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IN THE SUPREME COURT OF NEW ZEALAND SC 104/2023

I TE KŌTI MANA NUI O AOTEAROA [2024] NZSC Trans 11

BETWEEN **ADAM DAVID BANKS**

Applicant

AND **WILLIAM ROBERT FARMER**

First Respondent

SIMON MATHEW GAMBLE

Second Respondent

CHRISTOPHER JAMES MASSAM

Third Respondent

DOUGLAS LEROY FREDERICK

Fourth Respondent

Hearing:	25 July 2024
Court:	Williams J Kós J Miller J
Counsel:	M G Colson KC and J W A Johnson for the Applicant

R J Hollyman KC and A J Steel for the
First Respondent
A J Peat for the Second to Fourth Respondents

CIVIL ORAL LEAVE HEARING

MR COLSON KC:
May it please the Court. Counsel's name is Colson, I appear with Mr Johnson.

WILLIAMS J:
Tēnā kōrua.

MR HOLLYMAN KC:
E ngā Kaiwhakawā, tēnā koutou. Ko Hollyman ahau. Kei kōnei māua ko Mr Steel. Kei kōnei ahau mō te kaiwhakahē tuatahi.

WILLIAMS J:
Tēnā kōrua, haere mai.

MR PEAT:
May it please the Court, Peat, for the second to fourth respondents.

WILLIAMS J:
Tēnā koe Mr Peat. All right, Mr Colson and counsel generally I signal this, and it will come to no surprise to you I suspect, but we have a particular interest in the application of section 136 and the third payment under the executory obligation argument. So we'll need to see whether you can get any traction on that. You've got half an hour each, which you don't need to use, but it's there if you need it, and there's no right of reply.

MR COLSON KC:
Thank you sir.

WILLIAMS J:

Sorry, yes, half an hour between – Mr Peat, have you got much to say?

MR PEAT:

No your Honour, I've discussed with my friend and we'll cover the time between us.

WILLIAMS J:

Excellent.

MR COLSON KC:

Thank you for that clear indication your Honour. The – obviously the matter of general commercial significance which the intended appellant relies on there, is the timing of the assessment test in section 136. That is that: "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 [it] when it is required to do so." And from the indication of the Court in relation to the third advance, that is a particular live issue, given the executory nature of the contract, as I indicated in the key points in the oral application. I assume your Honours are fairly clear on the facts in that regard, which is, I've summarised the timelines, and your Honours will have seen a slight difference, or a difference between the High Court and the Court of Appeal in that respect.

In the High Court the Judge seemed to accept that the obligation really arose upon performance, that is when the money was passed on the 24th of April. That's recorded in the High Court judgment, as I indicate in my submissions.

KÓS J:

He doesn't really explain why though does he?

MR COLSON KC:

He doesn't explain why beyond indicating, well, it's consistent with an executory analysis of the contract, whereas the Court of Appeal obviously focuses on the

potential time at which the agreement was formed. I think from memory, the High Court Judge focuses on the fact that, well, until the money was received, there can't be an obligation either to repay it or to convert it in due course into equity and that, it's really paragraph 500 of the High Court judgment.

I also refer to a couple of other points in that regard, a decision which I can, of course, send through later this morning and perhaps ought to have, of Justice Fitzgerald's in *Dempsey Wood Civil Ltd v Gapes* [2021] NZHC 2362. There, the Judge was relying on the *Mainzeal* decision in the Court of Appeal, there was an ongoing building contract which covered work over a period of years and the Judge there made the point that in terms of the *Mainzeal* analysis in the Court of Appeal which was, of course, upheld in the Supreme Court, "agreeing" has the broader sense of agreeing to all obligations that follow upon a decision to continue to trade rather than agreeing in relation to a specific obligation and so that the section 136 test, if I can put it that way, also needs to apply almost to each month when there is an ongoing course of dealings between the parties pursuant to a contract.

And to similar effect, I just cite from *Yan v Mainzeal Property and Construction Limited (in liq)* [2023] NZSC 113 itself at [245] and [270] where the Court emphasises at [245] that a creditor dealing with a company assumes that if goods or services are provided, or money is provided, the directors will be in a position to believe that the company is capable of repaying that and the flip side of that at [270], the Supreme Court comments upon – or this Court comments upon the fact that directors have an ongoing obligation in that regard.

And when one puts that together with the general analysis in *Mainzeal* that "agreeing to" isn't a specific matter, but to all obligations that follow, then the intended appellant's argument is that on the facts here, and given that there was quite a lot of clarity, if not more than clarity, that the Sprint deal was tanking on 20 or 21 April, that it was incumbent upon the directors at that time to advise Mr Banks of that and not to take the money that was coming, in effect –

MILLER J:

Mainzeal is not at all the same case, is it? That's a contracting firm which has longer-term relationships with subcontractors in which it is incurring liabilities all the time.

MR COLSON KC:

Yes.

MILLER J:

So that's why the Court of Appeal spoke of that ongoing duty.

MR COLSON KC:

No, I accept that entirely, your Honour, of course, but the ongoing duty, in my submission, must apply in relation to directors generally when they're agreeing to allow the company to continue to trade. I know there's a point of distinction obviously between section 135 and 136, as was set out in *Mainzeal*. There is a clear distinction in terms of focusing on the incurring of obligations there, but the wider principle is, in my submission, is that to the extent the word "agreeing" in section 136 – or sorry, the word "agreeing" in 136 does not mean agreeing to a specific obligation at a specific point in time, but can and should be read more generally.

KÓS J:

Could we back up a step and just talk about basic contract law. So if I agree to lend you $100 on a particular date in the future, and just before that you are struck off, so there's some doubt about your ability to repay me if I give you $100, would you be under an obligation to let me know before I paid you the $100?

MR COLSON KC:

Well, your Honour, the answer to that, well –

WILLIAMS J:

It would have to be Colson Limited.

MR COLSON KC:

It would have to be Colson Limited, or the –

KÓS J:

Well, it doesn't really matter, in this context.

MR COLSON KC:

No, I understand what you're saying.

KÓS J:

It's a matter of contract.

MR COLSON KC:

Yes, no, I have been reflecting on that because one could say there is an implied term in that situation, that if there is a material change then the onus is on the borrower to let the lender know that and, of course, such a term is common in a – I talk about facility agreements, but practically we know that typically a bank facility agreement will have that type of clause.

MILLER J:

Yes, but it's express.

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MR COLSON KC:

Yes, but it's express there. And I was also reflecting on that, your Honour, in the context of theoretically if the company had gone into liquidation prior to Mr Bank's advancing his money and I don't have a complete answer to this, would the liquidator be able to sue Mr Banks to enforce the loan and take the 500,000, which would be a surprising result, but on the Court of Appeal's analysis it may be the correct result, yet a surprising one, because the contract would be formed at the latest by 24 or 25 March. So that reinforces, in my submission, why there must be an ongoing duty on the directors to consider in respect of executory contracts, whether they are still in a position to perform the obligations under those contracts at the time of performance, or at the time the

goods, services or money are provided and that, potentially, is a very important point for the wider commercial community.

MILLER J:

What do you say to the Court of Appeal's answer, which is confirmed in the recall decision, that this Court, well in effect we'd be asked to deal with this issue when the Court of Appeal was not required to.

MR COLSON KC:

The Court of Appeal indicated that it was before it, obviously on the pleadings, is my reading of the recall judgment. It preferred to say that it didn't – I should go back to the judgment. Its reasoning in the recall judgment seemed to me more about the reasons as to why it shouldn't make the award, and that of course is more about section 135 rather than section 136, because the Court of Appeal, like the High Court, concluded the company ought to have ceased trading in late April or early May, but didn't go on to consider compensation, so the recall was just on section 135.

KÓS J:

I don't have the recall judgment in front of me. Can you give me the citation?

MR COLSON KC:

Yes, it's in the bundle, it's [2023] NZCA 607, but it was limited to section 135 because the Court had dealt with section 136 in its judgment. Just looking back at my notes just in relation to section 136, I'm not sure beyond identifying the difference between the High Court and Court of Appeal, commenting on *Dempsey Wood* and just commenting on *Mainzeal* in the Supreme Court, there's a lot more I have to say on that, but in my submission the fact that it has come up not just in this case but also in *Dempsey Wood* is an indication that it's a not uncommon situation and I understand from my learned friend's submissions obviously he's opposing the application, but he concedes that there could be a point in time at which it's appropriate for the Court to consider the issue but not on this occasion.

WILLIAMS J:

So do you need to know whether you should sit down or go to the other arguments?

MR COLSON KC:

Yes, I suppose that, yes, well I do, unless your Honours have any other questions. I suppose one final comment, picking up on Justice Kós' point which – I've been thinking about it as well – is the interaction between contract law and the Companies Act 1993 here, because if you don't have that obligation, as it were, if you don't read section 136 in that way, you could end up in a situation where the obligation is obviously enforceable in the future by a liquidator or similar, and that is a real issue. Unless I can help your Honours further, I have comfortably completed within my 30 minutes.

KÓS J:

Well it's not necessary, actually, because I would have thought a liquidator would be dreaming in claiming against Mr Banks in that situation because he wouldn't be in a position to provide any kind of counter-performance.

MR COLSON KC:

Not in relation to the IPO at least.

KÓS J:

That's right. So I think that's clear enough but section 136 turns on its own particular words, and that's about incurring an obligation, and what you're really requiring is the Courts to engage in a kind of review of status from the moment of entry into the agreement until tendering of performance.

MR COLSON KC:

Or, to put it another way, yes the Courts may be supervising it, but they're just supervising the duty of the director, as they always do in relation to the Companies Act. Consequent upon litigation the obligation is primary on the directors to ensure the obligations incurred reasonably can be repaid.

KÓS J:

As to the other question as to whether you should sit down or continue, I don't think anything you might say, Mr Colson, on anything else is likely to persuade me that it's a leave point. This is the one point I think that is of interest to me. For myself.

MR COLSON KC:

Thank you your Honour.

MILLER J:

Yes, similarly. What scope would be left in the appeal were we to limit the practical outcome you seek recovery of the $500,000?

MR COLSON KC:

That would be the only practical scope arising from focusing on section 136 and the third agreement your Honour.

WILLIAMS J:

Can you tell –

MR COLSON KC:

I – sorry your Honour.

WILLIAMS J:

Sorry, you've not finished?

MR COLSON KC:

No, I am finished.

WILLIAMS J:

Can you tell me again what *Mainzeal* said about agreement or agreed?

MR COLSON KC:

Yes I'll just – I don't think it specifically addressed that. The passages I was referring to were at [245] where the Court said: "A creditor providing goods,

services or money to a company is likely to assume that the directors would not permit the company to incur the corresponding obligations unless confident on reasonable grounds that they would be honoured. Such an assumption is encouraged by the provisions of" amongst other things section 136, and at section – sorry, paragraph [270], the Court said: "Directors have a continuing obligation to monitor the performance and prospects of their company… should squarely address the future of the company if such monitoring reveals… by reason of the company's solvency… or other adverse factors, there is: … (b) doubt as to whether there is a continuing reasonable basis for belief that obligations to be incurred will be able to be honoured."

Which leads back to the question is what incurring the obligation, or agreeing to incur the obligation means in the context of an executory contract.

WILLIAMS J:

Right, so you're arguing that the term, the phrase "incurring the obligation" applies at the time and at any time after the initial agreement is entered into?

MR COLSON KC:

At any material time after in the sense that the directors know there is to be the provision of money or services pursuant to that executory contract, or umbrella agreement, depending on the nature of the contract.

WILLIAMS J:

So are you suggesting that is the incurring of a further obligation, or that incurring is not a single point in time, but a continuing phenomenon?

MR COLSON KC:

Yes, yes, correct Sir.

WILLIAMS J:

I gave you the two options. The second?

MR COLSON KC:

The latter. I think viewing it as an ongoing duty, as it were, or activity is consistent with the analysis in *Mainzeal* about the duties on a director, including those I just referred to.

KÓS J:

I thought your argument was a bit more crisp than that. I thought it was that on entering into the contract there was an obligation, but on receipt of payment, there was another obligation.

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MR COLSON KC:

Yes.

KÓS J:

The obligation to repay, it's subsidiary to the contract but it is, nonetheless, in its own right an obligation.

MR COLSON KC:

Yes.

KÓS J:

Until you receive the money, you have no obligation to repay it.

MR COLSON KC:

No obligation to repay it, yes, no, it is Sir.

KÓS J:

That’s what I understood your argument to be.

WILLIAMS J:

Isn't that the wrong obligation though?

MR COLSON KC:

No, not in my submission, because there are two separate obligations, in a way. There is the executory contract which of itself does not necessarily create an

obligation per se, it creates something that will arise in the future and then there is the actual event in the future that creates the real obligation, as it were, that is to repay or to convert to equity. So if, for example, in a situation of a credit arrangement with, say, Mitre 10 for a tradie, you might sign up to the credit arrangement and have a credit limit. That is an obligation, in a way, because you have agreed to pay up to that maximum amount or the suppliers agreed to give credit to that actual amount, but it is not until you actually order the individual parts and pick them up that the obligation really bites.

WILLIAMS J:

So isn't your argument really that in the context of an executory contract like that, often running credit contracts, there are two incurrings?

MR COLSON KC:

Yes, I think that's right Sir, yes.

WILLIAMS J:

That's better than the phasing?

MR COLSON KC:

Yes.

WILLIAMS J:

Right, okay, thank you.

MR COLSON KC:

Thank you, your Honours.

WILLIAMS J:

Thank you, Mr Colson. Mr Hollyman.

MR HOLLYMAN:

Thank you, your Honours. Just in terms of what this Court said in *Mainzeal*, the key references are [248] and [369]. In [248] it says and I will just read it out: "Under s 136 liability depends on the director agreeing to the incurring of an

obligation. As the singular includes the plural, "obligation" is to be read as "obligations". In this context, we see "agree" (the word used in s 136) as having its ordinary meaning, on which basis agreement to the continuation of trading may be taken as extending to the incurring of obligations that are the inevitable corollary of continuation of trading." And so, of course, the Court's thinking about those four further projects that were entered into, and then the corollary subsequently that those would all have.

And [369] is a little higher level but it does say – does contrast 135 and 136: "Section 35 is expressed in terms that are consistent with treating creditors as a class in relation to compensation. In contrast, s 136 does not treat all creditors as a class but rather contemplates both (a) an obligation-by-obligation, and thus a creditor-by-creditor approach and (b) as we have found, an approach based on categories of obligations and therefore creditors."

I do resist the suggestion that we can slice and dice this contract into separate obligations. The natural comparisons that we fall into, for example with the Mitre 10 tradie or the – or some sort of facility arrangement with particular draw-downs are situations where, as we so often see, there is a master agreement and there are specific sub-agreements and they don't really readily translate to this simple agreement where there was an advance to be made with an option to convert to equity.

Now, section 136, in my submission, is settled law and there is an extensive discussion in *Mainzeal* of the detail of how it is to be interpreted and applied. In my submission, the statute doesn't require a continual assessment of directors' obligations.

But really, in my submission, what the Court is being asked to do here is revisit the underlying facts and the submission I would like to develop to your Honours is that this actually is moot, even if my friend is right about the interpretation of 136.

If I can ask your Honours to, or I can refer your Honours to first of all the High Court decision at around about [500], just find it myself, at around about [500] the High Court Judge is dealing with agreement 3 and he does make the point that my friend has been making that if the funds hadn't been advanced there will not have been an obligation to repay and that is at [500].

But then he goes on to – his Honour goes on to discuss the prospects of the Sprint deal and there is quite a lot of discussion, there was quite a lot of evidence directed to this, but the key points are towards the end of [501], sorry, all through this paragraph [501]: "I have determined that until late April to mid-May … 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," that is the key date of advance, "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 the 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." And then there is a discussion about other avenues and the fact that it was, in [502], discussions with Mr Nasser of Sprint and it coming to an end on 17th of May.

Then over the page, [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 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."

So, that then is also the finding of the – I'm sorry, it is also further back it is discussed and I will just give your Honours the reference at [435] in the

High Court judgment, the same point: "... until 26 April … there was a reasonable and legitimate expectation that a binding agreement with Sprint ... was imminent." And then that same point –

MILLER J:

To what extent would we, were we to revisit agreement 3, to what extent would we also have to confront the Judges in the Court of Appeal's findings of fact on the first two advances? In other words, to what extent does this finding of reasonableness, if I can express it generally like that, on the part of the directors encompass the whole of the dealings between these people?

MR HOLLYMAN KC:

As I understand my friend's submission, it doesn't, in fact, because there is quite a gap in time between the advances under agreements 1 and 2 and agreement 3. Agreements 1 and 2 are around about a year or two years earlier, from memory.

MILLER J:

All right.

MR HOLLYMAN KC:

But the Court of Appeal makes concurrent findings on this exact issue and so at [283] onwards of the Court of Appeal decision there is discussion of agreement 3 and it starts at [283] with Mr Banks' pleading that the agreement was entered into on the 4th of April – 4th of March, sorry.

Then at [285] of the judgment, the Court said: "As can be seen, Mr Banks' pleaded claim was that the terms … were agreed on 4 March 2014 and the $500,000 was to be a further loan… with a conversion to equity ... in the context of an IPO." And then goes on to say the agreement: "... it may be that agreement was not finally reached until the meeting on 25 March 2014 ... The Judge made no finding as to when the agreement was reached, but it seems clear that the terms must have been agreed by 25 March 2014 at the latest. There is no recorded meeting between that date and the receipt of money on

24 April 2014. The only correspondence in the intervening period are the emails on 2 April 2014 when Mr Farmer asks when the money will be transferred and the response ... advising he should receive it around 24 April."

Now, [286] is the point that we have been discussing with your Honours: "The question to be asked is when were the directors required to direct their attention to their duties ... This turns on when the obligations were incurred. This was a significant one-off transaction that involved important commitments by Mako, including as to the future conversion of all his loans to equity on agreed terms."

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"Both parties were bound to these commitments at the latest by 25 March 2014. Thereafter, Mako was not at liberty to withdraw unilaterally from the agreement. This is entirely consistent with Mr Banks' pleading that he '*performed* the contract by paying the $500,000'. We therefore prefer the view that the relevant obligations were incurred for the purposes of s 136 no later than 25 March 2014 ... not on 24 April 2014 when Mr Banks performed his obligations," so they take that as the assessment date.

But going on, the Court of Appeal has already found, because this was also the subject of a Fair Trading claim, the Court of Appeal has already endorsed the 26 April date and that is back at paragraph [220] of the Court of Appeal decision. So [220] of the Court of Appeal: "On 26 April 2014, two days after Mr Banks' funds were received, Mr Gamble emailed Mr Farmer updating him on recent developments with Sprint," and this is the advice that there may be some issues.

And at [221]: "There is no mention of any discussion or other communication with Mr Banks about the negotiations for … Sprint … in appendix 1 to the Substantive judgment. Mr Banks' brief of evidence suggests the first time he heard about this agreement was ... [in] September 2014. It is hard to see how Mr Banks could have been misled about this transaction inducing his last advance on 24 April 2014 when he did not even know about it at that stage. Mr

Farmer first heard from Mr Gamble about the inability of Sprint to fund the purchase around 26 April 2014. The other directors did not know about it until a short time later," and hence they dismissed the Fair Trading Act claim.

But in my submission, those findings in both of the lower – I'm sorry, your Honour.

KÓS J:

So your submission turns on the last sentence of [221], really.

MR HOLLYMAN KC:

Yes, the last two sentences.

KÓS J:

Which you say is the same as [503].

MR HOLLYMAN KC:

Yes. Yes and so that, let's – even assuming that my friend is right and your Honours do wish to go down this path and your Honours do find that there is an ongoing obligation or that there is some division of the obligations, the factual findings in both of the lower courts preclude this going anywhere.

Now, I have, subject to any questions your Honours may have, I think I only have one more point to make – which I have lost – and that is that the recall judgment. Although the recall was directed to 135, it does touch on 136 and at paragraph [16] the Court of Appeal specifically says this: "Mr Banks' case included that the directors acted in breach of s 136 of the Companies Act in agreeing to Mako incurring obligations in connection with his investments from mid-2013 at the latest."

WILLIAMS J:

Can you give me that paragraph sorry.

MR HOLLYMAN KC:

Paragraph [16] Sir.

WILLIAMS J:

Of the recall judgment?

MR HOLLYMAN KC:

Of the recall judgment. But it is making the point that: "Mr Fisk, the principal expert called for Mr Banks ... expressed the opinion that the directors should have ceased trading around July 2013. However his evidence was that Mr Banks was unlikely to recover anything even if they had done so. This was because of the extent of Mako's liability to the secured creditor ..."

MILLER J:

That only focuses on the company's position, not the liability of the directors. The point you're making is that Mr Banks is unlikely to recover anything.

MR HOLLYMAN KC:

Yes, yes.

MILLER J:

Is unlikely to recover anything from the company in liquidation?

MR HOLLYMAN KC:

In a liquidation, quite right, your Honours.

MILLER J:

Right.

MR HOLLYMAN KC:

Now, I can also take your Honours to the specific findings about 136 in the High Court and Court of Appeal but they turn on exactly the same point, that the 26th of April is the earliest date and that even if the obligation is incurred on the 24th of April there was reasonable grounds, so there was no loss.

I'm sorry, Mr Steel has just pointed out to me, there's a further reference to 26th of April being the key date at [435] of the High Court judgment, [435].

Now, I don't need to take any more of your Honours' time unless there is something you'd like me to address.

WILLIAMS J:
Thank you, Mr Hollyman. Mr Peat, you're looking pensive and thoughtful over there?

MR PEAT:
Nothing further.

WILLIAMS J:
Thank you. All right, well, thank you counsel for incredibly crisp submissions. We will reserve our decision, of course, and issue it in due course.

COURT ADJOURNS: 10.35 AM