

**IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY**

CIV 2008-404-002406

UNDER The Declaratory Judgments Act 1908

BETWEEN RAY & PHYLLIS DENNING TRUSTEE
LIMITED
Plaintiff

AND WATERCARE SERVICES LIMITED
Defendant

Hearing: 30 April 2009

Appearances: B O'Callahan for Plaintiff
M T Davies for Defendant

Judgment: 6 May 2009 at 11:30am

**(RESERVED) JUDGMENT OF ANDREWS J
[Defendant's application for review of order for security for costs]**

*This judgment was delivered by me on the 6th day of May 2009 at 11:30am
pursuant to r 11.5 of the High Court Rules.*

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Deputy/Registrar

Solicitors: Carter & Partners, P.O. Box 2137, Auckland
Meredith Connell, P.O. Box 2213, Auckland

Background

[1] On 3 November 2008 John Hansen J heard an application by the defendant, Watercare Services Limited (Watercare) for an order that security for costs be given by the plaintiff, Ray & Phyllis Denning Trustee Limited (Denning). Denning did not dispute that security should be given, or that \$100,000 was the appropriate sum. The issue was whether security could be given by way of an undertaking to be given by a third party, Lake Gardens Limited (Lake Gardens).

[2] Lake Gardens was formed to undertake a commercial property development in Parnell Rise, Auckland (the Parnell property). John Hansen J was required to consider whether there was sufficient equity in the Parnell property to support an undertaking. It was noted that Lake Gardens had borrowings from Westpac Banking Corporation (Westpac) and Auckland Finance Limited (Auckland Finance).

[3] John Hansen J ordered that security be given by way of an undertaking from Lake Gardens in the sum of \$100,000. The Judge then said, at [7]:

That will be on condition that, in the event of any of the following occurring, the plaintiffs, Lake Gardens Ltd and the solicitors for the plaintiff, will have an obligation to report to the solicitors for the defendant:

- (a) if the balance of the construction costs exceed \$400,000;
- (b) if Lake Gardens Ltd increases its borrowing from Westpac, from Auckland Finance Ltd or from any other source by a sum in excess of \$50,000 and that overall borrowing does not exceed \$7.1m;
- (c) that the building is fully tenanted by the end of January 2009. The level of rentals for the remaining 40% of the property and any incentives offered for such tenancies are also to be notified.

[4] An additional condition was added by consent by a Minute of John Hansen J on 5 November 2008, such that any sale, conditional or unconditional, of the Parnell property was to be notified to the solicitors for Watercare.

[5] John Hansen J ordered Denning to pay costs on the application on a 2B basis. These amounted to \$4393.13. Leave was reserved to apply further on one day's notice. A copy of the sealed order was directed to be served on all secured creditors of Lake Gardens.

Memorandum seeking reconsideration of order

[6] By a memorandum of counsel dated 18 March 2009, Watercare asked that the question of security for costs be brought back before the Court. This was on the grounds that:

- a) Lake Gardens had failed to lodge (or serve) an undertaking until 18 March 2009;
- b) The basis on which John Hansen J accepted the undertaking from Lake Gardens as being sufficient security had materially changed in that:
 - i) The balance of construction costs for the Parnell property was now \$700,000;
 - ii) Lake Gardens had increased its borrowing from Westpac by more than \$50,000;
 - iii) Lake Gardens' overall borrowing now exceeded \$7.1m;
 - iv) Lake Gardens had not secured tenants for the 40% of the Parnell property not occupied as at the 3 November 2008 hearing;
 - v) The property market had softened since the time of the hearing; and
 - vi) Construction of the Parnell property remained incomplete.
- c) Neither Denning nor Lake Gardens had paid the order for costs (it is understood that that has now been paid);
- d) Watercare had no confidence that Lake Gardens would be in a position to meet an order for costs against Denning.

[7] In short, Watercare submitted that security for costs should be given by Denning/Lake Gardens to pay \$100,000 into Court, or that Denning/Lake Gardens should provide Watercare with a bank bond for \$100,000.

Evidence

[8] Watercare's request for reconsideration was supported by an affidavit by Mr Howard Cara, sworn on 4 March 2009, and two affidavits by Mr Allen Beagley, sworn on 16 March and 6 April 2009.

[9] Mr Cara is the property manager for Watercare. He referred to correspondence between the solicitors for Watercare and Denning. He recorded that on 19 February 2009 Watercare's solicitors were advised by solicitors acting for Lake Gardens that they had been instructed by Lake Gardens in relation to increased borrowing from Westpac. On enquiry being made, Denning's solicitors confirmed that construction costs were \$300,000 more than the \$400,000 specified in the order of John Hansen J, that Lake Gardens had increased its borrowings from Westpac by more than \$50,000, that its total borrowings were now \$7.46m, and that the remaining space in the Parnell property had not been leased. The solicitors stated that the Parnell property was, however, cash-flow positive on its existing tenancies.

[10] Mr Beagley, an independent valuer, had given affidavit evidence as to the value of the Lake Gardens property for the hearing before John Hansen J. At that time he assessed the value of the property, if fully tenanted, at between \$7.7m and \$8.4m. To reach that valuation he adopted an investment yield of between 8.25% and 9%.

[11] In his affidavit of 16 March 2009, Mr Beagley reconsidered the value of the Parnell property, in the light of the information provided by Denning's solicitors. He concluded that with increased borrowing, and remaining space still untenanted, Watercare's position would be "precarious from a debt recovery perspective" if there were a ("most likely") decrease in value.

[12] In response, an affidavit was filed by Mr Edgar Brett Smithies, a director of Lake Gardens, also a property valuer, dated 30 March 2009. He set out the interest rates charged to Lake Gardens and Lake Gardens' cash-flow projection for the coming twelve months. He asserted that Lake Gardens is cash-flow positive, even if the vacant space is required to be "dumped". He annexed a valuation dated 18 November 2008, prepared by C.B. Richard Ellis (CBRE). CBRE valued the Parnell property at \$10m (plus GST, if any) as if complete and leased, and at \$9.525m "as is", that is on the basis of the existing tenancies.

[13] Mr Beagley responded to Mr Smithies' affidavit in his further affidavit sworn on 6 April 2009. He noted that the CBRE valuation, dated 18 November 2008, is now six months old, and he noted the potential for the property market to decline. He also noted the comment made in the valuation that the assessed value would be subject to a substantial discount, should a forced sale take place. On the basis of the CBRE valuation, a forced sale at a 30% discount would realise \$7m, well below Lake Gardens' current borrowing.

Submissions

[14] On the basis of the affidavit evidence, Mr Davies submitted for Watercare that:

- a) The CBRE valuation is not current, and not a true reflection of the value of the Parnell property;
- b) The Parnell property would be worth considerably less than CBRE's "as is" value of \$9.525m;
- c) Market conditions and retail leasing activity have continued to decline;
- d) There is a risk associated with the two existing tenancies (from whom Lake Gardens has required a bank bond of \$400,000 and a personal guarantee, respectively);

- e) Lake Gardens does not have a strong cash-flow; and
- f) In the case of a forced sale, there would be no funds available to meet the undertaking as to costs, given secured lending of \$7.46m.

[15] Accordingly, Mr Davies submitted, it is appropriate that the order for security for costs be varied, such that either payment is to be made into Court of \$100,000, or a bank bond for \$100,000 is to be provided.

[16] In oral submissions, Mr Davies stressed that Watercare has two concerns: first as to the accuracy and completeness of the information before John Hansen J at the hearing on 3 November 2008, and secondly as to the reliability of the CBRE valuation for the purposes of assessing Lake Gardens' equity in the Parnell property.

[17] With respect to the accuracy and completeness of the information provided to John Hansen J, Mr Davies submitted that the Judge was told that the "maximum priority amounts" under the mortgages to Westpac and Auckland Finance were \$6.387m and \$660,000 respectively, leading to a total maximum possible indebtedness of \$7.047m. However, in fact, the maximum priority amounts were \$10m in the case of Westpac and \$2m in the case of Auckland Finance. Further, Mr Davies submitted that, at the hearing on 3 November 2008, Mr Smithies valued the Parnell property at \$10m, whereas Mr Beagley had valued it at \$7.71 - \$8.41m, if fully tenanted. The position now, he said, was that the property was still not fully tenanted.

[18] Further, he submitted that it had been learned that shortly after the 3 November 2008 hearing, Westpac was asked to lend an additional \$400,000. He noted that CBRE had been instructed to prepare the valuation on 17 November 2008, just two weeks after the hearing.

[19] Adding to Watercare's concern, he submitted, was what happened in respect of the reporting conditions, as set out in Mr Cara's affidavit.

[20] With respect to the CBRE valuation, Mr Davies noted that all but one paragraph of the valuation is premised on the assumption that the Parnell property is fully tenanted. The only consideration of an “as is” value is in one paragraph at p.48 of the valuation. Mr Davies also referred to section 6 of the valuation, headed “Market Commentary”, which he submitted was replete with warnings about decreases in market values, the current economic climate, and the tightening of credit availability.

[21] In summary, Mr Davies submitted that the Court should accept Mr Beagley’s conclusion that the CBRE valuation, prepared in November 2008, cannot be relied upon as an accurate valuation of the Parnell property.

[22] In general terms, Mr Davies submitted that faced with increased borrowings since November 2008, a decrease in the value of the Parnell property, and the increased risk arising out of current market conditions, Watercare is justified in submitting that it cannot have confidence in the undertaking provided by Lake Gardens. He submitted that Watercare has an order for security for costs and it should be entitled to be certain that if awarded costs, they would be able to be recovered without having to take steps against a limited liability company, with limited resources, to recover those costs. He submitted that it would be appropriate for the order to be varied such that security is given in the “normal way”, that is either by the deposit of funds in Court or by the provision of a bank bond. In this respect, he noted that Lake Gardens, itself, had required a bank bond in respect of one of its tenants’ obligations.

[23] In his written submissions on behalf of the plaintiff, Mr O’Callahan submitted that the security remains sufficient. He submitted that the renovation of the Parnell property is practically complete, and “the tenants are in”. He referred to the CBRE valuation, on the basis of existing tenancies only, at \$9.525m. He further submitted that because of “the substantial change in interest rates since October last year”, the property is now cash-flow positive, based on the existing tenancies. Any tenanting of the unlet space would only improve the cash-flow position.

[24] In his oral submissions, Mr O'Callahan submitted that the Court needed to ask what has changed since November 2008. He acknowledged that costs had increased by \$400,000 and that borrowings were now well in excess of the \$7.1m that was the case at the time of the hearing in November 2008. However, he submitted that there is now a current valuation and after assessing the "as is" valuation, there is still sufficient equity to support the undertaking.

[25] He submitted that, in any event, it is not appropriate to assess the value of the Parnell property on a "forced sale" basis, that there is equity of \$2m on the CBRE valuation and in that context, a security amount of \$100,000 would not put the company into the position of a forced sale.

[26] Mr O'Callahan also submitted that the interest rate applicable to the majority of Lake Gardens' borrowing (that is, the borrowing from Westpac) had "almost halved". There is some difficulty with this submission. In his affidavit sworn on 22 October 2008, filed in opposition to the application for an undertaking, Mr Smithies referred to Lake Gardens' borrowing, but did not set out any interest rates. In his affidavit in support of the application for security for costs, sworn on 30 October 2008, Mr Cara adopted an interest rate of 8% on total borrowings of \$7m in assessing Lake Gardens' liquidity. John Hansen J made no mention of interest liability in his judgment of 3 November.

[27] In their letter of 23 February 2009, Denning's solicitors advised Watercare's solicitors that Lake Gardens' "total possible indebtedness" to Westpac and Auckland Finance is \$7.46m, at an interest rate of 5.6% p.a. Then in his affidavit, sworn on 30 March 2009, Mr Smithies said, at 8:

I annex as Exhibit "2EBS5" an e-mail dated 24 March 2009 from Westpac to my co-director, Gary Cheyne, confirming the amount and interest rates on the Westpac facilities. The \$6,387,000 facility is fully drawn and is at 5.6%. The \$410,000 facility is drawn to \$376,000 and is at 6%. Mr Beagley is correct that the Auckland Finance Ltd facility is at a higher interest rate, namely 16%.

I note that the exhibit referred to does not appear to be an e-mail from Westpac, confirming the amount and interest rates on the Westpac facilities. Rather, it is a

cash-flow forecast from April 2009 to March 2010, which includes interest payable to Westpac and Auckland Finance.

[28] In light of the above statements, it is difficult to see the justification for the submission that Lake Gardens' interest cost has "almost halved".

[29] Essentially, Mr O'Callahan submitted, there has been no material change in circumstances since November 2008, except that Lake Gardens' position is "better and clearer" than it was at that time, and accordingly, he submitted, there is no basis on which to disturb the existing order.

Discussion

[30] This application for security for costs was made on the grounds that:

There is reason to believe that the Plaintiff will be unable to pay the costs of the Defendant if the Plaintiff is unsuccessful in this proceeding.

(Refer r 5.45(1)(b))

[31] As noted by John Hansen J, it is accepted by Denning that an order for security for costs is appropriate.

[32] The purpose of an order for security for costs in this proceeding is to protect Watercare, in the event that Denning does not succeed in the proceeding, in recovering costs awarded in its favour. In his judgment of 3 November 2008, John Hansen J concluded that there was sufficient equity in the Parnell property, so that Watercare was adequately protected by an undertaking given by Lake Gardens.

[33] However, John Hansen J was clearly concerned that that position may not continue, hence the conditions requiring reporting as to the balance of construction costs, increase in borrowings, and tenancing of the Parnell property.

[34] The question for the Court now is whether the undertaking by Lake Gardens provides Watercare with sufficient security that it is protected in the event that it

obtains an award of costs in its favour. I have concluded that the Lake Gardens' undertaking no longer gives Watercare sufficient security.

[35] Clearly, since November 2008, the balance of the construction costs has exceeded \$400,000 (by \$300,00), Lake Gardens has increased its borrowings by more than \$50,000 and its total borrowings exceed \$7.1m (to \$7.46m), and the untenanted 40% of the Parnell property remains untenanted. Each one of the matters that gave John Hansen J sufficient concern to lead to a requirement for reporting, has occurred.

[36] In addition, I accept Mr Beagley's affidavit evidence as to concern as to the value of the Parnell property in a period of "a softening of market conditions".¹

[37] In the circumstances, it is appropriate to grant Watercare's request for reconsideration of the order for security for costs.

[38] Mr Davies sought an order that Denning give security "in the usual manner" by lodging funds in Court, or by providing a bank bond for the sum of \$100,000. Rule 5.45(3) provides:

An order under sub-clause (2) –

- a) requires the plaintiff or plaintiffs against whom the order is made to give security for costs as directed for a sum that the Judge considers sufficient –
 - i) by paying that sum into court; or
 - ii) by giving, to the satisfaction of the Judge or the Registrar, security for that sum; and
- b) may stay the proceeding until the sum is paid or the security given.

[39] A bank bond is not necessarily the only alternative to a payment into Court, and it may be that Denning can provide sufficient security by other means.

[40] There will be an order that Denning is to provide security for costs in the sum of \$100,000 by either:

¹ Refer CBRE valuation, para 6.1

- a) Paying that sum into Court; or
- b) Providing a bank bond for the sum of \$100,000; or
- c) Providing other security as agreed between the parties and notified to the Registrar.

[41] If there is to be a payment into Court, application may be made for an order as to investment of funds, under r 3.12.

[42] The proceeding is stayed until this order is complied with. Leave is reserved to both parties to apply for further orders on short notice.

Andrews J