IN THE HIGH COURT OF NEW ZEALAND
WHANGAREI REGISTRY

CIV-2007-488-000285

	BETWEEN	FXHT FUND MANAGERS LIMITED (IN LIQUIDATION) First Plaintiff
	AND	PERI FINNIGAN AND BORIS VAN DELDEN AS LIQUIDATORS OF FXHT FUND MANAGERS LIMITED (IN LIQUIDATION) Second Plaintiff
	AND	DIRK OBERHOLSTER Defendant

Hearing: 8-12 December 2008

Appearances: G J Thwaite for Plaintiffs
A R Gilchrist for Defendant

Judgment: 9 April 2009 at 3.30 p.m.

JUDGMENT OF VENNING J

This judgment was delivered by me on 9 April 2009 at 3.30 pm, pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date........ ...

Solicitors: G J Thwaite, Auckland
Urlich McNab Kilpatrick, Whangarei
Copy to: A Gilchrist, Auckland

Setting the scene

[1] This case highlights the risk of a director becoming involved in a company whose business is outside the director's expertise. It also highlights the risk to investors who pursue high returns in speculative investments such as foreign exchange. It has led to loss by all parties concerned.

Background to the failure of FXHT Fund Managers

[2] Dr Oberholster is a general medical practitioner. He has interests in six companies associated with a family stud farm, as well as running/owning his medical practice. On 8 December 2005, he became a director of FXHT Fund Managers Limited. FXHT Fund Managers' business was the management of private clients' investments in foreign exchange markets. Investor funds were usually placed in overseas currency trading platforms, but FXHT Fund Managers also employed its own trader, Mr du Plessis. The driving force behind FXHT Fund Managers was Peter Hitchinson. Mr Hitchinson's parents were patients of Dr Oberholster. Both Mr Hitchinson and Dr Oberholster are South African. Dr Oberholster agreed to put $5,000 into FXHT Fund Managers. He also agreed to become a director to support Mr Hitchinson with his New Zealand residency application, and help the business become established. Dr Oberholster expected that, in the long term, the business venture would be successful, but he was not financially dependent on it, and did not become involved for that reason.

[3] With Dr Oberholster's backing, FXHT Fund Managers was established in premises in Whangarei. Dr Oberholster guaranteed the premises and equipment leases. FXHT Fund Managers advertised and attracted a number of local investors. The investors placed the equivalent of approximately US$927,000 with FXHT Fund Managers. In most, but not all cases, investors signed client agreements. Investors were told to expect up to a two percent return per month. FXHT Fund Managers' income was to come from commission, and the profit on the foreign exchange dealing over and above the return to investors.

[4] The foreign exchange investments managed by FXHT Fund Managers were not successful for either the investors or FXHT Fund Managers. Unknown to Dr Oberholster, Mr Hitchinson began to take money from some investors in order to pay other investors' returns, and to keep the company operating.

[5] In about September 2006, in an attempt to improve the returns to FXHT Fund Managers, Mr Hitchinson and Dr Oberholster decided to transfer the investments from FXCH, the trading platform the company was then using, to a South African trading platform, FX Active.

[6] The change to FX Active did not improve the company's fortunes. In late November 2006, Mr du Plessis told Dr Oberholster that he had not been paid commission for two weeks. At the same time, Mr du Plessis told him that some investors' funds were unaccounted for. Dr Oberholster confronted Mr Hitchinson on 29 November 2006. Dr Oberholster was not satisfied with Mr Hitchinson's response; he required Mr Hitchinson to resign as a director and reported the matter to the police. Dr Oberholster then took further steps to protect his and the investors' position, which led to the company being placed in liquidation on 14 December 2006.

[7] The liquidators' investigation confirmed that Mr Hitchinson had misapplied investors' funds. As a result, Mr Hitchinson has been charged with fraud. It is alleged that he has defrauded three investors of sums totalling US$297,751 and NZ$44,985.

[8] Although the liquidators have pursued the recovery of the investments through FX Active, they have not been able to recover any funds. It seems FX Active is no longer operating, and the money is lost.

[9] Against that background, the company and liquidators bring these proceedings against Dr Oberholster. The plaintiffs seek orders requiring Dr Oberholster to contribute to the liquidation, so as to compensate the investors, who are now unsecured creditors of FXHT Fund Managers. The plaintiffs do not pursue Mr Hitchinson in this proceeding.

The issues to decide

[10] The general issues in this case are the extent of the obligations that Dr Oberholster owed the company as a director, and what, if any, liability he has to contribute funds to its liquidation.

[11] The specific issues are whether, as a director of FXHT Fund Managers, Dr Oberholster:

- breached his duty as a director to act in good faith and in the best interests of the company: s 131 Companies Act 1993;
- failed to exercise his powers for a proper purpose: s 133;
- was guilty of reckless trading: s 135;
- improperly agreed to the company incurring certain obligations: s 136;
- breached his duty of care under s 137;
- owed the company a duty of care at common law to act prudently and appropriately as a director and, if so, whether he breached that duty;
- is entitled to relief under s 138;

[12] The final specific issue is, if Dr Oberholster was in breach of one or more of the above duties, how much should he be required to repay, restore or contribute to the company in liquidation?

Is this case so different?

[13] Mr Gilchrist submitted that this was an unusual case, and was different from most, if not all, other cases brought against directors for breach of statutory duties. He submitted this was not a case of a director permitting a company to carry on

trading when he knew the company was insolvent. Nor was it a case of a director taking illegitimate business risks. Mr Gilchrist submitted the case was not about trading losses at all, but rather the loss of investors' funds caused by Mr Hitchinson's dishonesty, and the failure of the FX Active platform.

[14] The two principal causes of loss to the investors are Mr Hitchinson's fraud, and the failure/refusal of FX Active to return the investors' funds. To that extent, Mr Gilchrist is correct when he says this case is brought because of the loss of investors' funds. The investors are not "trade creditors" as that phrase is generally understood. However, the investors were, at material times, contingent creditors of the company. In taking the funds for investment, the company assumed an obligation to invest the funds and return them (or at least 90 percent of them, taking account of the stop loss clause in the client agreement) at the request of the investors. It does not matter for present purposes whether the obligation to account for the funds is categorised as arising from a fiduciary, trust or contractual obligation. While the investors are different in nature to trade creditors and their losses have arisen in different ways, as Mr Gilchrist accepted, the investors are now creditors in the company's liquidation. The investors fit the definition of "creditor" in ss 240 and 303 of the Companies Act 1993, and Mr Gilchrist properly accepted they were creditors of the company in liquidation. The liquidators have accepted their claims as creditors.

[15] The general principles and statutory obligations under the Companies Act 1993 apply to Dr Oberholster's position as a director. As the Court of Appeal confirmed in *Mason v Lewis* [2006] 3 NZLR 225, there is a two-step process to follow when determining a director's liability in these circumstances. The first step is to consider whether Dr Oberholster was in breach of the duties he owed to the company. If he was, the second step is to consider what relief is appropriate. The unusual circumstances of the loss that Mr Gilchrist emphasised are more relevant to the second issue, the assessment of loss and the appropriate relief, than to the first step of deciding whether Dr Oberholster was in breach of the duties that he owed to the company as a director.

The plaintiffs' approach

[16] At paras 23 to 27 inclusive of the second amended statement of claim, the plaintiffs identify a number of failings they attribute to Dr Oberholster in relation to his duty as a director. They then plead, in the first cause of action, that these failings constitute a breach of a number of statutory duties owed by a director to a company under the Companies Act. The pleading does not match up the failings with the sections they are said to relate to. Even accepting that there may be a degree of overlap, the duties under the relevant provisions in the Companies Act are separate and distinct duties. It is for that reason that they appear in different sections. Not all alleged failings are relevant to all duties. Pleading in this non-specific way does not assist the Court in its consideration of the issues.

Did Dr Oberholster breach his duty as a director to act in good faith and in the best interests of the company?

[17] Section 131 as relevant, provides:

> (1) ... a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.

[18] In *Sojourner v Robb* [2006] 3 NZLR 808, Fogarty J noted that the obligation in s 131 was taken from case law developed in the United Kingdom, and adopted in New Zealand. The Judge approved the statement in Gower and Davies, *Principles of Modern Company Law* (7th ed 2003) that the duty was one of loyalty, arising out of the fiduciary relationship that directors as agents owe to their principal, the company. An appeal against the decision was dismissed, and no issue was taken with the Judge's categorisation of the nature of the duty.

[19] At its most basic, the duty means the director is not permitted to put his personal interests ahead of the company's. But where the director has reason to doubt the company's solvency, the duty may require him to consider the position of creditors, as opposed to the interests of shareholders. The best interests of the company can include discharging obligations to creditors: *Sojourner v Robb* at [102].

[20] It is not enough to submit generally, as Mr Thwaite did, that s 131 requires the director to be concerned for the overall advantage of the company, which "involves continuing prosperity and the fulfilment of contractual obligations". Something more specific is required for s 131 to be breached.

[21] Mr Thwaite did suggest that Dr Oberholster's motivate for encouraging one of the investors, Mr Whimp, to invest was for his own benefit as a shareholder. He also submitted that Dr Oberholster sought to ensure trade creditors were paid to protect his potential personal liability as guarantor, and also sought to ensure the company was making a profit, which would benefit him as a shareholder. Mr Thwaite suggested that by acting in those ways, Dr Oberholster was not acting in good faith and in the interests of the company.

[22] Putting the issue of Mr Whimp's investment to one side for the moment, it can hardly be said to be a breach of s 131 to ensure trade creditors are paid, and to ensure the company was making a profit.

[23] In any event, Mr Thwaite's submission that Dr Oberholster was in breach of s 131, because he was only concerned to ensure that he had no personal liability as guarantor for the rent and the equipment lease, is not supported by the evidence. Dr Oberholster's evidence is the only relevant evidence that bears on the issue. Dr Oberholster confirmed that as he had contact with some of the outside creditors, including the landlord, he was confident that the outside bills were being paid. There is nothing untoward about that. He also asked Mr Hitchinson, who confirmed the other creditors were paid. Dr Oberholster also understood that the investors had access to, and the ability to require repayment of their funds. The investors had computer access to track their investments, and he believed that would enable them to raise any problems. There is no evidentiary basis to support the suggestion that Dr Oberholster deliberately preferred the interests of trade creditors to those of the investors who, in this case, are the principal creditors.

[24] As for Dr Oberholster's involvement in Mr Whimp's decision to invest, again the evidence of the contact between Mr Whimp and Dr Oberholster, does not support the submission that Dr Oberholster's actions in relation to Mr Whimp were not in

good faith and in the interests of the company. Mr Whimp contacted Dr Oberholster when he was intending to invest in the company. Dr Oberholster told him that he believed the terms of the contract protected the investment because of the 10 percent stop loss clause. He also said that Mr Hitchinson had made "every previous post a winner", or words to that effect. The comments were made in good faith by Dr Oberholster, and on the basis of his knowledge at the time. They fall well short of establishing a breach of Dr Oberholster's duty to act in the best interests of the company. Whether Dr Oberholster was justified in considering Mr Hitchinson was successful is more appropriately addressed under other sections. I also accept Dr Oberholster's evidence when he said he told Mr Whimp that he would know more about it than him. I am unable to accept that Mr Whimp, an accountant, would have invested $350,000 (initially) without considering the contract in detail. The contract spelt out the risks. Mr Whimp made his own decision to invest. He may have been reassured when making that decision to know that Dr Oberholster was involved in the company, but ultimately it was his decision to invest in foreign exchange through the company. Further, the business of the company was investment of clients' funds in foreign exchange. To encourage a potential client to invest cannot be a breach of s 131.

[25] Mr Thwaite next submitted that Dr Oberholster took no real steps to prevent the theft of money by putting proper systems into place, or by engaging a professional person such as an auditor, even though he was aware of an act of dishonesty on the part of Mr Hitchinson. He also submitted that Dr Oberholster failed to properly review the appropriateness of the transfer of funds to FX Active.

[26] The act of dishonesty relied on was the company paying a traffic fine for Mr Hitchinson. Dr Oberholster was aware that Mr Hitchinson had incurred a traffic fine. He accepted the company should pay it, as he considered Mr Hitchinson was travelling for work purposes at the time. Again, this issue and the failure to appoint an auditor has nothing to do with the obligation under s 131.

[27] The evidence satisfies me that Dr Oberholster acted in good faith. He incorrectly, but genuinely, believed there were limited risks with the business. It is

also relevant that once he discovered the problem, Dr Oberholster acted swiftly and decisively in an attempt to protect the investors' money.

[28] While criticism might be made of Dr Oberholster's failure to supervise Mr Hitchinson, and his decision to transfer the investments to the FX Active platform requires further consideration, they are properly considered under other statutory duties, not under s 131.

[29] The claim for breach under s 131 must fail.

Did Dr Oberholster fail to exercise his powers as a director for a proper purpose?

[30] Section 133 provides:

> A director must exercise a power for a proper purpose.

[31] The requirement that directors must exercise their powers for a proper purpose reflects the position at common law, namely that even though a director may act entirely in good faith, the use of a power for something other than that for which it was intended may defeat the object of strict accountability. The failure to act for a proper purpose is taken as a breach of fiduciary duty: *O'Halloran v R T Thomas & Family Pty Limited* 45 NSLWR 262 (CA).

[32] There is no evidence that Dr Oberholster used his powers as a director for an improper purpose. Mr Thwaite sought to bring the case within s 133 by submitting that when Dr Oberholster exercised his powers as a director to control the management of the company by meeting with Mr Hitchinson, the power was not exercised to protect the funds of investors (the proper purpose), but rather to ensure trade creditors were paid and that the company was making a profit.

[33] Again, it can hardly be said that the exercise of powers by a company director to ensure trade creditors were paid and that the company was making a profit can be categorised as the exercise of powers for improper purposes.

[34] Nor is the submission supported by the evidence. Mr Thwaite sought to place emphasis on Dr Oberholster's acceptance in cross-examination that, if the company had a million dollars under investment and was making five percent a month, that would provide a return to him of about $180,000 a year. While Dr Oberholster agreed with the arithmetic, the scenario was entirely speculative. The evidence is that Dr Oberholster did not receive any return from the company during the year it was in operation. While Dr Oberholster accepted the calculation put to him, I do not accept that he had any expectation of receiving anything like that sum. Further, in order to achieve such returns, the investments would have to have been protected and successful. To that extent, Dr Oberholster's interests as a shareholder and the investors' interests coincided. Both have been let down by reliance on Mr Hitchinson.

[35] Mr Thwaite also suggested the decision to transfer the funds to FX Active was not made for a proper purpose. The decision was a business decision made by the directors. There were two factors underlying the decision. One was the failure of the existing trading platform to perform in terms of returns to investors, and the second was that FX Active in South Africa was offering a better commission to the company. For a director to seek to maximise return for the company cannot be said to be the exercise of a power for an improper purpose. Dr Oberholster did not believe he was preferring the company's interests over the investors. The evidence is that he believed the change in trading platforms would benefit both the investors and the company.

[36] Cases where directors have been held to have acted in good faith, but not for a proper purpose are quite different to the facts in this case. The most common examples arise in relation to the control of the company. *Howard Smith Limited v Ampol Petroleum Limited* [1974] AC 821 is one such example. The Privy Council accepted that there may be valid reasons for issuing shares other than the raising of capital, but the Court will examine the purpose for which shares are issued to determine whether it is a proper one. The Privy Council held that the effect of the directors' decision to allot further shares was to alter a majority shareholding, and thus interfere with the company's constitution. As that was separate from and set against the director's powers, it was improper for the directors to have acted in that

way. That is conceptually quite different to the allegations raised against Dr Oberholster in the present case.

[37] There is no basis for the claim under s 133. It must also fail.

Did Dr Oberholster engage in reckless trading?

[38] Section 135 reads:

> **Reckless trading**
>
> A director of a company must not—
>
> (a) Agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) Cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[39] The purpose of the section is to avoid loss to the company's creditors through reckless trading. While the duty is owed to the company, unlike the other sections referred to, s 135 is expressly directed at the protection of creditors.

[40] The particularly relevant subsection for the present case is s 135(b). Section 135(a) seems to contemplate a positive act of agreement to a course of action, whereas s 135(b) does not require such a positive act. The complaints directed at Dr Oberholster in this case are essentially that he allowed Mr Hitchinson to run the business without providing adequate supervision of Mr Hitchinson, and without ensuring that proper reporting systems and safeguards were in place. They fall more readily within s 135(b), so that the issue is whether Dr Oberholster caused or allowed the business of FXHT Fund Managers to be carried on in that way, and whether this was likely to create a substantial risk of serious loss to the company's creditors.

[41] The application of s 135 was recently considered by the Court of Appeal in *Mason v Lewis*. The Court noted that the preamble to the 1993 Act affirms the value of the company as a means of achieving economic and social benefits by, among other things, the taking of business risks, hence the requirement for substantial risk

of a serious loss before a director will be in breach of the section. At para [51] of the decision the Court noted:

> The essential pillars of the present section are as follows:
>
> - the duty which is imposed by s 135 is one owed by directors to the company (rather than to any particular creditors);
> - the test is an objective one;
> - it focuses not on a director's belief, but rather on the manner in which a company's business is carried on, and whether that *modus operandi* creates a substantial risk of serious loss;
> - what is required when the company enters troubled financial waters is what Ross (above at [48]) accurately described as a "sober assessment" by the directors, we would add of an ongoing character, as to the company's likely future income and prospects.

[42] The principal evidence for the plaintiffs on the issue of appropriate management systems was given by Mr Horrocks and Mr Hays. Mr Horrocks has worked as a forensic accountant with the liquidator's firm of accountants for a number of years. He has been directly involved in the administration of the liquidation of FXHT Fund Managers. Mr Hays is a chartered accountant with practical experience in company accounting and management. He has also served as a director on a number of companies.

[43] Mr Horrocks' review of the company's records and meeting with Dr Oberholster disclosed the following matters. Mr Hitchinson, apart from being a director, was also employed by FXHT Fund Managers as funds manager. The engagement was evidenced by an employment agreement, which appears to have been countersigned by FXHT Fund Managers on 1 September 2006. A letter records that Mr Hitchinson earned $127,680 per annum, but that salary was never regularly paid to him. The company paid sums to Mr Hitchinson at irregular intervals. There is no record of PAYE being deducted.

[44] In addition to Mr Hitchinson's role as manager, Mr du Plessis was engaged as a trader on an independent contractor basis. On 19 October 2006 FXHT Fund Managers entered into a tenancy agreement for a property at Whangarei. The

agreement was for a period of seven months, and the property seems to have been the residential address of Mr du Plessis.

[45] Dr Oberholster told Mr Horrocks that Mr Hitchinson was responsible for the financial affairs of the company, and Mr Hitchinson ran the business without asking or needing authorisation from him. Dr Oberholster also told Mr Horrocks (and repeated it in his evidence) that he inquired weekly as to the state of affairs. Mr Hitchinson always told him that things were going well, and that the investors' funds were doing well and accounted for. Dr Oberholster said he never authorised any business expenditure, as Mr Hitchinson did that. According to Mr Horrocks' investigation, the company undertook no periodic reporting to individual clients on the profit or loss being made on the funds under investment. Nor did there seem to be any checking or attempt to reconcile transactions when the accounts were closed.

[46] Mr Horrocks' review of the company's cheque account discovered that nine deposit slips were missing, and a number of the cheque butts contained no narrative. Mr Horrocks' analysis of certain cheque butts showed that money was used for two vehicles, a BMW car and a Suzuki motorbike. Why the company was paying for both was never explained. There were cash withdrawals. Mr Hitchinson seemed to use company money for personal items such as expenditure on his own pet. The company also apparently paid money to a horse stud. Dr Oberholster suggested that was for marketing. When Mr Hitchinson shifted to Auckland to live, despite the fact the company had its office in Whangarei, bank accounts were addressed to Mr Hitchinson in Auckland, at least for a time. Mr Hitchinson identified a number of questionable expenses including, for example, the purchase in June 2006 of a home theatre, freezer, bar-b-que and patio heater for in excess of $3,000. On the same date an agreement for a plasma t.v. was made. The installation address for the t.v. was noted as Esmonde Road, Takapuna, which was Mr Hitchinson's address in Auckland. Mr Horrocks also noted that the accounting firm of Yovich had some involvement in FXHT Fund Managers, but its involvement was limited. It seems to have been paid a total sum for services of $5,500. Mr Swanepoel was appointed by the company as the company solicitor, but according to Mr Horrocks' review, Mr Swanepoel was only paid the total sum of $112.50.

[47] Mr Horrocks was not able to find any budget for the company, nor any periodic income and expenditure statements. There were no records of directors' meetings by way of either agendas or minutes. Mr Horrocks could not locate any ledger of investors' records. At most there was a FXHT dummy file located in the accountant's file, but this was not drafted until 5 December 2006.

[48] Mr Horrocks noted no auditor had been appointed.

[49] In Mr Hays' opinion, before becoming involved in the company, Dr Oberholster should have ensured it had a business plan and a financial budget. Mr Hays also considered that Dr Oberholster should have familiarised himself with the current financial position of the company, and considered Mr Hitchinson's capabilities and the company's internal control systems. After becoming a director, Mr Hays considered that Dr Oberholster should have ensured that the investment funds of clients were properly recorded and accounted for, and that only proper expenses were paid by the company. He identified a number of expenses which he considered to be questionable. He also noted that the company had not appointed an auditor, and had apparently not taken appropriate professional advice. He noted that while the company and Dr Oberholster had taken advice from Yovich about a draft shareholders' agreement and governance and management of the company, he did not seem to have implemented that advice.

[50] Mr Waddel gave evidence for the defence. Mr Waddel is a fellow of the Institute of Directors, and has acted as a director on a number of boards. He is currently chair of a number of public agencies. He accepted that Dr Oberholster did not follow the requirements of the Institute as set out in the Code of Practice and the statements of best practice. However, Mr Waddel noted that a number of directors of small companies do not follow the strict requirements of the Institute, and there is no legal obligation to do so.

[51] Mr Waddel suggested that by attending the office regularly (normally weekly) and asking the following questions:

- Was the company trading profitably?

- Were creditors being paid on the due date?

- Was the investors' money held securely in their individual names?

- Could the investors access their accounts as agreed?

- Were the accounts frozen when a loss of 10 percent was incurred?

- Had arrangements been made for the appointment of an auditor?

Dr Oberholster was addressing himself to relevant, sensible and appropriate inquiries.

[52] Mr Waddel noted that while this was very informal, and there was no written confirmation of Mr Hitchinson's response to the questions, Dr Oberholster accepted Mr Hitchinson's positive responses. Mr Waddel noted that he would have expected Dr Oberholster to receive sufficient documentary evidence on a regular basis as to the "riskiness" of the business. He would also have expected a budget for the company to be prepared, and supported by a business plan to confirm profitability, with regular reporting on a monthly or, as a minimum, on a quarterly basis.

[53] Mr Waddel was of the view that even if an audit had been undertaken it would not necessarily have uncovered Mr Hitchinson's fraudulent activities.

[54] The thrust of Mr Waddel's evidence was that it was not the lack of records that caused the problems in this company, but rather the fact that funds were stolen by Mr Hitchinson.

[55] Dr Oberholster accepted that his direct involvement in FXHT Fund Managers was limited to his visits to the company's premises in Whangarei. He said he visited at least once a fortnight, and usually weekly. The meetings would be for five to 10 minutes. He would inquire of Mr Hitchinson how things were going, whether the company was making a profit and whether the clients' funds were all accounted for. Mr Hitchinson always responded positively. At times, Mr Hitchinson would show him client printouts on the computer. Further, as Dr Oberholster had contact with

outside creditors, he was confident that the outside creditors' accounts were being paid.

[56] Dr Oberholster accepted there was no business plan, no budget and that he never saw monthly reports. When asked by Mr Thwaite where the money came from to pay the bills, Dr Oberholster's response was that he "assumed" from trading profits. He accepted he left the running of the business to Mr Hitchinson, and that Mr Hitchinson had sole signing authority on the cheque account for the company.

[57] Mr Gilchrist submitted that Dr Oberholster asked all the right questions and got the right answers. Dr Oberholster inquired about the performance of the company, and Mr Hitchinson assured him that everything was all right and in order. Dr Oberholster asked if the company was making a profit, and again, Mr Hitchinson told him yes. When Dr Oberholster asked whether all clients were fully accounted for and happy, again he was told yes.

[58] Mr Gilchrist also emphasised that Dr Oberholster was not aware the company was insolvent until he learnt of the misappropriated funds in November, and submitted that until that point there was nothing more than the "normal" risk to creditors. Mr Gilchrist submitted that Dr Oberholster did not have any prior reason to question Mr Hitchinson's integrity, or to challenge Mr Hitchinson's assurances.

[59] But even so, that is no answer to the claim under s 135. The test is not whether Dr Oberholster had reason to doubt Mr Hitchinson, but rather, whether Dr Oberholster caused or allowed the company to be carried on in a manner which was likely to allow Mr Hitchinson to defraud investors. To allow an executive director free rein over the control of a company, which has as its business the investment of clients' funds, could readily be understood to create a substantial risk of serious loss to those investors through fraud or misapplication of money. While Dr Oberholster may have asked all the right questions, there was no basis upon which he could test the answers Mr Hitchinson provided.

[60] It is no answer for Dr Oberholster to say the losses have been caused by fraud. One of the directors in *Mason v Lewis* was fraudulent. The fraud was

unknown to the Lewises. Even though morally the Lewises had nothing to do with the fraud, their complete lack of appreciation of what their duties were as directors meant they had exposed the company to a substantial risk of loss through the fraud. The Court still held that the Lewises' conduct amounted to a breach of s 135. The Court said:

> [81] As to Mr Grant, [the fraudster] the Lewises simply relied on him and what he said without the proper inquiry they should have made as directors.
>
> ...
>
> [83] ... Directors must take reasonable steps to put themselves in a position not only to guide but to monitor the management of a company. The days of sleeping directors with merely an investment interest are long gone: ...

[61] As the test is objective it can make no difference when determining liability under s 135 that Dr Oberholster was innocent and unaware of Mr Hitchinson's fraud. The question is what the reasonably prudent director in Dr Oberholster's shoes would have done. Mr Hitchinson was able to carry out his fraudulent activity because he was left to run the business of the company without sufficient control by Dr Oberholster.

[62] Even accepting the reasonable constraints on a non-executive director of a small business with only two directors, and allowing for a degree of informality, Dr Oberholster's actions in this case fall well short of what could reasonably be expected of a director.

[63] Dr Oberholster's failure to put in place formal reporting systems, and to test Mr Hitchinson's verbal assurances was a failure to control Mr Hitchinson, which created the environment that allowed Mr Hitchinson's dishonesty to thrive. It was unreasonable for Dr Oberholster to accept, without challenge or any documentary support, Mr Hitchinson's reassurance that the company was doing well. The company had only recently started in business. To succeed it had to achieve more than a two percent return per month on the funds under its control. While the employment contract was not signed until 1 September, it was to operate from March. That obliged the company to pay $127,000 per annum, or over $10,500 a month to Mr Hitchinson. That required a return (by commissions or trading) of at

least 1% a month on $1 million, just to cover Mr Hitchinson's salary without even considering the cost of Mr du Plessis' contract, the rent and other outgoings. Dr Oberholster never bothered to find out just how much the company earned from month to month. Without monthly reports as to profit and expenditure, Dr Oberholster was in no position to be satisfied the company was operating successfully or responsibly.

[64] Mr Gilchrist submitted that there must be something in the financial position of the company that would have drawn the attention of an ordinary prudent director to the possibility that entering the transaction would cause serious loss to company creditors. But here it was not the trading or any particular transaction that gave rise to the loss, rather it was Mr Hitchinson's misappropriation of the clients' funds. By allowing the company to carry on under Mr Hitchinson's management, with Mr Hitchinson having free rein and without requiring any formal type of reporting, Dr Oberholster allowed the business of the company to be carried on in a way that facilitated fraud by Mr Hitchinson.

[65] In *Mason v Lewis* the Court of Appeal discussed the concepts of "substantial risk" and "serious loss" at [48]:

> As to what is meant by "substantial risk" and "serious loss", Ross, *Corporate Reconstructions: Strategies for Directors* (1999), suggests:
>
> > The first phrase, "substantial risk" requires a sober assessment by directors as to the company's likely future income stream. Given current economic conditions, are there reasonable assumptions underpinning the director's forecast of future trading revenue? If future liquidity is dependent upon one large construction contract or a large forward order for the supply of goods or services, how reasonable are the director's assumptions regarding the likelihood of the company winning the contract? Even if the company wins the contract, how reasonable are the prospects of performing the contract at a profit? (at 40)

[66] While the Court in that case was considering the situation of ongoing trading, the principles are applicable to the present case. The director must consider the company's position and the risks to it of, in this case, allowing it to be operated in the rather loose way it was. I conclude that the way Dr Oberholster permitted the business of the company to carry on did create a substantial risk of loss. While the systems would not necessarily have prevented fraud, they would have made it more

difficult and may have limited the number and extent of the frauds. Dr Oberholster never properly soberly assessed the risks to investors' funds of a lack of control over Mr Hitchinson.

[67] The indictment alleges Mr Hitchinson committed the frauds between April and November 2006. Dr Oberholster became involved in the company in December 2005, and was effectively acting as a director and directly involved from January 2006 until November 2006. By March or April 2006, it could reasonably have been expected that Dr Oberholster would have ensured reporting systems would be in place. He failed to do so. The first defalcations/frauds by Mr Hitchinson occurred on 4 April 2006.

[68] Dr Oberholster failed to carry out his responsibilities as a director properly. He let Mr Hitchinson have free rein over the running of the company. While he acted promptly when he found out about the fraud that was too late. Dr Oberholster took no steps to regularise or record the financial position of the company. Dr Oberholster effectively stood by and accepted Mr Hitchinson's assurances that all was well without testing them in any way. Dr Oberholster did not act as a reasonably prudent director would. His casual inquiries were not enough. Dr Oberholster caused, or at least allowed Mr Hitchinson to run FXHT Fund Managers in such a way that there was a substantial risk of loss to the investors as creditors of the company.

[69] Under s 135 the risk must be of serious loss. In this case, apart from ordinary trade creditors who might have been exposed to loss, the investors were the principal contingent creditors who faced the risk of serious loss. There are a limited number of investors. Each invested significant sums of money through FXHT Fund Managers. In the circumstances, it was not enough for Dr Oberholster to take the view, as he did, that the investors could check and monitor their investments on line. Unless the company had systems in place, there was always a substantial risk of serious loss to the invested funds. Dr Oberholster took no positive steps to ensure the investors' money was kept separate from the company's bank account.

[70] As Mr Hitchinson's actions show, it was not difficult to misapply the money.

[71] I conclude that by allowing Mr Hitchinson to operate the business without adequate supervision, and by failing to ensure proper reporting systems (even monthly profit/loss and cashflow reports) were put in place, Dr Oberholster caused or allowed the business of FXHT Fund Managers to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[72] The second aspect of the plaintiffs' claim that Dr Oberholster was responsible for reckless trading is in relation to the decision to transfer the trading platform to FX Active in South Africa. The section can apply to a one-off transaction or decision: *Re Wait Investments (in Liquidation)* [1997] 3 NZLR 96 and *Goatlands Ltd (In Liquidation) v Borrell* HC HAM CIV-2005-419-1643 14 December 2006 Lang J.

[73] The transfer of the trading platform was a positive business decision. The investors' funds were initially invested through a European trading platform. Although it was referred to as FOREX Swiss, it was noted in the documents as FXCH and, according to Mr Horrocks, seems to have been based in Salzburg, Austria. In September 2006, the investors' funds were withdrawn from FXCH, and FXHT Fund Managers decided to use FX Active in South Africa as the trading platform.

[74] Dr Oberholster was aware of and participated in the decision to change to the South African platform, FX Active. Dr Oberholster said Mr Hitchinson advised him that it would be more effective and recommended the change because they were having some problems with the Swiss platform. Dr Oberholster said he made inquiries about the platforms available, and was told there could be a change to either a South African or US platform. Dr Oberholster initially thought it would be better to go with the US platform because it was bigger but was told by Mr Hitchinson and Mr du Plessis that the South African platform was just as good and they could obtain a better rate of return from the South African platform. Dr Oberholster accepted their recommendation. The meeting where that decision was made took about 10 minutes from Dr Oberholster's point of view. Dr Oberholster was not provided with any written material about FX Active, but located and saw the website for the company. Mr Hitchinson and Mr du Plessis were more familiar with

the issue and had carried out research on the different trading platforms before the meeting. Dr Oberholster relied on Mr Hitchinson and Mr du Plessis' advice on the issue, particularly as they said they had used FX Active in the past.

[75] Dr Oberholster understood that the decision to change platforms was necessary because the existing platform was not performing. The decision to change, in those circumstances was, prima facie, a reasonable and legitimate business decision. The decision to change to the South African (as opposed to the alternative United States) platform was driven by the better profit margins offered by the South African platform. Again, that was a reasonable business decision.

[76] Mr Thwaite sought to make something of the fact that Dr Oberholster did not take advice from either his solicitor or accountant about the transfer. But neither of those professionals could be expected to provide any informed insight into what was essentially a business decision. The people with the best information about it were Mr Hitchinson and Mr du Plessis, and they recommended the change.

[77] Next, Mr Thwaite noted that Dr Oberholster did not see any documentation relating to the transfer before agreeing to it. Mr Thwaite referred to the following clause of the broker agreement between the company and FX Active:

> The infrastructure of the FX Active Group is under review with a consulting firm. This agreement will be amended accordingly and the amendments will be communicated to you for ratification.

[78] In cross-examination, when the clause was put to Dr Oberholster he volunteered that "if the infrastructure was under review you would be hard pressed to invest there wouldn't you". Mr Thwaite relied on the clause and Dr Oberholster's response to submit that FX Active was in serious financial trouble at the time of the change.

[79] But Dr Oberholster's candid and unguarded response does not really advance the plaintiffs' case. I take a different meaning from the reference to "review" in the document. The review of the FX Active group's infrastructure is most likely to be understood as a restructuring of the companies within the group so that, for example, other companies within the group might take over the role of trader, which, as the

clause suggests, would then require redocumentation of the agreement. There is no suggestion in the clause that the company was in serious financial trouble as Mr Thwaite submitted. If the company was in such financial trouble it would hardly have expressly referred to it in its client documentation. The fact the restructuring was expressly referred to, rather than being a matter of concern, is, if anything, an indication that FX Active was open – at least about its restructuring.

[80] In *Re South Pacific Shipping Ltd (in liquidation)* (2004) 9 NZCLC 263,570, William Young J made a distinction between the taking of legitimate and illegitimate business risks. The approach was confirmed on appeal in *Löwer v Traveller* [2005] 3 NZLR 479. The decision to transfer from the FXCH trading platform to FX Active was a legitimate business decision. There is no evidence that it was in some way associated with Mr Hitchinson's alleged frauds. With the benefit of hindsight it was a bad decision but, in agreeing to the change, Dr Oberholster was not objectively agreeing to the company's business being carried on in a manner likely to create a substantial risk of serious loss.

[81] Mr Thwaite noted that the Court can take into account the collateral advantage to a director of a decision *Löwer v Traveller* at para [21] when considering this issue, and submitted that Dr Oberholster stood to gain from the better commission returns offered by FX Active. But every business decision is designed to benefit the company and as a consequence also be to the advantage of a director/shareholder. There is a suggestion from Mr Horrocks' research that Mr Hitchinson may have received a personal commission from FX Active, but from Dr Oberholster's point of view it was a legitimate decision to transfer trading platforms.

[82] Viewed objectively, the decision to transfer the trading platform to FX Active was a justified business decision. The company had to use overseas foreign exchange platforms for trading. It changed from one platform in Europe to one in South Africa. The nature of the business did not change. The client agreements provided that FXHT Fund Managers could change the trading platform. The decision to change the platform was not a breach of s 135.

Did Dr Oberholster improperly agree to the company incurring obligations?

[83] Section 136 provides:

> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

[84] A preliminary point arises, namely whether Dr Oberholster actually agreed to the company incurring the obligations in question, which must be the obligation to repay the individual investors' funds. The obligation to repay arose out of the company's receipt of the funds in the first place. The evidence is that Mr Hitchinson was responsible for soliciting the investments, and that Dr Oberholster had no role to play in that. With the exception of Mr Whimp, Dr Oberholster only came to learn of the investments after they had been made. However, it is unnecessary to determine that point as the evidence does not support the claim in any event.

[85] The duty not to incur an obligation, unless the director has reasonable grounds to believe the company will be able to perform, contains both a subjective element, relating to the belief of the director, and an objective element concerning the grounds upon which the belief is based: *Fatupaito v Bates* [2001] 3 NZLR 386.

[86] Mr Thwaite submitted that FXHT Fund Managers took in investors' funds on the basis they would be returned on demand, and therefore the company had assumed an obligation to do so. He submitted that Dr Oberholster did not have reasonable grounds for believing the company would be able to perform its obligations to return the funds, because Dr Oberholster did not have the basic expertise to understand the company's operation, and took no steps to make proper inquiries or to put proper systems in place.

[87] The claim under s 136 is based upon *ex post facto* reasoning. The investors' losses are as a result of Mr Hitchinson's fraud, and the failure of the South African foreign exchange platform. Neither of those events were known to Dr Oberholster at the time that he agreed, to the extent that he did agree, to the company incurring the obligations by accepting the investments from the investors.

[88] Dr Oberholster understood that the clients' money was invested with the overseas trading platforms, but in their own names. Dr Oberholster was aware of the client agreements which contained the "stop loss" clause. He understood the clause meant clients could lose no more than 10 percent of the principal of their invested funds before the funds would be frozen. Dr Oberholster believed that as far as the investments were concerned, if investors required their investments back they would be able to close the investments and receive them back from the trading platform. Indeed, with the exception of Mr Hitchinson's fraud, that is what happened to the investments placed through FXCH.

[89] There was no reason for Dr Oberholster to doubt the ability of the FX Active trading platform in South Africa to repay the funds. From his point of view it was a similar set-up to FXCH.

[90] In summary, at the time the funds were taken in, Dr Oberholster had no reason to believe that Mr Hitchinson would misappropriate them, or that FX Active would fail or refuse to return them.

[91] The claim under s 136 is not made out.

Did Dr Oberholster breach his duty of care?

[92] Section 137 provides:

> A director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,—
>
> (a) The nature of the company; and
>
> (b) The nature of the decision; and
>
> (c) The position of the director and the nature of the responsibilities undertaken by him or her.

[93] Mr Thwaite submitted that Dr Oberholster had breached s 137 by failing to exercise the care, diligence and skill a reasonable director would have exercised in relation to:

a) the flawed business plan (or lack of one);

b) the character of Mr Hitchinson;

c) the absence of a trust account;

d) the entrustment of deposit and expenditure decisions to Mr Hitchinson;

e) the lack of supervision of Mr Hitchinson;

f) the absence of any control to implement the 10 percent stop loss; and

g) the transfer of funds to FX Active without proper procedures

each of which, or all collectively, meant that there was a substantial risk that monies invested would be lost.

[94] Under s 137 a director must exercise his duties as a director with diligence and skill that a reasonable director would exercise in the same circumstances taking into account the nature of the company, the nature of the decision and the position of the director and the nature of responsibilities undertaken by him.

[95] The failings identified by Mr Thwaite at a) to f) are essentially complaints that Dr Oberholster failed to control the business of the company properly in that he allowed Mr Hitchinson to run it without sufficient controls. To that extent the alleged negligence or failings are in large part a recasting of the breach of s 135 by permitting the business of the company to be carried on without adequate control. While I do not accept that it could be said Dr Oberholster was negligent in relation to Mr Hitchinson's character, he was negligent in relation to his lack of control of the company generally and in the latitude he extended Mr Hitchinson specifically.

[96] Dr Oberholster had no reason to question Mr Hitchinson's character. Mr Hitchinson's family were known to Dr Oberholster. At the time he met Mr Hitchinson the company was already established. Mr Hitchinson apparently had

experience of such trading, although he was not working full time in the company. There was no reason for Dr Oberholster not to have entrusted the day to day running of the company to Mr Hitchinson as he was the executive director of the company. Where Dr Oberholster fell down was in failing to ensure there were adequate systems of control. That is a different issue to whether Dr Oberholster should have questioned Mr Hitchinson's character further.

[97] In the end result little turns on that issue, however, because largely for the reasons given earlier, I accept that Dr Oberholster failed to exercise the care and diligence that a reasonable director would have exercised in relation to the implementation of systems and processes to the company to minimise the risk of misappropriation.

[98] The fact Dr Oberholster was a non-executive director is not of particular assistance to him in relation to this issue. Even as a non-executive director there are certain basic requirements that Dr Oberholster is unable to avoid responsibility for. His position as non-executive director is much more relevant to the issue of whether he was negligent and in breach of s 137 in relation to the issue of the decision to transfer funds to FX Active, which I now turn to.

[99] Mr Gilchrist submitted that there was no affirmative decision taken by Dr Oberholster that caused the losses in this case. That is not strictly correct. The decision to place the funds with FX Active provided an opportunity for the funds to be lost. A substantial part of the losses followed from the failure of FX Active to repay investors' funds. Dr Oberholster was involved in making the decision to change trading platforms.

[100] But bearing in mind that s 137 requires consideration of the nature of the decision and the position of Dr Oberholster as a director, I am unable to accept the submission that Dr Oberholster was in breach of s 137 by agreeing to transfer the trading platform to FX Active. Dr Oberholster was not the executive director, Mr Hitchinson was. Dr Oberholster was not responsible for the day to day management of the company. He had no working knowledge of the trading platforms. He was entitled to rely on Mr Hitchinson's (and the experienced trader Mr du Plessis')

advice about the change of platform. At an early stage, in January 2006 Dr Oberholster obtained a letter from Mr du Plessis setting out his experience and a basic explanation of the nature of the business. Dr Oberholster's evidence is that they discussed the change and the options before deciding to switch to FX Active. Dr Oberholster saw and checked FX Active's website. There was no reason for him to doubt Mr Hitchinson and Mr du Plessis' advice, or to consider that there would be any greater risk in the transfer to FX Active than there had been in relation to FXCH.

[101] For the reasons given earlier, and given the additional considerations under s 137(b) and (c) particularly, in my judgment, Dr Oberholster was not negligent in approving the change to FX Active. That aspect of the claim of breach of s 137 must fail.

The s 138 defence

[102] Mr Gilchrist submitted that if Dr Oberholster had acted in breach of any statutory duty, he was nevertheless entitled to rely on the defence under s 138. Section 138 of the Companies Act provides:

> **Use of information and advice**
>
> (1) Subject to subsection (2) of this section, a director of a company, when exercising powers or performing duties as a director, may rely on reports, statements, and financial data and other information prepared or supplied, and on professional or expert advice given, by any of the following persons:
>
> (a) An employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned:
>
> (b) A professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence:
>
> (c) Any other director or committee of directors upon which the director did not serve in relation to matters within the director's or committee's designated authority.
>
> (2) Subsection (1) of this section applies to a director only if the director—
>
> (a) Acts in good faith; and

(b) Makes proper inquiry where the need for inquiry is indicated by the circumstances; and

(c) Has no knowledge that such reliance is unwarranted.

[103] This section provides a defence to a director who reasonably relies on the advice of others in performing his or her duties as a director. Mr Gilchrist submitted that Dr Oberholster could take advantage of the statutory defence because he relied on the advice of Mr Hitchinson who appeared to him to be trustworthy: *Nippon Express (New Zealand) Ltd v Woodward* (1998) 8 NZCLC 261, 765.

[104] But directors have a responsibility to monitor the actions of persons in day to day control of the company: *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30, 79-81. I have already concluded that Dr Oberholster was in breach of his duty under s 135 by, inter alia, failing to require Mr Hitchinson to provide written reports as to, for example, profit and loss. It can hardly be a defence to then say he was entitled to rely on oral and informal advice. Further, for the protection of s 138 to attach, the information the director relies on must be prepared and provided more formally than the very informal oral advice Dr Oberholster was prepared to accept in this case. The section speaks of reliance on reports, statements, financial data and other information. That contemplates proper written documentation. There were no reports, statements and financial data in any formal sense in this case. The information passed on to Dr Oberholster by Mr Hitchinson was no more than general and unsubstantiated advice that the investors' funds were secure, and that the company was operating okay. For the reasons given earlier, those inquiries were not sufficient. Nor do they amount to a sufficient inquiry to support the statutory defence.

[105] Mr Gilchrist sought to suggest that, because this was a case of one director facing a claim because of the theft of another, the case was somehow in a different category. But the circumstances of this case do not, in my judgement, assist Dr Oberholster on this point. If anything, the fact that there were only two directors, that Mr Hitchinson had absolute control over the day to day operation of the company and it was, in Mr Gilchrist's submission, "Justin Hitchinson's company", makes it worse for Dr Oberholster when he seeks to rely on Justin Hitchinson's verbal reassurance. Dr Oberholster is not able to rely on s 138 to avoid liability.

The claim under s 301

[106] In the second cause of action the plaintiff pleads negligence in terms of s 301. But as the Court of Appeal made clear in *Mason v Lewis*, s 301 works in tandem with the earlier provisions of the Act and, in relation to claims by liquidators, provides for consequential orders rather than principal relief:

> [52] We observe that it is important not to conflate the provisions of s 135 and s 301 of the Companies Act 1993 when determining the "liability" issue. The issues are twofold: should there be liability, then, what is the appropriate relief?
>
> ...
>
> [55] ... if there is a breach, the Court has a discretion as to what recovery should be required under s 301 of the Act. This is why it is important not to conflate the two sections at the outset.

[107] I return to the issue of relief shortly.

Negligence at common law

[108] In the third cause of action the plaintiffs allege the defendant owed a duty at common law to the company, and was in breach of that duty.

[109] In *Daniels v Anderson* (1995) 13 ACLC 614, the Supreme Court of New South Wales concluded that the Corporations Law (AUST) does not preclude the existence of a common law duty of care. But as the Companies Act 1993 provides a more detailed prescription of the duties owed by a director than the Corporations Law (AUST), there may be an argument it should be interpreted as a code which excludes common law remedies. This is further supported by the fact that the clause in the Bill that said statutory duties were to be in addition to the common law duties of directors was not included in the Act. Reference can be made to the discussion in *Taurus Transport v Taylor* HC NAP CP33/99 22 May 2000 Master Thomson; *Benton v Priore* [2003] 1 NZLR 564; *Sojourner v Robb* (supra).

[110] In the present case it is unnecessary to resolve the issue of whether there is a common law claim in negligence in addition to the statutory duties (particularly

s 137). This is because the nature of the duties and the breaches alleged are identical, and any common law duty can add nothing to the relevant statutory duties in this case.

Relief

[111] Having found that Dr Oberholster has breached his duty as a director under s 135, and 137, at least in part, and is not entitled to the statutory defence under s 138, the next issue is the appropriate relief.

[112] The amount that the defendant should be required to contribute to the liquidation under s 301 is very much a broadbrush assessment by the Court as to what is appropriate in all of the circumstances of the case.

[113] In the present case a distinction must be made between the losses arising from Mr Hitchinson's default and dishonesty on the one hand, and those arising from the failure of FX Active on the other. For the reasons given earlier, I do not consider Dr Oberholster was in breach of any duty to the company in agreeing to change to FX Active as the trading platform and so can not be required to contribute to the losses sustained as a result of that transfer. The focus must be on his responsibility in relation to the losses caused by Mr Hitchinson's misappropriation of clients' funds. Those claims are identified in the indictment and total $44,985 and US$297,751.

[114] The approach to relief under s 301 has been recently confirmed by the Court of Appeal in *Mason v Lewis*:

> [109] The standard approach has been to begin by looking to the deterioration in the company's financial position between the date inadequate corporate governance became evident (really the "breach" date) and the date of liquidation.
>
> [110] Once that figure has been ascertained, New Zealand courts have seen three factors – causation, culpability and the duration of the trading – as being distinctly relevant to the exercise of the Court's discretion (see *Re Bennett, Keane & White Ltd (in liquidation) (No 2)* (1988) 4 NZCLC 64,317 per Eichelbaum J; and *Löwer v Traveller*, [2005] 3 NZLR 479 which endorsed those principles).

...

> [118] Finally, claims of this character necessarily have to be approached in a relatively broad-brush way. The jurisdiction to order recompense is of an "equitable" character.

[115] In some recent cases reference has also been made to the means of the director.

[116] I take 31 March 2006 as the "breach" date in this case. The impetus for the business came from Mr Reiher's investment in December 2005 for $US500,000 (albeit that he shortly thereafter withdrew $US350,000). Dr Oberholster became a director on 8 December 2005. The company's name was changed on 14 March 2006 to FXHT Fund Managers and on that date Dr Oberholster was confirmed as holding 440 shares. Allowing a reasonable period of time for Dr Oberholster to become involved in and familiarise himself with the business, by the end of March or early April he had had sufficient time to establish (or require Mr Hitchinson to establish) procedures for the proper management of the company. At the very least he had had sufficient time to establish a budget, a basis for a structured monthly reporting and review of profit and loss, together with some proper means of ensuring that clients' funds were treated as trust funds. Dr Oberholster failed to take any of those steps by that or any later date.

[117] If there had been regular reports then from an early stage, and at least by late March or early April 2006, Dr Oberholster should have been put on inquiry as to the viability of the business and the associated risk to the security of the investors' funds. By that time also there had been some unusual transactions, including for example the purchase of a rifle and the payment of the trader Mr du Plessis' rent. Dr Oberholster agreed that he would not have agreed to those expenditures. Of equal importance, Dr Oberholster would have realised the company was not earning sufficient to meet its outgoings. There is a causative link between Dr Oberholster's failure to properly involve himself in the management of the company and the supervision of Mr Hitchinson, and the losses occasioned by Mr Hitchinson's dishonesty. Dr Oberholster's failings provided the opportunity or, at the least, made it easier for Mr Hitchinson to commit the alleged frauds by taking clients' money

from the company. There was no control over Mr Hitchinson's access to clients' funds, and clients' funds were intermingled with the company funds.

[118] In the present case the duration of the company's operation is not directly relevant as it is not a case where the financial position of the company worsened over time as a consequence of the failures. Rather, the failure to supervise Mr Hitchinson led to the misapplication of clients' funds on a number of identified occasions. Mr Horrocks has been able to identify the money lost and they form the basis for the charges. The longer that Dr Oberholster allowed Mr Hitchinson to operate the company effectively unsupervised, the more opportunity Mr Hitchinson had to misuse the clients' funds. Dr Oberholster must be held responsible, at least in part, in relation to the losses sustained and the associated liability incurred by the company as a consequence.

[119] As to culpability, Mr Hitchinson is obviously the principal offender. He is the one who benefited personally from the misapplication of the funds. The company continued to operate and Mr Hitchinson continued to draw down monies for his own purposes. Dr Oberholster received nothing. In my judgment Dr Oberholster's culpability must be assessed as less than that of Mr Hitchinson. The Court of Appeal discussed the concept of culpability in *Löwer v Traveller* at [83]:

> The relevance of culpability is linked to the deterrent purpose of the provision. This factor calls for an assessment of the blameworthiness of Mr Löwer's conduct, bearing in mind that at one end of the range the nature of a director's involvement will be blind faith or muddleheadedness, while at the other end there will be actions or instances of inaction which are plainly dishonest: *Thompson v Innes* (1985) 2 NZCLC 99,463. The deterrent purpose of the section is served in cases involving a high degree of culpability by orders which are punitive as well as compensatory: *Re Cyona Distributors Ltd* at p 902.

[120] Dr Oberholster was in breach of his statutory duty to the company but acted honestly at all times. Dr Oberholster has been the victim of fraud too. In *Mason v Lewis,* in the quantum judgement, Stevens J fixed the liability of the Lewises at 60 percent. The Lewises were rather more actively involved in the failure of the company than I assess Dr Oberholster to be. Dr Oberholster was initially just less than a 50 percent shareholder and one of two directors. In my judgment, in relation to the money lost through Mr Hitchinson's dishonesty Dr Oberholster's liability

should be capped at about that level of involvement, namely one half of the losses. The one exception is the claim by Mr Ivan Read for $10,000 paid to Mr Hitchinson personally. Dr Oberholster cannot be held responsible for that decision by Mr Read to pay money directly to Mr Hitchinson. The money was never paid into the company. With that adjustment, Dr Oberholster should contribute one half of the sums identified as misappropriated by Mr Hitchinson in the indictment as confirmed by Mr Horrocks, namely NZ $17,492.50 and US$148,875.75.

[121] There is an issue as to the appropriate currency that any order should be expressed in. The Court has power to give judgment or to make orders for payment of sums of money expressed in a foreign currency where the claim is for debt or for damages. The orders are made and judgment entered in the currency which best expresses the plaintiff's loss: *Miliangos v George Frank (Textiles) Limited* [1976] AC 443; *Marr v Arabco Traders Limited* (1987) 1 NZBLC 102,732. A purposive reading of s 301 of the Act, particularly the reference to "such sum ... as the Court thinks just" in (1)(b)(ii) is consistent with that principle. While the investments were in NZ dollars, the investments were transacted in US dollars. Further, the majority of the money lost through Mr Hitchinson's misappropriation was money invested by Mr and Mrs Currie. There is documentation before the Court on the FXHT Fund Managers' letterhead, acknowledged by Mr Currie, as to the amounts outstanding in US dollars. That provides a sufficient basis for part of the judgment to be expressed in US dollars.

[122] Finally, I do not overlook that in some cases, the Court has discussed whether the means of a director might be relevant: *Re Cellar House Limited (in liquidation)* HC NEL CP13/00 18 March 2004 France J *Re South Pacific Shipping* but also note that in *Re Wait Investments (In Liquidation)* Barker J considered the amount should not be reduced because of the personal circumstances of a defendant. Dr Oberholster has given evidence of his financial position. It has not really been tested. To the extent means is relevant I do not consider it to be a significant enough factor in this case to alter the assessment I have arrived at.

The balance of losses attributable to the FX Active platform

[123] For the reasons given earlier I have concluded that Dr Oberholster was not in breach of any duty and is not to be held liable for losses following the transfer of investors' funds to the FX Active platform. In the event, however, I am wrong in coming to that view, I now go on to consider the amount Dr Oberholster should contribute in relation to those losses.

[124] The plaintiffs' total claim in this case is for US$926,360. That is made up as follows:

	US$
Barrett	$62,000
D & R Currie	$275,484
Donaldson	$14,000
Merritt and Read	$9,404
Oberholster	$3,700
Ivan Read	$25,000
Reiher	$100,000
Shadbolt	$81,000
Simperingham	$49,895
Whimp	$305,876
	$926,359

[125] The claim is overstated in a number of ways. First it includes claims on behalf of the defendant himself and his father-in-law Mr Donaldson. Mr Donaldson expressly confirmed in evidence that he did not pursue a claim.

[126] The claim also includes the amounts in relation to Mr Hitchinson's fraud. That is the entire amount of the claim on behalf of Ivan Read and the Curries. Mr Horrocks' investigation into the company's affairs and his interview with Mr Hitchinson confirms that none of the Curries' money was transferred to the FX Active platform. Those sums must also be deducted.

[127] Further adjustments are required.

Merritt and Read

[128] Mr Merritt invested US$100,000. He then became concerned at the lack of information from FXHT Fund Managers. On 25 August 2006 he performed a google search on Mr Hitchinson which disclosed he may have been involved in a fraud in South Africa. Mr Merritt immediately demanded full repayment of the investment. The amount of money returned was less than the amount then invested by NZ$9,404.58. Mr Merritt said that Mr Hitchinson explained that was due to a change in currency rates over the investment period. Mr Merritt does not accept that. However, the NZ$9,404 is less than the 10% stop loss that the investment provided for. I would not include Mr Merritt's loss in any claim relating to the FX Active platform.

Reiher

[129] Barry Reiher gave evidence that in December 2005 he invested US$500,000 but shortly thereafter withdrew US$350,000 leaving a balance invested of US$150,000. In early October 2006 he received a repayment of US$76,000 leaving a principal shortfall of US$74,000. Mr Reiher calculates that he is owed about US$100,000 on the basis he was told by Mr Hitchinson that that sum had been transferred in his name to FX Active. On 10 October 2006 Mr Reiher invested a further US$20,000 and on 17 October 2006 another US$65,000. Mr Reiher understands that Mr Hitchinson transferred the US$65,000 to repay US$30,000 to Mr and Mrs Currie and US$35,000 for funding the expenses of the company including Mr Hitchinson's salary. Mr Hitchinson has signed an acknowledgement of debt in respect of that US$65,000 in Mr Reiher's favour. It is included in the fraud claim.

[130] Putting the sum of $65,000 relating to the fraud to one side it seems the principal amount Mr Reiher is out of pocket for is $US94,000 rather than the US$100,000 referred to in the claim.

Mr Simperingham

[131] Mr Simperingham decided to test the system by initially investing $5,000 with FXHT Fund Managers. The money was invested and returned. Mr Simperingham then invested US$100,000. That money was paid to FXHT Limited, not FXHT Fund Managers. He recovered approximately US$50,000 back from FX Active but he claims the balance of US$49,895. Dr Oberholster had no involvement in the loss of Mr Simperingham's money which was paid to Mr Hitchinson's own company, not to FXHT Managers. Mr Simperingham is not a creditor of FXHT Fund Managers. On the information provided, it is at least arguable that he did not invest the monies with FXHT Fund Managers at all. He has a claim against FXHT Fund Managers and Mr Hitchinson personally. I would not include his claim.

Garry Whimp

[132] Mr Whimp claims US$305,876. Mr Whimp is an accountant. He and his wife had funds on investment pending completion of a new home. They invested NZ$350,000 on 1 August. They later invested a further US$84,000. The initial investment was transferred to FX Active. Mr Whimp signed a document retrospectively approving the transfer. He then invested the further US$84,000 through that platform on 29 November 2006. It seems that over the period of the investment Mr Whimp had received approximately US$18,000. The principal loss to Mr Whimp appears to be US$273,200.

[133] With those adjustments taken into account, the investors' loss through the failure/refusal of the FX Active platform to return investments is US$510,200 calculated as:

Barrett	62,000
Reiher	94,000
Shadbolt	81,000
Whimp	273,200
	510,200

Mr Horrocks' figure was less, at US$463,540 but he calculated Mr Whimp's loss at $224,000.

An email from FX Active records the accounts it held for the investors as:

Simperingham	47,798
Whimp	287,682
Shadbolt	82,040
Barrett	74,884
	US$492,404

[134] Accepting for present purposes the figure is between US$463,540 and US$510,200, there are a number of factors which would bear on the appropriate figure Dr Oberholster ought to contribute to those losses (if he was liable to).

[135] The first is that in the case of Mr Reiher, Ms Shadbolt and Mr Whimp, all entered client agreements which provided FXHT Fund Managers could transfer the trading platforms from time to time. The relevant clauses were to the effect that FXHT Fund Managers was authorised to manage and trade the trading account held with Forex Swiss or any other trading platform it saw fit and to transfer funds from one trading platform to another. Further, both Mr Whimp and Mr Reiher confirmed in their evidence that they were aware of the change and confirmed the authorisation of the transfer of the funds after the event. For his part Mr Reiher invested a further US$20,000 after the transfer.

[136] The agreements also contained a number of clauses dealing with the risks of trading in foreign exchange. For example:

> Risk acknowledgement
>
> Trader acknowledges that investment in leverage and non leverage transactions is speculative, involves a high degree of risk, and is appropriate only for persons who can assume risk of loss of their entire margined deposit. Trader understands that because of the low margin normally required in OTC trading, price changes in OTC may result in significant losses. ...

[137] While Mr Barrett did not enter a client agreement, he made the investment because of his personal association with Mr Hitchinson. He had flatted with Mr Hitchinson.

[138] Dr Oberholster's culpability in relation to the decision to use FX Active which led to the losses was extremely limited. While he agreed with the decision to change platforms he did so on the advice of Mr Hitchinson and Mr du Plessis. He did so in good faith. He had no reason to doubt their advice why the change should be made.

[139] In the circumstances, if Dr Oberholster had any liability arising from the decision to change the platform to FX Active, and was to be required to make a further contribution to FXHT Fund Managers in liquidation, I would not fix it at any more than 10%. In this case, and on the basis of the information available, that would equate to US$50,000.

Summary

[140] In summary I find that Dr Oberholster was guilty of breach of s 135 in that he allowed the business of FXHT Fund Managers to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors by allowing Mr Hitchinson free rein to run the company without requiring any formal reporting. He was also in breach of his duty of care under s 137 for failing to put in place adequate systems of control and reporting. Dr Oberholster was, however, not guilty of any breach of duty, be it statutory or common law, owed to the company in relation to his decision to agree to the transfer of the trading platform to FX Active.

[141] The losses for which Dr Oberholster has some responsibility are those frauds carried out by Mr Hitchinson which were facilitated by Dr Oberholster's lack of control over Mr Hitchinson and his failure to require proper systems. However, Dr Oberholster's responsibility in relation to those should be capped at no more than 50 percent of the monies misapplied by Mr Hitchinson (with the further deduction of the $10,000 paid directly by Mr Read to Mr Hitchinson).

Interest

[142] Section 301(1) contemplates that in addition to the sum to be repaid to the company the Court may also order interest on that sum. That is particularly so where the order is for the repayment or restoration of money to the company or where the application is made by a creditor. The application in the present case is made by the company and liquidators, not the creditors. While it might have been appropriate to order Mr Hitchinson to repay or restore money to the company that he has misapplied or retained, Dr Oberholster has not misapplied or retained money. Rather, because of his breaches of duty in relation to the company it is appropriate that he be ordered to contribute a sum to the assets of the company by way of compensation. Section 301(1)(b)(ii) does not expressly refer to interest. Even if interest can be payable on or in addition to a sum under the subsection, I do not consider interest should be included on the sum in this case for two reasons. First, the order is for a contribution rather than a repayment and second, a substantial part of the judgment sum is expressed in US dollars which of itself will involve a degree of further compensation to the company when it is converted to NZ dollars, given the movement in exchange rates.

Orders

[143] There will be judgment for the plaintiffs requiring Dr Oberholster to contribute the sums of NZ$17,492.50 and US$148,875.75 to the company in liquidation.

[144] The plaintiffs are entitled to costs. I am not aware of any reason why costs on a 2B basis would not be appropriate. However if counsel wish to exchange memoranda on the issue of costs they may do so.

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Venning J