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M2LR

IN THE HIGH COURT OF NEW ZEALAND 2/6
AUCKLAND REGISTRY

CP 2455/89 & CP 111/94

593

BETWEEN	EQUITICORP INDUSTRIES GROUP LTD (IN STATUTORY MANAGEMENT) & Anor	
	Plaintiffs	
AND	THE CROWN	
	12th Defendant	
AND	EQUITICORP AUSTRALIA LTD	
	14th Defendant	

LOW PRIORITY

Counsel: J A Farmer QC, Ms H Winkelmann for plaintiffs

Arthur Tompkins and Ms K L Clark for 12th defendant

P F A Woodhouse, N Manousaridis and Ms A C Challis for 14th defendant

Hearing: 19 May 1995

Date: 22 May 1995

JUDGMENT NO 35 OF SMELLIE J
REGARDING PARAGRAPHS 23, 40(a), 54, 61, 65, 81, 82, 90, 94 AND 149 OF MR FISCHL'S STATEMENT OF EVIDENCE

Introduction

Mr Fischl commenced reading his brief of evidence on 18 May. This is the second judgment to be delivered on questions of admissibility in relation to this evidence.

Judgment 34 addressed the question of whether a competent accountant's view that matching value is required before repayment is established should be admitted in evidence, the objection being that what was being stated was a matter of law and trenched on the ultimate issue to be decided by the Court. For the reasons given in Judgment 34 I ruled that the evidence could be adduced.

Mr Fischl having progressed to paragraph 23 of his statement, Mr Farmer on behalf of the plaintiffs has raised another objection. The paragraphs objected to are set out in the heading to this judgment. Mr Farmer submits that in those paragraphs Mr Fischl is saying that a competent accountant would look for the substance of the transaction (ie the financial and economic reality of the same) rather than, or not merely, its legal form. In a number of the paragraphs mentioned, the word "sham" is used.

For the plaintiffs, Mr Farmer submits that the witness cannot address the question of whether the transactions are shams or not. First because Mr Woodhouse has expressly disavowed that contention and secondly because the issues between the plaintiffs and EAL which take the place of pleadings, do not refer to such a contention.

The Material Referred to in the Preparation of this Judgment

In addition to the arguments addressed by counsel, I have gone back to my benchnote on 30 March 1995 which will be found at p 3781 of the

Realtime record. It commences by referring to discussions between Bench and counsel on the preceding 16 pages (3764-3800 inclusive). The benchnote dealt with a situation where objection had been taken to the line of cross-examination by Mr Woodhouse on behalf of EAL of the plaintiffs' witness Mr Paton. Because of Mr Paton's long and extensive involvement with Equiticorp both as an employee originally and subsequently retained by the Serious Fraud Office and the Statutory Managers, he can be regarded as an expert on the documentation. Four lines into the benchnote, the following is found.

> "Particularly in the early part of the afternoon, there will be found Mr Farmer's protest that neither in opening nor in issues was it suggested that any of the transactions were shams in the sense that they were not what they appeared to be but rather that what was attacked there was whether or not there was any real value, any return of moneys advanced, and whether or not what had occurred amounted to novation."

The benchnote further records that Mr Woodhouse indicated at that stage that the word "sham" was inappropriate, and he withdrew it. I then recorded that EAL would be held to its issues unless they were amended.

Looking back over pages 3764 to 3800 I am satisfied that Mr Farmer very clearly indicated that he wanted to know precisely where he stood on the sham allegation. I refer particularly to p.3779 between lines 10 and 20.

The matter was revisited on 31 March to see whether EAL wished to avail itself of the opportunity to amend its issues. I was advised that the issues would be amended and they were filed some time later on 13 April. I have again looked carefully at those issues. They do not herald an argument based upon the proposition that the legal form of the transactions in question does not represent their true substance.

I interpolate to say that on 31 March there was some discussion as to the rigidity of the issues and the extent to which, in the peculiar circumstances of this case they should be regarded as pleadings. But I have no doubt that, if at that time, it was intended to lead evidence of the kind advanced in the paragraphs referred to above, that should have been clearly and explicitly spelt out in the issues.

Submissions of Counsel

Mr Farmer's basic submission was that arguments as to whether the legal form of the transactions represented their true substance and whether or not the transactions themselves could be described as contrived or artificial or shams, were irrelevant, because those contentions had been disavowed by counsel for EAL and there was no reference to them in the issues.

Because the Court in the first instance was rather unreceptive of Mr Farmer's argument he found it necessary to advance supplementary arguments to persuade me that the point he was making here was different to those which are discussed in my Judgment No.34. But those submissions were really for the purpose of clearing away misconceptions in the mind of the Court about the relevance point, which is the substance of the objection.

The objection was responded to in the first instance by Mr Manousaridis. His submissions were to the effect that the witness was entitled to give the evidence in the paragraphs challenged. With respect, I am not sure that counsel fully appreciated that Mr Farmer's argument was that such evidence could be given if it was relevant, but that it was <u>not</u> because of the earlier disavowal and the absence of reference in the issues.

When by consent Mr Woodhouse took the argument over, he made three points. The first was, (and I quote him):

> "That EAL is not contending that the transactions, which are reflected in the journal entries, constitute shams."

Secondly, he submitted that the argument that had been addressed to me on the paragraphs in question here, had already in substance been dealt with by my earlier Judgment, No.34.

Thirdly, although acknowledging that the use of the word "sham" and expressions such as "artificially contrived" "may have connotations of EAL going back to a contention which is expressly disavowed" that that was not what was being done. But rather that the evidence was directed to a thorough investigation of the transactions in question. Counsel perhaps sought to sum it up at p 5682 between lines 7 and 10 when he said:

> "The Court needs, with respect, (in effect to address the issue of value which has already been the subject of argument)... substance is another way of expressing the same thing."

Counsel argued that rather than striking portions out of the brief, the better course would be to allow supplementary questions in chief to enable Mr Fischl to explain what precisely he means when he talks about looking at the substance or financial and economic reality of the transaction as opposed to its mere legal form.

Is this Objection covered by Judgment 34?

The answer is no.

It is true that in submissions made in support of the objection which led to Judgment 34, Mr Farmer did raise the "sham" objection in respect of paragraph 61 on a stand-alone basis, but it was very much a subsidiary issue and was not addressed in Judgment 34. The other paragraphs, the subject of this objection, were not referred to by either counsel in the earlier argument.

Substance rather than Form/Sham

The starting point of the problem is to be found in paragraph 23 of Mr Fischl's statement of evidence which reads as follows:

> "Furthermore, the competent accountant, having decided that further investigation was warranted, would be concerned to investigate the substance of the transaction in order to reflect its commercial reality in the accounts rather than the simple legal form. The doctrine of substance over form is found in:
>
> Australian Accounting Standards AAS 6 (which was re-issued in April 1986)
>
> > 'transactions and events should be accounted for in accordance with their financial reality and not merely with their legal form'
>
> New Zealand Statement of Accounting Practice No.1 SSAP - 1 (which was issued in November 1975 and revised in December 1983):
>
> > 'transactions and other events should be accounted for and presented in accordance with their substance, that is their financial and economic reality, and not necessarily in accordance with their legal form'
>
> Accounts must be presented in accordance with the relevant accounting standards. It follows, therefore, that further investigation of the transaction would be necessary before accepting the transaction at its face value."

The narrative of the paragraph and the two quotes from what appear to be standard sources for Australian and New Zealand accounting practice were

compared by Mr Farmer with the statement by Richardson J on the nature of a sham to be found in ***NZI Bank Ltd v Euro-National Corporation Ltd*** [1992] 3NZLR 528 at 539 between lines 30 and 49, set out hereunder:

> "The legal principles are well settled. First the true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. It is not to be determined by an assessment of the broad substance of the transaction measured by the overall economic consequences to the participants. The forms adopted cannot be dismissed as mere machinery for effecting other purposes. At common law there is no half-way house between sham and characterisation of the transaction according to the true nature of the legal arrangements actually entered into and carried out. A document may be brushed aside if and to the extent that it is a sham in two situations. The first is where the document does not reflect the true agreement between the parties in which case the cloak is removed and recognition is given to their common intentions. The second is where the document was bona fide in inception but the parties have departed from their initial agreement while leaving the original documentation to stand unaltered. Once it is established that a transaction is not a sham its legal effect will be respected. For recent discussions in this Court it is sufficient to refer to ***Re Securitibank Ltd (No.2)*** [1978] 2 NZLR 136, ***Buckley & Young Ltd v Commissioner of Inland Revenue*** [1978] 2NZLR 485; ***Marac Finance Ltd v Virtue*** [1981] 1 NZLR 586; ***Mills v Dowdall*** [1983] NZLR 154; and ***Marac Life Assurance Ltd v Commissioner of Inland Revenue*** [1986] 1NZLR 694."

Counsel submitted that in that authoritative review of the circumstances under which the legal form of a transaction can be set aside, because it is sham, is to be found the substance of the two accounting statements relied upon They clearly address, (as does the case cited), the distinction between financial reality (substance) on the one hand and legal form on the other.

Having introduced the concept of substance and form in paragraph 23, Mr Fischl comes back to it in each of the other paragraphs to which objection is taken.

Plaintiffs' objection upheld

Despite Mr Woodhouse's argument on his third point, I am of the clear view that the attack that is sought to be made in the paragraphs objected to, was not heralded in EAL's opening. Furthermore, after the matter had been the subject of a full debate on 30 and 31 March, and the "sham" allegation was expressly withdrawn, the issues that were filed on 13 April gave not the slightest hint that this line would be taken.

The plaintiffs in my view were entitled after Mr Woodhouse's disavowal, and certainly when the issues were filed, to rest satisfied that any issue of sham in the sense of substance displacing legal form, was not part of EAL's case.

The plaintiffs' objection is therefore soundly based, and if EAL's issues remain as they are and Mr Woodhouse maintains his stance that "sham" is not alleged, then all the paragraphs objected to will be ruled inadmissible and removed from the brief. Furthermore, evidence by way of supplementary viva voce questions which seeks to elicit from Mr Fischl what he meant by the use of the words "sham" "artificially contrived" etc and the significance he sees between substance and legal form, will not be allowed.

EAL to be given one final opportunity to reconsider

If as Mr Fischl's statements in the paragraphs challenged suggest EAL wants to be in a position ultimately to argue that the Court should look at

the financial and economic reality of the transactions rather than at their legal form, and that some or all of the transactions are "contrived", "artificial", or "shams" then that must appear clearly in the issues.

As earlier mentioned, on 31 March there was some debate about the status of the issues which also touched on whether leave is required to amend issues and whether such leave could have conditions attaching to it. I do not propose to allow technical arguments of that kind to stand in the way of getting this matter out in the open and tidied up once and for all. EAL must now declare clearly and unequivocally where it stands.

If EAL wishes to amend its issues, the amendment or additions must be produced promptly in writing. If such amendments or additions to the issues are forthcoming, I will then hear the plaintiffs in relation to anything they wish to submit about whether such amendments should be permitted, and if they are, the flow on consequences that result.

Advance Notice of this Judgment No.35 before the Judgement itself issued

This Judgment was under preparation over the weekend of 20-21 May and it was not anticipated it would issue until late on 22 May or possibly 9 am on 23 May. Counsel were advised of the result before the Judgment itself issued. That procedure enabled decisions to be made regarding adjournment while EAL considered its position and how the matter would proceed thereafter when it was indicated that amendment to the issues would be sought.

Costs

The plaintiffs will have the costs of the argument on Friday 19th, and the further time lost on Monday 22nd. Those costs will be payable in any event, and irrespective of the final outcome of the litigation as between the plaintiffs and EAL. Other costs that may arise, consequent upon any amendments or additions which are allowed will be addressed, if necessary, once I have heard from the plaintiffs.

I should also record that Mr Tompkins for the Crown indicated neutrality with a "mild support" of the plaintiffs' position. It may be that the Crown will also consider that it has a claim for costs as a result of the delay so far, and further delay which may eventuate. I make no order in that regard at this juncture, but I reserve leave to the Crown to raise the matter if it wishes to.

Robert Smellie J.

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R P Smellie J