IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKAURAU ROHE

CIV-2016-404-001398
[2017] NZHC 3267

BETWEEN	COMMERCIAL FACTORS LIMITED Plaintiff
AND	JEFFREY PHILLIP MELTZER, LLOYD JAMES HAYWARD AND AARON LESLIE HEATH Defendants

Hearing:	24-26 July 2017
Appearances:	E Telle for the Plaintiff A C Challis and D Turnbull for the Defendants
Judgment:	20 December 2017

JUDGMENT OF HINTON J

This judgment was delivered by me on 20 December 2017 at 3.30 pm pursuant to Rule 11.5 of the High Court Rules

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Registrar/Deputy Registrar

Solicitors:

Neilson Lawyers, Auckland
McElroys, Auckland

[1] This case is about interpretation of a funding agreement and whether the liquidators of Blue Chip New Zealand Ltd (Blue Chip NZ) failed to act in good faith in connection with it.

[2] Mr Meltzer and Mr Heath were partners, and Mr Hayward was a consultant in the accountancy firm of Meltzer Mason Heath (MMH), now Meltzer Mason. They were the liquidators of Blue Chip NZ and about 22 other Blue Chip companies.

[3] Commercial Factors Ltd (CFL) carries on business in debt factoring and finance, including providing funds for litigation. Its principal is Mr Haydon.

[4] Under a funding agreement dated 24 August 2009, CFL paid Blue Chip NZ $60,000 plus GST, for the liquidators to obtain a legal opinion as to potential proceedings against Blue Chip NZ's directors and auditors (the reckless trading proceeding). CFL sues to recover that payment, plus interest at 24 per cent per annum. The liquidators say that under the agreement, the terms for repayment have not been triggered and, if repayment has been triggered, the liquidators are not personally liable because they acted in good faith.

Facts

[5] Blue Chip NZ went into voluntary liquidation in early 2008. It was a difficult and complex liquidation.

[6] The liquidators were interested in taking proceedings against the directors and auditors of Blue Chip NZ. A Queen's Counsel agreed to provide an opinion for a cost of $50,000. The liquidators were short of funds and approached CFL for funding for the opinion.

[7] CFL agreed to provide funding of $50,000, which then changed to $60,000 (plus GST).

[8] On 18 May 2009, Mr Haydon of CFL wrote to Mr Meltzer, setting out basic terms, as follows:

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

[9] Various drafts of a funding agreement were then drawn up by the liquidators' solicitors, apparently to comply with Mr Haydon's email of 18 May 2009 and subsequent correspondence from him.

[10] On 24 August 2009, the "agreement relating to funding of legal opinion" was entered into by CFL, Blue Chip NZ and the liquidators.

[11] After recording the provision of funding, the agreement relevantly provides:

> **3. Additional Sum and Repayment**
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> 3.1 The Company (through the Liquidators) must pay CFL an additional amount of $18,000 or 24% per annum (calculated daily and compounding annually), whichever is greater, at the time of repayment of the Funding.
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> 3.2 If the Liquidators decide that as a result of the Advice they will endeavour to obtaining (sic) funding for proceedings against the parties identified in the Advice as having liability to the Company, the Company and the Liquidators will give CFL the first option to provide that funding on terms determined by the Liquidators. If CFL within 10 days of receiving notice of the funding requirements chooses not to fund the proceeding or does not respond:
>
> 3.2.1. The Company will not enter a funding agreement with another party on any less favourable terms without first re-offering the funding opportunity to CFL; and
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> 3.2.2. If another party agrees to fund the proceedings, the Company will procure that funder to repay to CFL the Funding and the Additional Sum before the proceedings are filed or any

funding for the proceedings is made available to the Company or the Liquidators.

3.3 If proceedings are commenced, whoever funds the proceedings, the Company will pay CFL 2.5% of net proceeds received from or on behalf of the defendants to those proceedings (whether those proceeds are received by way of settlement, by reason of a Court ordered judgment or otherwise) within 10 working days of receipt of the proceeds by the Company or the Liquidators.

3.4 If proceedings are not commenced and the Company receives any amounts from other sources (other than funds directly obtained for the purposes of funding investigations, legal advice or Court or other proceedings), the Company will apply those amounts in the following order:

3.4.1 to meet the Company's obligations to any party who funded the obtaining of those amounts, and to reimburse the Liquidators' remuneration, costs and expenses in obtaining those amounts to the extent they were not funded;

3.4.2 towards repayment to CFL of the Funding and Additional Sum;

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

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

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

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

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

…

> **6. Exclusion of Personal Liability of the Liquidators**
>
> 6.1 The parties acknowledge that the Liquidators are entering into this Agreement in their capacity as joint and several liquidators of the Company. The Liquidators will have no personal liability under or in connection with this Agreement except in circumstances where they fail to act in good faith.
>
> …

[12] The Queen's Counsel provided his opinion in September 2010, one year after the agreement. The opinion indicated available claims against a number of directors of Blue Chip NZ and related companies, and against auditors.

[13] After receipt of the Queen's Counsel's opinion, CFL paid the amount due under the agreement. Mr Haydon was fed up with the time lag, so he advised the liquidators on 14 September 2010, that CFL would not be providing any additional funding.

[14] The liquidators decided they would endeavour to obtain funding for the proceeding and looked for other sources.

[15] On 8 February 2011, Mr Haydon wrote to the liquidators:

> Can you please give me an update as to the likelihood of finding a funder and the repayment to CFL. Similarly if this is not going to happen when do you draw the line and clause 3.4 kicks in for CFL to be reimbursed?

[16] On 9 February 2011, Mr Heath wrote to Mr Haydon saying the search for a funder was ongoing. He said it was unlikely that funds would "be recovered for the benefit of funders etc unless proceedings can be commenced". He said Blue Chip NZ's only assets were inter-company advances and recovery of those was "uncertain and probably unlikely".

[17] By November 2011, the liquidators had incurred very significant unbilled time (WIP) in the liquidation.

[18] On 30 November 2011, the liquidators filed the reckless trading proceeding against the directors and auditors of Blue Chip NZ, although they had not at that stage obtained funds from a litigation funder or equivalent source.

[19] The cost of issuing the proceeding, which it seems was about $57,500, was met by the partners of MMH, being two of the liquidators, Mr Meltzer and Mr Heath, and Ms Mason. The liquidators say that the three partners personally paid funds into the MMH practice account, which in turn were paid directly to counsel for fees incurred in preparing the statement of claim in the reckless trading proceeding. The liquidators say they issued the proceeding in part to preserve limitation periods, but also in the hope that the issue of proceedings might promote a settlement, or show steely resolve. They intended to continue the proceeding, and continued to search for a funder.

[20] To quote from their closing submissions, the liquidators "saw the decision to fund the preparation and filing of the statement of claim as an investment in the claim which might see WIP invoiced and paid, as well as achieving a positive outcome for investors and creditors. It would have seen CFL repaid."[1]

[21] It seems that at the time of issue of the reckless trading proceeding in November 2011, the liquidators did not anticipate any material source of funds for Blue Chip NZ, other than via that proceeding.

[22] Mr Haydon's evidence is that he was somewhat surprised by the issue of proceedings, as his understanding was that the liquidators did not have any funds whatsoever.

[23] Between the date CFL advised it was not interested in funding the proceeding, and 30 November 2011 (when the liquidators issued the reckless trading proceeding), Blue Chip NZ received GST refunds of $2,903 and IBD transfers were made of $17,300.

[24] In March 2012, the liquidators became aware of what Mr Meltzer referred to as a "complete windfall recovery" for Blue Chip NZ, by way of partial repayment of

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[1] This last statement would only be true if the proceeding were successful.

the inter-company advances following the successful outcome of litigation brought by those companies. These companies fell outside of the liquidators' umbrella. From that source, Blue Chip NZ ultimately received in total $307,961, the first $64,715 on 9 March 2012 and further payments down to May 2012. These were all recorded in the ledger as "group transfers". Mr Meltzer confirmed that, prior to March 2012, the liquidators were not aware that any funds were coming in.

[25] The sum of $307,961 was mostly spent on liquidators' remuneration, expenses and legal fees.

[26] From the issue of the reckless trading proceeding in November 2011, the liquidators continued to seek litigation funding, but were unsuccessful. Some further steps were taken in the proceeding in the meantime.

[27] On 22 November 2012, Mr Haydon wrote to the liquidators asking if there was "any news on the Blue Chip matter and recovery for us". Mr Heath replied that litigation funding for the reckless trading proceeding had not been confirmed. (Earlier in the year, Mr Meltzer had sworn an affidavit that they had a litigation funder who was "presently very interested".)

[28] In February 2013, the liquidators announced (and informed CFL) that in the absence of funding, they would discontinue the reckless trading proceeding. The media release said:

> … The Liquidators have used their best endeavours to pursue the defendants for the benefit of the creditors and to date have personally funded significant sums towards the investigations and legal proceedings.

[29] Between March 2013 and February 2014, the MMH partners paid $112,000 more, to settle further legal and related fees in connection with the reckless trading proceeding. It was clear by then that none of that money could be recovered.

[30] The liquidators made their final report in the liquidation on 10 October 2014.

[31] On 16 July 2015, Mr Haydon wrote to the liquidators seeking payment of $98,392 under clause 3.4 of the funding agreement. Mr Meltzer replied that day, saying he would review the position and respond as soon as he could. Correspondence

continued without resolution. The statement of claim later filed, pleaded that the sum of $98,392 did not include the "plaintiff's full entitlement for interest".

[32] On 16 June 2016, CFL issued this proceeding, claiming $213,807, plus interest at 24 per cent per annum from date of issue until judgment.

[33] The liquidators/MMH were significantly out of pocket overall. They said that their shortfall was much greater than that of CFL.

Is Blue Chip NZ in breach of the agreement?

[34] The liquidators unsuccessfully sought summary judgment as defendants.[2] Associate Judge Bell, in declining summary judgment said, inter alia, he considered that Blue Chip NZ was in breach of clause 3.4 of the funding agreement and CFL should have been repaid out of the "group transfer" monies received in the liquidation, subsequent to the agreement.[3] He did not have to consider the really material question of whether the liquidators had personal liability.

[35] CFL's primary and repeated argument is that the liquidators were obliged to repay CFL as a first priority, and if they failed to do so, they could not be relieved by clause 6.1 and were personally liable.

[36] CFL argues, similarly to the finding of Associate Judge Bell, that clause 3.4 applies, and that the group transfer monies received by the liquidators subsequent to the agreement should have been paid to it. CFL submits that clause 3.4 was supposed to apply whether proceedings were commenced or not, or at least was supposed to apply not just if proceedings were not commenced, but also if proceedings were commenced and then not actively pursued. CFL says that proceedings were not "commenced" in the sense contemplated by the agreement and that therefore clause 3.4 remains applicable.

[37] I do not agree with CFL's interpretation of the word "commenced". Applying the ordinary sense of the word, a proceeding was commenced in this case when it was

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2 *Commercial Factors Ltd v Meltzer* [2017] NZHC 30, [2017] NZCCLR 7.
3 At [19].

filed, and furthermore, it was not just simply filed. There were a number of other steps taken, including filing and service of statements of defence, filing of an amended claim, and filing of a request for particulars. I also find as a matter of fact that the liquidators did not issue the proceeding just as a formality. I accept their evidence that they hoped to continue on with it. There was no evidence to the contrary.

[38] To read the word "commenced" in clause 3.4 as meaning "commenced and followed through to an end", or "commenced and taken some distance" as CFL contends, would be to read a considerable amount into that clause, which I do not consider is correct or appropriate. At what point would a proceeding be "commenced" on that logic? Also, Associate Judge Bell reached the conclusion he did, in part because he considered there was otherwise a large lacuna in the agreement in that it would not cover a situation such as the present. With the benefit of time and more comprehensive argument, I take a different view.

[39] As I canvassed with the parties during the hearing, in my view clause 3.4 does not apply, but clause 3.2 does.

[40] Under clause 3.2.2:

> If another party agrees to fund the proceedings, the Company will procure that funder to repay to CFL the Funding and the Additional Sum before the proceedings are filed or any funding for the proceedings is made available to the Company or the Liquidators.

[41] Messrs Heath and Meltzer, alongside Ms Mason, paid their own personal funds into the MMH practice account, from which fees of $57,500 were paid for filing the statement of claim.

[42] The liquidators say that this money was not paid to Blue Chip NZ nor even, according to Mr Meltzer's oral evidence, was this money lent by MMH to Blue Chip NZ. Rather it was an "investment" by MMH. They say this was therefore not an agreement "to fund the proceedings". I do not agree. In my view, the three MMH partners (which included two of the liquidators) had agreed to fund the proceeding in terms of clause 3.2. I note that MMH also paid further costs associated with the issue and subsequent conduct of the proceeding, totalling approximately $112,000. I accept

Mr Meltzer's oral evidence that the funds were provided by way of an investment rather than a loan to Blue Chip, but the difference in this context is a fine line, as evidenced by Mr Meltzer's apparently incorrect email to Mr Haydon dated 8 October 2015. In that email he refers to the legal fees in connection with the reckless trading proceeding being "funded by *advances* from MMH – from Karen, Aaron and me personally – to [Blue Chip NZ] to settle these legal fees. Subsequent receipts by [Blue Chip NZ] were then paid to *part reimburse MMH for these advances*. …"[4] Whether a loan or an investment, looking at the substance of the transaction this was an agreement between MMH and Blue Chip NZ to fund the proceeding.

[43] The liquidators also say that clause 3.2.2 does not apply because "another party" did not agree to fund the proceedings. They say "another party" means a party other than those to the agreement. However, I read "another party" in clause 3.2 as referring to a party other than CFL. Also, the partners of MMH (including Ms Mason), not being identical to the liquidators, are "another party" in any event.

[44] The liquidators no doubt correctly submit that it was not contemplated that the MMH monies would be the sort of "funding" covered by 3.2.2. In other words, the parties envisaged funding being provided by an independent lender in an amount sufficient to see the proceedings through to an end. Consistently with that, knowing there was no independent funder, Mr Haydon did not react to the issue of the reckless trading proceeding by seeking repayment or inquiring into how the cost was funded. However, I see no reason to read the clause down. It seems to me that on a fair reading of clause 3.2, MMH has agreed "to fund" the proceeding and it does not matter that the funding was not from an independent litigation funder and was only partial. This is the natural and ordinary meaning of the clause, and in these circumstances, I do not consider it is displaced by the wider context in which the agreement was made.[5] In fact, the meaning I have given to clause 3.2.2 is reinforced by the wider context.

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4 (Emphasis added)

5 *Firm PI 1 Ltd v Zurich Australian Insurance Ltd t/a Zurich New Zealand* [2014] NZSC 147, [2015] 1 NZLR 432 at [63].

[45] My view is reinforced by the words in clause 3.2.2 that "*before the proceedings are filed* or *any* funding for the proceedings is made available" (ie not "all" funding), CFL is to be repaid.

[46] If clause 3.2.2 were interpreted as referring only to a formal independent funding arrangement, as the liquidators submit, then that would be inconsistent with the language to which I have just referred, and would leave a large loophole in the agreement, of the sort Associate Judge Bell considered problematic. I also consider such an interpretation would depart from the purpose of the agreement. While repayment to CFL was clearly in no way guaranteed under the agreement, and nor was CFL recorded as a simple first-priority creditor, it would not have been contemplated that CFL could be materially disadvantaged by the issue of proceedings in a partly-funded context. To the contrary, in my view CFL was entitled to repayment on the simple issue of the proceeding, at least if a party other than CFL had agreed to fund it.

[47] This interpretation is consistent with the agreement as a whole. It provides coverage for CFL in broad terms, without a strained reading of the agreement or any part of it.

[48] As I see it, the agreement essentially provides for three scenarios:

(a) CFL would fund the actual proceeding, in which event repayment of the $60,000 sum was not addressed, but would presumably have been part of a formal funding agreement between CFL and Blue Chip NZ. (If the proceeding were successful, CFL would also receive 2.5 per cent of net proceeds under clause 3.3.)

(b) A party other than CFL would provide funding to bring the proceeding (after CFL had been given first option and declined) in which case, before the proceeding was filed, CFL would receive $60,000 (per clause 3.2.2) plus the Additional Sum of $18,000 or 24 per cent per annum (per clause 3.1). (Again, if the proceeding were successful, CFL would receive 2.5 per cent of net proceeds as an extra amount.)

(c) The proceeding would not be commenced, in which event any amount Blue Chip NZ received from elsewhere (after the date of the agreement and after costs directly related to obtaining that amount) would be paid to CFL in repayment of the $60,000 and the Additional Sum (per clause 3.4).

[49] That is a commercially sensible interpretation. I note that there are still gaps in the agreement, but not gaps that are relevant here. As noted under (a) above, the agreement does not provide for repayment of the $60,000 sum if CFL does fund the proceeding. It would also seem to enable the liquidators to issue proceedings without repaying CFL if there were no funding involved, which arguably would occur if, for example, the Queen's Counsel had offered to draft the proceeding on an ex gratia basis.

[50] I find that Blue Chip NZ was not in breach of clause 3.4, but was in breach of clause 3.2.2 by failing to procure the MMH partners personally to repay to CFL "the Funding and the Additional Sum", before the reckless trading proceeding was filed on 30 November 2011.

The plaintiff's other arguments against Blue Chip NZ

[51] Given my finding that Blue Chip NZ was in breach of clause 3.2.2 by not requiring MMH to repay CFL's loan, any further arguments against Blue Chip NZ are prima facie redundant. But in case I am wrong in my primary finding and in any event, given the need to still consider whether the liquidators are liable, which may arguably differ depending on the nature of any breach by Blue Chip NZ, I deal with the further arguments raised by CFL.

$20,203 from IBD and GST

[52] CFL argues that clause 3.4 was applicable at least up until proceedings were actually commenced, and says that from the date it declined to fund the reckless trading proceeding, until the proceeding was issued in November 2011, Blue Chip NZ received approximately $20,203 of "money from other sources", which it was required to apply to CFL's loan by virtue of clause 3.4, but did not.

[53] Arguably, if a proceeding is commenced at any point, clause 3.4 does not apply, even to payments received by Blue Chip NZ up until that point. I say this on the basis that clause 3.4 does not begin "Until proceedings are commenced". It begins, "If proceedings are not commenced". I note that Mr Haydon also seemed to take this approach in the passage I quoted earlier from his email of 8 February 2011.[6]

[54] However, the liquidators do not seem to oppose CFL's interpretation, so I proceed on the basis of CFL's argument that clause 3.4 does apply to amounts received by Blue Chip NZ up until issue of the reckless trading proceeding. I note that Mr Meltzer and Mr Heath both at times accepted CFL's position in this regard.

[55] Nonetheless, I do not consider that clause 3.4 applies to the receipts of $20,203, which came partly from IBD transfers and partly from GST refunds.

[56] I agree with the liquidators that the IBD transfers of $17,300, being withdrawals from money already held on deposit by Blue Chip NZ at the date of the agreement, are not amounts covered by clause 3.4. Clause 3.4 at best covers amounts received after the date of the agreement. The clause says "If proceedings are not commenced and the company receives …". It does not say "has received". It does not cover amounts received prior to the agreement. It would be absurd to construe the agreement on the basis that Blue Chip NZ had no funds at all when it was signed. If CFL's construction were correct, the liquidators would be in an impossible position. Blue Chip NZ would be in breach at the date of entering the agreement, as it would instantly be obliged to pay to CFL any funds it held. It is simply not practical to construe the agreement on the basis that the liquidators had no funds at all available to them. The liquidators had to have some funds for conduct of the liquidation other than the potential reckless trading proceeding, or they would have been seeking money for more than just that proceeding. Clause 3.4 must apply only to funds received after the agreement.

[57] In terms of the GST refunds of $2,903, I would be prepared to assume that the relevant costs, referred to in clause 3.4.1, would subsume the total of the GST refund in each instance. Further, the amount involved is very minor in the scheme of things.

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6 See [15] of this decision.

[58] I therefore find that Blue Chip NZ was not liable to account to CFL for the sum of $20,203 or any part of it.

Potential Ministry of Economic Development (MED) funds

[59] CFL also argues that Blue Chip NZ had access to other funding which it wrongly failed to call on, being MED funding from the Liquidation Surplus Account. The simple answer to this claim is that no such funds were received by Blue Chip NZ and therefore no amount was payable to CFL under clause 3.4 or 3.2. A sum of $275,000 was allocated to Blue Chip (not one of the liquidators' companies), but not to Blue Chip NZ, and MED did not agree to fund the reckless trading claim.

Implied terms

[60] CFL argued that the agreement was subject to implied terms that:

(a) The liquidators would have sufficient funding to pursue the proceeding to determination or resolution;

(b) A proceeding had to be filed with the intention of pursuing it to determination or resolution; and

(c) In the event a proceeding was not commenced at the time CFL notified the liquidators that it would not be providing any further funding, that the liquidators would repay the funding (and the additional sum) pursuant to clause 3.4 of the agreement.

[61] These suggested terms followed a similar theme. CFL's argument was based on the "obvious absurdity" that would arise if a proceeding were issued and then discontinued. As Mr Telle, counsel for the plaintiff, put it, the liquidators could say CFL had no right to be paid because clause 3.4 could not apply, and clause 3.2 would not apply because there was no funding.

[62] I do not agree that any of these terms could be implied. The underlying argument falls away given my interpretation of clause 3.2. There is no gap in the

agreement, at least not in the context of this case, which could lead to an implied term. Further, the first claimed term would run contrary to business efficacy and be impossible to apply. The first and second claimed terms are both contrary to clause 4.1 of the agreement (that the liquidators can conduct the proceedings as they consider appropriate), and are not capable of implication on that basis alone. The third implied term is not necessary for business efficacy, nor even consistent with the conduct of Mr Haydon. It is not capable of clear expression, and certainly not so "obvious it goes without saying".[7]

[63] A significant element of CFL's argument, both in this regard and throughout the proceeding, was premised on how clause 3.4 of the agreement should have read as far as Mr Haydon was concerned. If any of these points was so clear, CFL could have sought rectification, but did not.

Did the liquidators fail to act in good faith and are therefore liable?

[64] Upon the appointment of a liquidator, all the company's powers necessary for the effective winding up of the company become exercisable by the liquidator as the company's agent.[8] Decisions made by liquidators which are reasonable and made in good faith are generally unlikely to be overturned by the Courts.[9]

[65] Consistent with their position at law, it is standard practice for liquidators to require express liability limitation provisions in any contract they enter. Mr Meltzer gave evidence that was his invariable practice.

[66] To that effect, clause 6.1 of the agreement provides that the liquidators have no personal liability under the agreement, except in circumstances where they fail to act in good faith.

[67] Mr Telle's primary argument in this regard is that clause 6.1 has a more narrow effect than on its face. He says it is directed at providing protection to the liquidators in respect of the proposed reckless trading litigation itself, and that clause 6.1 "does

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7 *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 180 CLR 266 (PC).
8 Companies Act 1993, s 260. See also *Re Farrow's Bank Ltd* [1921] 2 Ch 164 (CA).
9 *Young & Associates Ltd v Ruscoe* [2012] NZHC 1438, [2012] NZCCLR 23 at [8].

not and cannot operate to relieve the defendants from liability for breach of contract for failing to pay CFL under the funding agreement …" In other words, if there is a breach, the liquidators are personally liable.

[68] I see no basis for such an interpretation. There is no question but that CFL must show, not just a breach, but that the liquidators have failed to act in good faith, in order to hold them personally liable. (I acknowledge that in some circumstances a breach alone might amount to a failure to act in good faith.)

[69] Mr Telle argues that the liquidators did not act in good faith in the following ways:

(a) by deliberately issuing proceedings to cut CFL out of the benefit of clause 3.4;

(b) by, in breach of their contractual obligations (whether deliberate or not), retaining funds, or applying funds to their own related interests to the detriment of CFL;

(c) by breaching their contractual obligations because they were a party to Blue Chip NZ receiving funds, which were misapplied; and

(d) by their ongoing failure to provide information and repay the advance.

[70] I first have to determine what is meant by "good faith" in this context. Surprisingly, given the evidence that such clauses are common, neither counsel has been able to refer me to relevant authority in the liquidation context.

[71] In the context of whether an obligation to perform a contract in good faith existed, the Court of Appeal has said that good faith connotes "fairness, honesty and reasonableness".[10]

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[10] *Bobux Marketing Ltd v Raynor Marketing Ltd* [2002] 1 NZLR 506 (CA) at [41] per Thomas J.

[72] In *Heli Holdings Ltd v The Helicopter Line Ltd,* Nation J said: "a contractual obligation of good faith is perhaps best conceptualised as an "excluder" – a promise to abstain from various forms of bad faith, rather than a promise to surmount some vague threshold of good faith."[11]

[73] Nation J also talked about 'good faith' requiring the parties to have appropriate regard to the legitimate interests of each other.[12] However, that is in the context of a mutual obligation to "deal in good faith" in an ongoing commercial relationship. The clause here excludes liability, in effect unless the liquidators act in bad faith, which is materially different.

[74] The case of *Young & Associates Ltd v Ruscoe*, involved an application under s 284(1)(b) of the Companies Act 2006. That section provides that a creditor can apply, inter alia, to reverse a decision of a liquidator.[13] In *Young*, Williams J approved *Commissioner of Inland Revenue v Hulst*[14] where the Court said a liquidator's decision will not be interfered with unless there is a fraud where it can be demonstrated the discretion has not been exercised bona fide, or unless the liquidators acted in a way no reasonable liquidator would have acted.[15] While this is a different context again, and does not involve interpretation of "failing to act in good faith", in my view the language in *Hulst* better informs the approach I should take than the cases considering a contractual obligation to act in good faith.

[75] I do not agree with the liquidators' submission that in order to show a lack of good faith, CFL needs to prove the liquidators acted intentionally or with an improper purpose. Ms Challis, on behalf of the liquidators, says an example of acting improperly would be if the liquidators had filed the proceeding with the express and deliberate intention of avoiding having to repay CFL. In my view, that example is the high-water mark of a lack of good faith. CFL would not have to go so far as to prove deliberate action or improper purpose in order to establish a lack of good faith.

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11 *Heli Holdings Ltd v The Helicopter Line Ltd* [2016] NZHC 976 at [112].
12 At [114].
13 *Young & Associates Ltd v Ruscoe* [2012] NZHC 1438, [2012] NZCCLR 23.
14 *Commissioner of Inland Revenue v Hulst* (2000) 8 NZCLC 262,266.
15 At [24].

[76] However, I do agree with Ms Challis' submission that it is not enough for CFL to show that the liquidators misinterpreted Blue Chip NZ's obligations to CFL concerning repayment. Ms Challis submits that if the liquidators did not believe Blue Chip NZ had an obligation to pay CFL because they honestly and reasonably considered that the terms of the agreement did not require them to do so, it cannot be said they failed to act in good faith. I agree that must be so.

[77] I would need to be satisfied either that the liquidators acted dishonestly or that they acted in a way no reasonable liquidator would have acted, for the liquidators to personally be liable for the breach of clause 3.2.2.

[78] The liquidators say that their understanding was there was no requirement for Blue Chip NZ to repay CFL, because the reckless trading proceeding had been commenced. They say they did not make the decision to issue the proceeding capriciously or arbitrarily or unreasonably. Rather they obtained detailed advice from experienced Queen's Counsel that there were grounds to issue proceedings and a reasonable prospect of success for the proceedings. They took account of counsel's opinion that the claim should be issued as soon as possible due to limitation considerations, and they wanted to send a strong signal to the directors and auditor and their insurers and funders that the liquidators believed the claim had merit. The liquidators believed that they still had a prospect of alternative litigation funding arrangements being entered into and would not have personally provided funds to pay the legal costs of the statement of claim had they not had that belief. They point to the fact that over a relatively lengthy period, they took steps to obtain litigation funding, with creditors being kept informed about their progress in the six-monthly reports. As far as it goes, I accept all of this is borne out by the evidence.

[79] Turning to the first alleged failure to act in good faith, I find that the liquidators did not file the proceeding in order to cut CFL out of clause 3.4. I accept that in funding and filing the proceeding, the liquidators hoped to promote early resolution of the claim and to generate funds. I have no doubt that in doing so, they were trying to do the right thing in their capacity as liquidators by all creditors, including CFL. I note the liquidators were also hoping, by issuing proceedings, to recover the significant costs they had incurred, but there was nothing improper in that per se.

[80] At the time of issue of proceedings, it was not known that $307,961.29 was to come into the liquidation by way of group transfers. As noted earlier, this was considered to be a windfall recovery. So it seems the liquidators considered at the point of issuing the reckless trading proceeding that it was the only hope for anyone, including CFL.

[81] I accept that the liquidators would have honestly and reasonably held the view that the MMH funding of the proceeding would not fall under the agreement. As I have said, Mr Haydon himself obviously did not consider there was any question of CFL's being repaid on the liquidators issuing proceedings without an independent litigation funder in place. When he found out about the issue of the proceeding (which admittedly does not seem to have been when it was filed), he did not query how the proceeding had been funded or say to the liquidators that clause 3.2.2 had been triggered and CFL wanted its money. CFL brought its claim on the basis that clause 3.4 applied and it was that clause that had been breached.

[82] Best practice would have had the liquidators reviewing the agreement before issuing the proceeding. They or their advisers could then have seen that it was at least arguable that the CFL funding had to be repaid in the circumstances. The liquidators' position could then have been covered off by legal advice to the contrary; by repayment to CFL; or by striking terms with CFL, which would no doubt inter alia include preserving its rights under clause 3.4. However, failure to do so in circumstances where both parties were focused on a third-party litigation funder, and where the proceeding was seen as the only hope, is not failing to act in good faith, and such an argument was not even run by CFL.

[83] In answer to Mr Telle's points at [69](b) and (c), regarding misappropriation of the $307,961 funds, I do not consider that it was a breach of good faith for the liquidators to disburse the funds received from the group transfers (including to themselves), and not pay CFL. Mr Heath said their view of the agreement was that there was no requirement to repay CFL out of the group transfer funds, because proceedings had been issued. Once proceedings were issued, CFL's recovery rights fell under clauses 3.2 and 3.3. I cannot disagree with that, given that I have held that clause 3.4 has not been breached. I am satisfied the liquidators acted honestly and not

unreasonably given on the face of it clause 3.4 did not apply. The liquidators' error was at the earlier stage of issuing the proceeding, in respect of which I have already held they were not acting other than in good faith.

[84] In relation to ongoing failure to provide information, the liquidators accept that they did not keep CFL fully informed as to progress with the reckless trading proceeding once it was issued. They also did not inform CFL as to money received, but do not seem to have had an obligation to do that. The failure to provide information on the proceeding was not causative of damage, and therefore would not lead to personal liability in terms of clause 6.1.

[85] I understand it may seem unfair to CFL that it has no recovery against the liquidators personally, but the agreement did not guarantee repayment, nor did it provide CFL with priority ranking in all circumstances, as Mr Haydon repeatedly claimed it did. Clause 3.4 of the agreement could readily enough have begun with "whether or not proceedings have been commenced …" but it was not signed in that form, nor was rectification sought. Similarly, Mr Haydon could have refused to agree to clause 6.1, or insisted on modification so that it said what he contended.

[86] I do not consider the liquidators have engaged in best practice here, but I do not consider they have deprived themselves of the protection of clause 6.1 of the agreement.

[87] I conclude that the liquidators did not fail to act in good faith and they are not personally liable for the breach of clause 3.2.2 of the agreement, or otherwise.

Orders

[88] The plaintiff's claim therefore fails.

[89] Judgment is entered for the defendants.

[90] The defendants should file a memorandum as to costs by 31 January 2018 and the plaintiff by 14 February 2018.

Hinton J