors to reject the offer was one which was reasonably open to them in the circumstances.

[522] The other point, as Mr Hollyman submits, is at the relevant time the defendants had reasonable grounds to believe that Mr Banks had converted his debt to equity. They did not believe they would have to repay any of this advance, or any of the earlier advances. This is supported by later correspondence in which Mr Farmer and Mr Banks referred to a "reinstatement" of Mr Banks' loans.

(c) Overlap between Mr Banks' claims under ss 135, 136 and 137

[523] For completeness, I note that Mr Banks also pleads that the defendants breached s 136 by taking on obligations in respect of Telecom Rentals.[105] Mr Johnson did not deal with this part of the claim in either his written or oral submissions. If the essence of the claim is that the directors should not have taken on the obligations they

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[105] Amended statement of claim dated 18 April 2019 at [110], [111] and [140(c)].

did in relation to the restructuring of the debt, I cannot agree. The breach under s 136 must be assessed at the time at which the company incurred the obligation, that is as at 7 February 2014 when the debt restructure was formally agreed. At that point the agreement injected $5 million into the business. The terms gave Mako a repayment holiday of two years. The Sprint deal was likely to be concluded within a few months and with it the very significant benefits I have already discussed. There were positive and potentially lucrative leads identified in the Norcal Pipeline Assessment Report. Mako was rolling out its solution to thousands of Chevron sites.

[524] Significantly in my view, Telecom Rentals had reassured Mako of its ongoing support in writing before the restructuring agreement was finalised:

> "We appreciate that the Mako directors are aware of their legal duties and obligations in the present circumstances – including the need to consider the interests of Telecom its most significant creditor. Telecom's proposal allows the directors to continue trading for a period in which to conclude the sale of certain assets and the restructuring referred to above, of Telecom's $27 million debt. Telecom, as the most significant creditor, strongly supports the directors continued trading for this purpose."

[525] In these circumstances, it is difficult, in my view, to see how the directors may be criticised for negotiating and completing the debt restructuring.

[526] In any event, Mr Hollyman says the pleading is duplicitous. It adds nothing to the plaintiff's case and should be rejected for the reasons earlier advanced in respect of ss 135 and 136.

[527] Although the considerations under s 137 are somewhat broader, I agree with Mr Hollyman. In fairness to Mr Johnson he properly and fairly accepted the overlap between breaches of s 137 and ss 131, 135 and 136.

[528] In support of his claim that the directors failed to exercise the necessary skill and care of the reasonable director, Mr Johnson relies on the evidence of Mr Killick.[106] I have already touched on Mr Killick's evidence.

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[106] Mr Killick is a chartered accountant and a professional director whose directorships in governance roles have included a wide range of industries and sizes of organisations. He was instructed to provide expert evidence on the conduct of the defendants in terms of the expectations, obligations and responsibilities of a reasonable director in terms of ss 131, 135, 136 and 137 of the Companies Act 1993.

[529] The admissibility of Mr Killick's evidence was initially challenged by the defendants on the basis that it would not be substantially helpful to the trier of fact in understanding the other evidence in the proceeding or ascertaining any fact that is of consequence to the determination of the proceeding.[107] Objection was also grounded on the basis that Mr Killick's evidence touched on "ultimate issues", although Mr Hollyman accepted that in terms of s 25(2)(a) of the Evidence Act 2006 ("the Evidence Act"), this would not automatically render such evidence inadmissible. Mr Hollyman referred to particular aspects of Mr Killick's opinions which he described as egregious examples of usurping of the Court's function, including Mr Killick's conclusions and findings. He thus submitted that for these reasons Mr Killick's evidence-in-chief and reply evidence should be struck out in its entirety not only by reason of its breach of s 24 of the Evidence Act but also under s 8 which permits such a course where the probative value is significantly outweighed by the fact that the evidence will needlessly prolong an already lengthy proceeding.

[530] However, after reflection, Mr Hollyman withdrew his admissibility objection but submitted Mr Killick's evidence ought to be given limited weight for the same reasons.

[531] Mr Johnson, in his closing oral submissions, submits that Mr Killick's evidence regarding stress testing assumptions, having a good understanding of working capital, having full board packs, measuring performance against projections and challenging management were aspects of his evidence which were substantially helpful. However, he accepted that anything else is "probably of questionable admissibility".

[532] I agree with Mr Hollyman that in certain material aspects Mr Killick's evidence must be given limited weight. In my view, in certain key areas, his evidence was surprisingly dogmatic and, occasionally, bordered on advocacy. For example, on the question of the company's solvency calculations under s 136, he made the bald, unqualified statement that "It is forbidden to trade while insolvent". As already discussed, that is not the law. In cross-examination, Mr Killick accepted that the use of the word "forbidden" was "probably too strong".

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[107] Evidence Act 2006, s 25.

[533] Another example may be found in his evidence-in-chief, when he suggested that in terms of s 136 of the Companies Act the defendants knew or ought to have known that they could not perform their obligations in respect of all three agreements. However, in cross-examination, he accepted that the first advance on 4 February 2011 was a “line call”. When referred to Mr Fisk’s contrary evidence on the same point, Mr Killick conceded that what he had said in his first brief might have come through “fairly strongly” and that at the time he had made that statement, he had not seen Mr Fisk’s brief.

[534] Similar observations may be made in relation to Mr Killick’s criticism of the defendants over their salaries in 2013 and 2014. Mr Killick described these as “crippling” for the company. When it was put to him that Mr Farmer had, in fact, taken only $42,000 in cash in the 2014 year, Mr Killick observed that the Court would have to look through the continuum of the company rather than in the later years where there were steps taken to “reduce the cash earned”.

[535] Another example was when Mr Killick made comments suggesting that there were quality issues regarding the delivery of Mako’s product. He referred to an email chain relating to Chevron in December 2013. When it was put to him that all issues with Chevron had been resolved and that by the middle of 2014 Mako had successfully installed at over 2,200 Chevron sites, Mr Killick conceded he was not aware of that.

[536] Interestingly, he appeared to regard Mr Frawley’s conduct as a director to be something of an exemplar, repeatedly citing examples of Mr Frawley’s actions as examples of what a reasonable and prudent director should have done in the circumstances. In cross-examination, he readily accepted that Mr Frawley’s actions throughout were prudent and reasonable. Given that Mr Frawley remained an active member of the Board until late December 2013, it is implicit from Mr Killick’s evidence that his fellow directors, who were party to the same decisions up until that point, must be similarly exculpated on Mr Killick’s analysis.

[537] Thus, in summary, for the reasons I covered in the discussion of the duties under ss 135, 136 and 137, I am satisfied that until it was reasonable for the directors

to believe that Sprint would not enter a binding contract, the defendants exercised the care, diligence and skill of a reasonable director in the circumstances.

[538] However, for the reasons already discussed, I am of the view that from that point the directors should have caused Mako to cease trading. Having regard to the s 137 factors, Mako had continued as a viable business for more than a decade. However, by mid-2014, its chronic cashflow difficulties were such that without the realistic and likely prospect of a lucrative, multi-million dollar deal within the foreseeable future, it would not be possible for the company to meet its obligations. At that point, a reasonable director, exercising due care, diligence and skill, would have caused Mako to cease trading and go into liquidation.

[539] It follows that consistent with my conclusions in respect of s 135, I am satisfied that the directors also breached their duties under s 137 of the Companies Act.

[540] Having so found, the next question is whether there is any remedy available to Mr Banks. It is to that question I now turn.

Section 301 – Remedy

Introduction

[541] I have found that the directors breached both the ss 135 and 137 duties. However, despite this, I am satisfied s 301 does not provide Mr Banks with relief in the form of compensation for the reasons which follow.

Legal principles

[542] Mr Banks seeks relief under s 301 of the Companies Act:

> “**301 Power of court to require persons to repay money or return property**
>
> (1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or

breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder, —

(a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and

(b) order that person—

(i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or

(ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or

(c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.

…"

[543] I address the availability of relief by way of compensation under s 301 by posing two questions:

(a) Is the remedy available given that Mako was not in the course of liquidation?;

(b) Can creditors be personally compensated under s 301(1)(c) for breach of directors' duties?

(a) Is the remedy available given Mako was not in the course of liquidation?

[544] Mr Hollyman points to the express words of s 301. He emphasises the phrase "in the course of the liquidation of a company". He says that wording is clear and that the Court is only able to inquire into the conduct of a director and make orders under s 301 in the course of a liquidation. A creditor may apply for orders under s 301 during the course of the liquidation, but the Court's jurisdiction under s 301 exists only for as long as the company remains in liquidation. Mako's liquidation concluded and it was removed from the Companies Register ("the Register") on 27 February 2018. Now that Mako is no longer in liquidation, the Court no longer has jurisdiction to award relief under s 301.

[545] Mr Johnson submits that this narrow interpretation cannot be right. He says that s 301 requires "an application" to be made during the course of the liquidation, not that an order by the Court must be made within that timeframe. Mr Johnson says that s 326 of the Companies Act means the directors' liability continues to exist even after the company's removal from the Register.

[546] The dispositive issue of whether a remedy is available under s 301 is the effect and meaning of the words "in the course of the liquidation of a company". Mako was placed in liquidation shortly after the Board meeting of 19 August 2015. The liquidators' final report was filed on 26 January 2018.[108] Mako was removed from the Register on 27 February 2018. The statement of claim seeking relief under s 301 was filed on 13 January 2016. Thus, Mr Banks' claim was made in the course of the liquidation. However, the liquidation ended before the trial started. So, while Mako existed and was in the course of liquidation at the time the claim was filed, it is now neither.

[547] At first glance, it may appear odd that an order under s 301 is required to be made in the course of a company's liquidation. Liquidations and Court proceedings vary in length. Some are completed in relatively short order. Others may take years. Instinctively, it seems unjust and unfair that the Court may refuse a creditor's claim for relief, when that claim was filed in the course of a liquidation process which concluded earlier than the Court proceedings.

[548] The problem, however, is that when the liquidation ends and the company is removed from the Register, there is nothing onto which the Court can attach an award under s 301. Compensation for breaches of director's duty is payable to the company.[109] It is then distributed to creditors by the liquidator with the exception of the limited circumstances in which creditors might be personally compensated (an issue I address below). Obviously, when there is no longer a corporate entity in existence, nor a liquidation in progress, this cannot occur.

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[108] "BPSI Limited, Simes Limited, OBST Limited, 95 Victoria Street Limited, Silverspur Developments Limited, Mako Networks North America Limited, Mako Networks Limited, Mako Networks Finance & Leasing Limited and Mako Networks Holdings Limited (all in liquidation)" (26 January 2018) *New Zealand Gazette* No 2018-ds398.

[109] Section 301(1)(b)(ii).

[549] In light of that practical problem, Parliament included provisions in the Companies Act which enable creditors (among others) to pursue claims for breaches of director's duty following the removal of the company from the Register.

[550] Section 326 provides that the removal of a company from the Register does not affect the liability of any former director of the company in respect of any act or omission that took place before the company was removed from the Register, and that liability continues and may be enforced as if the company had not been removed.

[551] Given that a director's liability persists after deregistration of the company, Parliament enacted a procedure for the restoration of the company to the Register.[110] Section 329 provides that where a company has been removed from the Register, a creditor of a company has standing to apply for an order that the company be restored to the Register. The grounds for making such an order include that the company was in liquidation at the time it was removed from the Register,[111] or that it is just and equitable to restore the company to the Register.[112] A company which is restored to the Register is deemed to have continued in existence as if it had not been removed from the Register.[113]

[552] Thus, the combined effect of ss 326, 329 and 330 is that directors continue to be liable to the company for breaches of directors' duties after deregistration, and the company entity can be restored for the purpose of receiving compensation payable under s 301.

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110 I note that s 328 of the Companies Act 1993 provides a procedure for the restoration of a company to the register by the Registrar of Companies. In *Commissioner of Inland Revenue v Commercial Management Ltd* [2019] NZCA 479, (2019) 29 NZTC 24-019 at [32] the Court of Appeal commented that "Section 328 contemplates a relatively simple and uncontroversial restoration process where it is apparent that the company should not have been removed from the register having regard to circumstances at the time of that removal, and where no one objects to that restoration. Section 329 enables a wider range of grounds to be invoked, including the broad "just and equitable" ground. It is available in cases where restoration is opposed."

111 Section 329(1)(a)(iii).

112 Section 329(1)(b).

113 Section 330.

[553] In *Registrar of Companies v Body Corporate 307730*, the Court of Appeal explained how a company that has previously been liquidated can be restored and the liquidation reinstated:[114]

> "[14] The process of liquidation begins with the appointment of a named person or an Official Assignee as liquidator. One of the ways the liquidation comes to an end or is completed is when the liquidator provides his or her final report to the Registrar together with certain other specified documentation. On the filing of the final report and the other documentation, the liquidator is discharged from office and the Registrar is required to remove the company from the Register. Pending removal from the Register, the status of the company is that it is no longer in liquidation but is awaiting removal.
>
> [15] As Associate Judge Doogue recognised, the fact the company is not in liquidation at the point of removal means that a restoration order on its own will not result in the restored company automatically resuming its former status as a company in liquidation. The restoration order must be accompanied by other orders to achieve that result if it is considered desirable, as it was in this case.
>
> [16] Under s 284(1)(b), the court has the power to reverse an act or decision of the liquidator on the application of a prospective creditor (such as the owners in this case). The power may be exercised after a company has been removed from the Register. The filing of a final report is an act of the liquidator and therefore the reversing of a final report is within the scope of the s 284 power. As noted in *Re Ocean Shipping Ltd*, reversing the filing of a final report has the effect of abrogating the completion of the liquidation. Thus, the combined effect of a restoration and a reversal order is that the company is restored to the Register still in liquidation and the former liquidator resumes office. The liquidation is reinstated."
>
> (footnotes omitted)

[554] This approach has been applied in cases where the claimant has applied for relief under s 301 after the liquidation has ended (as opposed to the liquidation ending prior to the claim being determined). In *McHugh v Austral Group Investment Management Ltd*,[115] this Court struck out an application for relief under s 321 of the Companies Act 1955[116] because it had not been made in the course of the liquidation. By the time the proceedings were commenced the company had been removed from the Register. Master Hansen (as he then was) held that the plaintiff needed to make an application to the Court for the restoration of the company to the Register, and

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114 *Registrar of Companies v Body Corporate 307730* [2013] NZCA 659, [2014] 2 NZLR 623.

115 *McHugh v Austral Group Investment Management Ltd* HC Christchurch CP505/87, 23 March 1992.

116 This is the predecessor provision to s 301 of the Companies Act 1993.

subsequently an application for it to be wound up. The plaintiff could then apply for relief under s 321 during the winding up process.[117]

[555] *Hampson v Registrar of Companies* concerned, among other things, a defendant's application for strike out of the plaintiff's claim under s 301 on the basis that the plaintiff's application had not been made in the course of the liquidation.[118] Associate Judge Matthews agreed that a claim under s 301 could not be considered while the company was not in liquidation, noting that the section was a "procedural mechanism for bringing these claims during a liquidation".[119] He stayed the proceeding until a decision had been made about whether the company would be restored to the Register.[120]

[556] It follows that for Mr Banks' claim to succeed, he first needed to apply for the restoration of Mako to the Register under s 329 and the reversing of the final report under s 284(1)(b). Those applications could have been made at any time between Mako being removed from the Register in February 2018 and the delivery of this judgment. There are no such applications before the Court, let alone orders for restoration. In the absence of such orders,[121] the company does not exist, nor is it in the course of liquidation. The plaintiff is thus unable to apply for remedy under s 301.

(b) Can creditors be personally compensated under s 301 for breach of directors' duties?

[557] Mr Hollyman submits that even if it is possible for Mr Banks to claim under s 301, s 301(1)(c) does not permit him to be personally compensated for a breach of director's duty. He submits that while s 301(1)(c) may permit direct recovery to a particular creditor such recourse is not available where, as in the present case, the creditor's claim is for breach of directors' duties. He submits that if Mr Banks is entitled to any remedy at all, it must be under s 301(1)(b), in which case compensation

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[117] *McHugh v Austral Group Investment Management Ltd* HC Christchurch CP505/87, 23 March 1992 at 18 and 19.

[118] *Hampson v Registrar of Companies* [2013] NZHC 1202 at [1] and [5].

[119] At [44].

[120] At [42]-[43] and [50].

[121] I note in any event that it is not a given that the applications would be granted. Mr Hollyman submits that there are numerous potential grounds of opposition, including that Mr Banks stands to gain nothing from the restoration and re-liquidation of the company, noting that the first ranking secured creditor, Spark NZ, is still owed around $24 million.

is payable to the company and not Mr Banks. It follows that Mr Banks may only recover after Telecom Rentals' secured debt of some $25 million has been paid.

[558] Mr Johnson submits that Mr Banks is entitled to direct recovery under s 301(1)(c). He submits that there is no appellate authority on the issue, and this Court is not bound by the existing High Court authority to the effect that a creditor cannot personally recover under s 301(1)(c) for breach of director's duty.[122] Mr Johnson submits this Court's decision in *Mitchell v Hesketh* took an "unduly formulaic" interpretation of s 301. That s 301(1)(c) was included at the Select Committee stage of the Bill's passage indicates Parliament intended that it strengthen a creditor's ability to recover from directors. He further says that s 301 is merely a procedural mechanism for remedying breaches and should be interpreted broadly.

[559] The appellate Courts have left open the question of whether a creditor may personally recover for a breach of director's duty under s 301(1)(c). In *Mainzeal*, the Court of Appeal stated that:[123]

> "It has been held in the High Court that this power is available where the defendant has misapplied or retained or become liable or accountable for money or property of the company, but not in relation to compensation for breaches of a duty owed by a director to the company. However, in [*Madsen-Ries v Cooper*] the Supreme Court expressly left the question of when an award can be made to a creditor for decision in a case where the issue arises directly. As the present proceedings were brought by the liquidators of Mainzeal, not by creditors, we also need not decide that issue."
>
> (footnotes omitted)

[560] The Court in *Mainzeal* was referring to a footnote in *Madsen-Ries v Cooper*, where the Supreme Court commented that:[124]

> "We have not been asked to decide how any relief ordered would be distributed amongst creditors… We also note that s 301(1)(c) provides that, where an application is made by a creditor, the court may order a director to pay or transfer money or property to the creditor. It has been suggested that under s 301(1)(c), at least in cases where the liquidator takes no steps, the Court can order all restitution or compensation to go to the particular creditor: *Marshall Futures Ltd v Marshall* [1992] 1 NZLR 316 (HC) (Tipping J) at 332–333; and *Sanders v Flay* (2005) 9 NZCLC 96-989 (HC) (Heath J) at [18]–[19].

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[122] *Mitchell v Hesketh* (1998) 8 NZCLC 261,559 (HC).

[123] *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99 at [309] citing *Mitchell v Hesketh* (1998) 8 NZCLC 261,559 (HC).

[124] *Madsen-Ries v Cooper* [2020] NZSC 100, (2020) 29 NZTC 24-088 at [156], n 179.

> Note that *Marshall Futures* was decided under the 1955 Act, and *Sanders* was decided under the 1993 Act. We leave consideration of creditors' rights under s 301(1)(c) to a case where it arises and has been fully argued."

[561] There are currently two competing lines of High Court authority on whether creditors may recover directly under s 301(1)(c). The first denies creditors personal compensation for claims of breach of duty. The second permits recovery in some limited circumstances. I set out both approaches before determining whether, in the present case, Mr Banks may recover directly under s 301(1)(c) for breach of director's duty.

[562] In *Mitchell v Hesketh*, Master Venning (as he then was) took a constructional interpretation when considering whether a creditor seeking relief might recover under s 301(1)(c):[125]

> "There are thus two circumstances identified in the body of s 301(1) where orders may be made. The first circumstance is where the director owes a specific item of money or property to the company, and the second circumstance is where the director has breached his duties to the company and caused loss generally to the company.
>
> It follows in my view as a matter of construction that the reference to restoring ***the money or property or any part of it*** in s 301(1)(b)(i) is a reference back to the first circumstance. The reference to the "money or property" and "repay or restore" are consistent with such an interpretation. The more general option of contributing ***such sum to the assets of the company*** under s 301(1)(b)(ii) is consistent with the second circumstance where general damage has been caused to the company. An assessment of the damage is required to be made by the Court and an order that the director contribute such sum to compensate for the damage can then be made. The reference to "such sum" in s 301(1)(b)(ii) is not to an identifiable or specific sum, but to the sum assessed by the Court by way of compensation.
>
> Against that background s 301(1)(c) falls to be considered. It provides that where the application to the Court is made by a creditor the Court may order the director to pay or transfer the money or property or any part of it to the creditor. The irresistible inference is that the reference to "the money or property" is a reference back to the money or property identified in the first circumstance in the main body of s 301(1) and repeated in s 301(1)(b)(i). No provision is made in s 301(1)(c) for the Court to order a payment by the director to the creditor of any part of the general damages sum that may otherwise be ordered under s 301(1)(b)(ii)."
>
> (emphasis original)

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[125] *Mitchell v Hesketh* (1998) 8 NZCLC 261,559 (HC) at 261,562.

[563] Master Venning's approach limits the circumstances where a creditor may recover directly under s 301(1)(c) to where "a past or present director, manager, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company". Where the claim is for "negligence, default, or breach of duty or trust in relation to the company", the Court may only award relief by ordering that the director pay compensation to the company under s 301(1)(b)(ii).

[564] In *General Marine Services Ltd v The Ship "Luana" (No 2)*, the applicant creditor sought to recover directly under s 301(1)(c) for alleged breaches of the ss 135 and 136 duties.[126] Woodhouse J referred to *Mitchell* and found that although s 301(1)(c) does make provision for direct payment to a creditor, the "provision does not apply in respect of a director's breaches of statutory duty".[127]

[565] In *Luscombe v O'Sullivan*, Associate Judge Abbott referred to both *Mitchell* and *General Marine Services*.[128] The Judge accepted in principle that the plaintiff creditor may have a claim for breach of director's duties and could therefore bring a claim under s 301. However, an order that the plaintiff recover directly for a breach of director's duty (rather than the payment of compensation to the company) would be contrary to case law and require the Court to "read the power in s 301(1)(c) without regard to the rest of the section".[129] The Associate Judge considered that s 301(1)(c) is applicable to claims for "specific money or property rather than for losses generally"[130] and that "s 301(1)(c) does not apply to a director's breach of statutory duty".[131]

[566] In contrast, the second line of authority considers that s 301(1)(c) permits creditors to recover directly for breaches of director's duty, but in limited circumstances. In *Marshall Futures Ltd (in liq) v Marshall*, Tipping J considered

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126 *General Marine Services Ltd v The Ship "Luana" (No 2)* HC Auckland CIV-2010-404-2435, 7 February 2010 at [19].

127 At [19].

128 *Luscombe v O'Sullivan* [2012] NZHC 2300 at [36]. I note that Associate Judge Abbott had previously cited *Mitchell v Hesketh* and taken that approach in *Drilling Fluid Equipment NZ Ltd v Falloon* HC New Plymouth CIV-2008-443-337, 27 March 2009 at [28].

129 At [36].

130 At [36].

131 At [36].

whether "moneys which are the subject of the declaration of personal responsibility are payable to the company…for the benefit of the creditors of the company as a whole" or whether they "are payable directly to the creditor" succeeding in the application under ss 319 and 320 of the Companies Act 1955.[132] If compensation was payable to the creditor directly, then the claim could be regarded as between the creditor and the director, with no need for the liquidator or creditors to be involved.[133]

[567] Tipping J noted that none of the cases referred to by counsel involved an application by a creditor, as opposed to the liquidator.[134] His Honour referred to *Re Cyona Distributors*,[135] where the Court of Appeal of England and Wales considered a creditor's application for a remedy for fraud by a director under s 332 of the Companies Act 1948 (UK). Tipping J endorsed the reasoning of Lord Denning MR, who commented that:[136]

> "An order can be made…at the suit…of a creditor. The sum may be compensatory. Or it may be punitive. The court has full power to direct its destination. The words are quite general: "all or any of the debts or other liabilities of the company as the court shall direct." By virtue of these words the court can order the sum to go in discharge of the debt of any particular creditor; or that it shall go to a particular class of creditors; or to the liquidator so as to go into the general assets of the company, so long as it does not exceed the total of the debts or liabilities. Of course, when an application is made by a liquidator, the court will usually order the sum to go into the general assets…but I do not think it is bound to do so. Certainly when an application is made by a creditor who has been defrauded, the court has power, I think, to order the sum to be paid to that creditor…When a creditor applies…he applies on his own account…He can discontinue his application, if he likes, without getting the sanction of the liquidator. But no doubt the liquidator should always be made a party to the proceedings, so that the interests of the other creditors can be safeguarded."

[568] Tipping J also adopted the reasoning of Danckwerts LJ, who said:[137]

> "The situation seems to me to be quite different where a creditor begins proceedings at his own expense under the section. The creditor should be entitled to his reward. I do not think that he is acting as a trustee for the general body of creditors. In any case, the court would appear to have a wide discretion under the section."

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[132] *Marshall Futures Ltd (in liq) v Marshall* [1992] 1 NZLR 316 (HC) at 332.
[133] At 332.
[134] At 332.
[135] *Re Cyona Distributors Ltd* [1967] Ch 889.
[136] *Marshall Futures Ltd (in liq) v Marshall* [1992] 1 NZLR 316 (HC) at 332 citing *Re Cyona Distributors Ltd* [1967] Ch 889 at 902.
[137] At 333 citing *Re Cyona Distributors Ltd* [1967] Ch 889 at 908.

[569] His Honour also referred to *Re Gerald Cooper Chemicals Ltd*, where Templeman J explained the relevance of the liquidator being a party to the proceedings:[138]

> "…if an order is to be made under section 332, the court must know whether to order payment to the creditor applicant or to the liquidator. [The creditor] should, therefore, ask the liquidator to elect whether to intervene to claim relief under section 332, either based on the transaction with [the creditor] or based on any other transactions of the…company which implicate the respondents. The liquidator should also be asked whether he wishes to contend that the whole or any part of any moneys for which the respondents may prove to be liable under section 332 should be paid to him and not to [the creditor]. He should be informed that if he does not choose to intervene now he will not be able successfully to institute section 332 proceedings against the respondents in the future. But it is essential that the liquidator should be advised of the present proceedings."

[570] In light of these authorities, Tipping J concluded that notice of the proceeding should be given to the liquidator of the company.[139] The question of whether the causes of action under ss 319 and 320 should be heard at the same time as the claims for breaches of duties was to be determined in light of the stance taken by the liquidator.[140]

[571] *Marshall Futures* was not applied in any of the cases referred to in the first line of authority. In *Sanders v Flay* however, Heath J relied upon *Marshall Futures* and ordered the payment of compensation directly to a creditor under s 301(1)(c).[141] The plaintiff was the executor of his late mother's estate.[142] The defendant was the director of a company which operated a rest home.[143] The plaintiff's mother had entered an arrangement with the company under which she was entitled to occupy a unit in the rest home.[144] In consideration, she paid the company $85,000.[145] Six per cent of that sum would be deducted by the company each year until she died, or the agreement otherwise terminated.[146] The plaintiff's mother transferred the $85,000 to the

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138 At 333 citing *Re Gerald Cooper Chemicals Ltd* [1978] 1 Ch 262 at 268.
139 At 334.
140 At 334.
141 *Sanders v Flay* (2005) 9 NZCLC 263,906 at [18].
142 At [1].
143 At [2].
144 At [2].
145 At [3].
146 At [4].

defendant director, who initially held it in her solicitor's trust account, but later used it to pay personal debts.[147]

[572] While the claim was based on six causes of action (including breach of director's duties), Heath J considered that "[i]n essence the claim proceeds on the footing that [the director] has received company funds and misapplied them for her own benefit thereby depriving the estate as a legitimate creditor of the company of its debt."[148]

[573] Heath J determined that "the nature of the claim falls squarely within s 301 relating as it does to misapplication of company funds".[149] The Judge commented:

> "[18] Ordinarily, the claim under s 301 for misapplication of company funds would result in restoration of those funds to company assets for distribution among all creditors. But the section itself gives standing to a creditor to bring the proceeding. It has been acknowledged that the Court has a discretion to award any moneys for which judgment is entered to be paid to the creditor rather than the liquidator, particularly when the liquidator takes no steps: see s 301(1)(c) and *Marshall Futures Ltd v Marshall*…
>
> [19] … I am satisfied that the circumstances of this case justify an approach along the lines suggested by the majority in *Cyona*."

[574] I do not consider that either line of authority assists Mr Banks. Mr Johnson accepts that the first line of authority is obviously contrary to his position. Each case expressly determined that s 301(1)(c) has no application where a creditor claims remedy for breach of director's duty.

[575] To the extent that *Marshall Futures* suggests the Court has a wider discretion to order that a creditor recover directly, I note that such a power was expressly limited by the requirement that the liquidator must be notified of the claim. The liquidator was not notified of the plaintiff's claim in the present case.

[576] I also note that *Marshall Futures* was decided under ss 319 and 320 of the Companies Act 1955, with reference to the Companies Act 1948 (UK). The wording of both statutes is materially different to s 301(1)(c). Section 319 governed a director's

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147 At [5].
148 At [13].
149 At [16].

failure to keep proper books of account. Section 320 governed a director carrying on the business of the company with the intention of defrauding creditors. Neither is sufficiently similar to s 301 to be of real assistance to the present issue. It follows I am satisfied that *Marshall Futures* is not authority for the proposition that s 301 permits personal recovery by Mr Banks.

[577] Mr Johnson submits that *Sanders v Flay* supports his submission that the plaintiff is entitled to claim under s 301(1)(c). I disagree. Although Heath J referred to *Marshall Futures* in determining that s 301(1)(c) was applicable, he did not actually depart from the first line of authority (and it does not appear that *Mitchell* was brought to his attention). The approach taken in *Mitchell* is that a creditor may recover directly under s 301(1)(c) where there is a misappropriation of specific company funds. The director in *Sanders* misappropriated specific and identifiable company funds, being those owed by the company to the plaintiff's mother under their agreement. It was that misappropriation which Heath J determined provided a basis to order the director to pay money directly to the creditor under s 301(1)(c). A creditor claiming a breach of director's duty may only receive personal compensation to the extent that the conduct complained of also represents a misappropriation of company funds.

[578] There is no misappropriation of company funds in the present case. I do not accept, as Mr Johnson submits, that if Mr Banks was misled by the directors that the present case gets sufficiently close, factually, to a misappropriation of funds which would permit recovery under s 301(1)(c). All of the authority discussed above supports the conclusion that Mr Banks cannot recover personally under s 301(1)(c).

[579] Alternatively, Mr Johnson submits that, even if I was to accept this position, there remains scope to view a breach of s 136 as an exception. Section 136 specifically contemplates the position of specific creditors, and unlike s 135, a creditor will suffer an identifiable loss. Mr Johnson thus submits that a broad interpretation is called for. He says that an award for a breach of the s 136 duty is appropriate because the directors misled Mr Banks to make his investments in Mako, Mr Banks has expended time and money in pursuit of this claim, and neither Spark nor the liquidators have brought claims against the directors.

[580] I have found there was no breach of the s 136 duty. However, even if I am wrong, I am not satisfied that s 301(1)(c) provides any relief for Mr Banks for the reasons which follow.

[581] I do not accept that a decision by the liquidators or Spark not to pursue a claim against the directors provides a basis for Mr Banks to receive personal compensation. There is no evidence as to why Mako's liquidators and/or creditors chose not to pursue the directors personally. There are many available reasons. However, weighing against that is the principle that a claimant who makes the effort of successfully pursuing their claim should receive its fruits.

[582] Mr Johnson refers me to this Court's decision in *Mainzeal*, where Cooke J commented that:[150]

> "The New Zealand provisions are different in that s 136 is directed to the entry of a particular obligation, and accordingly contemplates the position of a particular creditor. But similar issues arise in relation to the application of s 301, including whether ss 301(b)(i) or (c) should be applied when there is a breach of s 136. Nothing I say below should be taken to express a view on such questions."

[583] I do not accept that the s 136 duty may be treated as an exception to the principle that creditors cannot recover directly for breaches of director's duty under s 301(1)(c). Cooke J prefaced his comments by observing that he was not expressing a view on the question. His comments must also be considered in the context of *General Marine Services Ltd*, which found that a creditor was unable to directly recover under s 301(1)(c) for a breach of the s 136 duty. I am not prepared to depart from that approach.

[584] Although the s 136 duty may relate to particular obligations, sums of money, and creditors, the duty is nevertheless owed to the company. It is inconsistent with the treatment of other duties owed to the company to permit an exception for the s 136 duty. It further allows creditors to effectively bring personal claims against directors in a manner inconsistent with the hierarchy of the liquidation, despite the duty being owed to the company and a breach affecting all creditors.

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150 *Mainzeal Property and Construction Ltd v Yan* [2019] NZHC 255 at [385].

[585] It follows I accept Mr Hollyman's submission that Mr Banks is unable to recover directly under s 301(1)(c) for the alleged breaches of director's duty. Any recovery must be under s 301(1)(b), by way of a compensatory payment to the company. Given that the company no longer exists, nor is it in liquidation, the same pragmatic considerations discussed above operate to preclude recovery.

Section 383 – Banning orders

[586] Mr Banks seeks an order under s 383 of the Companies Act banning the defendants from being directors of any company. He does not indicate the length of any such orders. He claims that the defendants' breaches are at the level where a banning order is required. He says such an order is necessary, not only to punish the defendants and to deter others from engaging in similar conduct, but also to protect the public from future misuse of the limited liability structure by the directors.

[587] Mr Johnson submits the defendants' have "acted in a reckless or incompetent manner in the performance of [their] duties"[151] and that their conduct has been such that banning orders are appropriate.

Legal principles

[588] Section 383 of the Companies Act gives the Court the power to disqualify certain persons from being directors of companies, or from taking part in the management of a company, either for a specific period of time or on a permanent basis. Banning orders are designed to protect the public and those dealing with companies from the harmful use of the corporate structure and to ensure the suitability of directors to hold office. They are not punitive although their purpose includes personal and general deterrence. In assessing the fitness of an individual to manage a company, it is necessary they understand the proper role of the company director and the duty of due diligence that is owed to the company. It is necessary to balance the personal hardship to the director against the public interest and the need to protect the public from any repetition of the conduct.[152]

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[151] Companies Act 1993, s 383(1)(c)(ii).

[152] *Registrar of Companies v Blake* [2019] NZHC 680, (2019) 12 NZCLC 98-071 at [43] and [44], per Venning J citing with approval *Australian Securities & Investment Commission v Adler* [2002] NSWSC 483 at [56].

[589] Mr Hollyman submits that what is required before a banning order may be made is misconduct rather than mismanagement. He says the section is not aimed at minor acts of negligence or carelessness, but at conduct which is "wilful or deliberate or culpable", involving dishonesty or a gross failure to meet the required standards of conduct. Mr Hollyman says that even if the defendants did breach their duties, which he submits they did not, their conduct falls well short of that required for imposition of banning orders. He says at worst the defendants were unduly optimistic in their assessments of timeframes and the capital requirements. Such optimism does not amount to a gross or serious failure to meet the standards required of company directors justifying a banning order.

[590] Given my findings on all causes of action I am satisfied there is no basis to make banning orders in respect of any of the defendants. While I have found the directors breached their duties under ss 135 and 137, these were not breaches characterised by gross departures from the required standards. Neither caused loss to Mr Banks. The decision to continue to trade beyond the point I have found Mako should have been put in liquidation did not materially add to creditors' losses. The deterrent purpose of a banning order is not made out. Neither is there a need to protect the public or those dealing with companies from the conduct of the defendants.

[591] I am not prepared to make orders under s 383 of the Companies Act.

SECOND AND FOURTH CAUSES OF ACTION: MISREPRESENTATIONS – S 55G OF THE SECURITIES ACT AND S 9 OF THE FAIR TRADING ACT

Introduction

[592] Mr Banks has brought two causes of action alleging misrepresentations made by the defendants. These are under:

(a) section 55G of the Securities Act against all defendants for misrepresentations in advertisements; and

(b) section 9 of the FTA against all defendants (excluding Mr Frederick) for misleading and deceptive conduct in trade.

[593] Mr Johnson acknowledges:

(a) these are "either/or" causes of action and there cannot be double recovery or liability under both;

(b) that in relation to advertisements, if there is no liability under the Securities Act, there can be no liability under the FTA (and vice versa);[153]

(c) his submissions focus on what Mr Johnson described as "the most significant misrepresentations"; and

(d) where a representation is made as to a future fact, the question becomes whether the person making the representation had an honestly and reasonably held belief in the correctness of the representation.[154]

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153 Securities Act 1978, s 63A; and Fair Trading Act 1986, s 5A.

154 Securities Act 1978, s 56(3)(c); Andrew Brown and others *Securities Law* (online loose-leaf ed, Thomson Reuters) at [SE56.05(3)]; *Premium Real Estate Ltd v Stevens* [2008] NZCA 82, [2009] 1 NZLR 148 at [51]; *Prattley Enterprises Ltd v Vero Insurance New Zealand Ltd* [2015] NZHC 1444, [2015] 18 ANZ Insurance Cases ¶62-075 at [184]-[186]; and *Clode v Sullivan* [2017] NZCA 548, (2017) 14 TCLR 678 at [45].

Section 55G of the Securities Act

[594] Section 55G of the Securities Act permits a Court to order a liable person to pay compensation to any person who "subscribed for any securities on the faith of an advertisement or registered prospectus that includes an untrue statement" for the loss or damage the person has sustained by reason of the untrue statement.

[595] To invoke the section Mr Banks must establish:

(a) that he subscribed for the securities on the faith of an advertisement that included an untrue statement; and

(b) that he sustained a loss or damage by reason of the untrue statement.

[596] For the reasons I have already given in relation to the first cause of action, I am satisfied that the Securities Act is not engaged. More particularly, for the purpose of s 55G, I am satisfied that Mr Banks did not subscribe for any security.

[597] As a consequence, this cause of action necessarily fails. However, as both parties acknowledge, the available remedy under s 55 is effectively shared or duplicated by the second cause of action under the FTA and, accordingly, the next section of the judgment deals with that claim.

Section 9 of the Fair Trading Act

Mr Banks' case

[598] Mr Johnson submits that it is clear on the evidence that Mr Banks made his investments in reliance on misrepresentations which included inaccurate statements of fact, statements of future fact made without a reasonable basis and critical omissions of key information. As such Mr Banks should be entitled to a remedy under s 43(3)(e) or (f) of the FTA.

[599] Mr Banks has pleaded 53 specific representations. In order to properly follow this part of my decision and my determinations on the alleged misrepresentations and omissions, the full list as pleaded is annexed as Appendix 1 to this judgment.

[600] Mr Johnson arranged his claim under this cause of action by listing the various misrepresentations, in generalised form, relative to each Agreement. These are set out below:

(a) prior to Agreement 1, that the prospects for Mako were as set out in the PPM and failing to advise that Mako was trading well below forecasts;

(b) prior to Agreement 2:

(i) failing to disclose that Mako's trading was substantially behind that projected in the PPM;

(ii) failing to disclose the concerns of Telecom Rentals;

(iii) representing that an IPO was likely when it was not, including failing to disclose the Telecom Rentals' debt was a critical barrier to listing and that Telecom Rentals was unlikely to convert;

(iv) stating that the business was worth $100 million or more (with the implication the IPO advisors agreed) when there was no professional advice to that effect and indications were to the contrary;

(v) failing to disclose the forthcoming security to be provided to Telecom Rentals; and

(vi) failing to disclose that accounts provided to Mr Banks were not an accurate statement of Mako's position and would shortly be restated; and

(c) prior to Agreement 3:

(i) representing that an IPO was still a possibility when it was not (given there was no professional advice to that effect),

Telecom Rentals had clearly advised it would not convert and negative feedback had been received from potential investors;

(ii) representing Mako was still worth more than $50 million, given the financial position of Mako, the absence of a supporting valuation and the feedback from investors;

(iii) failing to advise of the failure to convert key opportunities, notably Sprint, Telstra and PUMA;

(iv) failing to advise the extent of the restatement of the 2012 accounts; and

(v) failing to properly advise of risks in 2014 and failing to disabuse Mr Banks of his notion that his money would be as safe as six months ago.

[601] Additionally, Mr Johnson submits the Court may have regard to Mr Farmer's general pattern of conduct throughout this period. Mr Johnson submits that despite Mr Farmer's insistence that he was frank with Mr Banks as to the state of the company and the associated risks of investment, that claim is inconsistent with the contemporaneous documentary record.

Legal principles

Misleading and deceptive conduct in trade

[602] Section 9 of the FTA provides:

> "**9 Misleading and deceptive conduct generally**
>
> No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive."

[603] There are three key terms in s 9 to be defined; "trade", "engage in conduct" and "misleading or deceptive".

[604] The term "trade" is defined in s 2 of the FTA as:

> "any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services or to the disposition or acquisition of any interest in land"

[605] To "engage in the conduct" is defined in s 2(2) and provides:

> "… a reference to engaging in conduct shall be read as a reference to doing or refusing to do an act, and includes,—
>
> (a) omitting to do an act; or
>
> (b) making it known that an act will or, as the case may be, will not be done."

[606] On this, it is apparent that conduct, for the purposes of s 9, includes both acts and omissions. It can include misrepresentations, half-truths, silence and failures to disclose a material change in circumstances. The director of a company may be liable under s 9 of the FTA where the representations in question were made on behalf of a company. The general principle is that both the person and company are liable. Section 45(2) of the FTA provides:

> "(2) Any conduct engaged in on behalf of a body corporate—
>
> (a) by a director, servant, or agent of the body corporate, acting within the scope of that person's actual or apparent authority; or
>
> (b) by any other person at the direction or with the consent or agreement (whether express or implied) of a director, servant, or agent of the body corporate, given within the scope of the actual or apparent authority of the director, servant or agent—
>
> shall be deemed, for the purposes of this Act, to have been engaged in also by the body corporate."

[607] In *Body Corporate 202254 v Taylor*, the Court of Appeal said:[155]

> "… the Courts have not regarded corporate form (and particularly the separate legal identity of companies) as precluding personal liability on the part of senior employees who engage in misleading and deceptive conduct."

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155 *Body Corporate 202254 v Taylor* [2008] NZCA 317, [2009] 2 NZLR 17 at [19].

[608] This Court said in *Gilmour v Decisionmakers (Waikato) Ltd*:[156]

> "A director who participates directly in his or company's business will not ordinarily be able to avoid liability under s 9 of the Act…"

[609] The next question is what "in trade" means. This term is defined in s 2 as:

> "any trade, business, industry, profession, occupation, activity of commerce, or undertaking relating to the supply or acquisition of goods or services or to the disposition or acquisition of any interest in land"

[610] The Supreme Court in *Red Eagle Corp Ltd v Ellis* observed:[157]

> "This is a broad term encompassing all kinds of commercial dealing by the party whose conduct is under examination. The section applies to transactions between large, sophisticated corporations as well as to those of persons dealing with consumers."

[611] The test for what amounts to misleading and deceptive conduct was also discussed:[158]

> "[28] …[Section 9] is directed to promoting fair dealing in trade by proscribing conduct which, examined objectively, is deceptive or misleading in the particular circumstances. Naturally that will depend upon the context, including the characteristics of the person or persons said to be affected. Conduct towards a sophisticated businessman may, for instance, be less likely to be objectively regarded as capable of misleading or deceiving such a person than similar conduct directed towards a consumer or, to take an extreme case, towards an individual known by the defendant to have intellectual difficulties. Richardson J in *Goldsboro v Walker* said that there must be an assessment of the circumstances in which the conduct occurred and the person or persons likely to be affected by it. The question to be answered in relation to s 9 in a case of this kind is accordingly whether a reasonable person in the claimant's situation – that is, with the characteristics known to the defendant or of which the defendant ought to have been aware – would likely have been misled or deceived. If so, a breach of s 9 has been established. It is not necessary under s 9 to prove the defendant's conduct actually misled or deceived the particular plaintiff or anyone else. If the conduct objectively had the capacity to mislead or deceive the hypothetical reasonable person, there has been a breach of s 9. If it is likely to do so, it has the capacity to do so. Of course the fact that someone was actually misled or deceived may well be enough to show that the requisite capacity existed."
>
> (footnotes omitted)

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156 *Gilmour v Decisionmakers (Waikato) Ltd* [2012] NZHC 298 at [87]. See also *Murren v Schaeffer* [2018] NZHC 3176; and *Gloken Holdings Ltd v The CDE Company Ltd* (1997) 8 TCLR 278 (HC).

157 *Red Eagle Corp Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [26], n 13.

158 At [28].

Relief under the FTA

[612] Section 43(1) of the FTA provides:

> "**43 Other orders**
>
> (1) This section applies if, in proceedings under this Part or on the application of any person, a court or the Disputes Tribunal finds that a person (person A) has suffered, or is likely to suffer, loss or damage by conduct of another person (person B) that does or may constitute any of the following:
>
> (a) a contravention of a provision of Parts 1 to 4A (a relevant provision):
>
> (b) aiding, abetting, counselling, or procuring a contravention of a relevant provision:
>
> (c) inducing by threats, promises, or otherwise a contravention of a relevant provision:
>
> (d) being in any way directly or indirectly knowingly concerned in, or party to, a contravention of a relevant provision:
>
> (e) conspiring with any other person in the contravention of a relevant provision.
>
> …"

[613] To be subject to secondary liability under s 43(1), the defendant must have knowledge of the essential facts which make up the contravention and be a conscious or intentional participant in it.[159]

[614] Section 43(3) provides for the kind of relief that may be available, and includes an order directing the refunding or returning of the money or property lost,[160] and an order directing payment to the amount of the loss or damage.[161]

[615] I now turn to consider Mr Farmer's liability under s 9 of the FTA before considering that of the other directors. I shall consider each element of s 9 in turn.

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159 *Megavitamin Laboratories (NZ) Ltd v Commerce Commission* (1995) 6 TCLR 231; and *NZ Bus Ltd v Commerce Commission* [2007] NZCA 502, [2008] 3 NZLR 433.
160 Section 43(3)(e).
161 Section 43(3)(f).

Analysis

[616] The starting point for the analysis in regard to the FTA cause of action must be cl 4(f) of Agreement 1. It reads:

> "This letter agreement is the entire agreement between the parties and supersedes all prior agreements, negotiations, representations and the like concerning its subject matter. The Lender confirms it has entered into this agreement on its own judgment and has not relied on any representation of the Borrower or its agents, officers and personnel."

[617] I note that cl 4(f) also forms part of Agreements 2 and 3. I step through the following analysis with this in mind.

(a) Was Mr Farmer "in trade"?

[618] Mr Hollyman submits that while it is possible for a director to be held personally liable for misleading and deceptive conduct, a director cannot be personally liable under the FTA unless the relevant conduct is accompanied by evidence of some personal endorsement or representation. He submits that the cases which have followed *Body Corporate 202254 v Taylor* have involved liability on the basis of that Court's minority's view, being the narrower interpretation of "in trade". In other words, personal liability under s 9 is confined to a person trading on his or her own account.[162] These are also cases where the company is the alter ego of the director. Thus, Mr Hollyman submits that Mr Farmer is not liable because he was not the alter ego of Mako. Mako was a company with 120 employees and a board of five directors. Mr Banks was told that Board approval was needed for the transactions and Mr Farmer provided information prepared by the company which he presented to Mr Banks. Thus, Mr Hollyman submits, Mako was the entity which was in trade and not Mr Farmer.

[619] I cannot agree. The definition of "in trade" is deliberately broad and designed to capture the transactions of a wide range of entities which deal with consumers. I cannot accept that Parliament intended the application of s 9 to be so constrained that representations made by the director and CEO of a company, on behalf of the company, fall outside the regime of the FTA and s 9.

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162 *Body Corporate 202254 v Taylor* [2008] NZCA 317, [2009] 2 NZLR 17 at [101] and [105].

[620] Further, *Body Corporate 202254 v Taylor* referred to *Kinsman v Cornfield*s *Ltd*.[163] There, the director had been involved in face to face negotiations with the parties to whom the representations had been made. Reflecting on this, the Court in *Body Corporate v Taylor* commented "the director/senior employee making the representations might be thought, by implication at least, to be inviting the other party to believe him or her".[164] In *Kinsman*, the Court said this:[165]

> "It will be a rare case where a director who participates directly in negotiations as to his or her company's business will be able to avoid s 9 liability simply on the basis that he was acting only on the company's behalf. The Fair Trading Act is intended in our view to cast its net wider than that and in the circumstances of this case the representations made by Mr Kinsman must be regarded as "in trade"."

[621] I am thus satisfied Mr Farmer was in trade for the purposes of this section.

(b) Did Mr Farmer engage in conduct?

[622] Again, the definition of engaging in conduct for the purposes of s 9 is wide, including as it does both acts and omissions and representations as to future conduct.

[623] Mr Farmer engaged with Mr Banks in correspondence, by telephone and in person.

[624] Given these circumstances I am easily satisfied that Mr Farmer engaged in conduct relative to Mr Banks.

(c) Was Mr Farmer's conduct misleading or deceptive?

[625] This is where the real contest lies. Given the sheer number and detail of the alleged representations, it is neither practical nor desirable to deal with each individually. Rather, a more convenient approach, which I shall adopt, albeit principled, is to group the representations into two broad categories, verbal and written, and deal with each category. Where possible, I assess the representations and

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163 *Kinsman v Cornfields Ltd* (2001) 10 TCLR 342.

164 *Body Corporate 202254 v Taylor* [2008] NZCA 317, [2009] 2 NZLR 17 at [82].

165 *Kinsman v Cornfields Ltd* (2001) 10 TCLR 342 at [27].

omissions relating to similar themes or content together. Necessarily, some of the more specific and significant allegations will be considered separately.

[626] As a preliminary observation, I note that the alleged representations 35 to 53 were made after the transfer of funds under Agreement 3. They cover the period between 25 August 2014 and 11 June 2015. It follows that even if I was to find they amounted to actionable misrepresentations under s 9, Mr Banks suffered no consequential loss. They cannot have influenced him in his decision to invest as is required for orders under s 43. He had already invested his funds and he did so on the basis they would be equitised.

[627] This leaves 34 pleaded representations; 14 verbal and 20 written. I turn to consider each of those categories.

(i) Verbal representations

[628] Of the 14 verbal representations, being representations 4, 5, 10, 12, 14, 15, 17, 18, 21, 23, 25, 29, 30 and 32, all are alleged to have taken place at local cafés,[166] in private homes[167] or via telephone calls.[168] Some Mr Farmer remembered. Many he did not. Notably, in cross-examination, Mr Banks had difficulty remembering most of these encounters.

[629] Having seen and heard Mr Banks' descriptions of these meetings, I find material aspects of his claims of misrepresentation implausible. As part of my consideration, it is appropriate to supplement my earlier credibility findings with further adverse findings, particularly in relation to the significant number of representations which are unsupported by contemporaneous documents. My reasons for disbelieving Mr Banks on his uncorroborated accounts of the claimed oral misrepresentations follow.

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166 Meetings at Kokako Café on 20 June 2012, SPQR Restaurant on 8 August 2012, Kokako Café on 30 November 2012, Café People on 98 March 2013, Kokako Café on 26 April 2013, Pescado Restaurant on 17 September 2013, Café People on 23 October 2013, Occam Café on 29 November 2013, Occam Café on 4 March 2014 and Café People on 26 March 2014

167 Meetings at Mr Farmer's house on 27 January 2011 and Mr Banks' home on 13 June 2011.

168 Telephone calls on 27 January and 9 March 2011.

[630] First, Mr Banks' recollection of these meetings and the detail as to what was discussed is remarkable, particularly given his vagueness under cross-examination. By way of example, in his brief Mr Banks described representation 12 which he said was a meeting at his house on 13 June 2011. Mr Banks claimed Mr Farmer told him:

> "(i) Mako was doing well and there were plenty of interested customers;
>
> (ii) [Mr Farmer] was unlike those who take investment monies from others without being fully committed to the business in question;
>
> (iii) [Mr Banks] could rely on the figures and representations in the [PPM] and that the clauses in the report which excluded reliance only applied to Mako's earlier capital raising efforts which finished on 30 November 2010;
>
> (iv) in relation to page three of the [PPM]:
>
> > (1) [Mr Farmer] was happy to accept money from any member of the public as long as the amount was large enough to be worth his time. This followed [Mr Banks'] questioning Mr Farmer about the first section on page three relating to "qualified investors", which [Mr Banks] told Mr Farmer [he] did not believe [himself] to be;
> >
> > (2) that it was not a problem that [Mr Banks] was not interested in buying shares and that [he] was more interested in lending money;
> >
> > (3) [Mr Banks] could ignore the "No Authorisation" section and that Mr Farmer's representations could be relied upon;
> >
> > (4) Clauses like the "No Authorisation" section are not always applicable to every investor but are always required by lawyers to be included in such documents; and
> >
> > (5) [Mr Banks] could be assured that [he] was the right kind of investor and everything was being done appropriately;
>
> (v) Agreement 1 clause 4f existed only because Mako's lawyer had required it but that in practice it would not be applicable;
>
> (vi) [Mr Farmer] would provide [Mr Banks] with reliable information as per clause 3b of Agreement 1."

[631] When challenged as to how he was able to compile such a comprehensive and detailed account of this meeting in his statement of claim and brief of evidence, Mr Banks said that he relied on notes. This is what he said in cross-examination:

> "Q You talk about a meeting with Mr Farmer at your house on the 13th of June 2011?
>
> A Yes.
>
> Q Is this another matter in which you say you took notes?

A I repeat, I took notes of every meeting I had, even insignificant ones, forget that comment. I made notes of all meetings and anything significant said in a phone call."

[632] When asked whether he had any independent recollection of these events beyond the details of his brief, Mr Banks said:

> "Yeah, I'm sorry, I can't remember much about the meeting. I would strongly recommend you rely upon the brief".

[633] As to other verbal representations, Mr Banks accepted he had no independent recollection beyond the contents of his brief.

[634] Despite Mr Banks apparently having the foresight to maintain detailed contemporaneous notes, no such notes have ever been discovered. When Mr Hollyman was exploring this question with Mr Banks, Mr Johnson properly advised the Court that he knew nothing of the notes.

[635] I do not accept Mr Banks' evidence. It beggars belief that such detailed notes would have been maintained and used as the foundation for the particulars under the second cause of action and the preparation of Mr Banks' brief of evidence only to be destroyed, lost or otherwise misplaced between then and the time of trial. This is yet another example of Mr Banks' facility for bending the truth when it comes to the evidence he is prepared (and not prepared) to adduce in pursuit of his claim against the defendants.

[636] Thus, to the extent that Mr Banks' account of the various representations differs from that of Mr Farmer's, I prefer the latter's evidence.

[637] It follows Mr Banks' cause of action under the FTA in respect of representations 4, 5, 10, 12, 14, 15, 17, 18, 21, 23, 25, 29, 30 and 32 consequently fails.

(ii) Written representations

[638] I next consider the 20 written communications, being representations 1, 2, 3, 6, 7, 8, 9, 11, 13, 16, 19, 20, 22, 24, 26, 27, 28, 31, 33 and 34. I have grouped these

into three subcategories, reflecting the periods which preceded each of the Agreements. In places it is necessary to also reference related verbal representations. Alleged omissions are also addressed under the relevant subcategory.

[639] Mr Johnson submits the misrepresentations made to Mr Banks during the period after Agreement 1 and before Agreement 2 include those until 30 June 2013 when Agreement 2 was signed. He submits that it was only at this point that Mr Banks was committed to keeping the funds in Mako. I cannot agree. As I have already found, the date Agreement 2 was formed was 15 May 2013, the date the first tranche was transferred to Mako. Although the document added a layer of formality to Agreement 2, Mr Banks had already committed to keeping his funds with Mako because of the potential for high returns. Agreement 3 is similar, although no written contract followed. The transfer of funds took place on 24 April 2014. Agreement 1 may be distinguished in that the written contract was executed before any transfers were made.

[640] On this analysis the subcategories include the following alleged misrepresentations:

(a) prior to Agreement 1: representations 1, 2, 3, 6, 7 and 8 being those made before 4 February 2011;

(b) prior to Agreement 2: representations 9, 11, 13, 16 and 19, being those made between 4 February 2011 and 15 May 2013; and

(c) prior to Agreement 3: representations 22, 26, 27, 28, 33 and 34, being those made between 15 May 2013 and 24 April 2014.[169]

Representations 20, 24 and 31

[641] I deal briefly with representations 20, 24 and 31. Although technically fitting into the above categories, they can be distinguished in that they go to Mr Farmer's

[169] Although the second tranche of Agreement 2 was paid on 31 May 2013, it was made under the same Agreement as the first tranche.

general pattern of conduct. They are emails from Mr Farmer to Mr Banks where he says he:

(a) is concerned with fairness for all parties and is objective in his consideration;[170]

(b) has "our" best interests at heart;[171] and

(c) was working to get the best arrangement available for Mr Banks.[172]

[642] This correspondence paints Mr Farmer as reassuring and familiar. I accept that statements containing sentiments such as these are capable of being construed as giving Mr Banks some measure of confidence. However, the emails are dispersed across the chronology and each must be considered in context. The statements were made on 13 April 2013, 23 September 2013 and 16 March 2014. The first was made after Mr Banks had been involved with Mako for approximately 15 months. Only representation 20 is proximate to an Agreement. It was made approximately four weeks before the first transfer under Agreement 2.

[643] All these representations are, in my view, both too general and too remote in time to have been causative of any loss suffered by Mr Banks.

Representations prior to Agreement 1

[644] The primary question under this heading is whether the PPM[173] and the alleged failure to advise Mr Banks that Mako was trading well below the forecasts[174] amounted to misleading and deceptive conduct. Other representations included under

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170 Representation 20.
171 Representation 24.
172 Representation 31.
173 Representation 1.
174 Representation 2.

this heading relate to capital raising efforts and strategy,[175] shareholder employee salaries,[176] and the need for confidentiality given Mako's position in the market.[177]

[645] The emails relating to Mako's capital raising effort and strategy, and the need for confidentiality constitute honestly and reasonably held beliefs. Mr Farmer was simply updating Mr Banks on Mako's possible incoming funds and its ever-changing position regarding capital raising and investors. Comments on the need for confidentiality reflect Mako's competitive and disruptive technology. Mr Banks was aware that Mako's technology had been specifically designed to fill a gap in the market. In relation to representation 3, which concerns shareholder employees' salaries, I am not satisfied the email actually means what the plaintiff contends. Mr Farmer simply set out what was and was not possible in terms of salary reductions should Mako fall on hard times.

[646] The PPM is criticised primarily because the revenue projections are said to have been unrealistic. Certainly, it is common ground they were never reached. It is claimed Mr Farmer did not advise Mr Banks how the current financial year was tracking against the forecasts. In cross-examination, Mr Farmer accepted that the projections were extrapolations. They were not binding commitments.

[647] According to Mr Johnson, Mr Gamble, who co-authored the PPM, adopted a generally cavalier approach to forecasting by including cashflow prospects and revenue forecasts which fell well short of the actuals. Mr Johnson submits that there was no reasonable basis for the directors to believe the financial projections could or would be met. These errors were compounded by the failure to update Mr Banks on the actual performance of Mako, making the PPM misleading at the time it was given to Mr Banks.

[648] For the reasons advanced by Mr Hollyman, I am not satisfied these complaints are made out.

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175 Representations 6 and 7. I include here reference to two emails dated 3 February and 3 March 2011 which Mr Johnson referred to in his oral closing submissions, but which are not included in the written submissions.

176 Representation 3.

177 Representation 8.

[649] First, the revenue forecasts and related statements were honestly and reasonably held opinions and, as such, are not actionable under s 9. It is apparent from multiple evidential sources that Mako was, at the time, on the threshold of an exciting and promising period in its development. Mr Gamble was extensively cross-examined on the appropriateness and correctness of the projections based on client interest. He confirmed that at the time, Mako was "inundated with serious enquiries". He explained the uniqueness and value of PCI-DSS compliance and how shortly before the PPM was drafted, he and Mr Farmer had attended a Mastercard convention in San Diego where the reaction to Mako's new product was positive, observing that "… it was crazy how good it was for us". These were heady times full of promise for Mako, an innovative tech company with a world-leading and pioneering product. Mako was being recognised through positive global customer interest from major, world leading multi-nationals.

[650] Secondly, it is apparent from the first two pages of the PPM that the directors were explicit in the reservations and qualifiers to their opinions. Some of those qualifications are set out in full in the introductory part of this judgment. The PPM explicitly stated that the financial information it contained was based on "numerous assumptions, projections and best estimates". It stated that the risks and uncertainties inherent in projections meant that the actual results were likely to vary, and that "such variations could be material". By way of example, at page 4 of the PPM, it was stated "No representations are made by the Company, its directors or its management that the results set out in the Memorandum will be achieved". No potential investor could have been left with any misunderstanding as to the qualifications to and limits on the information contained in the PPM.

[651] For completeness, I note here a related verbal representation,[178] which I have already determined was not made. I do not accept Mr Banks' evidence that Mr Farmer advised him at a meeting on 13 June 2011 that he could ignore the "No Authorisation" section of the PPM. Mr Farmer denied saying this and for the reasons already set out, I prefer his evidence over Mr Banks'. In any event, the alleged statements are claimed

178 Representation 12.

to have been made on a date more than four months after Mr Banks entered into Agreement 1. They could not have caused him to enter the Agreement.

[652] Further, a contemporaneous email was sent by Mr Farmer to Mr Banks on 17 January 2011, two weeks before Agreement 1 was executed. It described the PPM as:

> "…a fair snap shot of the complete business (including all subsidiaries) as at the date it was released. As outlined in the document, neither the company, its Directors or Employees are responsible for its content. The Directors have signed off each of the years Financial Statements included."

[653] For the reasons just discussed, I cannot see how this representation can be viewed as misleading.

[654] It is also worth noting that this same email stated that neither Mr Farmer nor the company would offer any guarantees, which Mr Banks wished included. The correspondence is direct and bland. None of the language used by Mr Farmer in this email is consistent with the extravagance and hyperbole which Mr Banks claims characterised so many of his dealings with Mr Farmer.

[655] Thirdly, I regard it as significant that Mr Banks said that he undertook independent research on Mako and its competitors before deciding to invest. In other words, his decision to invest in Mako was influenced by his own enquiries into the business. On this point, Mr Banks said during cross-examination:

> "I will repeat myself. I looked at Mako, its competitors and IT companies that wanted investment. I saw lots of information being presented to the public, some of it was bad and none of this included such a list. And I thought, 'Well, I see an absence in the marketplace, wouldn't it be a good idea if a business actually had something clear like this' and I thought I would give this business the benefit of my very unprofessional advice."

[656] Later in this evidence, Mr Banks said:

> "Before the Mako opportunity presented to myself, I wouldn't say I was shopping around for investments. What I can definitely say is once it presented itself I thought, "Mhm, this looks interesting". But I did what I always do, or would say at least 99% of cases, I researched it and associated matters. I like to have a holistic picture of the world. So, in the, sure, in the years in which I was an investor of Mako I read about it. I read about IT security in general, its competitors, its customers and so on. So it's certainly

> safe to say that I read about associated matters, but definitely what you said. I was not shopping around for other investments when Mako came along."

[657] Finally, there is little or no evidence that Mr Banks was, at the time he entered Agreement 1, looking for an investment with the potential for realising massive gains. This is apparent from his repeated references to the loan being an investment and that projected profits estimated in the tens of millions were not material to his decision or assessment of Mako's ability to repay him.

[658] I am easily satisfied that the optimistic projections contained in the PPM, read in conjunction with its extensive reservations, represented the reasonably held and honest views of the directors at and about that time.

[659] For the above reasons I am not satisfied that the representations made prior to Agreement 1 were misleading or deceptive and led to or caused Mr Banks' loss.

Representations prior to Agreement 2

[660] The representations falling into this subcategory concern whether the "good news" Mr Banks was given regarding Mako's financial position prior to entering Agreement 2, and the representations and omissions concerning the likelihood of an IPO amounted to misleading and deceptive conduct.

[661] The "good news" Mr Banks referred to consists of emails from Mr Farmer where he remarked positively on Mako's business,[179] progress with capital raising,[180] meetings he was attending,[181] events he had attended,[182] and investments or contracts which were being finalised or confirmed.[183]

[662] Mr Banks asserted in evidence that after two years of good news from Mr Farmer he agreed to lend more money to Mako. However, the documentary record contradicts that claim. It was, in fact, Mr Banks who initiated the steps which led him

[179] Representations 11, 16 and 19. Representation 19 is not as described in the pleadings, with the email referring to Mako as having a "great week".
[180] Representation 9.
[181] Representation 16.
[182] Representation 13.
[183] Representation 13.

to advance the funds under Agreement 2. He approached Mr Farmer by email on 2 March 2013:

> "How are things with Mako? In very roughly four weeks I'll have about £234k become available in the UK. I was wondering if Mako needed to borrow any more. I'd be happy to have you create a new tranche with the same terms as the others except the time periods, which we can discuss."

[663] In cross-examination, Mr Banks said he had no recollection of this particular communication, although he accepted that these things were being talked about.

[664] Even if Mr Farmer's representations had inspired Mr Banks to initiate a second investment, I consider the representations to be honestly and reasonably held opinions. Mr Farmer was reporting on Mako's business as he then knew and experienced it. The emails in question shared Mako's successes, informing Mr Banks of the outcomes of different negotiations, and of the meetings Mr Farmer was attending on Mako's behalf. Having examined the emails, I find that on both an individual and collective level they are simply statements of fact (such as when Mr Farmer announced Mako "had a great finish to the year end with 3 significant contracts confirmed")[184] or convey Mr Farmer's opinion of Mako's business at that point (such as when Mr Farmer wrote "great week this week with the team refining our strategy…")[185].

[665] Mr Johnson also submits that there was a failure to inform Mr Banks that the security terms under Agreement 1 and the soon to be signed Agreement 2 were to be breached. I have already addressed the circumstances surrounding this at [514]-[516]. There I found that although there was an inadvertent breach, Mr Banks would likely have waived his rights had he been given the opportunity to do so.

[666] The other set of representations relevant to Agreement 2 relate to the possibility of a future IPO. Mr Johnson places considerable emphasis on these representations. He submits there were multiple representations that an IPO was likely when patently it was not. Agreement 2 expressly contained this representation when it stated that Mako had "initiated a further capitisation (sic) programme" and was likely to list on the NZX. Mr Johnson says there was no reasonable foundation as at

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[184] Representation 13, email dated 13 January 2012.
[185] Representation 19.

30 June 2013 to make such a representation given the implications of the Telecom Rentals debt, the unlikelihood of Telecom Rentals agreeing to convert their debt to equity, and the consequences of restating the accounts.

[667] I cannot agree that any of these representations were misleading or deceptive. Prior to Agreement 2, the only professional advice Mako had received about a possible NZX listing was from Cameron Partners. The Weldon Report would not be received until 7 October 2013, some four months after Agreement 2 was concluded and even it did not refer to an IPO. Agreement 2 made express reference to Cameron Partners' strong recommendation that any debt on the balance sheet should be removed. This was an appropriate disclosure made on the face of the lending document itself. Significantly, Cameron Partners had never suggested to the directors of Mako that an IPO was an unattainable or unrealistic ambition. Indeed, in its report to Mako, Cameron Partners set out a number of strategic proposals which could be implemented to achieve a successful listing. They would not have done that had they believed this was a forlorn or deluded aspiration. Furthermore, Deloitte were only engaged to audit Mako's accounts on 30 June 2013. The later restatement of accounts was not in contemplation at any earlier point. The directors had taken advice from Duns Accounts Ltd as to their financial position prior to the audit and acted in good faith in reliance on that advice. As Mako's auditors, Deloitte determined the treatment of sales required a re-characterisation and a restatement of the accounts. I do not detect any sinister implications attributable to the conduct of the directors.

[668] Thus, it follows I am satisfied that there were no material representations made by Mr Farmer which were misleading or deceptive relative to Agreement 2.

Representations prior to Agreement 3

[669] The alleged misrepresentations relating to this period also concern the possibility of an IPO[186] and Mako's financial position.

[670] Mr Johnson submits the position in relation to Agreement 3 "could almost be described as cynical". He suggests a failure to disclose critical information about

186 Representations 26, 27, 28, 33 and 34.

Mako's prospects meant Mr Banks was fundamentally misled before he made his final investment. Mr Johnson submits Mr Farmer could not have held a reasonable belief at that point that an IPO was a possibility given Mako's parlous financial state at the time.

[671] In the period between 15 May 2013 and 24 April 2014, Mr Farmer made representations as to Mako's finances and the contracts it had in the pipeline. He advised Mr Banks of the completion of the contract with Bullseye in the United States,[187] and announced the Telstra deal.[188] Both of these events were true and based on Mr Farmer's honest and reasonable belief at the time. The deals continued to progress as revealed in the September 2013 Board minutes. Mr Gamble provided updates, describing the Bullseye sales opportunities as "very positive" with the first two proposals underway and the first order of 104 units expected. He also commented on the finalisation of the Telstra contract, noting there was potential for Telstra to be a "node operator", which would have had favourable cashflow benefits for Mako. The fact these opportunities remained alive months after the representation goes to Mr Farmer's honest and reasonably held opinion at the relevant time.

[672] Mr Johnson also submits the directors failed to advise Mr Banks of the collapse of the Sprint deal. Four days prior to Mr Banks' transfer of funds under Agreement 3 Mr Gamble received news from Mr Callender at Sprint that the deal was unlikely to proceed in the form earlier proposed. Mr Farmer and Mr Gamble described this change in stance by Sprint as occurring "for no apparent reason". Neither considered it represented a complete or terminal collapse in the negotiations or the reasonable prospect of achieving a successful conclusion to the deal.

[673] Earlier, beginning at [427], I discussed the chronology around the Sprint deal and its collapse. I determined that until 26 April 2014 at the earliest, the directors had a reasonable belief that the Sprint deal would result in binding contracts.[189] I consider this finding is supported by the fact Mr Farmer did not tell Mr Banks to hold off on transferring funds, as he had previously done in late 2013 and early 2014 when the

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187 Representation 22.
188 Representation 34.
189 At [435] of this judgment.

Telecom Rentals negotiations were in train. On that occasion Mr Farmer made it plain to Mr Banks that an investment at that time was too uncertain and risky. Mr Farmer's failure to adopt a similar approach relative to the Sprint deal serves only to emphasise that the directors at that time still honestly believed the agreement with Sprint was salvageable and were working towards achieving that. Mr Gamble was looking into alternative financers for Sprint, and a meeting with Mr Nasser was imminent.

[674] Mr Johnson submits the directors failed to advise Mr Banks of updates to Mako's financial situation as professional advice was received, and what that meant for a potential IPO. By this time the Weldon Report had been published, Deloitte had advised of the restatement of accounts and Telecom Rentals had cemented its position against equitising. For these reasons, Mr Johnson submits, the defendants were well aware of the combination of factors which made an IPO all but unattainable.

[675] Mr Johnson also submits Mr Banks was not informed of these updates. However, that is not strictly correct on the evidence. Mr Farmer's evidence is that the Weldon Report was tabled at the 8 October 2013 shareholders AGM meeting. Mr Weldon attended in person. This was an important meeting to which Mr Banks had been invited. Mr Banks did not attend. Mr Farmer's evidence is that at a meeting with Mr Banks at Occam Café on 29 November 2013,[190] he told Mr Banks about the challenges Mako was facing with Telecom Rentals and its deteriorating financial position. Mr Banks said he had no recollection of this conversation. The meeting was followed by Mr Farmer emailing Mr Banks and advising him to hold off on any advances and that he would make contact again when it was "all clear to do the same". Nonetheless, Mr Banks accepted he was made aware of the situation with Telecom Rentals via emails in January and February 2014. I have earlier discussed and set out the relevant correspondence. Mr Banks also received the shareholder update and the attached draft special resolution on 5 February 2014. Furthermore, in an email to Mr Farmer, Mr Banks referred back to the resolution, commenting on his disappointment that Mako had "panic" sold the SecureME business to Telecom Rentals. In my view it is inconceivable that Mr Banks was not fully aware of Mako's

[190] Representation 29.

situation before he made his last advance, although I do accept that he still believed an IPO was possible.

[676] Regardless, I am satisfied that even if any such representation or omission as to the potential of an IPO was misleading or deceptive, it did not cause Mr Banks any recoverable loss that would warrant relief under s 43. Mr Banks' evidence was that the prospect of an IPO did not cause him to enter either Agreement 2 or Agreement 3. This is evident from an answer that he offered in cross-examination:

> "…but you mention the IPO, yes, of course, that was on my mind as well. When making investments 2 and 3 I had in my mind the possibility of an IPO, that certainly motivated me but it was never more than a bonus, given how complex IPOs are no one can guarantee when they are going to happen. I never banked on that happening. It was just, it was a nice addition to the positive story that I (inaudible) had every year."

[677] Relief under s 43 requires that the claimant has suffered, or is likely to suffer, loss or damage by misleading or deceptive conduct of the defendant. Mr Banks' claim therefore must fail; there is no causative nexus between the alleged representations or omissions and his loss. He would have advanced the funds regardless of those representations or omissions.

Liability of the other directors and relief

[678] Considering my findings that Mr Farmer is not liable under s 9 of the FTA, there is no need to consider the secondary liability of the other directors under s 43.

SUMMARY OF CONCLUSIONS

[679] In conclusion and by way of summary, I have determined:

(a) First cause of action

[680] On the first cause of action under s 37 of the Securities Act, I am satisfied that in respect of all three Agreements there was no offer to the public. As a consequence, none of the defendants are liable, and relief under s 37(6) of the Securities Act is not available to Mr Banks.

(b) Third cause of action

[681] On the third cause of action, that is breach of directors' duties under Part 8 of the Companies Act:

(a) in respect of s 135 of the Companies Act (reckless trading), I am satisfied that although there was a breach of this duty, it was not causative of any loss suffered by Mr Banks;

(b) in respect of s 136 (improperly incurring obligations), I am not satisfied that any of the defendants breached this duty in respect of any of the Agreements. Accordingly, no relief is available to Mr Banks; and

(c) in respect of s 137 (duty to exercise skill and care), I am satisfied that although there was a breach of its duty, it was not causative of any loss suffered by Mr Banks.

[682] In any event, I conclude that relief by way of compensation under s 301 of the Companies Act would not be available to Mr Banks because Mako was not in the course of liquidation and in the circumstances of this case, s 301 does not permit Mr Banks to be personally compensated for any breach of the directors' duties.

[683] No banning order is made under s 383 of the Companies Act.

(c) Second and fourth cause of action

[684] Given my finding in respect of the first cause of action:

(a) in respect of s 55G of the Securities Act, I am satisfied that this section is not engaged because Mr Banks did not subscribe for any security; and

(b) in respect of s 9 of the FTA, I am satisfied that neither Mr Farmer, nor any of the other defendants is liable because the pleaded representations (or omissions) were not misleading and/or deceptive conduct and, in any event, no representation caused Mr Banks any loss.

[685] Accordingly, judgment is entered in favour of the defendants.

COSTS

[686] The defendants, as the successful parties, are entitled to costs. I invite counsel to confer with a view to reaching agreement on the question of costs. In the event of no such agreement, I direct that the parties file memoranda, not exceeding 10 pages (excluding appendices) no later than **5:00 pm on Friday, 10 September 2021** and I shall determine the issue of costs on the papers.

Moore J

Solicitors:
Mr Johnson, Auckland
Mr Porter, Auckland
Mr Hollyman QC, Auckland
Mr Steel, Auckland

Copy to:
Second, Third and Fourth Defendants

Appendix 1

Mr Farmer's representations to Mr Banks included (without limitation):

1 Providing Mr Banks with the PPM dated November 2010.

2 An email on 22 December 2010 reporting that according to the PPM:

(a) Mako's financial performance from 2007 to 2010 was acceptable; and

(b) Mako was projected to have a pre-tax net profit of $8 million in 2012 and tens of millions in 2013, 2014 and 2015.

3 An email on 15 January 2011 intimating that the cash flow of Mako is more important than salaries of shareholder employees.

4 A phone call on 27 January 2011 that about $4.5 million had been committed by prospective investors to Mako.

5 A meeting at Mr Farmer's house on 27 January 2011 where Mr Farmer, his wife Jenny, Mr Banks and Mr Banks' friend Isabel were present, Mr Farmer represented that:

(a) Mako was liquid and would remain that way. He could not guarantee in writing that employees will be paid less in case of future illiquidity but assured Mr Banks that keeping the company liquid was more important than keeping people employed. If there were liquidity problems in the future the employees would probably be asked to take their money later; if they refused they would have to be fired;

(b) during the decade that the Mako group had existed it had never failed its obligations to its creditors with the exception of a few cases where creditors had to wait one – three months (one month being more usual) to be paid;

(c) the Plaintiff could expect Mr Farmer to continue to take those obligations seriously; and

(d) Mako was Mr Farmer's most significant project and he was dedicated to ensuring its success.

6 An email on 3 February 2011 regarding Mako's expansion initiative into the United States that it was raising money for.

7 An email on 3 February 2011 stating that Mako would close off Mr Banks' loan at $4.73 million, it was in discussions with another significant investor for a further $5 million investment and that further investment opportunities would increase the company's value by tens of millions of dollars.

8 An email on 4 February 2011 from Mr Farmer to Mr Banks asking him to keep Mako's business strategies to himself because Mako's product was considered a disruptor in the market.

9 An email on 3 March 2011 intimating that Mako's PPM had seen applications for $4.35 million and expressions of interest from three further investors in excess of $5 million each.

10 A phone call on 9 March 2011 stating that business was good and customers (including telecommunications customers) were happy.

11 An email on 31 May 2011 that stated "Business is going particularly well for Mako currently and the prospects look encouraging from our initiatives into new markets".

12 The parties had a meeting at Mr Banks' home on 13 June 2011 where Mr Farmer stated:

(a) Mako was doing well and there were plenty of interested customers;

(b) he was unlike those who take investment monies from others without being fully committed to the business in question;

(c) Mr Banks could rely on the figures and representations in the PPM and that the clauses in it which excluded reliance only applied to Mako's earlier capital raising efforts which finished on 30 November 2010;

(d) in relation to page three of the PPM:

(1) he was happy to accept money from any member of the public as long as the amount was large enough to be worth his time. This followed Mr Banks questioning Mr Farmer about the first section on page three relating to "qualified investors", which Mr Banks said to Mr Farmer he did not believe himself to be;

(2) that it was not a problem that Mr Banks was not interested in buying shares and that he was more interested in lending money;

(3) Mr Banks could ignore the "No Authorisation" section and that Mr Farmer's representations could be relied upon;

(4) clauses like the “No Authorisation” section are not always applicable to every investor but are always required by lawyers to be included in such documents; and

(5) Mr Banks could be assured that he was the right kind of investor and everything was being done appropriately.

13 Emails on 29 June 2011, 13 January 2012, 27 February 2012 and 15 March 2012 intimating to Mr Banks that business activity was strong for Mako.

14 A meeting at Kokako cafe in Grey Lynn on 20 June 2012 where Mr Farmer reported that Mako was going well.

15 A meeting at SPQR restaurant in Ponsonby on 8 August 2012 stating:

(a) the business was going well; and

(b) Mr Banks and Mr Farmer both agreed that they disliked business people who do not fulfil their obligations.

16 Emails on 26 November 2012, 4 March 2013 and 6 March 2013 intimating that Mako's business activity was high and encouraging.

17 A meeting at Kokako café on 30 November 2012 where Mr Farmer said that there were many barriers to a NZ listing. A NZ listing was expected to occur in 2013 and Mr Farmer expected enough interest to allow him to reward employees and investors like Mr Banks with shares. Mako could raise $250 million and a Nasdaq listing may occur after about 5 years.

18 A meeting at Café People, Grey Lynn on 8 March 2013 where Mr Farmer intimated:

(a) there were many parties interested in Mako including the company that handled Xero's IPO;

(b) that company would handle Mako's IPO;

(c) there would be a NZ and probably a Nasdaq listing;

(d) Mako was very likely to grow to over ten times its size over a period of 7 years;

(e) Mr Farmer wished to make Mako NZ's largest company; and

(f) Mako had many current and interested customers, and during the next 12 months was going to receive in the order of $100 million from customers and investors.

19 An email on 5 April 2013 intimating that other investors were interested in Mako.

20 An email on 13 April 2013 stating "As always I am most concerned with fairness for all parties so you (as always) can be assured of my objective consideration".

21 A meeting on 26 April 2013 at Kokako café where Mr Farmer talked about sales pitches made by him and his staff to potential customers and intimated that business was strong and that he could be relied upon as a source of information.

22 An email on 24 June 2013 stating "Last week we completed a contract with Bullseye Telecom in the US and they already have their first customers lined up. We also got the first full version of a product supply agreement with Sprint. They too have their first customers lined up".

23 A meeting at Pescado restaurant, Wynyard Quarter on 17 September 2013 where Mr Farmer reported that business was great.

24 An email on 23 September 2013 stating, "I have all our best interests at heart".

25 A meeting at Café People, Grey Lynn on 23 October 2013 where Mr Farmer reported that:

(a) NZ investors were showing a lot of interest and that he wanted an American investor to impress them;

(b) Mr Banks' investment was going to be worth a lot in a few years' time;

(c) Mr Banks was able to buy shares at that time but would be better off by 20-50% if he waited until listing (estimated to occur March - April 2014).

26 An email on 5 November 2013 reporting that:

(a) Mako had secured a lot of business with Sprint (a large United States business);

(b) "Sprint's U.S. business customer base offers a significant growth opportunity for Mako";

(c) "Mako's technology is leading the way in secure, PCI-compliant networking for the distributed enterprise. (Mako's) business customers will appreciate the ease of use and powerful connectivity options the Mako System provides".

27 Emails on 12 November 2013 and 18 November 2013 reporting that there was a significant amount of business for Mako to capitalise on.

28 An email on 18 November 2013 stating "With the opportunities building in Oz and the US we may look to list earlier and require extra capital to ramp up as quickly as we can. This could also play a little better into your hands with a more robust story and greater opportunity of uplift".

29 A meeting at Occam café in Grey Lynn on 29 November 2013 where Mr Farmer reported that:

(a) the latest capital raising proposal involves $5 million and that Mr Farmer would contribute $250,000 - $300,000;

(b) Mako had been valued by multiple parties with the range being from $26 - $256 million; and

(c) Mr Farmer did not "bullshit people".

30 A meeting at Occam café on 4 March 2014, Grey Lynn where Mr Farmer reported that he might be able to sell Mako for USD 150 million and was open to the idea of continuing to grow Mako while considering purchasers. Mr Farmer was not enthusiastic about selling a portion of Mako because of various problems including the likelihood of it being a venture capital arrangement.

31 An email on 16 March 2014 where Mr Farmer stated he was working to get "the best arrangement that is available" for Mr Banks.

32 A meeting at Café People, Grey Lynn on 26 March 2014 where Mr Farmer reported that the next capital raising effort would probably seek around $100 million.

33 An email on 2 April 2014 reporting that $700,000 of investment money was committed to Mako from a shareholder.

34 An email on 24 April 2014 informing Mr Banks that Mako was "able to finally announce the Telstra deal".

35 An email on 25 August 2014 reporting that there was strong interest from Mako's customers.

36 An email on 2 September 2014 that Mr Farmer's objectives were 'totally aligned' with those of Mr Banks.

37 A meeting at Toru restaurant, Ponsonby on 3 September 2014 where Mr Farmer reported that:

(a) the Sprint deal was the largest Mako had ever been presented with and that Mako needed working capital to handle the deal;

(b) in response to Mr Banks' queries regarding directors being paid less and taking their pay later that Mako's expenses were being handled well and that everything that could be done to reduce expenses, especially directors' salaries, had been done or was being done.

38 Mr Farmer was selling his house and would use the proceeds to support Mako to raise capital.

39 An email on 10 September 2014 that the Lotto deal with Telecom was all but closed.

40 An email to Mr Banks on 16 September 2014 that he could expect to soon receive an information pack regarding the Sprint deal (pack was never received by Mr Banks).

41 Emails on 18 September 2014 in response to Mr Banks' query about what to tell other potential investors stating:

(a) "If you are OK with working with the Customer names i.e. Chevron, BullsEye, Sprint, FedEx and the sales pipeline being rebuilt of close to $2.1b in total that would be best. We are really looking for an equity investor who should expect a 3-5 times return over 4 years if we execute well and either list or sell"; and

(b) "Sales pipeline of $2.1b. Expect revenue of $150m 3-4 years out".

42 An email on 21 October 2014 reporting that three capital raising options were progressing.

43 An email on 20 October 2014 from Mr Farmer stating "I am...working through acceptable investment arrangements out of the US and think I am close to a deal that is going to work for everyone both short and long term".

44 A meeting at Mr Banks' home on 7 November 2014 where Mr Farmer intimated that:

(a) Mako was valuable and had been for years;

(b) D&S (a company) were interested in a merger based on net values of each company of USD 50 million and that this may happen in December 2014; and

(c) since April 2011 all people investing in Mako had done so at a valuation of greater than $50 million.

45 A meeting at the home of the mediator on 21 November 2014. At the meeting Mr Farmer reported that Mako was considered by investors that had recently spoken to him to be worth in the order of $100 million.

46 In a conversation on 21 November 2014 outside the mediator's home following the meeting Mr Banks questioned why Mr Farmer was so eager to equitize the investment because if the representations were true Mr Farmer should want to keep as many shares as possible as the expected return was much higher than the 10% p.a. of Mr Banks' debt. Mr Farmer responded that he wanted to compensate Mr Banks for his loyalty by making him a shareholder, thus giving him access to much greater returns.

47 An email on 17 December 2014 stating "there has not at any point in time been a cessation of capital raising initiatives and there is still a strong option being pursued to list on the New Zealand stock exchange amongst other alternatives...the listing along with all other capital raising initiatives are still a reality".

48 An email on 12 January 2015 stating "As most of my summer break has been taken up supporting the US sales initiative I am hopeful of an announcement within days that will give us all reason for cheer in starting 2015".

49 An email on 20 January 2015 stating "We have had a lot of positive feedback from the current sales prospects in the States and expect a wider announcement in 10 odd days".

50 An email on 8 February 2015 stating "at the moment I am expecting to be in the (US) to finalise our latest win, that being the award of the BP fuel site business we have been chasing for the past year".

51 An email on 11 March 2015 stating "The situation is significantly improved from our position late last year. Arrangements for an IPO are being resurrected as discussed. I have engaged with some investment bankers and expect to have a plan to take to Telecom (Spark) for consideration by the end of April. At this point in time they are not aware of the current initiative (although they know we are working on various capital raising options) but I expect them to respond favourably once we have consolidated our plans. Arrangements that Mako have in place with our US distribution partners should ensure short term cash requirements are met whilst we finalise plans going forward. Once the large contract rollouts begin this position will be further reinforced".

52 An email on 22 March 2015 reporting that:

(a) Mr Farmer was working to improve the balance sheet; and

(b) the solvency situation was fine.

53 An email on 11 June 2015 stating "we received confirmation that the final elements being negotiated with BP for the preferential supply of BYOB services in the US have been agreed. We expect to complete the contract in short order and have everybody ready for an immediate customer acquisition initiative".