IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2008-404-008469

BETWEEN	TRANSACTOR TECHNOLOGIES LIMITED First Applicant
AND	LOYALTY APPLICATIONS NZ LIMITED Second Applicant
AND	MARKETSMART INTERNATIONAL (NZ) LIMITED First Respondent
AND	PAUL GREGORY HARPER Second Respondent
AND	PETER KINGSLEY ABOTOMEY Third Respondent
AND	ONCARD INTERNATIONAL LIMITED Fourth Respondent
AND	MARKETSMART INTERNATIONAL PTY LIMITED Fifth Respondent

Appearances: M J Tingey and J S Cooper for Applicants
T J P Bowler for First Respondent
S J Katz and T S Glasgow for Second and Fifth Respondents
No appearance for Third and Fourth Respondents

Judgment: 23 December 2009 at 4:30 pm

RESERVED JUDGMENT OF COURTNEY J

This judgment was delivered by Justice Courtney
on 23 December 2009 at 4:30 pm
pursuant to R 11.5 of the High Court Rules.

Registrar / Deputy Registrar
Date……………………….

Introduction

[1] The applicants (to which I refer to collectively as "Transactor") are, respectively, the licensee and owner of a software system known as "Thor". In 2008 the first respondent, MarketSmart International (NZ) Limited (MarketSmart NZ), acquired a copy of Thor from Transactor's joint venture partner, Evolution E-Business Limited. Transactor commenced proceedings against both, alleging breach of copyright, breach of confidentiality and breach of trust. It obtained interim relief preventing MarketSmart NZ from accessing, using or disclosing Thor to any other person. It subsequently obtained search and preservation orders. Transactor has now applied for indemnity costs against MarketSmart NZ in relation to the various applications. It alleges that MarketSmart NZ acted obstructively and in flagrant disregard of court orders, thereby putting Transactor to substantial unnecessary expense. MarketSmart NZ is now in liquidation and did not make submissions on the application.

[2] Transactor has also sought indemnity costs against two non-parties. The first is the former general manager of MarketSmart NZ, Mr Paul Harper. Transactor says that Mr Harper was in control of MarketSmart NZ and gave undertakings that were false and was obstructive in the conduct of the litigation. Mr Harper maintains that he acted in what he believed to be the interests of MarketSmart NZ, believed that the undertakings were true when he gave them and never deliberately breached court orders.

[3] The second non-party is MarketSmart NZ's parent company, MarketSmart International Pty Limited (MarketSmart Pty). Transactor alleges that MarketSmart Pty funded MarketSmart NZ's resistance to Transactor's applications knowing that MarketSmart NZ was insolvent and for the purpose of acquiring knowledge about Thor for its own benefit. MarketSmart Pty denies funding MarketSmart NZ or using or seeking to use Thor material for its own benefit.

[4] In addition, Transactor made applications for costs against Mr Peter Abotomey (a director of MarketSmart NZ) and Oncard International Limited (MarketSmart NZ's ultimate parent company). However, following their filing of protests to jurisdiction, Transactor did not pursue these applications.

Procedural matters

Leave to continue proceeding

[5] MarketSmart Pty placed MarketSmart NZ in voluntary liquidation in June 2009. Transactor cannot pursue this proceeding further, including any application for costs, without leave under s 248(1)(c)(i) Companies Act 1993. The factors to be taken into account in considering whether a proceeding should be allowed to continue are primarily directed towards fairness to other creditors. There must be equality among creditors and allowing proceedings to continue should not give one creditor an advantage over others, nor should the assets of a company be dissipated in wasteful litigation. The onus is, of course, on the party seeking to continue the proceedings and the applicant must satisfy the Court that its claim is not clearly unsustainable. Also of relevance is whether the plaintiff's claim is one which could be easily dealt with in the liquidation.[1]

[6] MarketSmart NZ's debts, other than to its parent company, total approximately $77,000. Its debt to MarketSmart Pty exceeds $1m. Its total assets are $433,241. Transactor's costs are $226,822.45 (excluding the costs connected with the present applications). Although allowing this proceeding to continue would affect other creditors, the effect would not be significant, given the size of the MarketSmart NZ debt. It is not a claim that would be easily determined in the context of a liquidation; the determination of a costs award following defended hearings is best made by a judge, especially where a claim for increased or indemnity costs is made since an assessment of the party's conduct is required. For these reasons this is an appropriate case in which the proceedings should be allowed to continue and I therefore make an order that the proceeding be allowed to continue.

Evidence admissible against Mr Harper

[7] Ms Katz, for Mr Harper and MarketSmart Pty, submitted that the formal application made by Transactor for leave to continue the proceeding was limited to continuing the proceeding specifically for the purposes of obtaining costs against the

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[1] *Fisher v Isbey* (1999) 13 PRNZ 182; *Body Corporate 81381 v Trebe NZ Limited (in liquidation)* HC Wellington, CIV-2003-485-000332 13 May 2003;; *Sieradzki v Kahikatea Manufacturing Limited (in liquidation)* HC Auckland M54-SW00, 15 March 2000

non-parties. She resisted Transactor's claim that it was entitled to obtain leave to proceed against MarketSmart NZ as well. Although it might appear that little would turn on the difference, Ms Katz said that it was significant because it affected the evidence being advanced in relation to the non-parties. In particular, she did not accept that documents belonging to MarketSmart NZ could be used as evidence against the non-parties for the purposes of the costs application.

[8] Mr Tingey, however, submitted that the s 248 application was always intended to be determined in respect of MarketSmart NZ and there was no need for any separate application in relation to the costs issue. I consider that this is correct. It is inherent in the s 248 application that the proceedings that will be allowed to continue are the substantive proceedings against MarketSmart NZ which, of course, include the claim for costs. However, counsel agreed between themselves that for the purposes of the application for costs against the non-parties, the email from Mr Harper to Evolution 22 December 2008 and the affidavit of Mr Kidd, a data management expert at PricewaterhouseCoopers would not be admissible against Mr Harper. Ms Katz accepted that documents that appeared in her own bundle of documents and anything referred to in the non-party costs order and submissions can be relied on. This includes Mr Harper's affidavit except for the aforementioned email. There was no need for the matter to be resolved further

Joinder of additional defendant

[9] MarketSmart NZ holds an insurance policy with QBE Insurance (International) Limited that may be relevant (though QBE's position is that the policy does not respond to the claim against MarketSmart NZ). Transactor seeks to join QBE as a third defendant pursuant to s 9 Law Reform Act 1936. There was no opposition to this application and QBE's solicitor has signed a consent memorandum in respect of the joinder. I accordingly make an order joining QBE as a third defendant.

[10] QBE seeks costs on the application or, alternatively, that costs be reserved. QBE did not appear at the hearing (its counsel having filed a memorandum) and the

response of the policy is yet to be determined. In the circumstances I reserve costs on the joinder of QBE.

Claim for indemnity costs against MarketSmart NZ

Relevant principles

[11] Rule 14.6 of the High Court Rules permits the Court to make an order for indemnity costs at any stage of a proceeding and in relation to any step in it. Circumstances in which such costs might be ordered include where the party has:

- Acted vexatiously, frivolously, improperly or unnecessarily in commencing, continuing or defending a proceeding or a step in a proceeding; or

- Ignored or disobeyed an order or direction of the Court or breached an undertaking given to the Court or another party.

[12] In determining an application for indemnity costs the proper approach is to consider first whether there is a principled ground for the exercise of the discretion to award indemnity costs and secondly, if indemnity costs are to be awarded, consideration as to what costs are reasonable.[2] In *Prebble v Awatere Huata (No 2)*, in the context of an application for costs under R 44 Supreme Court Rules 2004, the Chief Justice observed that:[3]

> In New Zealand, costs have not been awarded to indemnify successful litigants for their actual solicitor and client costs, except in rare cases generally entailing breach of confidence or flagrant misconduct.

[13] That observation was followed by the Court of Appeal in *Bradbury v Westpac Banking Corporation*:[4]

> …Indemnity costs, which depart from the predictability of the Rules Committee's regime are exceptional and require exceptionally bad behaviour. That is why to justify an order for such costs the misconduct

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[2] *Bradbury v WestpacBanking Corporation* [2009] 3 NZLR 400 at [9]
[3] [2005] 2 NZLR 467 at 470
[4] *Bradbury* at [28]

> must be "flagrant" (*Prebble v Awatere Huata (No 2)* [2005] 2 NZLR 467 (SCNZ) at para [6]).

[14] As to particular types of conduct that might justify indemnity costs, the Court of Appeal went on to refer approvingly to the circumstances identified by the Federal Court of Australia in *Colgate-Palmolive Co v Cussons Pty Limited*,[5] namely:

> (a) The making of allegations of fraud knowing them to be false and the making of irrelevant allegations of fraud;
>
> (b) Particular misconduct that causes loss of time to the Court and to other parties;
>
> (c) Commencing or continuing proceedings for some ulterior motive;
>
> (d) Doing so in wilful disregard of known facts or clearly established law;
>
> (e) Making allegations which ought never to have been made or unduly prolonging a case by groundless contentions, summarised in French J's "hopeless case" test.

Transactor's claim against MarketSmart NZ

[15] Transactor says that MarketSmart NZ's attitude from the outset was obstructive and non-compliant. It asserts the following as flagrant misconduct justifying indemnity costs:

a) Knowingly assisting Evolution in breaching its obligations to Transactor and receiving a benefit from Evolution's breach by way of access to and use of the Thor system;

b) Giving undertakings to Transactor on 18 and 19 December 2009 to the effect that it did not possess or hold copies of the Thor system or Thor-related materials which were untrue;

c) Destroying evidence of its use of the Thor system after proceedings had been commenced with the result that Transactor was no longer able to determine precisely what use had been made of Thor;

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[5] (1993) 118 ALR 248, also cited in *Hedley v Co-op Dairies Limited* (2002) 16 PRNZ 694, 698

d) Breaching the interim orders by continuing to use Thor software and other material obtained from Transactor's programmes after orders had been made prohibiting it from doing so;

e) Failing to comply with the terms of the search orders requiring it to provide an affidavit setting out its use of the Thor system;

f) Failing to comply with the terms of the amended orders requiring the delivery up and deletion of all copies of the Thor system; and

g) Defending the various applications on wholly unmeritorious grounds and making a hopeless application to discharge the search orders.

[16] In determining these allegations I am required to consider some allegations that could be relevant in the substantive proceeding. I do so on the basis of the various affidavits that have been filed. I note that, although the parties had the opportunity to reply to one another's affidavits, there was no request for cross-examination of any deponent. I therefore caution that, in relation to findings that might overlap with issues arising in the substantive proceeding, they are findings made without the benefit of cross-examination.

Acquisition of Thor material

[17] Thor is a customer management and database software used by retailers to maintain their loyalty and gift programmes. It used to be marketed by Transactor and Evolution pursuant to a joint venture agreement. Under the agreement Evolution was required to maintain confidentiality in relation to Thor and precluded from allowing any other party access to the system. Evolution managed the retail customers directly and had access to Thor for that purpose. In 2008 disputes arose between Transactor and Evolution with Transactor alleging breaches of the joint venture agreement by Evolution. When Evolution realised that Transactor was likely to terminate the joint venture agreement it consulted MarketSmart NZ for assistance in servicing customers without the Thor system. It provided MarketSmart NZ with a

copy of Thor which Transactor claims was a breach of its obligations under the joint venture agreement.

[18] The allegation that forms the background for Transactor's assertions of flagrant misconduct is that MarketSmart NZ knew from the outset that it had no right to access the Thor system. MarketSmart NZ denies that it had reason to think that this was so until receiving notice from Transactor's solicitors in mid-December 2008. Mr Harper has described his dealings with Evolution in some detail, conveying that he had no reason to think that MarketSmart NZ was not entitled to receive the Thor material from Evolution. According to Mr Harper, Evolution presented a potential business opportunity and MarketSmart NZ was keen to explore a future relationship with it. However, Mr Harper said that he had no intention of using Evolution as a means of accessing Transactor's technology for MarketSmart NZ's benefit; at that early stage his focus was on assisting Evolution with the hope that MarketSmart NZ would benefit in the process.

[19] Mr Harper reported Evolution's approach to one of MarketSmart NZ's directors, Mr Abotomey, by email 3 November 2008 and characterised the email as reporting on a potential, significant business opportunity. In his affidavit 24 August 2009 Mr Harper said:

> 19. I had no reason to believe that MarketSmart NZ was not entitled to carry out this work for Evolution. Indeed, Evolution consistently assured me that MSNZ was entitled to be undertaking work on the servers and information which they provided to us. Chris Johnson of Evolution told me that any intellectual property in the information provided was jointly owned by the joint venture partners in circumstances where TTL had wrongfully terminated the joint venture and that Evolution was free to with it as it saw fit.
>
> 20. To me it seemed perfectly reasonable for Evolution to be seeking technical assistance given the predicament in which TTL had left it. I trusted Evolution and its representatives and had no knowledge of the formal arrangements between TTL and Evolution in respect to the information provided to us…

[20] There is, however, evidence that is inconsistent with Mr Harper's assertions. In his affidavit of February 2009, Mr Harper, describing the original approach by Evolution, said that he had been told by Evolution that Transactor had encrypted the source code for Thor but that Evolution gave MarketSmart NZ an external hard-drive

containing a back-up copy of Thor made before it was encrypted. Further, in the email to Mr Abotomey, Mr Harper said:

> Relations with John [Mr Norrie, Transactor's managing director] deteriorated where he has told customers they have until Friday to get off system or be in breach of copyright…
>
> The current relationship with John is that they [Evolution] own all their own hardware and "licence" the system from him.

[21] Mr Harper has had a long history in the IT industry where intellectual property in proprietary software is notoriously jealously guarded. MarketSmart NZ itself owns proprietary software (the CIS system) and competes directly against Transactor. During the course of this proceeding, MarketSmart NZ strenuously resisted any step that would result in Transactor seeing the source code for CIS. I find that MarketSmart NZ, and Mr Harper personally, knew from the very beginning that Transactor was asserting copyright over Thor and was probably entitled to do so, in which case there was no lawful means by which MarketSmart NZ could acquire a copy of the Thor system.

[22] Transactor alleges that, not only did MarketSmart NZ know that it was not entitled to access Thor material but that it received a benefit in doing so. Of significance to this issue is the fact that, whilst Evolution wanted technical support from MarketSmart NZ, both companies knew that MarketSmart NZ's product could not offer the feature that Thor provided and Evolution needed. This was the ability of the Thor system to combine gift and loyalty programmes so that they could operate contemporaneously. One of Evolution's customers was Subway and the importance of being able to offer this service to Subway is evident from the email 3 November 2008 from Mr Harper to Mr Abotomey. Mr Harper commented that:

> They [Evolution] see that we can do the Gift business easily but worry about the Subway business – this is because Subway are immediate update of rewards – the theory is you could buy a Subway and then the very next transaction use your points along with your gift card for the next Sub.

[23] Although Mr Harper has downplayed the differences between the Thor and CIS systems, he has never denied that Thor offered this particular function and CIS did not. Self-evidently, if CIS could offer this function then it would acquire not only Evolution and its clientele but also increase the functionality of CIS for its own

marketing beyond servicing Evolution. Also self-evidently, having access to Thor was the only means by which MarketSmart NZ could write a programme of its own that would service this aspect of Transactor's business within a short timeframe. Although Mr Harper denies using the Thor material to improve its own software, it is apparent from the evidence that this is precisely the use to which Thor was being put.

[24] On the evidence before me, I find that MarketSmart NZ undertook work aimed at enabling its product, CIS, to offer the same functionality as Thor and that it used Thor to do so. In support of its application for the search and preservation orders Transactor filed an affidavit by Benjamin Smith, then the technical manager of Evolution. He described the work done by Evolution and MarketSmart NZ in late 2008. Mr Smith said that he was instructed by Evolution to work with MarketSmart NZ on migrating clients to the CIS system which involved building a link that would enable client data to be migrated from the Thor platform to the CIS platform. This work was required because the Thor and CIS systems were completely different and data held by one could not simply be transferred to the other. Mr Smith said that:

> The most fundamental issues are the structure in which data is stored (the table structure) and the procedures for data entering and leaving the database (the system logic). Information about the table structure and the system logic is commercially valuable and is not publicly available nor is it available to clients. They are fundamental elements of what makes the Thor software different to other systems and gives it its functionality…
>
> To enable data from a Thor system to be transferred to the CIS system we needed to map the structure of all the data fields in the Thor system that we wanted to transfer. Together with fellow Evo (Evolution) employee Benjamin Fellowes, I undertook the following process:
>
> a) We looked at CIS and Thor to compare their functionality and identify gaps in the CIS system;
>
> b) We took a copy of the relevant table structure from Thor and pasted this into an Excel file. We also took sample data from the Thor database;
>
> c) We then wrote business rules (i.e. instructions) to assist the MarketSmart developers to write software to enable data from the Thor table structure to be transferred into the CIS table structure and to build/develop functionality in CIS where necessary;
>
> d) In the first or second week of December we emailed both the Excel files and the business rules to MarketSmart's developers for them to use to create the link.

[25] It is apparent from this evidence that the "gap analysis" (a comparison of the new transaction processing systems' existing features as against the customers' requirements) and use of the Thor table structure and sample data was used to enable CIS to be upgraded to meet the level of functionality offered by Thor and which Evolution required.

[26] Further, despite Mr Harper's denial that Thor was being used for this purpose, his own description of the work done confirms it. In his earlier affidavit of 5 February 2009, Mr Harper had described the work that MarketSmart NZ did for the purposes of migrating data. It included a gap analysis and work to ensure that the retailers' point of sale (POS) system and the transaction processing software could communicate and to facilitate the migration of historical data. In relation to the migration of historical data Mr Harper said that MarketSmart NZ's staff examined the way in which data was stored in the Thor system and experimented with ways of extracting it in a form which could then be imported into CIS as Evolution was unable to export data from the Thor system.

[27] In relation to the communication between retailers' POS system and the transaction processing software, Mr Harper referred to the use of an industry standard known as XML to communicate with retailers' POS systems which was used by CIS. In relation to the POS system, Mr Harper said that:

> …the usual way to ensure that a retailers's POS system can communicate with a new transaction processing software package is to have the retailer get the developer of its POS system to amend it so as to change the way in which it communicates with the transaction processing software. However MarketSmart NZ was concerned that there would be insufficient time to have the POS systems amended. So MarketSmart NZ intended to write a small piece of new software to convert incoming information about transactions from the format that the retailers' POS systems generated to the format used by CIS and to convert outgoing messages from CIS to the format accepted by the retailers' POS systems. MarketSmart NZ staff examined the way in which Thor communicates with retailers' POS software…with a view to writing this software.

[28] I find that the work done by MarketSmart NZ involved the use of the Thor system to make amendments to the CIS system which would enable it to service Evolution. Achieving that would, in turn, benefit MarketSmart NZ. That was the

reason that it devoted time and technical expertise to the project. It follows that MarketSmart NZ did benefit from its unauthorised access to Thor.

Deletion of Thor material and false undertakings

[29] This is a convenient point at which to refer to Mr Harper's explanation of the way the litigation was managed by MarketSmart NZ. In his affidavit of 24 August 2009 he emphasised that he did not believe he had ever misled the Court or knowingly failed to comply with court orders. Mr Harper said that he was not experienced in litigation and relied heavily on legal advice and, further, because he believed that MarketSmart NZ's insurers would eventually take over the litigation, saw his role as one of temporary management until that happened. In terms of the various interlocutory orders, Mr Harper said:

> 34. Given the nature of the various interlocutory orders being sought by the plaintiffs (as far as I understood them) my instructions to Simpson Western were that steps must be taken to protect MSNZ's confidential information and intellectual property. At no stage however did I suggest that Simpson Western raise spurious issues or defences so as to achieve this purpose. To my knowledge all applications and defences raised by MSNZ were justified and well founded or were intended to ensure that the plaintiffs were put to proof in gaining the orders which they sought. I considered the protection of MSNZ to be at the heart of MSNZ's best interests.

[30] MarketSmart NZ was formally notified of Transactor's assertion of its rights in Thor on 16 December 2008 when Transactor's solicitors, Bell Gully, wrote to MarketSmart NZ's solicitors, Simpson Western, recording Transactor's understanding that hardware containing the Thor system had been relocated to MarketSmart NZ. Bell Gully stated that this was without Transactor's agreement and, if it had happened, would give rise to claims against both Evolution and MarketSmart NZ including for breach of copyright.

[31] Bell Gully asked for details of MarketSmart NZ's access to Thor, the dates on which hardware or software had been relocated, actions carried out using the hardware or software, whether any software or customer data was copied, whether Transactor software had been disclosed to MarketSmart NZ and whether any copy of information derived from any copy remained in MarketSmart NZ's control. Bell Gully requested an undertaking that no hardware, software or customer data

belonging to Transactor or to the former joint venture between Transactor and Evolution or the joint venture's customers remained in MarketSmart NZ's possession. The letter concluded by indicating that if the information and undertakings were not provided by 2 pm on 18 December 2008 Transactor would apply for an injunction. The following day Bell Gully wrote again, partly in connection with a different matter but also seeking confirmation as to whether MarketSmart NZ had obtained remote access to former joint venture servers located at ICONZ.

[32] Mr Harper has deposed that he wanted to avoid litigation and saw the dispute very much as being between Evolution and Transactor. On his instructions Simpson Western wrote to Bell Gully on 18 December 2008 in the following terms:

> Our client considers that it has no obligation to provide the information that you have requested in your email of 16 December 2008. Our client considers that your request for information should properly be addressed to Evolution given that Evolution is your client's former joint venture partner and it appears that your client is in dispute with Evolution in relation to the joint venture arrangement.
>
> We refer to your email dated 17 December 2008 and to the draft application which was enclosed with that email. We are instructed to advise that our client does not have any copies or adaptations of the Thor Transactor software or any other material derived from that software in its possession, custody or control.

[33] Bell Gully responded by advising that proceedings would be issued unless the undertaking sought was given. Simpson Western then sent an undertaking from MarketSmart NZ signed by Mr Harper that included:

> 1. MarketSmart undertakes that:
>
>   (a) It has no copies or adaptations of the Thor Transactor software or any other material derived from the Thor Transactor software in its possession, custody or control;
>
>   (b) MarketSmart will not use, disclose, provide access to, adapt or copy the Thor Transactor software…

[34] In his affidavit of 5 June 2009, Mr Harper explained the circumstances leading up to the giving of the undertaking on 18 December 2008. He said that prior to giving the undertaking he spoke with his staff and told them that they needed to get rid of anything that might be on the system relating to Thor or Transactor. He

did not specifically instruct them as to how to go about deleting such material and did not check to ensure that his instructions had been followed. On the basis of his instructions to his staff he gave the undertaking in the belief that all Thor-related material would have been deleted by that time. It is unclear whether this instruction was also given prior to Simpson Western's letter being sent.

[35] As a result of Mr Harper's undertaking Transactor obtained an order against MarketSmart NZ only precluding it from accessing, using, disclosing or providing access to, adapting or copying any Thor software. It did not seek an order requiring the delivery up of any copies of Thor. However, Transactor returned to the Court on an *ex parte* basis in mid-January 2009 seeking search and preservation orders in relation to material held by both Evolution and MarketSmart NZ and relying on the affidavit of Mr Smith to which I have already referred. Evidence obtained under the search orders confirmed that MarketSmart NZ was in possession of adaptations of and extracts from Thor. It further showed that MarketSmart NZ had destroyed material relating to Thor. The evidence also suggested that MarketSmart NZ continued to use parts of the Thor system in January 2009. There is, for example, an email from Mr Harper to Evolution on 22 December 2008 acknowledging that MarketSmart NZ could not access the Thor system and saying that:

> …"we can't access the 'system' so it will have to be copy and paste…"[6]

[36] Given Mr Harper's explanation and without his evidence being tested under cross-examination I am not prepared to find that Mr Harper knowingly gave a false undertaking. However, MarketSmart NZ's general handling of this issue is very concerning. It knew when first contacted by Transactor's solicitors, that it was holding Thor material. Its response, through its solicitors, was unapologetic, assertive and thoroughly disingenuous. In framing the undertaking in the way it did MarketSmart NZ effectively sidestepped the whole issue of delivery up of Thor material which Transactor was clearly seeking. Significantly, it made no mention of having deleted material from its system. Mr Harper has said that he did not realise that he should not have destroyed material and that MarketSmart NZ's solicitors did not explain this. If there are shortcomings in the legal advice MarketSmart NZ

[6] This piece of evidence is only available for use as against MarketSmart NZ rather than against Mr Harper personally for reasons discussed at [8]above

received, then that is a matter for MarketSmart NZ to take up with its solicitors. However, I find it difficult to accept that an experienced businessman could genuinely believe that, when specifically asked if his company had possession of specified material, an adequate response was to destroy the material and then deny having possession of it.

[37] I find that MarketSmart NZ did breach the undertaking that it gave and that in giving the undertaking it misled Transactor's solicitors into thinking that MarketSmart NZ had never had possession of Thor material. This was largely the reason for the application for search and preservation orders and caused Transactor to incur the substantial costs typically associated with this type of application.

Unnecessary opposition to compliance with search orders

[38] Transactor alleges that MarketSmart NZ was obstructive and unreasonable in relation to compliance with the search orders. The search orders made by Venning J on 22 January 2009 included the following order intended to protect MarketSmart NZ's confidential information:

> (i) The plaintiff's solicitor shall only be entitled to provide to the plaintiffs, and use in these proceedings, such documents which relate to matters in question in these proceedings and are not privileged, subject to any orders for confidentiality that may subsequently be made by the Court on the application of the defendants. Except as provided for, no documents shall be used for any other purpose.

[39] This order was later varied to provide that documents obtained pursuant to the order were not to be disclosed to Transactor except with the agreement of the defendants (or pursuant to a further order of the Court) and that, for this purpose, the defendants were to provide a list identifying the documents in respect of which confidentiality was asserted. Transactor maintains that MarketSmart NZ took an obstructive and unreasonable approach to this order by asserting categories of confidentiality so broad as to effectively restrict the plaintiff's ability to pursue its substantive claim. For example, MarketSmart NZ claimed confidentiality of any materials involving gap analysis, migration plans, systems design and database designs. It also claimed confidentiality to any material where there was reference to:

> …customers of MarketSmart or potential customers, whether or not the customers or potential customers are also customers of the plaintiffs and/or the first defendant and/or the joint venture.

[40] Such documents related directly to the allegations being made in the substantive proceeding and would have been discoverable in any event. Transactor made an application for inspection of the documents seized pursuant to the search order, which MarketSmart NZ opposed unsuccessfully. Whether MarketSmart NZ's position was taken on legal advice without any appreciation of what the effect would be on Transactor or whether MarketSmart NZ gave its solicitors instructions fully understanding the effect is a matter on which I cannot reach a conclusion, but I accept Mr Tingey's submission that MarketSmart NZ's attitude was both unreasonable and obstructive.

[41] Another of the orders made by Venning J on 22 January 2009 was:

> (j) The first and second defendants each provide an affidavit to the plaintiffs' solicitors, Bell Gully, within 10 working days setting out their possession, use and communication of the Thor system software and the presence and location of any other material as described in paragraph (c) above and specifically describing any deletion or destruction or attempted deletion or destruction of any such material at any time before or after the issue of these proceedings, including the time and date on which this occurred, and the method used (including any deletion programme used).

[42] Evidence obtained following the execution of the search order disclosed that even in February 2009 MarketSmart NZ retained Thor material including manuals, electronic copies of the source code and amended or modified copies of the source code. Mr Harper swore an affidavit on 5 February 2009 in purported compliance with this order, which was not accepted by Transactor as proper compliance. Bell Gully wrote to Simpson Western on 12 February 2009 asserting that Mr Harper's affidavit of 5 February 2009 was:

> …plainly inadequate and does not comply with the terms of the Order. Instead it is limited to setting out Mr Harper's personal understanding of how our client's software was used (as opposed to a full account of all possession and use of the software by MarketSmart) and omits to address the current presence and/or location of any restricted material, of which it is clear there is a substantial quantity.

[43] The response from MarketSmart NZ's solicitors on 13 February 2009 has been the subject of criticism by Transactor, criticism that I consider amply justified:

> We consider that this criticism of Mr Harper's affidavit is disingenuous. It is axiomatic that an affidavit by an individual may only contain evidence of what they know. Furthermore, it is obviously not possible for our client t o swear an affidavit itself given that it is a company.

and in relation to the material retained by MarketSmart NZ, Simpson Western said:

> The documents which were copied during execution of the search orders included document entitled "Thor XML Transaction gateway – Thor transaction format". We understand that this was located on one of our client's programmer's desk. We are instructed that the material had been overlooked by the individual concerned when he was checking to see if he had any material which would be covered by the injunction and that the manual had not been used since the injunction was granted.
>
> We consider that our client's possession of this document does not breach either the undertaking that our client gave on Thursday 18 December 2008 or the interim orders which were made by the Court on Monday 22 December 2008.
>
> Our client undertook that it had no copies of the Thor software or material derived from it. We do not consider that this document is covered by our client's undertaking. It is obviously not a copy of the Thor software and we do not consider that it is material derived from the software either. The word "derived" denotes something that is produced by the software and the document specifying the XML format was not produced by the Thor software.
>
> In addition, the orders made by the Court on Monday 22 December 2008 make no reference whatsoever to hard copy documents. In any event, as we have indicated above, our client's continued possession of this particular document was inadvertent.
>
> Our client does not consider it has any obligation to deliver up this manual to your client. However, our client is prepared to deliver up any copies of the specification manual which it still has in its possession without admitting that it is under any obligation to do so…

[44] This response from MarketSmart NZ's solicitor was combative and, itself, disingenuous. Once again, I am unable to tell whether responsibility for that approach lay with MarketSmart NZ or with its solicitors. As between MarketSmart NZ and Transactor, however, Transactor was entitled to expect compliance and it ought not to bear the cost of unreasonable non-compliance.

[45] Transactor applied to vary the original interim injunction by requiring MarketSmart NZ to deliver up all material related to Thor, including the Thor XML Gateway. In its notice of opposition MarketSmart NZ denied that the Thor XML Gateway format was copyrighted or confidential, stated that it did investigate the possibility of using the Thor XML Gateway format to provide services to Evolution's customers but no longer intended to do so and that it needed to retain the documents sought by Transactor in order to defend itself against the substantive proceeding, and a denial that it held any further material belonging to the plaintiff. Ultimately, however, MarketSmart NZ agreed to deliver up the documents and an order varying the interim injunction was made by consent on 25 February 2009.

[46] At the same time Transactor also applied to enforce the preservation order by requiring MarketSmart NZ to file an affidavit that complied with order (j). However, MarketSmart NZ resisted the application on the ground that order (j) was limited to information or material concerning Thor not already stored at the premises specified in the order (being MarketSmart NZ's premises). Duffy J confirmed that Transactor's interpretation (that the order encompassed all material) was correct set a fresh timetable for the filing of affidavits that would comply with it.

[47] However, Transactor complains that MarketSmart NZ took an obstructive and vexatious approach to compliance with the amended orders. Under the amended orders the deletion of Thor material from MarketSmart NZ's system was to be independently verified by PricewaterhouseCoopers (PwC). MarketSmart NZ resisted attempts to search its live server which resulted in a further application by Transactor in relation to that issue and to the ongoing dispute over inspection of documents and compliance with order (j) of the search and preservation orders. Transactor's application was resisted by MarketSmart NZ which responded with its own application for an order discharging the search order altogether.

[48] On 21 May 2009 I made orders permitting Transactor to inspect all documents obtained under the search orders which either Bell Gully or PwC considered relevant, requiring MarketSmart NZ to file a further affidavit in compliance with order (j) and directing verification of deletion of remaining copies or adaptations of Thor. I dismissed MarketSmart NZ's application to discharge the

search order which was hopeless, given that the order had been executed four months earlier.

Does this conduct justify indemnity costs?

[49] Although indemnity costs may be awarded in respect of particular steps, the sequence of events that are the subject of the application for indemnity costs occurred within a relatively short space of time and were all directed towards aspects of the interim relief being sought by Transactor. Stepping back and looking at MarketSmart NZ's response, first to Transactor's expressions of concern and later to its applications to the Court, it is apparent that, at every turn, MarketSmart NZ did its best to conceal the true position and obstruct Transactor from pursuing its rights.

[50] Perhaps the most striking aspect of MarketSmart NZ's response to Transactor's proceedings has been its lack of recognition that it has done anything wrong. It has only ever provided the least amount of information it considered necessary at any given time. It has never acknowledged any wrongdoing on its part in its dealings with Evolution and the Thor system. Its position can generally be summarised from Mr Harper's affidavit 5 February 2009 in which, commenting on Transactor's claims against MarketSmart NZ, he said:

> 62. MarketSmart accepts that it had a copy of the Thor system in its position when it was endeavouring to assist Evolution to provide services to its clients. Evolution had advised MarketSmart that TTL had wrongfully terminated the joint venture agreement. In these circumstances, MarketSmart considered that its activities were covered by the software licence which was implicit in clause 14.3(b) of the joint venture agreement.

[51] The undertakings given in December 2008 were fasle. Even allowing that Mr Harper believed them to be true, the deliberate failure to respond to the issue of delivery was misleading. It is apparent to me that at every step in this proceeding MarketSmart NZ's attitude has resulted in additional and substantial cost to Transactor. MarketSmart NZ's conduct easily satisfies the description of flagrant misconduct that Transactor is required to demonstrate to support its application for indemnity costs.

[52] I turn then to consider the quantum of the costs claimed. These costs are set out in the affidavits of Mr Christiansen. They total $226,822.45. The amounts claimed have been broken down into those amounts relating to each of the applications. In respect of the applications for interim orders, search orders and inspection, only half of the amount charged has been claimed to reflect the fact that those applications were made against both Evolution and MarketSmart NZ. I have been provided with a schedule of the names, positions and charge-out rates of the Bell Gully partner and staff (three senior associates, a solicitor and two law clerks) involved in this proceeding.

[53] MarketSmart NZ has filed an affidavit by an independent solicitor, Mr Latton, commenting on the quantum of the claim for indemnity costs. However, whilst Mr Latton makes some worthwhile comments, his evidence was not of great assistance to me in determining the reasonableness of Bell Gully's fees. His comments as to hourly rates were mainly based on what was accepted in *Bradbury v Westpac Banking Corporation & Anor*, coupled with his observation that rates in the Auckland offices of national law firms had in fact increased since that decision by as much as 15%. These observations did not really assist. Whilst the hourly rates are, undeniably, at the top end of what one would expect to pay for legal services, given the nature of the work being undertaken I do not regard them as excessive.

[54] Nor was I assisted by Mr Latton's assessment of the appropriate amount of time required for the work that was undertaken. Based on his time estimates the fees would have been approximately half the actual costs. However, Mr Latton did not have the benefit of access to Bell Gully's files and therefore could only speculate as to precisely what might have been involved. In fairness to him, he acknowledged the significant degree of urgency in relation to much of the work together with the complexity relating to many of the affidavits that were prepared. I am not prepared, on the basis of Mr Latton's evidence, to reduce the amount claimed by Bell Gully.

[55] I find that there is a strong basis for awarding indemnity costs against MarketSmart NZ and I accept as reasonable in the circumstances the actual fees rendered and disbursement incurred by Bell Gully in connection with the matter.

Application for non-party costs

Relevant principles

[56] It seems from *Dymocks Franchise Systems (NSW) Pty Limited v Todd (No 2)*[7] that the discretion to award costs against a non-party should only be exercised if there is a causative link between the conduct of the non-party and the incurring of the costs; having referred to *dicta* to this effect in *Hamilton v Al Fayed (No 2)*[8] and *Gore (T/as Clayton Utz) v Justice Corporation Pty Limited*[9] the Privy Council said at [20]:

> Although the position may well be different when a number of non-parties act in concert, Their Lordships are content to assume for the purposes of this application that a non-party could not ordinarily be made liable for costs if those costs would in any event have been incurred even without such non-parties' involvement in the proceedings…

[57] The Privy Council also identified the principles to be applied in exercising the discretion to order indemnity costs against a non-party at [25] as:

> (1) Although costs orders against non-parties are to be regarded as "exceptional", exceptional in this context means no more than outside the ordinary run of cases where parties pursue or defend claims for their own benefit and at their own expense. The ultimate question in any such "exceptional" case is whether in all the circumstances it is just to make the order.
>
> (2) Generally speaking, the discretion will not be exercised against "pure funders" i.e. those with no personal interest in the litigation, who do not stand to benefit from it, are not funding it as a matter of business and do not seek to control its course.
>
> (3) Where a non-party not only funds proceedings but also substantially controls or benefits from them justice will ordinarily require that if the proceedings fail the non-party will pay the successful party's costs. In these cases the non-party is "the real party" to the litigation.
>
> (4) Where non-parties fund receivers or liquidators (of financially insecure companies) in litigation that is designed to advance the funder's own financial interests there are several considerations, namely the financial position of the party through whom the proceedings were conducted, the likelihood of that party being able

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[7] [2005] 1 NZLR 145 (PC)
[8] [2002] 3 All ER 641
[9] (2002) 189 ALR 712

> to meet an award of costs, the possible benefit to the non-party and whether the bringing or defending of the claim was reasonable.

[58] The non-parties in this case are, respectively, the general manager of MarketSmart NZ and the shareholder of the company. Although Mr Harper was not a director, he had effective day-to-day control of the company and oversight of the litigation. The directors of MarketSmart NZ lived in Australia and there is no evidence of any direction from them until May 2009, following delivery of my judgment of 21 May 2009.

[59] I find that the cases involving applications for costs against directors are of assistance and the principles expressed in them are applicable to Mr Harper. These cases generally indicate that it would be rare for a director who does not stand to benefit personally from the litigation to be faced with an award of costs as a non-party. The same consideration is relevant in relation to a shareholder against whom costs are sought. In summarising the relevant principles the Privy Council in *Dymocks* particularly referred to the situation of a director acting in the company's best interest rather than his own:

> [29] In light of these authorities Their Lordships would hold that, generally speaking, where a non-party promotes and funds proceedings by an insolvent company solely or substantially for his own financial benefit, he should be liable for the costs if his claim or defence or appeal fails. As explained in the cases, however, that is not to say that orders will invariably be made in such cases, particularly, say, where the non-party is himself a director or liquidator who can realistically be regarded as acting in the interests of the company (and more especially its shareholders and creditors) than in his own interests.

[60] In *Carborundum Abrasives Limited v Bank of New Zealand (No 2)*,[10] Tompkins J refused applications for costs against the directors of a company which commenced proceedings at a time after receivers had been appointed and (as the Judge found) when the directors knew or ought to have known that it was likely, if not probable, that if the proceedings failed the company would be unable to meet a costs order. However, the directors believed that the company had a contract with the first defendant and that enforcement of the contract was in the best interests of the shareholders. The directors had no financial interest in the proceedings other

[10] [1992] 3 NZLR 757 at 767

than, had the action been successful and the company been able to re-finance, they may have continued as directors. The Judge accepted that their motive was to act in what they then conceived to be the best interests of the shareholders and creditors in that they hoped, by commencing the proceedings they would be able to stave off the receivership, re-establish the company and restore its fortunes. Taking all of those circumstances into account the Judge found that the case was not an exceptional one that justified the making of the order against the directors.

[61] More recently, in *Goodwood Recoveries Limited v Breen*[11] the English Court of Appeal, citing from the earlier case of *Taylor v Pace Developments Limited*[12] observed at [47] – [48]:

> [In *Taylor*] the plaintiff sued and succeeded against the defendant company which turned out to have been hopelessly insolvent from the commencement of the proceedings. The plaintiff then sought a s 51(3) order for costs against the defendant's managing director and sole beneficial shareholder on the basis that he had known all along of his company's insolvency; but the application failed. Lloyd LJ said (at 409):
>
>> 'The controlling director of a one-man company is inevitably the person who causes the costs to be incurred, in one sense, by causing the company to defend the proceedings. But it could not be right that in every such case he should be made personally liable for the costs, even if he knows that the company will not be able to meet the plaintiff's costs should the company prove unsuccessful. That would be far too great an inroad on the principle of limited liability. I do not say that there may not be cases where a director may not properly be liable for costs. Thus he might be liable if the company's defence is not *bona fide*, as, for example, where the company has been advised that there is no defence, and the proceedings are defended out of spite, or for the sole purpose of causing plaintiffs to incur irrecoverable costs. No doubt there will be other cases. But such cases must necessarily be rare. In the great majority of cases the directors of an insolvent company which defends proceedings brought against it should not be at personal risk of costs.'
>
> That is a well-known passage. I would merely comment first, that the passage is carefully balanced between a normal situation and the exceptional, and second, that the case and company which is forced to defend a claim is not necessarily the same as the case of a company which initiates a claim.

Should costs be awarded against Mr Harper?

[11] [2006] 2 All ER 533
[12] [1991] BCC 406

[62] I have already concluded that MarketSmart NZ was guilty of flagrant misconduct in its response to Transactor's assertions regarding Thor. There is no doubt that it gave a false undertaking, opposed legitimate applications on spurious grounds and failed to comply with court orders. The question is whether that conduct should result in a costs award against Mr Harper.

[63] Ms Katz (relying on *Carborundum*) submitted that non-party costs should only be awarded where the director's personal motives are plainly evident and not where he or she is acting in what the director considers to be the best interests of the company. She said that Mr Harper was acting in what he considered to be the best interests of the company and had no personal interest in the outcome. Transactor, however, asserted that Mr Harper was not *bona fide*. It asserted that, although not a director or a shareholder of MarketSmart NZ, Mr Harper did have an interest in the outcome of the proceeding because of his shareholding in Oncard, MarketSmart NZ's ultimate parent company.

[64] As at 30 June 2008, Mr Harper and his wife held 860,000 shares in Oncard. They were among the 20 largest shareholders of ordinary shares in Oncard. Oncard's 2008 annual financial report records Mr Harper as one of the four executives in the consolidated group who received the highest remuneration for that financial year. The report records the company's remuneration policy in detail and includes statements to the effect that senior managers are remunerated so as to reward company, business unit and individual performance against benchmark targets. The executive remuneration programme included short-term incentives for meeting operating targets usually paid by way of a cash bonus determined annually.

[65] Given Mr Harper's position in the Oncard group it cannot be said that his financial interest was as limited as that of the directors in *Carborundum*. As a senior manager who stood to gain in terms of remuneration and as a shareholder in OnCard Mr Harper necessarily had a bigger picture in mind when determining how MarketSmart NZ would respond.

[66] Mr Tingey also submitted that Mr Harper would have been concerned about his personal liability but I do not accept that Mr Harper was ever motivated by such

concerns. Mr Harper has never been joined as a party to this proceeding and it is apparent from his affidavit of 27 August 2009 that he always expected MarketSmart NZ's insurers to take over the litigation. Whether justified or not, I am satisfied that Mr Harper did not perceive himself as having personal exposure until served with the application for non-party costs.

[67] Ms Katz also submitted that I should take the availability of insurance to cover costs awarded against the company into account. However, I was not provided with a copy of the insurance policy and know nothing of it except that the insurer asserts that the policy does not respond to the present claim. Its existence is therefore something I cannot take into account.

[68] I find Mr Harper's approach and attitude to the whole proceeding perplexing. MarketSmart NZ had been caught "red handed" with confidential material in its possession, obtained through a breach of the joint venture agreement between Transactor and Evolution. The evidence strongly points to an attitude by MarketSmart NZ that it would continue certain types of work derived from its knowledge of the Thor system and would resist at every turn efforts by Transactor to enforce the Court orders it had obtained. Even if Mr Harper had believed that MarketSmart NZ was entitled to the Thor material, once he was on notice as to the seriousness of the issue there can be no reasonable explanation for the obstructiveness shown by MarketSmart NZ. It may be that Mr Harper was thinking about the best interests of MarketSmart NZ in adopting the tactics that he did. However, an officer of a company who promotes the interests of the company through illegitimate means cannot expect to be viewed in the same light as a director who seeks to advance the company's interests through legitimate means.

[69] There can be no doubt that the manner in which MarketSmart NZ conducted itself in response to Transactor's various applications resulted in significant additional cost to Transactor and that Mr Harper was primarily responsible for that conduct. I find that there are grounds on which to award non-party costs against Mr Harper.

Should indemnity costs be awarded?

[70] Transactor seeks indemnity costs against Mr Harper. Ms Katz submitted that large non-party costs awards against directors are without precedent; to date such awards have been not only rare but also modest. Neither counsel cited any New Zealand case in which indemnity costs had been awarded against a non-party.

[71] In *de Vries v Queenstown.com Limited*[13] both the plaintiff, Mr de Vries, and the non-party against whom costs were sought, Mr Ward-Holmes, were shareholders in Queenstown.com Limited. In addition, Mr Ward-Holmes was a director of the company. Applying *Metalloy Supplies Limited (in liquidation) v MA (UK) Limited*[14] Panckhurst J proceeded on the basis that the key was identifying whether the defence of the proceeding was *bona fide* and for the benefit of the company or whether Mr Ward-Holmes had acted in bad faith, not so much by defending the proceeding but in refusing to supply the company information and thereby forcing Mr de Vries to obtain a court order. Millett LJ said at 4245:

> It is not, however, sufficient to render a director liable for costs that he was a director of the company and caused it to bring or defend proceedings which he funded and which ultimately failed. Where such proceedings are *bona fide* and for the benefit of the company, the company is the real plaintiff. If in such a case an order for costs could be made against a director in the absence of some impropriety or bad faith on his part, the doctrine of the separate liability of the company would be eroded and the principle that such orders should be exceptional would be nullified.

[72] The Judge concluded that Mr de Vries had a statutory right to the information, had exercised that right and made demand but that Mr Ward-Holmes refused to provide the information. Even faced with a formal application to the Court and the threat of costs Mr Ward-Holmes did not comply. Panckhurst J concluded that:

> Compliance eventually occurred in the face of the Court's order. All of this suggests bloodymindedness on Mr Ward-Holmes' part. That amounts to bad faith.

[13] HC Invercargill CIV-2003-425-000086 23 December 2004
[14](1997) 1 WLR 1613 per Millett LJ at 4245

[73] In *Asset Building M Pritchard Limited v Hambeg Limited*[15] costs were sought against the director of the defendant company, which disputed a statutory demand, took no steps in response to proceedings seeking ajn order that it be placed into liquidation and belatedly applied for leave to appear out of time and file a statement of defence. The company was placed in liquidation before that application could be determined and the original creditor sought an order against the director for costs relating to the company's application for leave to appear out of time and file a statement of defence. Having considered *Dymocks*, *Metalloy Supplies* and *de Vries* Asher J concluded that the sole director and major shareholder of the company would have benefited financially from delaying or preventing the company's liquidation. Those facts alone would not justify an award of costs but, when considered with the spurious defences offered by the company, they suggested an attempt to manipulate the court system by delaying an order for liquidation. Asher J also found that the director's actions had put the creditor to legal costs likely to exceed scale costs and had delayed the date of liquidation which could have consequences for other creditors. All of these factors together did justify awarding costs against the director.

[74] Examples of costs awards against shareholders or parent companies are also to be found in *Fitzroy Engineering Group Limited v Technic Engineering Limited*[16] and *Eco Horticultural Supplies Limited v Attwood*.[17] In *Ftizroy*, a contribution of slightly over 40% of actual costs was awarded against the parent company (and director of the parent company) where an application for an order placing the defendant company into liquidation was opposed without any grounds for doing so and for the improper purpose of preventing embarrassment to the parent company which was negotiating to sell its business.

[75] In *Eco Horticultural* Glazebrook J awarded costs against the shareholder of an insolvent plaintiff but accepted that the fact that the shareholder knew of the company's position did not provide a sufficient connection to justify costs being awarded against him. She identified other factors that did have sufficient connection

[15] HC Auckland CIV-2008-404-003781, 21 November 2008
[16] HC New Plymouth M 47/98, 3 March 1999 Master Kennedy-Grant
[17] (2001) 15 PRNZ 663 at 669

to justify an award of costs namely that the case being pursued was hopeless and the shareholder was the driving force behind the case, the company was insolvent and that the shareholder knew this, the shareholder was funding the litigation and stood to benefit from it. In addition, the shareholder had stated in cross-examination that he was prepared to pay the defendant's costs if they were successful. Against that situation the Judge awarded costs on a basis of a contribution to scale costs at about half of the amount awarded against the plaintiff company.

[76] In *Cash for Scrap Limited v Canwest TV Works Limited & Auckland Regional Council*,[18] Heath J awarded costs against the sole shareholder of a company which brought a claim for defamation when the shareholder ought to have known of the company's poor financial position and proceedings were commenced when those financial difficulties were worsening. The costs that were awarded were scale costs on a 3B basis. I note that costs against the company had been uplifted by 50% to reflect the company's failure to prosecute the proceeding diligently and failing to comply with court orders. However, that uplift was not applied to the shareholder against whom costs were ordered.

[77] In *de Vries v Queenstown.com*, the plaintiff had incurred just over $12,000 in costs together with disbursements of slightly over $4,600. The Court ordered $6,000 by way of contribution to the costs and disbursements. In *Asset Building* costs were awarded according to the scale, slightly over $2,000. It did not appear from either of these cases that the parties were seeking indemnity costs from the non-party and, further, it seems that in both cases the extent of the proceedings, and hence the cost to the plaintiff, had been considerably less than the present case.

[78] In this case, the amount sought is very substantial and reflects the extraordinary lengths to which Transactor was forced to go to protect its legitimate interests. However, although I have held that indemnity costs are justified against MarketSmart NZ, I consider that Mr Harper should have the benefit of the doubt in terms of his belief that the undertaking that he gave was true and the extent to which his conduct may have reflected inadequate legal advice or legal advice which he

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[18] HC Auckland CIV-2006-404-005175, 17 November 2008

misunderstood. I consider that costs calculated according to the scale on a 2B basis are appropriate rather than a indemnity costs.

Non-party costs against MarketSmart Pty

[79] Transactor's other application for non-party costs is brought against MarketSmart Pty as MarketSmart NZ's shareholder. The general basis for this application is that MarketSmart NZ was insolvent through 2008, that MarketSmart Pty had been funding it and that in mid-2009 it placed MarketSmart NZ in voluntary liquidation, this development coinciding with Transactor's application for indemnity costs against it.

[80] In his affidavit of 24 August 2009 responding to the application for non-party costs, Mr Harper touched on MarketSmart NZ's financial arrangements with its shareholders and ultimate parent company and on the funding of the litigation. According to Mr Harper, by September 2008, the Oncard group board had initiated a strategy that would see it withdraw its holding in regional operations that were not meeting its targets. MarketSmart NZ had posted a loss in the 2008 financial year and its performance generally worsened during 2009. For example, its year to date targets fell from being 24% above target in January 2009 to 65% below target by April 2009 and 130% below target by May 2009. However, Mr Harper deposed that during this period neither MarketSmart Pty nor Oncard provided any funding either of a general or specific nature that might have contributed to its costs in the litigation. According to Mr Harper, MarketSmart NZ's parent entities had not contributed to its business since an original loan advanced prior to 2002.

[81] Transactor invites me to infer MarketSmart NZ had been insolvent and operating only with the support of MarketSmart Pty during late 2008-2009. In MarketSmart NZ's statement of financial position for the year ended June 2008 the auditor's report stated:

> In forming our unqualified opinion we have considered the validity of the going concern assumption on which the financial report is prepared which depends on the ongoing support of the ultimate parent company…

[82] The notes to the financial statements contain the following:

> The financial statements have been prepared on a going concern basis notwithstanding the fact that the company is showing net liabilities of $704,335 in its balance sheet as at 30 June 2008. The ability of the company to continue in operation is dependent primarily on the timing and amount of revenue which may be generated from operating activities or alternatively from the provision of capital by way of issuing new shares or securing borrowing facilities and continued support from the parent company.
>
> The company's parent MarketSmart International Limited have loaned the company $948,707 which is payable on demand. If the companies were to recall the loans, then the company may cease to be a going concern.

[83] The inter-company advance of $948,707 shown as a current liability in the statement of financial position was some $200,000 lower for the 2008 financial year than it had been for the previous financial year. That, coupled with Mr Harper's assertion that funding had not been provided, means that there is no basis on which I could conclude that MarketSmart Pty had been funding MarketSmart NZ by way of loans or advances.

[84] The other funding issue raised was the fact that MarketSmart Pty had not made demand for payment of licence fees for the CIS software. Transactor's suspicions regarding this aspect were aroused by statements contained in the liquidator's first report to creditors on 1 July 2009, which referred to MarketSmart NZ having serviced its customers using software provided by MarketSmart Pty under a software licence. Although licence fees were not shown as an operating expense in MarketSmart NZ's statement of financial performance, MarketSmart Pty has lodged a claim in the liquidation of $5,833,333 for licence fees pursuant to a licence agreement with MarketSmart NZ. Further, although the licence was terminated by MarketSmart Pty on notice of the liquidation, MarketSmart AU is now servicing MarketSmart NZ's previous customers under a "representation agreement" entered into prior to the liquidation.

[85] Although the liquidators are to further consider the status of the representation agreement, their enquiry suggests that the intellectual property in CIS was always owned by MarketSmart Pty, there being in existence a contract dated 1 July 2000. It also seems that, historically, payment has never been required. I find

that this arrangement was not a form of funding of an otherwise insolvent company and not significant for the purposes of the costs application.

[86] Transactor asserts that MarketSmart NZ was insolvent well before it was placed in liquidation and should have been placed in liquidation at an earlier stage. Had this been done it would have prevented the unnecessary costs to Transactor connected with the proceeding. I am unable, on the evidence before me, to reach a conclusion as to whether MarketSmart NZ was insolvent prior to being placed in liquidation and, if so, at what stage. The only financial information I have about the company is its annual report as at 30 June 2008 and the liquidator's statement of position as at 24 June. The statement of position prepared by the liquidators shows claims by preferential creditors (employees and IRD) totalling $56,072. Unsecured creditors other than related parties total $21,159. There is no evidence to suggest that prior to its liquidation MarketSmart NZ was not paying its debts as they fell due. I do not accept that the related party debt was due, since there is no evidence of demand having been made prior to the liquidation.

[87] MarketSmart NZ has also filed an affidavit by Mr Ferguson, a former director of Oncard, who was closely involved in the winding up of MarketSmart NZ. From his affidavit I conclude that, by late 2008, MarketSmart NZ's under-performance had attracted adverse attention from the Oncard board and it was, by then, likely that the company would eventually be wound up. The winding up was, however, precipitated by my judgment of 21 May 2009 which caused Oncard to re-assess the view it had previously held of the litigation. Mr Ferguson became involved at that point, assessed the state of the litigation and MarketSmart NZ's financial outlook, with the result that Oncard determined that MarketSmart NZ would be wound up by September 2009 when the lease on its premises was due to expire.

[88] Transactor has, understandably, attributed significance to the coincidental timing of the judgment of 21 May 2009 and the decision to wind up MarketSmart NZ. However, it is apparent from Mr Ferguson's affidavit that the judgment, whilst providing impetus for the winding up, was only one of several factors and indeed, not the most important, that led to MarketSmart NZ being wound up.

[89] Further, it does not appear that MarketSmart Pty, despite being the 100% shareholder of MarketSmart NZ, was actually exercising any direct control over MarketSmart NZ either during 2008-2009 or made the decision to wind MarketSmart NZ up. Mr Harper has recorded his belief that MarketSmart Pty was a holding company. Presumably, it had a greater function than that since the original inter-company advance was made by MarketSmart Pty and, more significantly, it is said to be the owner of the intellectual property in MarketSmart NZ's software. Nevertheless, there is no evidence to support a finding that MarketSmart Pty actually took any part in MarketSmart NZ's operations so as to affect the litigation between Transactor and MarketSmart NZ.

[90] There is, however, one aspect of the evidence that does require careful attention. Transactor asserts that as the owner of the CIS software, MarketSmart Pty stood to benefit from enhancements to the system resulting from MarketSmart NZ's access to the Thor system. I have already referred to Mr Harper's evidence as to the commercial advantages he saw in a relationship with Evolution and Evolution's clients. I have also referred to the differences apparent on the evidence between Thor and CIS, in particular, the contemporaneous gift/loyalty function that Thor offered and CIS did not.

[91] In April 2009 Mr Norrie was contacted by a senior marketing manager of Subway NZ who provided him with stills from a PowerPoint presentation made to Subway in Singapore by Mr Harper within the preceding few weeks. It will be recalled that Subway NZ was the customer specifically named by Evolution as requiring the contemporaneous functionality that Thor offered. In Mr Norrie's affidavit of 22 April 2009 he confirms that Subway NZ and Subway Europe were both users of the Thor system. The significance of the PowerPoint demonstration by Oncard to Subway was that on a page headed "Oncard International Proposal for Subway Loyalty Card" one of the points made was that:

> The system uses proven technology based on the successful New Zealand Subcard.

[92] Transactor maintains that this PowerPoint demonstration is evidence that MarketSmart NZ (and consequently Oncard) has benefited from access to Thor by

being able to produce a programme based on the New Zealand Subcard which uses the Thor system. Mr Harper denies this. In his affidavit of 22 January 2009, he said that the PowerPoint presentation was a standard company presentation, that the system on offer was the CIS system and the "proven technology" referred to in the PowerPoint demonstration was the MarketSmart NZ system. He went on to say that:

> The phrase which I used in the Power Point presentation was meant to convey that the loyalty card scheme which Oncard was proposing used MarketSmart's CIS transaction software which was proven technology as Oncard and MarketSmart use it to provide loyalty schemes for companies such as Amcal Pharmacies, Dymocks Booklovers and that the loyalty scheme itself would provide similar outcomes for customers to those offered by the scheme which operates in New Zealand. I did not imply that there was any similarity between the back-end transaction processing software which Oncard proposed to use for the Subway loyalty scheme in Asia and the Thor Transactor software which is the transaction processing software which was used to run the Subway loyalty scheme in New Zealand.

[93] It is very difficult to accept this explanation. The New Zealand Subcard used the Thor system. The evidence is strong that both Evolution and MarketSmart NZ perceived CIS not to be able to service Subway because of limits on the gift/loyalty functionality of CIS. To say that the Oncard system uses proven technology based on that Subcard invites the strong inference that the technology being offered by Oncard has the features of the Thor system. That implies that such functionality was developed with the benefit of the Thor system.

[94] This aspect of the evidence has, understandably, caused Transactor considerable concern. However, I am not satisfied that any benefit that is accrued to MarketSmart Pty has been shown to be the result of flagrant misconduct by that company. On the evidence I have it seems more likely to be the consequence of MarketSmart NZ's misconduct. It may be that a substantive claim lies against MarketSmart Pty. But I do not consider that this aspect should be reflected in an award of costs against the company.

Conclusion

[95] I have found that there was flagrant misconduct by MarketSmart NZ from the earliest point in this proceeding. Being on notice as to Transactor's rights and its

concern to identify what material MarketSmart NZ was holding, MarketSmart NZ destroyed most of that material and then provided an undertaking to the effect that it did not have possession of any such material. Subsequent attempts by Transactor to assert its rights and to find out precisely what material MarketSmart NZ had had possession of and what it had done with it were met with unreasonable resistance.

[96] I find that Mr Harper personally contributed to MarketSmart's misconduct, though I am prepared to allow him the benefit of the doubt in terms of his belief in the truth of his undertaking and the extent to which he may have been relying on legal advice.

[97] I find that MarketSmart Pty probably has benefited from MarketSmart NZ's acquisition of Thor material but this is not something that can be addressed in the context of the present application and that its conduct does not justify an award of costs against it.

[98] I therefore make the following orders:

a) Proceedings against MarketSmart NZ are allowed to continue.

b) QBE is joined as a third defendant; costs on the joinder application are reserved.

c) MarketSmart NZ will pay costs to Transactor in the sum of $226,822.45.

d) Mr Harper will pay to Transactor costs calculated on a 2B basis together with disbursements. If parties cannot agree on the calculation they may file further memoranda;

e) The application for non-party costs against MarketSmart Pty is dismissied.

[99] MarketSmart NZ and Mr Harper will each pay costs and disbursements on this application on a 2B basis. If counsel cannot agree on the calculations they may file memoranda.

P Courtney J

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