

Litigation Alert

November 2008

Successful Appeal By Lab Tests Restores Contract To Provide Auckland Laboratory Services

On 25 September 2008, the Court of Appeal (Justices Hammond, Arnold and Ellen France) unanimously allowed an appeal by Lab Tests Auckland Limited ("**Lab Tests**") resulting in the reinstatement of an eight year, \$560 million dollar contract to provide community laboratory services to the Auckland region. *Lab Tests Auckland Limited v Auckland District Health Board, Waitemata District Health Board and Counties Manukau District Health Board and Ors* (2008) NZCA 385. A team from Russell McVeagh, led by former litigation partner Gerard Curry, acted for Lab Tests.

The contract was awarded to Lab Tests in July 2006 by the Auckland Region District Health Boards ("**ARDHBs**") following a contested "request for proposal" ("**RFP**") process. The ARDHBs sought a "strategic partner" to provide the service from 1 July 2007. An evaluation panel received proposals from both Lab Tests and the incumbent supplier, Diagnostic Medlab Limited ("**DML**"), and undertook an evaluation process involving several meetings and re-submitted proposals from both providers, before recommending to the ARDHBs that Lab Tests be selected as first preferred provider. In accordance with the RFP process, the ARDHBs then proceeded to negotiate a contract for the supply of laboratory services with Lab Tests.

DML filed judicial review proceedings challenging the ARDHBs decision. What had hitherto been an important but relatively non-contentious medical service became the subject of national media and political attention.

Community laboratory services involve the collection and analysis of blood and other samples ordered by approved referrers - typically General Practitioners ("**GPs**") - for members of the public. The results of such tests are an important diagnostic tool and DML had provided well-respected services in the Auckland region for more than 70 years. District Health Boards ("**DHBs**") had (relatively recently) been given the responsibility for "purchasing" the services from the provider - for the people being tested, and the health professionals requesting the tests, the services are free of charge. Under s25 of the New Zealand Public Health and Disabilities Act 2000, a DHB can negotiate and enter into a contract for the provision of services, provided it is permitted and in accordance with its annual plan.

DML tried to extend the scope a court has to review a commercial decision of a public body. Judicial review of those commercial decisions is available where there is fraud, corruption or bad faith. DML pressed to extend review to "... any material departure from accepted public sector ethical standards...". In the High Court Asher J did extend the scope but the Court of Appeal was firm that he did not give proper consideration to the commercial context. The court was "particularly troubled" by Asher J's conclusion that the DHBs "could follow the statutory procedures ... yet still be found to have breached their public law obligations in respect of those matters." Arnold J for the Court described DML's claim as "very broad" and "based on a notion that it is the role of the courts to ensure ... good hygiene in public decision making." This "overstates" the courts' role and would lead to "... almost indeterminate scope for intervention by the courts in this context".

Before the High Court, DML also argued that, amongst other things, the tender process used to award the contract was procedurally flawed. DML alleged that Dr Tony Bierre, shareholder and CEO designate of Lab Tests had gained an advantage from "insider information" through his role as an elected board member of the Auckland District Health Board, and that the process was allegedly tainted by Dr Bierre's conflict

of interest. It was also argued that there had been a failure to adequately consult with stakeholders in the decision, including Primary Health Organisations (**PHOs**) and GPs whose interests were represented in the High Court by an intervener, Harbour Primary Health Organisation.

In March 2007 the High Court determined that the ARDHBs' decision to award the contract to Lab Tests was ultra vires and consequently the contract was void and of no effect, requiring the tender process to be run again. The High Court held that there was an information advantage acquired by Dr Bierre which damaged the integrity of the tendering process, and that Dr Bierre had a conflict of interest which meant, in the circumstances, that the ARDHBs should never have entertained a proposal involving him. The High Court also found that the ARDHBs had an obligation to consult with GPs and PHOs, and had breached those obligations.

The Court of Appeal, having been required to examine the evidence in detail, determined that on the facts the High Court was wrong to find that the ARDHBs decision was flawed. It also overturned the decision on consultation, determining that in the circumstances the obligation to consult had not been triggered and as such, there was no breach of the ARDHBs public law consultative obligations.

Whether the Court of Appeal decision is the final word in this case is yet to be seen - DML has now applied for leave to appeal to the Supreme Court.

Shell Successfully Defends Insider Trading Claim

Following nearly 9 years of litigation and a 30 day trial in the High Court, a team led by Russell McVeagh litigation partner Sarah Katz and Jim Farmer QC have successfully defended Shell and a former Fletcher Challenge Energy ("**FCE**") senior manager in the first insider trading proceedings to have gone to trial in New Zealand: *Haylock & Ors v Patek & Anor* (CIV 1999-404-899, HC Auckland, Williams J, 1 September 2008).

The case relates to FCE's 1995 takeover of Southern Petroleum No Liability ("**Southern**"). The plaintiffs alleged that due to a study carried out by a team of its employees ("**deep gas study**"), FCE subsidiary Petrocorp Exploration Limited ("**Petrocorp**") was aware that the Mangahewa prospect (a deep gas prospect in onshore Taranaki) contained significant amounts of gas that could be commercially extracted. It was alleged that this information was disclosed to Petrocorp senior management at a presentation on 2 November 1995, the contents of which were subsequently relayed to Mr Patek. (Shell only became involved in the litigation as it subsequently acquired FCE and assumed its role).

The plaintiffs had been granted leave under s 18 of the Act to bring a derivative claim on behalf of Southern in 2002 (Petrocorp and Southern both became part of the Shell group when Shell acquired FCE in 2000). Due to a unique feature of New Zealand's insider trading legislation, Shell (as successor to FCE) was required to pay the plaintiffs' costs in bringing Southern's claim as well as its own costs in defending the case.

In order to succeed the plaintiffs had to show Petrocorp or Mr Patek (a) possessed "inside information" about Southern (information not publicly available that was likely to materially affect the price of Southern's shares); (b) held that information "by reason of" their respective positions of being a substantial security holder or director of Southern and (c) encouraged FCE's takeover vehicle Petroleum Industries Limited ("**PIL**") to buy shares in Southern.

As Southern owned half of the prospecting licence area, the plaintiffs alleged that if the information were released to the market it would have increased Southern's share price. The plaintiffs alleged the information was not released so that the takeover could be achieved by FCE for less than fair value, and that both Mr Patek and Petrocorp encouraged PIL to purchase Southern shares. The compensation sought by the plaintiffs was the alleged difference between what they were paid for their shares during the takeover (75 cents per share) and the market value of Southern had the information been made public (said to be an additional \$1.24 to \$11.35 per share).

Twelve factual and eight expert witnesses gave evidence at the trial. Having heard that evidence, Williams J dismissed all claims against both defendants. While Petrocorp held information about the licence area, it did not have this "by reason of" its shareholding in Southern but because it was operator of the licence area under a joint venture agreement. The claims against Mr Patek failed as it was found he did not possess the alleged inside information during the takeover. Of interest to company directors, the Court held that had Mr Patek received the information from Petrocorp, this could also have been received "by reason of" his being a director of Southern if he could not have legitimately refused a request from Southern to disclose the information.

Williams J also held that had it been established the defendants possessed the alleged inside information "by reason of" their relationship with Southern, the plaintiffs would have nonetheless failed because, on the basis of the defendants' expert evidence (which was preferred by the Court), the information would not have materially affected the value of Southern's shares. The Court held that the hypothetical release of such information must be balanced and plaintiffs cannot rely only upon the hypothetical release of positive information.

The plaintiffs have appealed the decision, so the law on this topic may be considered by the Court of Appeal in the near future.

Auckland Airport Retains Its Land

In late 2006, the Craigie Trust laid claim to an area of land originally acquired for Auckland Airport under the Public Works Act 1928. The claim, heard earlier this year in the Auckland High Court, centred around the Public Works Act 1981 and its offer back obligations set out in s40 of the Act. *McElroy & Ors v Auckland International Airport* (CIV 2006-404-005980, HC Auckland, Williams J, 27 June 2008).

The Craigie Trust asserted that land acquired from the Trust under the Public Works Act 1928 (by the original operators of Auckland Airport - the Crown and the Auckland Regional Authority), was not being used for the "aerodrome purposes" for which it was acquired. This was alleged to have resulted in an obligation on the Crown/ARA to offer back the land to the Craigie Trust, an obligation which has since passed on to Auckland Airport. If correct, the claim could have required Auckland Airport to offer back to the Craigie Trust the land, along with the developments and buildings on the land, as at its value at 1 February 1982 (when the offer back obligations came into force). Russell McVeagh acted for Auckland Airport.

The land claimed by the Trust amounted to just over 36 hectares and is situated just north of the Airport's runway. It currently accommodates the major intersection at George Bolt Memorial Drive and Tom Pearce Drive, along with freight facilities, flight catering services, rental car facilities, office blocks, car service facilities, a service station, food outlets, supermarket and Butterfly Creek. It also houses the Airport's power centre, along with numerous drainage, power and water facilities. It was fully acquired for the purpose of an aerodrome in 1975 from its then owners and farmers the Craigie Trust (a Trust settled by the late Hugh Lambie, the former Mayor of Manukau). Hugh Lambie, and later his son John, leased the land from the Trust and grazed cows on it for the purposes of supplying part of Auckland's milk supply. John Lambie continued to lease and graze parts of the undeveloped land until very recently.

Another team led by Sarah Katz and Alan Galbraith QC acted for the Auckland Airport. The case was heard by Justice Williams who delivered his judgment on 27 June 2008. His Honour found in favour of Auckland Airport. He agreed with three out of the four arguments presented in the Airport's defence. In essence, the judgment recognised that the developments on the land and the intended uses of the land had consistently been shown to be wholly or partly used in connection with the aerodrome or its administration, as they (a) met the expectations of Auckland Airport's users (including travellers, staff, security and boarder agents, travellers' services, "meeters and greeters" and other airport users); and/or (b) provided for the future expansion of Auckland Airport.

Justice Williams further commented that had he been required, he would have also ruled in favour of Auckland Airport in respect of its third and fourth arguments in that it would have been unreasonable and unfair to require the Airport to offer the land back to the Craigie Trust, and that the land had undergone a significant change in character since acquisition, both warranting the application of the exceptions under s40.

The Court responded in a pragmatic, yet principled way to the unique challenges which arise where the relevant public work (aerodrome/airport) is a dynamic entity which must necessarily develop to meet huge technological advances and the ever-changing needs of airlines, passengers and its work-force. The High Court's decision will, in the very least, provide guidance as to the interpretation of public work, recognising the need to adopt a broad definition so as to meet the changing nature and evolution of public works. However, given the Craigie Trust has appealed and Auckland Airport's cross-appeal (in respect of the High Court's decision surrounding its first argument), the law is still very much in a state of flux. The appeal is likely to be heard sometime in the middle of next year.

Class Action Litigation

A team lead by Wellington partners Adrian Olney and Hamish McIntosh continue to act for CSFB defending a \$250m class action involving 10,000+ claimants. The High Court recently issued an interlocutory judgment which gives important guidance to the approach NZ courts will take to class actions and litigation funding. All the indications are that potential claimants and those minded to promote litigation for profit are focussing on potential class actions and such claims will no doubt become increasingly prevalent in NZ.

The claim follows the collapse of Feltex and relates to the floating of the company in 2004. While there are a number of causes of action, fundamentally it is a claim for damages on the basis of an allegedly misleading prospectus. There are two named plaintiffs - one is the representative for those who purchased in the IPO and the other is the representative for those who purchased on the market in the year or so after that. Unusually, the plaintiffs obtained ex parte orders that all shareholders within those groups would: (i) be part of the represented group; and (ii) be party to the litigation funding arrangements; unless they specifically opted-out before a particular date. The defendants challenged those representative orders, among other things.

The judgment demonstrates the increasingly liberal approach by the Courts to adapting the existing procedural rules to support class actions. However, it also demonstrates that there are limits to how far the Courts will go. For example the Court confirmed that:

- » the NZ rules require that the class be constituted on an 'opt-in' basis (ie only those who have specifically consented to being included); and
- » not all claims will be allowed to proceed as class actions - eg the Courts may not allow class actions which depend upon proof by each individual class member of an element of the cause of action (in this case some causes of action depended on individual investors proving that they relied on the allegedly misleading statements in the prospectus).

As it happened, the challenge was largely successful - the Court limited the claims that could be brought by way of class action and ordered that the class be re-constituted on a properly informed, opt-in basis (ie those promoting the litigation are now required to write to all potential members of the class

and obtain their informed consent to being included in the represented class).

This judgment also confirms an increasingly liberal approach to litigation funding. While the judge did not agree that the funding agreement was so bad as to amount to an abuse of process, she did agree that it was champertous - which may well give rise to enforceability issues for the parties to this form of agreement.

We are in the process of preparing a seminar on this topic (what the law is in NZ, recent developments and where the law is heading (eg the Australian experience), what sorts of claims can be brought as class actions, strategies for pre-empting/managing class actions etc) to be held in November. Please contact us for details if you are interested in attending.

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