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IN THE COURT OF APPEAL OF NEW ZEALAND CA 209/95

BETWEEN JATIVA INVESTMENTS LIMITED

Appellant

AND HERBERT PACIFIC LIMITED

Respondent

Coram Richardson J
Gault J
McKay J

Hearing 11 December 1995

Counsel J R F Fardell and K J Crossland for Appellant
J M Kirkland and Mrs A J Adams for Respondent

Judgment 11 December 1995

JUDGMENT OF THE COURT DELIVERED BY RICHARDSON J

This appeal is against the judgment of Williams J delivered in the High Court at Auckland on 28 September 1995 granting Herbert Pacific Limited an interim injunction restraining Jativa Investments Limited and its agents from taking any further steps until further order of the High Court with respect to the compulsory acquisition of the shareholding of Herbert Pacific in American Bistro Limited.

In proceedings instituted on 22 August 1995 Herbert Pacific sought a declaration as to whether or not it was in default of a shareholders' agreement entered into between Jativa and itself on 17 November 1993 and an interim injunction restraining completion of the acquisition by Jativa of Herbert Pacific's

shares in American Bistro Limited. Herbert Pacific and Jativa each own 50% of the shares in American Bistro, a company operating a restaurant in Christchurch pursuant to a franchise from an American company called TGI Friday's. On 16 December 1994 Javita through its solicitors gave notice to Herbert Pacific of what Jativa saw as Herbert Pacific's then breaches of the shareholders' agreement. The letter was in these terms:

"AMERICAN BISTRO LIMITED

1. Pursuant to the shareholders' agreement for American Bistro Limited ("Company") dated 17 November 1993 ("Agreement") between Jativa Investments Limited ("Jativa") and Herbert Pacific Limited ("Herbert Pacific"), Jativa hereby gives notice in accordance with clause 13.1(b) of the Agreement in respect of the failure by Herbert Pacific to perform certain of its obligations under the Agreement.

2. For your information, we set out the defaults below:

(a) Clause 4.2 of the Agreement provides that the equity required by the Company shall be paid by each of Jativa and Herbert Pacific in equal shares. On the advice of the Company's accountants, KPMG Peat Marwick, as at 12 December 1994, Jativa's shareholder's loan account stands at $1,678,076.09 and Herbert Pacific's shareholder's loan account stands at $1,450,240.65. The failure by Herbert Pacific to pay the difference of $227,835.44 is a default of its obligations under clause 4.2.

(b) Clause 6.1 of the Agreement provides that where the Company requires further funds the parties shall use all reasonable endeavours to obtain such funding by way of bank accommodation. The parties agreed to acquire funding from the ANZ Banking Group (New Zealand) Limited to the amount of $800,000, with security provided by each of the parties to the value of $400,000. Jativa has provided its portion of the security and on that basis ANZ has advanced the sum of $400,000 to the Company. In breach of the parties agreement, Herbert Pacific has not provided adequate total security to enable the drawdown of the remaining $400,000. Herbert Pacific (through Colin Herbert) has advised that, rather than providing the requisite security to ANZ to enable the drawdown of $400,000, Herbert Pacific

will advance $400,000 in cash to the Company, but to date such money has not been paid to the Company.

(c) Clause 9.5 of the Agreement provides that each party has entered into the Agreement in the utmost good faith, pledging to act in connection with its obligations under the Agreement in a fair and reasonable way towards the other party. Herbert Pacific has breached this obligation in a number of material respects and in particular as detailed hereunder.

(i) The directors of the Company resolved that the "OO" bank account of the Company be operated in a certain manner. Particularly the board resolution of 16 November 1994 provides that not more than $30,000 shall be maintained in the OO account at any one time and that the maximum for any one cheque written shall be $10,000. Herbert Pacific has knowingly allowed Chris Herbert as manager to operate the account in breach of the board's resolution and has accordingly breached its obligation to act in a fair and reasonable manner toward Jativa.

(ii) On numerous occasions Herbert Pacific through Chris and Colin Herbert has been uncooperative in supplying information as to the Company's operations when requested to do so by Jativa and the Company's accountants, KPMG Peat Marwick.

3. Jativa requires that the breaches specified above be remedied as follows,by:

(a) Herbert Pacific paying to the Company the sum of $227,835.44 to be credited to its shareholder's loan accounts.

(b) Herbert Pacific either:

(i) providing the necessary security to enable the drawdown of $400,000 from the ANZ; or

(ii) paying $400,000 in cash to the Company.

(c) Herbert Pacific co-operating with KPMG Peat Marwick and Jativa with respect to the provision of any information to ensure the proper and efficient operation, management and administration of the Company and its accounts.

4. If such defaults are not remedied within 28 days of the date of this notice, Jativa will exercise its rights pursuant to section 13 of the Agreement.

5. Jativa is aware that there may be other breaches and defaults by Herbert Pacific of the provisions of the Agreement. This notice is given without prejudice to any other rights and remedies available to Jativa whether under the Agreement, at law or otherwise."

Clauses 4.2 and 6 of the Shareholders' Agreement provide:

"4.2 Subject to clause 6.1, any further equity required by the Company shall be contemporaneously paid by each of Jativa and Herbert to the Company in equal shares and shall be applied by the Company first in paying up the balance of the unpaid share capital of the Company and secondly to the credit of an unsecured shareholders' loan account for each of Jativa and Herbert. The shareholders' loan account shall be repayable upon demand together with interest if agreed to be paid by the Company.

6. FUNDING

6.1 Funding for the business of the Company shall be provided initially by the cash subscriptions for the shares referred to in section 4. Subject to the provisions of clause 6.2, as and when the Company requires further funds the parties shall use all reasonable endeavours to obtain for the Company such funding by way of bank accommodation or otherwise as the parties consider prudent but neither party shall be obliged to provide any guarantee or security in respect thereof or to provide any further funds to the Company.

6.2 Unless otherwise agreed to in writing by the parties all funding of the Company's business activities shall be financed to a maximum of 50%."

On the footing that Herbert Pacific was in default for failing to remedy the matters specified in paras 2(a) and (b) of that notice Jativa, by notice dated 18 January 1985, invoked the procedure in the shareholders' agreement entitling the non-defaulting party at its option to purchase the shares of a defaulting shareholder in that company with the price being set by arbitration. It claimed that the arbitration was properly completed and it was entitled to acquire Herbert Pacific's shares in American Bistro. On 23 August 1995 Jativa endeavoured to effect

settlement of Herbert Pacific's shareholding by tendering a bank cheque for $159,945.23 and seeking the share certificates, share transfers, resignations and the like, but settlement was refused.

Jativa opposed the application for an interim injunction. Voluminous affidavits were filed on both sides. With exhibits they ran to some 760 pages. Williams J reviewed the evidence relating to the 2 claimed defaults in some detail. He also reviewed the evidence relating to the further defaults specified in para 2(c) of the letter of 16 December 1994 which however had not been relied on by Jativa in its later notice of 18 January 1995 invoking compulsory acquisition of Herbert Pacific's shares in American Bistro. For the reasons he gave the Judge was not prepared to hold against Herbert Pacific its delays in commencing proceedings.

Applying well settled principles Williams J considered in turn whether there was a serious question to be tried; the balance of convenience; and the overall justice of the case. The first issue, whether there was a serious question to be tried, required consideration as to whether Herbert Pacific was in default of its obligations in the respects set out in its letter of 16 December 1994. The Judge concluded that the true position as to the suggested loan imbalance remained unclear; that it had not be demonstrated that the equity contributed by Jativa as at 16 December 1994 exceeded that contributed by Herbert Pacific; that whether Herbert Pacific had used "all reasonable endeavours" to obtain bank accommodation, that being its relevant obligation under the shareholders' agreement, was a matter of disputed fact on which it was not possible to reach a clear view on the affidavit evidence alone; and that the defaults alleged in paras 2(c) (i) and (ii) had not been made out. Overall the court concluded that there was a serious question to be tried as to whether Herbert Pacific was in default of its obligations under the shareholders' agreement of 16 December 1994.

Turning to the balance of convenience, the Judge accepted that while on the evidence so far before the court it appeared that Jativa was in a stronger financial position than Herbert Pacific, that was not the end of the matter; that after a difficult start American Bistro was trading profitably, at least on a cash basis, and appeared to be honouring arrangements with its major creditors; and that to refuse an injunction would effectively require Herbert Pacific to transfer its shares in American Bistro at the price set by Mr Lane, Jativa's arbitrator. That expropriation would in turn depend on the validity of his arbitration. Since Mr Lane and Mr Wall, representing Herbert Pacific, did not in any real sense conduct an arbitration, that entitlement in turn depended on Mr Lane being entitled to embark on the reference unilaterally. There was, the Judge considered, at least an arguable case that the award failed to comply with the terms of the shareholders' agreement and the Arbitration Act 1908. But even if that were not the case the power for Jativa to appoint Mr Lane depended on Jativa having the right to issue the default notices. It followed that the balance of convenience favoured Herbert Pacific and on his overall assessment the Judge concluded that the justice of the case lay with not forcing Herbert Pacific to sell its shares in American Bistro.

The first question arising on the appeal is whether, as Mr Fardell submitted, the Judge erred in holding that there was a serious question to be tried. Mr Fardell confined his submissions in that regard to the second default as alleged in the notice of 16 December 1994. Mr Fardell's first point was that the parties had obtained banking accommodation for the provision of $800,000 from the ANZ Bank and that in not meeting the guarantee requirements in that loan agreement on its part Herbert Pacific was in breach of clause 4.2. In short, it was not a reasonable endeavours situation to which clause 6 still applied. The short answer is that the default was pleaded in the letter of 16 December 1994 by reference to clause 6.1. Jativa was asserting default under the contract and specified the default in para 2(b) beginning "Clause 6.1 of the agreement provides that where the Company requires further

funds the parties shall use all reasonable endeavours to obtain such funding by way of bank accommodation." Para 2(b) goes on to refer to the agreement to acquire funding from the ANZ Banking Group; to Jativa's compliance with its obligations under the loan offer; to Herbert Pacific having not provided adequate total security to enable the drawdown of the remaining $400,000; and to Herbert Pacific having advised that rather than providing the requested security to ANZ to enable that drawdown Herbert Pacific would advance $400,000 in cash to the company but, the paragraph continued, to date such money had not been paid to the company. Clearly the default alleged in para 2(b) is directed to non-compliance with clause 6.1 - just as the default alleged in para 2(a) is directed to non-compliance with para 4.2.

Mr Kirkland for Herbert Pacific for his part submitted that the agreement to find $800,000 could be construed as a separate agreement between shareholders wholly outside the terms of the shareholders' agreement to which, accordingly, the default provisions of the shareholders' agreement cannot attach. He noted that in all correspondence between the parties both had referred to the agreement as being an agreement between Jativa and Herbert Pacific and not a company call for further funds such as is contemplated by clause 6.1 of the shareholders' agreement.

It was not argued before Williams J that the agreement to fund $800,000 was outside clause 6.1 altogether. Jativa and Herbert Pacific were the only shareholders in American Bistro. Mr Mahon and Mr Herbert could bind their companies and together could bind American Bistro. In his affidavit Mr Herbert relied on the steps he took as satisfying the reasonable endeavour obligations in clause 6.1. It would be unduly technical to give any weight to Mr Kirkland's submissions in this respect.

That brings us to the question of whether on the material before the court there is a serious question to be tried as to whether Herbert Pacific failed to meet

the reasonable endeavour responsibilities under clause 6.1. As to that, Mr Herbert in his affidavit said:

> "In or about September 1994 it was agreed between Jativa and HPL that both parties would take steps to each provide security to enable $800,000.00 working capital be available to HPL.
>
> It was further agreed that both Jativa and HPL approach the ANZ Banking Group (New Zealand) Limited to arrange a facility of $800,000.00 (each to provide security for $400,000.00).
>
> I entered into negotiations with the ANZ Bank on behalf of HPL and arranged for a second mortgage over a Dunedin property to be offered as security.
>
> My estimate of value in respect to that property was $1.2 million but, the ANZ valuation for mortgage purposes was $900,000.00 and the first mortgagee would not consent to the priority sum sought by the ANZ Bank.
>
> Hence, this arrangement founded.
>
> 23. THROUGH another business association I attempted to arrange security to enable ABL to drawdown $400,000.00 by offering certain redeemable preference shares to the ANZ Bank (as security). This offer was not accepted.
>
> 24. THE ANZ Bank virtually requested a deposit equal to the advance be lodged with it before it would approve a drawdown of $400,000.00. It seemed to me, I should attempt to find cash as the interest differential on "frozen" funds was not satisfactory.
>
> 25. AS at the date of the default notice (16 December 1994) HPL had been and was still taking positive steps and using all reasonable endeavours to arrange further capital for ABL.
>
> On behalf of ABL further enquiry and negotiation was made with:
>
> a. ANZ Bank;
> b. Auckland Savings Bank;
> c. BNZ Bank,
>
> with a view to providing further capital."

The reference to "September 1994" is clearly an error. The ANZ Bank letter offering accommodation on terms and agreed to by Mr Mahon and Mr Herbert was dated 30 May 1994. To complete the factual narrative we should add 2 further comments. The first is that a supporting security in respect of Herbert Pacific's commitment was changed by agreement between Herbert Pacific and the Bank in August 1994 from a second registered mortgage over a Dunedin property to a lien over Dorchester Finance Limited debenture stock with a face value of $200,000. The term deposit lien of $200,000 referred to in the original Bank offer also never materialised. The second is that prior to receipt of the default notice of 16 December 1994 Herbert Pacific had taken steps to arrange a guarantee from a Mr Valentine which Herbert Pacific hoped would be acceptable to the Bank and an offer of guarantee, which however was not acceptable to Jativa, materialised on 30 January 1995 after expiry of the 28 days given in the notice of 16 December 1994 to cure the default.

In the end we have concluded that the Judge has not been shown to have erred in his assessment that whether those efforts satisfy the reasonable endeavours test in the circumstances is a matter of disputed fact on which it is not possible to reach a concluded view on the affidavit evidence alone.

In practical terms that conclusion disposes of the appeal and it is unnecessary to consider the balance of convenience and overall interests of justice arguments. This is because Mr Fardell accepted that Jativa could not pursue the existing or a fresh arbitration process to fix the value of Herbert Pacific's shares in American Bistro while there was a dispute as to whether default had occurred and had not been timeously cured so as to trigger the right of compulsory acquisition of the shares. But the order of the High Court should be amended to make it clear that it is restricted to the defaults relied on in the notice of 16 December 1994. It will accordingly be amended by the addition of the words "pursuant to the notice given

on 16 December 1994". That will allow Jativa, if so advised, to issue a fresh notice relying on clause 4.2 rather than clause 6.1 in respect of the $800,000 accommodation, and on any other defaults alleged against Herbert Pacific. Of course if the grounds on which any fresh notice are based are disputed the compulsory acquisition of Herbert Pacific's shareholding in American Bistro cannot proceed in the absence of an affirmation finding of default.

Subject only to that modification of the interim injunction the appeal is dismissed with costs to the respondent in the sum of $3,500 together with all reasonable disbursements as fixed by the Registrar including the travel and any accommodation expenses of one counsel.

Solicitors
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