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IN THE HIGH COURT OF NEW ZEALAND M 428/97
AUCKLAND REGISTRY

IN THE MATTER of the Companies Act 1993

A N D

IN THE MATTER of Abbotts Way Holdings Limited

LOW PRIORITY

BETWEEN: **R C LEONI, J LEONI and G R McCOMB**

First Plaintiffs

AND: **G R McCOMB and M R WINGER**

Second Plaintiffs

AND: **P M MAXWELL, I N MARGAN and M J MAXWELL**

First Defendants

AND: **WINDANSEA INVESTMENTS LTD and MAXWELL & FRIENDS LTD**

Second Defendants

AND: **ABBOTTS WAY HOLDINGS LTD**

Third Defendant

Date of Hearing: 26 September 1997

Counsel: P J O'Toole for Plaintiff
P R Cogswell for Defendants

Date of Judgment: - 6 OCT 1997

RESERVED JUDGMENT OF PATERSON J

Solicitors:
Holmden Horrocks, DX BX 10626, Takapuna for Plaintiff
Hesketh Henry, DX CP 24017, Auckland for Defendants

The applications before me in this proceeding are ongoing steps in a dispute between two parties to a joint venture operated through a company (the third defendant). Both parties complain of the actions of the other party. The plaintiffs (the Leoni Group) complain that the first and second defendants (Windansea and Maxwell) are operating the third defendant (Abbots Way) for the benefit of Windansea and Maxwell to the detriment of the Leoni Group. On the other hand, Windansea and Maxwell complain that the Leoni Group wishes to place Abbots Way in liquidation because that group will benefit more than Windansea and Maxwell from such a liquidation. To date, both parties have taken actions which appear to be in their interests rather than in the interests of the company or the joint venture. It is inappropriate to make final factual findings at an interlocutory stage but it is appropriate to observe that the parties, having chosen to operate through a corporate structure, place themselves under the provisions of the Companies Act 1993 (the Act). If necessary, this Court will utilise the provisions of the Act to maintain the status quo, as best it can, pending the substantive hearing to resolve the outstanding issues.

The background to this matter is set out in my judgment of 4 June 1997 when an interim injunction was granted albeit in a very much modified form from that originally sought. The applications before the Court at this hearing are -

(a) An application by the Leoni Group to restrain the directors of Abbots Way from

  (i) Allowing Abbots Way to make principal payments in reduction of its loan to Windansea and Maxwell;

  (ii) Allowing payment of Hesketh Henry's legal fees and disbursements relating to these proceedings being made by Abbots Way;

(iii) Approving Messrs I N Margan and P M Maxwell as joint managing directors of Abbots Way;

(iv) Appointing Hesketh Henry to represent Abbots Way.

(b) If the Leoni Group is successful in obtaining the orders sought in sub-paragraphs (a) (i) and (ii) an order is sought directing Windansea and Maxwell and the parties associated with them to refund principal and legal fees already paid;

(c) An application by the Leoni Group for costs on an application for further and better discovery;

(d) An application by all defendants seeking directions as to further funding of Abbots Way. In effect, this application seeks an order that Abbots Way give a debenture to Windansea and Maxwell to secure further advances to the company.

Although it is unnecessary to traverse the background in detail at this stage, it is noted that Windansea and Maxwell control more than 50% of the capital in Abbots Way, and that the articles provide for the exercise by the chairman of the company of a casting vote. As a result, resolutions of the directors are passed on the casting vote of Mr Margan. Thus, while both the Leoni Group and the Windansea and Maxwell interests have an equal number of nominees on the board of directors of Abbots Way, the Leoni Group's appointees can be and are often over-ridden by the casting vote of Mr Margan. Whether the directors are acting in good faith and the best interests of the company or whether they are entitled to do what they are doing pursuant to the constitution of Abbots Way when interpreted against the provisions of s131 of the Act, cannot be resolved on this interlocutory application. Most of the applications before the Court today arise because of the exercise by Mr Margan of his casting vote or because of the

differences between the two groups. It is unfortunate that the groups are unable to work together for their mutual benefit and that obvious distrust exists between them.

Principal Repayments

The loan due by Abbots Way to Windansea and Maxwell arose from the financing of the purchase by Abbots Way of the complete share capital of Golf Today. It is the latter company which owns the property which the joint venturers propose to develop as a retirement village. The purchase price of the shares in Golf Today was $3.5 m. which was funded as to $2.5m. by the Windansea and Maxwell interest and bank borrowings of $1 m. (the bank also provided a facility of $600,000 for working capital). Windansea and Maxwell borrowed the sum of $2.5 m. and there was an agreement that they would receive interest on their contribution. Mr Leoni had the rights to purchase the shares in Golf Today and at the time of the purchase it was assessed that the land owned by Golf Today was worth approximately $4.8 m. The difference between this value and the price of $3.5 m., namely, $1.3 m., was assessed as Mr Leoni's interest in the venture. He contributed no cash and in effect, $75,000 was paid to him and deducted from his assessed interest of $1.3m. In January 1996, portion of the funds provided by Windansea and Maxwell was capitalised as was Mr Leoni's outstanding interest which was taken in the name of the Leoni Trust. Thus, each party had capital of slightly less than $1.3m. in Abbots Way and there remained an outstanding loan account of approximately $1.2m. due to Windansea and Maxwell. Until October 1996, Abbots Way paid to Windansea and Maxwell the sum of $20,208 a month and although those payments stopped in October 1996, they have obviously recommenced at a later date. There is a dispute between the parties as to the rate of interest payable by Abbots Way on this loan and the amount on which it is to be paid. Windansea and Maxwell allege

that they are entitled to interest on both the outstanding principal and the loan and the portion which they capitalised. While this seems both illogical and inequitable, I cannot discount that this may have been the agreement between the parties because the Leoni Group has in fact contributed no cash to the venture.

The dispute which is now before the Court arises because the monthly sums of $20,208 have evidently recommenced recently and the Leoni Group say that this payments include principal and such payments are not permitted in view of the interim injunction granted to them on 4 June 1997. There are two issues -

(a) Are Windansea and Maxwell entitled to principal repayments on their loan in view of the terms of the injunction? and

(b) Are the payments principal in any case?

It was my intention when granting the injunction on 4 June 1997 to restrain principal payments being made to Windansea and Maxwell. I acknowledge that this was not expressly stated in my judgment but was implied when I authorised payment of ongoing expenses including interest due to Windansea and Maxwell. If Windansea and Maxwell have treated the payments received as part of their payment of principal, it is surprising that they have not sought clarification of the position in view of the statements of the earlier judgment.

On the question of whether or not Windansea and Maxwell are entitled to interest on the total amount contributed by them, there is a disagreement. It is unfair to the Leoni Group to enable interest to be taken with the consequential effect that it has on the ability of Abbots Way to pay its other expenses, if there is no such right. On the other

hand, if there is such a right, it is disadvantageous to Windansea and Maxwell to disallow them that interest in the interim if they are in turn paying interest on borrowings. I am influenced in the orders which I intend to make in this respect by the fact that Windansea and Maxwell are on the one hand, saying that they are entitled to the money and that it should therefore be paid to them but on the other hand, are then prepared to lend large sums of money back to the company on a secured basis. Their claim to the monthly payments is not on the basis of a requirement to pay it to the financiers but on the basis of an alleged entitlement which in part is disputed. On the evidence before the Court they will not be financially embarrassed if they are restrained from taking both principal payments and interest on the capitalised amount. If it is subsequently established that they are entitled to this amount then on the information before me, there will still be security in the assets of Abbots Way to enable payment to be made.

Hesketh Henry

The Leoni Group seeks to prevent payment of Hesketh Henry's legal fees by Abbots Way and to obtain an order preventing Hesketh Henry from representing Abbots Way. There are related but discrete issues. The payment issue relates to fees which on the evidence before the Court must include fees which are payable either by the first defendants in their personal capacity or Windansea and Maxwell as second defendants in their capacity as shareholders of Abbots Way. Some portion of the fees may have been incurred by Abbots Way. Under clause 63 of Abbots Way's constitution, Abbots Way is authorised to indemnify a director for any liability or costs for which a director may be indemnified under the Act. Under s62 of the Act, Abbots Way may indemnify a director for any costs incurred by him in any proceeding that relates to liability for any act or

omission in his capacity as a director and in which judgment is given in his favour. Further, it may indemnify a director in respect of liability to any person other than Abbots Way for any act or omission in his capacity as a director or any costs incurred by that director in defending any claim or proceeding relating to any such liability. Windansea and Maxwell say they are entitled to have their costs paid under these provisions. I am not satisfied that this is completely correct and note in respect of one of the indemnities, it is necessary for there to have been a judgment in their favour. Further, the indemnity does not extend to costs which have been incurred by a shareholder of the company as distinct from a director.

If Windansea and Maxwell are correct in their argument, then there is an argument that the company should also pay the costs of the Leoni Group. The effect of the costs paid and proposed is that a sizeable sum of money will be paid by Abbots Way to Hesketh Henry and it will then be necessary for Abbots Way to borrow further money from Windansea and Maxwell at interest to pay other expenses of Abbots Way. Windansea and Maxwell through the directors and Mr Margan's casting vote, are obtaining for themselves a benefit to which they may not be entitled. I intend to maintain the status quo and make an appropriate order restraining payment of any legal costs by Abbots Way other than costs which are directly incurred by it.

The second issue is whether this Court should restrain Hesketh Henry from continuing to act for the Windansea and Maxwell interests in their dispute with the Leoni Group. One of the reasons put forward by the Leoni Group in support of its application is that there is no evidence of any resolution passed by the directors appointing Hesketh Henry to represent Abbots Way. I do not intend to resolve this issue at this stage but observe

that it is unlikely in a private company that the lack of a resolution would in itself be sufficient to debar Hesketh Henry from acting for Abbots Way. The other issue raised, and I understand raised for the first time at the hearing and not referred to in earlier correspondence or in the notice of application, was that by acting, Hesketh Henry is in breach of certain provisions of the New Zealand Law Society Rules of Professional Conduct for Barristers and Solicitors. If they are, that is a matter for Hesketh Henry. As I see the position, this Court should only consider intervening if there is an obvious conflict of interest situation and the Leoni Group suffers as a consequence. Even if this is the situation it may be more appropriate for the Leoni Group to institute an action against Hesketh Henry for damages. On the evidence before me I am not prepared to restrain Hesketh Henry from continuing to act. Firstly, I am not satisfied that there is an arguable case of sufficient strength to prevent them from acting and secondly, if there is an arguable case, the balance of convenience in this case would not be exercised against Windansea and Maxwell. This is a dispute basically between two groups of shareholders who have used Abbots Way as the vehicle for a joint venture. It is inevitable that Abbots Way will be in some respects involved in the litigation. If Windansea and Maxwell have used this situation to their advantage, and I have no evidence that they have, then this is a matter which can be dealt with by way of damages or compensation at the substantive hearing.

Joint Managing Directors

The appointment of joint managing directors is governed by clause 59 of Abbots Way's constitution. The directors have power to appoint one or more of their directors to this office. I see no reason why the Court should intervene in this appointment at this stage. If, as the Leoni Group contends, the appointment is unnecessary or if it has the result of

Abbots Way paying remuneration for services which were either unnecessary or which were not rendered, then this is a matter for the substantive hearing.

Refund of Payments

While I propose to make certain orders in respect of future payments I do not propose to make orders for refund of payments already made. If these payments should not have been made then this is a matter which can be adjusted at the substantive hearing between the parties. There is nothing before me which would suggest that Windansea and Maxwell both through its interest in Abbots Way and from other sources, does not have the capacity to make any cash adjustment if it is necessary to do so because of payments already made. If the payments made have impacted adversely on the cash position of Abbots Way, and those payments are ultimately found to be unjustified, then there will be capacity to make an appropriate adjustment in damages including interest.

Discovery

This is a relatively inconsequential matter which I do not propose to resolve at this stage. I go no further than to say that it does appear from the evidence that when costs are finally settled, there should be an allowance for the Leoni Group of a modest amount, say $350, because of Windansea and Maxwell's defaults in complying with discovery.

The Debenture

The debenture which Windansea and Maxwell wish to have Abbots Way execute, when initially submitted, was for an amount of $150,000, was security for past advances and was also on demand. It was quite unrealistic to expect the Leoni Group to sanction a

debenture in this form as it is quite unrealistic to expect a Court to order that such a debenture be executed. This is one of the actions which has led the Leoni Group to suspect that Windansea and Maxwell are using the present circumstances to endeavour to obtain rights to which they are not entitled under the joint venture agreement. At the hearing, Mr Cogswell conceded that Windansea and Maxwell were prepared to undertake that if a debenture is executed, no enforcement steps will be taken under it until the resolution of the substantive issues between the parties and that the debenture would not cover past advances. As already noted, it is a bit ironical that Windansea and Maxwell wish to take $20,208 a month from Abbots Way because they are entitled to it but then wish to lend funds back to the company on a security which would give them greater rights than to which they are entitled.

I can find no authority which would give this Court power to order that the company execute a debenture unless it be s174 of the Act. The Leoni Group brought its proceedings under this section and there may be power under that section to make the order but I express no view on this point at this stage. In my opinion it is not appropriate to make an order at this stage. There are two reasons for this. First, I am not satisfied as to the need for the funds in view of Windansea and Maxwell's position of wanting money out of the company but being prepared to put it back on security. Because of the orders I propose to make there may not be the same need to borrow money. Secondly, I would need to see the form of security proposed and although the proposed debenture was not before the Court, there was sufficient evidence of it for me to conclude that it was not in an acceptable form.

I note however that if Abbots Way does need money to continue, it may well be appropriate for those funds to be advanced by Windansea and Maxwell and in view of the Leoni Group's inability to contribute funds, it may also be appropriate for security to be given for such further advances. That security however should not give Windansea and Maxwell any rights to exercise it prior to the substantive hearing. If funds are necessary and the Leoni Group is not prepared to agree to a security on reasonable and appropriate terms, then leave is given to Windansea and Maxwell to make a further application to this Court for appropriate orders. If this is necessary a cashflow statement, a summary of the reasons for the need for the funds and a form of the proposed security should be submitted to the Court.

Orders

(a) Abbots Way is restrained from the date hereof from making any further payments to Windansea and Maxwell in respect of funds contributed by that company with the exception that it may pay interest at a rate of 10% on that portion of its initial advance which has not been capitalised and may also pay interest at an appropriate rate on any funds which are after the date hereof, advanced to it by Windansea and Maxwell. An appropriate rate will be, either Windansea and Maxwell's actual costs of borrowing the said money which it then on lends to Abbots Way or if it does not borrow such money, the rate of 10% per annum.

(b) Abbots Way is restrained from the date hereof from paying any legal costs other than those which it itself has incurred for services rendered to Abbots Way.

(c) Costs on this application are reserved.

B J Paterson J