

Litigation Alert

20 February 2009

End of the road for Diagnostic Medlab Limited

In our last Litigation Alert in November, we reported that a team from Russell McVeagh led by former partner Gerard Curry had successfully appealed a High Court decision of Asher J, resulting in the reinstatement of an eight year, \$560 million contract to provide community services to the Auckland Region, but noted that DML had applied for leave to appeal to the Supreme Court.

We can now report that on 12 February 2009, the Supreme Court refused leave to appeal. (*Diagnostic Medlab Limited v Auckland Health Board and others* [2009] NZSC 10).

The Supreme Court noted that the Court of Appeal had differed from the High Court on a number of factual issues. Most importantly, contrary to the decision in the High Court, the Court of Appeal decided that there was no conflict of interest at the relevant time between Dr Tony Bierre and the Auckland District Health Board. Although Dr Bierre was a member of the Auckland District Health Board and was also a shareholder and CEO designate of Lab Tests, the Court of Appeal concluded that there was no conflict of interest because he took leave of absence from the Board and suspended his Board participation until after the tender process for community laboratory services was completed. In addition, and again contrary to the decision in the High Court, the Court of Appeal found that Dr Bierre had not misused confidential information. The Supreme Court concluded that these findings were matters of fact, and did not raise issues of public or general importance such as warranted the intervention of the court.

The Supreme Court did note that the Court of Appeal judges had identified different approaches to judicial review, and that if these differences had been determinative, it might have granted leave. However, the Supreme Court found that

given the facts as found by the Court of Appeal, DML could not have succeeded irrespective of which approach to judicial review was applied.

As we noted in November, the Court of Appeal judgment was important in that it declined DML's invitation to extend the scope a court has to review a commercial decision of a public body. In particular, the Court of Appeal held that it was erroneous to view the role of the courts as ensuring "good hygiene" in public decision making. That overstates the courts' role and would lead to almost indeterminate scope for intervention by the courts in this context. In this respect, both appellate decisions closely followed the submissions made on behalf of our client Lab Tests Auckland Limited.

Given the Supreme Court's refusal of leave, the Court of Appeal decision is the law on the legitimate scope of review of a commercial decision of a public body - at least for the time being.

Auckland Court Defines "Habitual Investor"

On 9 December 2008, the Auckland District Court found property developer Dan McEwan guilty of breaching the Securities Act 1978 ("**Act**") by offering investments to members of the public without a registered prospectus or investment statement. McEwan argued that the documents were not required because the investments were being marketed to habitual investors. However the Court found against McEwan.

The decision (*Ministry of Economic Development v Stakeholder Finance Ltd, Agnes Water Acquisitions Ltd & Robert Daniel McEwan*, District Court Auckland, CRI 2007-004-028150, 9 December 2008, Judge Cunningham) is significant because it is the first time a court has determined

who qualifies as a “habitual investor” under the Act. It provides a useful guideline as to the factors the court will take into account when determining whether a person is a habitual investor under the Act and therefore has significant implications for offerors of securities attempting to shortcut their obligations towards prospective investors.

The Act defines a habitual investor as a person whose principal business is the investment of money or who, in the course of and for the purposes of his or her business, habitually invests money. Persons falling within this definition are presumed to be able to make investment decisions on their own without the need for protection under the Act. Any offers of securities made to persons falling within this category are therefore excluded from the requirement to provide a registered prospectus and investment statement.

In this case, McEwan was the director of Investors Forum NZ Ltd (“**Forum**”), an organisation responsible for providing educational seminars and access to professional advisers on property investment. Forum members could apply to be classified as habitual investors. In 2004, Peter and Susan Gale applied to be habitual investors on the grounds that they had bought several rental properties and established several companies. The application was declined. Dissatisfied, Gale requested that the application be re-considered and was subsequently approved. Gale invested in two development projects.

In 2006, Gale left the Forum. He later expressed some concern over his status as a habitual investor. He did not believe that he fell within the definition of “habitual investor” under the Act. After some investigation into the matter, the Securities Commission ultimately came to the same conclusion and in 2007, proceedings were commenced against McEwan. One of McEwan’s arguments was that applications to be habitual investors were directed to his legal advisors therefore it was their responsibility to determine who was a habitual investor.

The key issue before the Court was whether Gale was a “habitual investor” under the Act. The Court held that a habitual investor is someone who invests constantly or continuously, and took the view that an investment history of four to five years was not a sufficient period for Gale to be said to be in the business of investment. As clarification, the Court listed a number of factors which must be considered in deciding whether someone is a habitual investor. These include the number of investments, the period of time over which those investments were made, the nature of the investments or transactions, the amounts of money involved, and the success or otherwise of those investments.

The decision is expected to be appealed to the High Court.

Night on the town goes horribly wrong

A judgment issued in the District Court at Wellington on 23 December 2008 provided a timely reminder of the dangers involved with the festive, impulsive use of credit cards.

During a night spent at Mermaid’s Bar, the plaintiff made two payments on his American Express Credit Card. On discovering receipt of those payments in the sober light of day, he claimed that he had no intention of making them and that he must have had “a mental blackout attributable to his consumption of alcohol combined with his diabetes condition”.

The plaintiff had successfully obtained an ex parte Mareva injunction on an interim basis restraining Mermaids from seeking payment of the \$41,000 from American Express, and in turn restraining American Express from paying those sums to Mermaids as merchant. American Express opposed the continuation of the injunction on several grounds, primarily that there was no cause of action pleaded against it, (ie the plaintiff was not seeking relief against American Express in the substantive proceedings). This argument was accepted in the District Court, and with the citation of well established case law *Siskina (Cargo Owners) v Distos Compania Naviera SA* [1979] AC 210 and *Ernst & Young v Kiwi Property Holdings Limited* [2003] 3 NZLR 82, it was affirmed that a Mareva injunction cannot be made against a party unless there is also a cause of action available against it.

Given that the injunction was clearly misconceived and ought never to have been granted, American Express was entitled to costs. On behalf of American Express, Russell McVeagh partner Adrian Olney sought indemnity costs in the sum of \$10, 000 - 12, 000. Although the plaintiff’s lawyers had been shown to be wrong in applying for the ex parte injunction against American Express, the District Court declined to award indemnity costs on the grounds that they had fairly thought that time was of the essence given that payment could be made at any time, and had not been able to conduct a lengthy and detailed examination of the legal position, or pursue the contract between the plaintiff and American Express.

On the other hand, the judge agreed that the case was of considerable importance to American Express given that:

The flow of payments through the traditional means of production of a credit card, signing of a chit, the submission of that chit by the merchant to a card issuer such as American Express, payment by the issuer and the recovery from the credit card holder is relied on by all parties to the transaction and is at the heart of the use of credit cards internationally.

Merchants accept credit cards on the basis of their confidence in the card issuer to make payment, and cardholders produce cards in the confidence that merchants will rely on them to supply them with goods or services. Anything which interferes with that improperly is a matter which goes to the heart of the issuer's business and the issuer is therefore entitled to treat the matter seriously.

As a result, the judge concluded that American Express was entitled to a substantial contribution towards the actual costs it had incurred, and awarded \$7,500 - an award which can only have further underlined to the plaintiff the folly of his generosity during his night on the town.

Banks not a soft target

The recent substantive and cost judgments in *JPMorgan Chase Bank v Springwell Navigation Corporation* spell out a clear warning to claimant investors considering bringing mis-selling claims against financial institutions in the wake of the global credit crisis. Not only were Springwell Navigation Corporation's allegations that JP Morgan Chase Bank had mis-sold it complex financial products rejected, but the court awarded costs against the plaintiff of £19 million. Such a costs award is a timely warning to those who might otherwise have seen banks and other financial institutions as soft targets in these "credit crunch" times, and have been minded to bring speculative and extravagant mis-selling claims.

Springwell's claim that JPMorgan Chase Bank was liable for negligent misstatement or misrepresentation and breach of fiduciary duty was heard in the High Court Queen's Bench Division on 25th July 2008. In considering whether Chase owed duties in either contract or tort to give general investment advice to Springwell, the Judge detailed the relationship between the parties which had spanned more than 12 years, emphasising the recommendations and advice Chase provided to Springwell on a regular basis throughout their dealings. Ultimately, however, it was held that that recommendations and advice at question could not amount to the positive obligation of a duty of care on Chase's behalf to give general investment advice to Springwell.

The Judge identified the relationship between Springwell and Chase as that of both banker and customer and trading counterparties. Without express terms providing the basis for the advisory relationship Springwell alleged existed, no such duty could be implied from a contractual viewpoint.

However, the substantive decision was only the first blow for the plaintiff. On 21 November 2008 the High Court delivered the costs decision. The defendant sought indemnity costs.

Allowing Chase to recover costs on a standard basis would result in a recovery rate of 60%, whereas to award indemnity costs would result in 80% recovery. Despite Springwell's submissions that the allegations of serious mis-selling claims were only at the margin of the case, the Court concluded that Springwell had indeed relied on false and exaggerated evidence to support its not only insubstantial, but unjustified claims. Alongside the wider commercial considerations in focus, such as the need to ensure that misrepresentations or overarching duties of care are not "deployed as unjustified negotiating tools", Springwell's damaging allegations were considered serious enough to justify an award of indemnity costs to Chase - a staggering £19 million.

Despite speculation that the substantive decision may be appealed by Springwell, the message to claimant investors remains clear: proceed with caution or pay the price.

Property rights over Blackmount Station resolved

A team led by Russell McVeagh partner, Adrian Olney, has successfully defended a claim in damages brought in relation to a property known as Blackmount Station in the South Island. (*Angus McGregor-Koch v Zane Barrett and Tina Marie Barrett*, High Court Invercargill, CIV-2007-425-000236, Fogerty J).

The plaintiff, Angus McGregor, claimed that he had a right to repurchase the property from the defendants, Zane and Tina Barrett. Angus' father, John McGregor, and his partner bought Blackmount station in 1996. Angus lived with John at the property, and became best friends with Aku, the son of the defendants. Angus in effect became part of the Barrett family, and moved into a cottage with Aku.

On 25 June 2003 John was arrested on several charges arising from the discovery of cannabis plots on the farm of Blackmount Station and in nearby forest. The implications this had for his continued ownership of the property were obvious. John wished to retain the property so Angus could have the opportunity to farm it in the future, and raised the possibility of Zane and Tina purchasing it.

The case centred on the terms of the agreement to purchase between John and the Barretts. John submitted that the terms were agreed to at the Barrett home around the kitchen table and Angus agreed with this version of events. The Barretts, on the other hand, maintained that the terms of sale were settled over a phone call, the property being offered well below market value at \$350,000.

The fundamental feature of John's version of the agreement was the consensus that Angus would have the opportunity to repurchase the property in 10 years' time at the bargain price. The Barretts vigorously denied that this agreement took place. They conceded that they discussed in loose terms with John the possibility of giving Angus an opportunity at some time in the future, as a young adult, to buy back the property. The conversation may have entailed an agreement that the Barretts would look after Angus for a timeframe of 10 years, although this did not include a definite buy-back price. The agreement was described by the Barretts more as a vague understanding that there was a commitment to look after Angus, rather than an agreement with defined terms.

On 6 May 2006 the Barretts signed an agreement for the sale of Blackmount Station to Mr and Mrs Conveney for \$1,115,000. In June the same year, John McGregor went to trial, was found guilty on various accounts, and was sent to prison for four years in July. Having learnt of the Barretts' plans to on-sell the property, he sought legal advice as to whether he could stop the sale of the farm, although no further action eventuated. John McGregor's only method of seeking damages for the sale of Blackmount Station were through Angus, by proving that, following the "agreement" between John McGregor and the Barretts, Angus had a right to repurchase the farm.

McGregor had to prove that there was an enforceable oral agreement that the Barretts bought the farm on the condition Angus would be able to repurchase it. In deciding whether there was such an agreement, Fogarty J looked both at the assertions of what was said, as well as the wider factual context in which the agreement was made. On the balance of evidence, he found that there was not sufficient particularity in the discussions between John McGregor and the Barretts for them to be enforceable as a contract. Although Fogarty J accepted that the Barretts intended to look after Angus, and that there was probably a readiness on the part of Zane Barrett to entertain Angus buying the farm back, any such arrangements fell a long way short from expressing an intention to be contractually bound to sell Blackmount Station back to Angus.

Another relevant consideration was the fact John McGregor was selling the land in order to avoid its forfeiture to the State. Fogarty J reasoned that the intended legal enforceability of an agreement could be gauged by the context in which it was made. In posing the question: "How comfortable would the purchasers be entering into an agreement in writing of the sort being advanced by the plaintiff?", Fogarty J concluded that the Barretts would not have been willing to be party to an arrangement to defeat the State.

The illegal purpose behind the sale of Blackmount Station had further impact than just the forming of an enforceable agreement. It was held that due to the sale of Blackmount Station being a transaction to avoid the impact of the Proceeds of Crime Act 1991, it therefore interfered with the administration of justice, meaning it was also unenforceable by reason of it being contrary to public policy.

Despite being somewhat masked by the thorny factual context, the legal issues in Barrett were widespread and pertinent. If anything, it should offer a reminder to vendors and purchasers that electing to secure a property sale through a mere oral agreement is to step onto dangerous territory. And another sad reality: it is difficult to sell your version of events to the Court when your criminal record suggests you are less than trustworthy.

Supreme Court gives the final word on the effect of amalgamations under Part 15 of the Companies Act 1993

A recent Supreme Court decision has considered the effect of an amalgamation under Part 15 of the Companies Act 1993, and whether such an amalgamation amounts to the transfer or disposal of assets: *Elders New Zealand Ltd v PGG Wrightson Ltd* [2008] NZSC 104 (5 December 2008).

Elders was joint owner of a number of saleyards with Wrightson. There were several agreements between Elders and Wrightson governing their ownership of the saleyards. All of these agreements contained a pre-emption clause that allowed one party to purchase the other's interest in the saleyards if the co-owner wished to sell, transfer or otherwise dispose of their interest in the saleyards.

In 2005 Wrightson amalgamated with Pyne Gould Guinness to become PGG Wrightson. The amalgamation was approved by the High Court under Part 15 of the Act, with PGG Wrightson taking over Wrightson's interest in the saleyards. Following the amalgamation Elders commenced this proceeding, in which it sought to establish that the pre-emption clause had been triggered by the amalgamation. If successful, Elders would have gained the contractual right to purchase PGG Wrightson's interest in the saleyards. Both the High Court and Court of Appeal dismissed Elders' claim. Elders appealed to the Supreme Court.

The issue for the Court turned on the differences between amalgamations under Parts 13 and 15 of the Act. Under Part 13, amalgamation occurs following a vote by interested parties, and does not require the approval of the High Court. The language of this Part deems that the companies "continue" as one company following amalgamation. It has been long established for amalgamations under Part 13 that the amalgamated company is not a new or different entity and 'stands in the shoes' of the original companies. Accordingly, amalgamation under Part 13 would not have triggered the pre-emption clause as no transfer of Wrightson's interest in the saleyards would have occurred.

In contrast, an amalgamation under Part 15 requires the approval of the High Court. Once the High Court has ordered the amalgamation it is binding upon all persons that the Court sees fit. While Parts 13 and 15 of the Act achieve the same outcome, there are differences in their wording and they have different legislative histories.

Elders argued that because Parts 13 and 15 are worded differently, the existing law on Part 13 did not apply to Part 15. Relying on English case law applying to legislation similar to Part 15, it argued that a Court approved amalgamation did not result in the automatic assignment of contractual rights to the amalgamated company and required the transfer of property to the amalgamated company. In reliance on the decisions of the High Court and Court of Appeal in this proceeding, PGG Wrightson argued that the concept of "continuance" under Part 13 equally applied to Part 15.

The Court agreed with PGG Wrightson. It held that the concept of "continuance" under Part 13 was inserted for administrative efficiency, which is an important purpose of the Act. The similarity between Parts 13 and 15 required them to be read together. The Supreme Court also noted that Court approved amalgamations are a useful process covering situations not provided for under Part 13, and that it would be unduly complex if utilising Part 15 resulted in a different outcome than an amalgamation under Part 13.

Substantial increase in fines for workplace accidents

As the result of an important recent decision of the High Court, employer can expect a substantial uplift in existing levels of fines for workplace accidents.

The full court of the High Court (ie two judges) is rarely convened - judges of the High Court usually sit alone.

However, in a recent case the full court was convened to hear appeals by the Solicitor-General in three cases where it was alleged that the fine imposed was manifestly inadequate. (*Department of Labour v Hanham and Ors* High Court Christchurch, CRI-2008-409-000002; CRI-2008-409-000034, CRI-2008-418-000009, 18 December 2008, Randerson and Pankhurst JJ).

The Solicitor-General noted that almost 90% of fines imposed at the District Court were below \$20, 000 compared to a statutory maximum of \$250, 000, and that the highest fine ever imposed was \$110, 000 - or 32% of the maximum available, and invited the court to issue a guideline judgement which would increase the level of fines being imposed by the District Court. The High Court agreed with the Solicitor-General that the fines being imposed by the District Court were inadequate, and in particular did not accord with section 8(c) and (d) of the Sentencing Act which requires the court to impose penalties at or near the maximum for offending within or near to the most serious cases.

As to future starting points, the High Court endorsed the comments of Duffy J in *Department of Labour v Street Smart Limited*, High Court Hamilton, CRI-2008-419-000026, 8 August 2008, that: "where Employers infringe, penalties must bite and not be at a mere 'licence fee' level", and held that starting points should generally be fixed at:

- » low culpability - a fine of up to \$50,000;
- » medium culpability - a fine of between \$50,000 and \$100,000; and
- » high culpability - a fine of between \$100,000 and \$175,000.

It was also noted that higher levels of fines may be required in cases of extremely high culpability (up to the statutory maximum of \$250,000).

These starting points will be significantly higher than the starting points previously adopted by the District Court.

Once the starting point has been established the Court will then adjust the fine upwards or downwards on the basis of aggravating or mitigating factors and the relevant statutory purposes of denunciation, deterrence, and accountability.

In terms of mitigating factors, a common one advanced is that the defendant has paid reparation. The High Court held that although reparation was to be taken into account in assessing the level of fine, there was not a 1:1 correlation. In other words, a fine would not be reduced by the amount of any reparation. Rather a discount of 10-15% from the starting point would be appropriate to reflect reparation.

For defendants who have insurance cover for reparation payments, the High Court concluded that an otherwise appropriate fine cannot be increased just because a defendant's reparation payment is in fact met by an insurance company. On the other hand, a defendant who has arranged such insurance cover for the benefit of their employees is not to receive any additional discount for having done so. Furthermore, the existence of insurance cover to meet reparation will be material in assessing overall financial capacity to meet reparation and fines.

The High Court also decided that sections 40(1) and (2) of the Sentencing Act 2002 allow the court to take into account the financial capacity of the defendant whether this has the effect of increasing or decreasing the fine. This is in contrast to previous case law, including a High Court decision in November 2008 in which Mallon J concluded that that section 40(1) only operates to decrease fines in cases where the offender lacks financial capacity, and that the fine ought not to be increased for substantial defendants to ensure that it "bites".

Turning to the three cases before it, the High Court imposed significantly higher fines in each case, although it is worth noting that the offence with the most serious consequences resulted in the smallest fine, due to the offender being a relatively small company with limited ability to pay.

A fine imposed on commercial construction company Hanham & Philp Contractors was increased from \$5,000 to \$50,000 following an accident in which an employee of a contractor was injured by falling off some wooden scaffolding on a building site.

Food manufacturer Cookie Time also had a fine increase from \$15,000 to \$40,000 in relation to an accident when an employee's arm became caught in the mechanism of a conveyor belt.

A fine imposed on mining company Black Reef was doubled to \$20,000 along with an order for reparation of \$25,000 added to the \$50,000 due to the widow of a miner who died when a mine became flooded.

As a result of this decision, all employers can expect much higher fines to be imposed fines much closer to the statutory maximum.

Post-contractual conduct as a guide to interpretation

In a recent case, His Honour Justice Wylie adopted a conservative approach to the use of post-contractual conduct as a guide to interpretation (*ANZ National Bank Limited and another v Tower Insurance Limited and another*, High Court Auckland, CIV-2005-404-007271, 12 February 2009).

Historically, contractual interpretation was confined by what was known as the parol evidence rule which excluded extrinsic evidence to add to, vary or contradict the written terms of a contract. Over the years this rule was attenuated by a number of exceptions, and at least since the decision of Lord Wilberforce in *Prenn v Simmons* [1971] 1 WLR 1381, modern contractual interpretation has proceeded on the basis that "the time has long passed when agreements were isolated from the matrix of facts in which they were set, and interpreted purely on internal linguistic considerations."

Since then, lawyers have become adept at using the "factual matrix" to advocate an interpretation of a contract which favours their clients. However, until the decision of the Supreme Court in *Gibbons Holdings Limited v Wholesale Distributors Limited* [2008] 1 NZLR 277, the factual matrix did not include evidence of the parties' post-contractual conduct.

In *Gibbons*, the Supreme Court favoured the view that post-contractual conduct could be taken into account when interpreting a contract. The court considered that the practical difficulty that would arise from this - that a lawyer asked to give an opinion on the interpretation of a contract would have to become familiar with the parties' post-contractual conduct - was relatively minor compared to the advantage the court might derive from having post-contractual conduct as part of the factual matrix it could call upon to aid its task of interpreting contracts.

One issue which was discussed in *Gibbons* was whether the conduct of one party could be called in aid interpreting a contract, or whether it was only mutual conduct which could be relied upon. His Honour Justice Thomas went further than the rest of the court and considered that even conduct which was not mutual may nevertheless be of assistance to the court in interpreting a contract - a point that His Honour Justice Tipping had expressly disavowed.

In *ANZ National Bank*, counsel for Tower Insurance sought to reply on post-contractual conduct. Justice Wylie followed the Supreme Court's lead and found that "if the parties

have conducted themselves post contract in a way which is objectively capable of shedding light on the meaning that they themselves placed on the words in dispute, then it is logical that that conduct can be taken into account to assist the Court in interpreting the written contracts." However, His Honour held that the conduct relied upon must be *mutual* conduct. Conduct is only relevant if it demonstrates a shared understanding of what a contract means. Conduct by one party only demonstrates what that party understood the contract to mean, and that is not of assistance to the court.

Accordingly, the decision of Wylie J endorses the more conservative view expressed by Tipping J, and rejects the bolder approach of Thomas J.

To borrow the words of Wigmore, one of the great legal commentators of last century, the decisions of the Supreme Court and of Justice Wylie confirm that "the history of the law of interpretation is the history of a progress from a stiff and superstitious formalism to a flexible rationalism" - albeit conservative progress.

New class action legislation?

The High Court Rules Committee is in the process of finalising consultation on draft legislation and High Court Rules to support the bringing of class actions in New Zealand. We understand that the intention is to present these documents to the Minister towards the end of the first quarter of 2009. The draft legislation sets out a class action regime similar to the Australian model, and allows for both "opt-out" and "opt-in" actions. It would also give the Commerce Commission additional powers to pursue claims under the Commerce Act, Fair Trading Act and CCCFA on a class basis.

If passed, this legislation, together with other factors such as the growth in litigation funding, could well bring about a significant increase in class action litigation in New Zealand.

Last year we ran a series of well attended seminars on class actions on the current law in New Zealand, recent trends and potential changes, how to manage class actions, and participation in the legislative process should the proposed draft legislation be taken up by the Government.

Please let us know if any of these matters are of interest as we would be happy to discuss them further with you.

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