IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2008-404-4757

UNDER	The Fair Trading Act 1986
BETWEEN	FRESH DIRECT LIMITED Plaintiff
AND	J M BATTEN AND ASSOCIATES First Defendant
AND	RAYMOND KEITH BATTEN Second Defendant

Hearing: 6 April 2009

Appearances: Mr Turner for plaintiff
Mr Lawless for defendants

Judgment: 8 April 2009 at 4.30 p.m.

JUDGMENT OF ASSOCIATE JUDGE DOOGUE

This judgment was delivered by me on
***08.04.09 at 4.30 pm**, pursuant to*
Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date……

Counsel

L J Turner, Old South British Chambers, Auckland
Shieff Angland, P O Box 2180, Auckland

Background

[1] The plaintiff sues the defendants for loss to it and a related company, which was the parent company of the plaintiff, suffered as a result of engaging the defendants as its accountants. I shall refer to the parent company, J and P Turner Ltd, as "J and P Turner". The plaintiff says it suffered loss as a result of negligent accounting services that the defendants provided. In particular, the plaintiff says that in August 1999, acting on the advice of the defendants, the plaintiff put in motion changes to its shareholdings. The effect of the changes in the shareholdings was that tax losses accumulated by the plaintiff to 31 March 2000 were no longer available to the plaintiff. Those losses up until 31 March 2000 totalled in excess of $2,600,000.

[2] The plaintiff, as it happened, did not make any profits until the financial year 2006. As that was the first year when a profit was earned, it was also the first year when losses that might have been carried forward could have been applied to reduce the taxable profit earned by the plaintiff. Because the losses up until the year 2000 were no longer available, to the extent that the plaintiff could not apply those losses for tax reasons, it has suffered a loss.

[3] At some point Mr Batten, a principal of the first defendant and the accountant who actually provided advice to the plaintiff, became aware the problem had arisen as a result of the changing shareholding in the holding company. Mr Batten notified the plaintiff of the problem at a meeting on 26 July 2005. He tabled a document, which is now in evidence. That document analysed the shareholding changes from 1999 and analysed their effect, which was that the tax losses would no longer be available.

[4] Thereafter, he and his fellow defendant notified their insurer on 1 August 2005. Later that month the insurers obtained a report from specialist taxation advisors, NSA.

[5] It was not until December 2006 that anything approximating a claim was made by the plaintiff on the defendants. That month, J and P Turner wrote to the

defendants describing the consequences of the change of shareholding as a 'major concern'. In the letter, it said that the losses will 'cost us in the vicinity of $500,000 together with any penalties imposed on us by the IRD'.

[6] On 12 December 2006, the defendant replied to J and P Turner advising that they had insurance but had not made a claim at that point. In the letter it was suggested that voluntary disclosure be made to the Inland Revenue Department and that:

> … depending upon the outcome, then we would be in a position to judge whether or not to file a claim with the Insurers.

[7] On 7 April 2007 J and P Turner wrote to the defendants again summarising the problems that were likely to flow from the 1999 changes to the shareholding arrangements and stating the following:

> Our loss due to not being able to carry forward the tax losses is in excess of $500,000 and we have been advised to make a claim against J M Batten and Associates for this loss, together with any other costs and penalties that we incur.

[8] Less than a week later the defendants' insurer engaged solicitors to act for it on the claim. Proceedings were eventually commenced against the defendants on 25 August 2008. In the course of those proceedings the defendants gave discovery. The plaintiff was not satisfied with discovery and filed an application dated 20 November 2008 which sought orders in the following terms:

> 1. Setting aside the claim to privilege at 3.1 of the Schedule to the defendants' Affidavit of Documents sworn on 1 October 2008 (**"Defendants' Discovery Affidavit"**) in respect of communications which are not between the defendants and their legal advisors made in the course of and for the purpose of the defendants obtaining professional legal services or the provision of such services.
>
> 2. Setting aside the claim to privilege for the document listed at 3.3 of Schedule to the Defendants' Discovery Affidavit.

[9] The relevant parts of the affidavits of documents which the application refers to are now set out:

Doc No	Date	Doc Type	Description	Category
3.1	5.4.07-	C/O	Correspondence between the defendants, their insurers, insurance brokers and SA or any of them	P1
3.3	18.8.05	C	L NSA to QBE	P4

[10] The description of the documents in 3.1 is self-explanatory. The document referred to at 3.3 is a copy of the letter from NSA, the taxation specialists, to the defendants' insurers, QBE.

[11] The plaintiff has narrowed down what documents are the subject of the application. The documents at issue are described in more detail from paragraph [22] onwards.

[12] The grounds upon which the defendants now justify non-discovery of the documents are essentially those contained in section 56 of the Evidence Act 2006 ("the Act"), to which I make further reference below.

[13] I should mention that the defendants made some reference to s 54 of the Act, which relates to communications with legal advisors but I agree with Mr Turner that s54 does not seem to have much relevance in this case. The reason for that observation is that the documents are communications with the professional indemnity insurance company and fall into two categories:

a) Communications directly from the defendants to the insurance company including notification of a 'circumstance'. It might give rise to a claim together with supporting documentation;

b) Communications between NSA, the accounting expert, and the insurance company dated 18 August 2005.

Issues
The law

[14] The parties agreed that the starting point for consideration is the statutory provision giving rise to the privilege, section 56 of the Evidence Act 2006. That section provides:

> **56 Privilege for preparatory materials for proceedings**
>
> (1) Subsection (2) applies to a communication or information only if the communication or information is made, received, compiled, or prepared for the dominant purpose of preparing for a proceeding or an apprehended proceeding (the "proceeding").
>
> (2) A person (the "party") who is, or on reasonable grounds contemplates becoming, a party to the proceeding has a privilege in respect of—
>
> (a) a communication between the party and any other person:
> (b) a communication between the party's legal adviser and any other person:
> (c) information compiled or prepared by the party or the party's legal adviser:
> (d) information compiled or prepared at the request of the party, or the party's legal adviser, by any other person. […] (My emphasis)

[15] The issues in this case are whether in regard to each class of disputed document:

a) The document was made with the dominant purpose of preparing for a proceeding; and

b) The defendant at the time of making the document contemplated on reasonable grounds that it would become a party to proceedings.

[16] The statutory provision apparently follows the common law as enunciated in *Waugh v British Railways Board* [1980] AC 521, and was considered by Cooke J in *Guardian Royal Exchange Assurance of New Zealand Limited v Stuart* [1985] 1 NZLR 596 where, after referring to what he described as the English dominant purpose test, he continued (at p 600):

> On the latter there is an instructive application of *Waugh v British Railways Board* by Woolf J in *Victor Melik & Co Ltd v Norwich Union Fire Insurance Society Ltd* [1980] 1 Lloyd's Rep 523. A burglary insurance policy was subject to a condition that the burglar alarm be kept in efficient working order. After a burglary a meeting took place between a representative of the plaintiffs and assessors on both sides to consider the facts bearing on whether the insurers could rely on that condition. The insurers' assessor made a report to them. Woolf J said at p 525:
>
> "It is quite clear on the facts as I have recited them that one purpose of the insurers in instructing the assessors must have been to have a report which could be used for the purpose of obtaining legal advice if that should prove necessary in the circumstances. In this case the circumstances required the report to be used for precisely that purpose. However, as I understand the authorities, and, in particular, the view taken recently by the House of Lords in the case of *Waugh v British Railways Board* [1979] 2 All ER 1169, it is not sufficient that a document should come into existence for a series of purposes, one of which is obtaining legal advice in order to establish privilege. It is necessary that the dominant purpose for which the report came into existence was for the purpose of obtaining legal advice.
>
> Assessing the facts of this particular case as best I can on the evidence which was put before me, I am quite satisfied that in this case the dominant purpose of the assessors making their report was to enable the insurers to ascertain the facts in order to come to a decision as to whether or not they should rely upon the clause of the policy in order to repudiate liability. That was the primary purpose for which the report was obtained. A secondary purpose was to obtain advice of the solicitors on the facts in the event of their deciding to repudiate.
>
> I, therefore, would take the view that the assessors' report is a document which falls within the category of documents in respect of which I have a specific application for discovery and in respect of which there is no legal professional privilege."

[17] Another passage from the judgment of Cooke J in *Guardian Royal Exchange Assurance of New Zealand* case at p 599 is helpful:

> As to the documents that we have inspected, it is evident that they have been prepared for mixed purposes. Their immediate purpose was to enable the defendant to decide whether or not to accept liability. No doubt this decision would be made after taking legal advice; indeed some of the reports were actually made to the defendant's solicitors. But that does not meant that, to adopt one of Skerrett CJ's phrases in *Laurenson v Wellington City Council* [1927] NZLR 510, they were compiled "in the bona fide belief that litigation will probably ensue". Litigation was no more than a possibility.

[18] The question of whether the documents, which are the subject of the application, were prepared for the dominant purpose of preparing for a proceeding or apprehended proceeding is essentially a matter of fact. I have examined the documents in question.

[19] In order to resolve the issue it is necessary to say something more about the terms of section 56 (1). Because that subsection is couched in the passive voice, it is not explicit who must have an apprehended proceeding in mind. It seems to me that it must be the person who seeks to invoke the privilege, or any additional person who is to be equated with that person because of a common interest in the proceedings.

[20] The next point is whether the existence of the apprehension is to be judged purely on subjective grounds or whether some element of reasonableness exists in the test for establishing whether that person in fact apprehended that there would be a proceeding. In my view, consistency between s 56(1) and s 56(2) requires that that the apprehension is held on reasonable grounds. Purely subjective grounds that are unreasonable will not suffice.

[21] Lastly, the relevant purpose contemplated by section 56(1) is not just that of the person who originated the document. The purpose of the person who 'received' the information can also be relevant. If a person is a party to litigation and invites the receipt of information that another supplies, then if the dominant purpose in seeking the information is to prepare for hearing, the information would qualify for the protection of privilege.

Consideration of the documents in question

[22] The first of the documents is a 'notification of a possible professional indemnity claim" dated 23 July 2005. The second document is a letter from MSA Limited to QBE Insurance (International) Limited dated 18 August 2005, containing advice on the effect of the changes in shareholding of the parent company. The third document is an inscription on the second document dated 22 August 2008, which is in effect an internal memorandum between employees of the insurance company.

[23] I shall deal with the application as it relates to the 2005 documents first. In order to do, it is necessary to say something additional about the factual background.

[24] Some 17 months after the date when the defendants disclosed the problem that had arisen, the directors of J and P Turner noted in a letter to the defendants of 5 December 2006 that the advice that they had been given was incorrect. However, the tone of that letter stops a long way short of amounting to a threat of litigation. There are two elements in the letter which are significant. The first is that while the writer states his conclusion that the advice given about the shareholding had been incorrect, he goes on to say that the directors were looking to Mr Batten for advice as to how to protect the interests of the company – notwithstanding that Mr Batten had apparently been the author of the problem in the first place. Moreover, the letter contained no threat of a claim. It left matters on the basis that the writer of the letter clearly expected that Mr Batten, as a trusted advisor, would suggest a way forward. Indeed, the letter is conspicuous for its restrained tone.

[25] The letter of 5 December was followed by Mr Batten's letter of 12 December 2006 in response. I have already set out a passage from that letter in paragraph [6] above. In that letter Mr Batten advised, in essence, what future steps needed to be taken would depend on how the Inland Revenue Department would respond to the voluntary disclosure that had been made. Mr Batten made the suggestion that advice be obtained from MSA Limited (and that advice apparently was accepted by the plaintiffs and J and P Turner).

[26] Even some four months later when the tone of the plaintiffs correspondence with Mr Batten was somewhat firmer, the directors still did not give notice of a claim – it seemed they were still hoping to resolve matters on an apparently consensual basis: see the letter of 2 April 2007. The tone of that letter again is one of restraint with the writer recording that he was 'very sad that we need to be writing to you in this regard'.

[27] I now return to a consideration of the elements that need to be established before the section 56 privilege can be established. The first is that the communication must have been made, received, compiled or prepared for the dominant purpose for preparing for an apprehended proceeding. Certainly, when Mr Batten completed his 'notification of a possible professional indemnity claim' on 23 July 2005, he had no grounds for apprehending that proceedings were to be issued

against him. He had, after all, made the recommendation that the parties wait and see what the response of the Commissioner of Inland Revenue would be. I assume, and have no reason to doubt, that that recommendation was made in good faith and that Mr Batten seriously expected that there might not after all be a problem between the parties. Further, I do not attach a great deal of weight to Mr Batten's deposition in his affidavit of 30 January 2009 to the following effect:

> 8. I realised that, if FDL or the Turners considered they had suffered a loss as a result of the earlier changes in shareholding, they would undoubtedly blame me for it and want to recover their losses from me. I believe there was a very real prospect that FDL would sue me.

[28] This deposition sets out Mr Batten's conclusion but does not establish any grounds for them.

[29] In considering this aspect of the application, it seems relevant to me that Mr Batten would have known of the relatively conciliatory stance being taken by the parent company's directors. Also, Mr Batten obviously hoped that there would be a favourable outcome with the Inland Revenue Department. Further, he no doubt expected his insurers to stand behind him and protect not only his interests but also those of his clients if he had made a mistake. I cannot accept that Mr Batten therefore expected in July 2005 when he filled in the claim form that it was probable that litigation was going to commence.

[30] I next consider the position of the company. In the circumstances of the present case, I assume in the absence of argument to the contrary that by operation of the doctrine of common interest, the insurance company would be able to invoke privilege arising from circumstances where the purpose of receiving the information was preparation for proceedings.

[31] However, at the point where the notification of a possible indemnity claim was made in August 2005, it seems unlikely that the insurance company would have known anything about the background circumstances. In the absence of other evidence I will assume that their first detailed information about the problems arising from the 1999 share transfer is contained in the document that originated with Mr Batten. It is therefore unlikely that at the time when Mr Batten submitted his

professional indemnity claim that the insurance company had any basis for apprehending that proceedings would come into existence, other than a generalised understanding that a certain percentage of all claims eventually ripen into Court proceedings. The insurance company would have appreciated, however, that many other claims are resolved by the claimant being successfully fended off. It cannot be uncommon that persons with claims are deflected by the reasoned arguments pointing out to them why their claim cannot succeed. In other cases, defendants and insurance companies must appreciate that they need to take a realistic attitude to settling the claim because there is no answer to it. Again, in these circumstances it could not be said that litigation is even a likely outcome. Then there will still be a further category of very small claims that the parties will not go to litigation because it simply would not be economic to do so. I accept that this claim does not fall into that category. But the point is that there is no evidence that the insurance company even knew what the quantum of the claim was at the point it received Mr Batten's professional indemnity claim.

[32] For all of these reasons, my conclusion is that the insurance company, merely because it agreed to receive a professional indemnity claim, cannot be said to have known that it required such a document to enable it to prepare for litigation.

[33] I turn next to the letter from MSA Limited (MSA), the taxation advisors. It is not clear when the report was requested but it must not have been long after the insurance company received Mr Batten's claim on 1 August 2005. The level of understanding that the insurance company had was therefore dependent upon what Mr Batten had told them in his claim form dated 23 July 2005. On its face, the claim form showed that Mr Batten took the view that if the plaintiff made taxable profits from 1 April 2005 exceeding $2,601,830.51 and up to an amount of $4,245,951.87, without incurring any further tax losses, then it will pay company tax at the rate of 33% which it would otherwise not have had to pay. Mr Batten also concluded that the company was at risk of penalties because it had completed its accounts on the basis that tax losses were available, when in fact they were not. The insurance company's understanding of the factual position had by now improved because it would have considered the report that Mr Batten had enclosed with the claim. It would have known the main features of the plaintiff's complaints. It would also

have known by this point that the claim was potentially for hundreds of thousands of dollars.

[34] It would also have known that Mr Batten, having set out all the circumstances, did not claim that notwithstanding that the mistake seemed to be his, there was a good answer to any claim that might eventually be brought against him.

[35] That, then, was the state of the apparent knowledge of the insurance company at the date when it sought the report from MSA. There was an additional document (3.1.5 in discovery) indicating that the brokers involved wrote to the defendants passing on 'queries' from the insurance company on 4 April 2005 but that document has not been produced for my inspection and I cannot comment on its contents.

[36] My conclusion is that when the insurance company received the report from MSA, it did not receive it for the dominant purpose of preparing for a proceeding or an apprehended proceeding. A reasonable party in the insurance company's position would not have apprehended that it was probable that proceedings would commence within the foreseeable future. There were simply too many contingencies and it was too early to reach a judgment on that aspect of matters.

[37] The last sentence from *Guardian* that I quoted at paragraph [17] accurately sums up the position with regard to the present application. That is, there was not present a bona fide belief that litigation would probably ensue. Therefore, my conclusion is that at the time when the MSA report was prepared, and when the insurance company received it, it was not covered by s 56.

[38] The final disputed document is the hand-written note subscribed on the insurance company's file copy of the MSA report of 18 August 2005. This document, like the other two that I have been required to examine, has been included in the affidavit of documents as a relevant document but the point has been taken that it is protected by s 56 privilege. The note was written on 28 August 2005. For the reasons that I have given elsewhere, the insurance company could not have bona fide believed that at that point litigation was probable. My conclusion is that the

insurance company is not entitled to invoke privilege under s 56 in respect of this document either.

Conclusion

[39] In my opinion, the three documents that are the subject of the plaintiff's application are not protected by privilege under section 56 of the Evidence Act 2006. The parties should confer on the issue of costs. If they are unable to agree, I will arrange time for a brief hearing to consider what costs orders ought to be made.

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J.P. Doogue
Associate Judge