IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CRI-2010-085-2538
[2012] NZHC 265

THE QUEEN

v

DOUGLAS ARTHUR MONTROSE GRAHAM
MICHAEL HOWARD REEVES
WILLIAM PATRICK JEFFRIES
LAWRENCE ROLAND VALPY BRYANT

Hearing: 17, 18, 19, 20, 21, 25, 26, 27, 28, 31 October 2011
1, 2, 3, 4, 7, 8, 9, 10, 11, 14, 15, 16, 17, 18, 21, 22, 23, 24, 25, 28, 29, 30 November 2011
1, 2, 5, 6, 7, 8 December 2011
31 January 2012
1, 2, 3 February 2012

Counsel: C R Carruthers QC, D R La Hood and V C Brewer for Crown
P J Davison QC, M A Corlett and R C Woods for Accused Graham and Bryant
S M Henderson for Accused Reeves (and D G Hurd on 24 February 2012)
D G Hurd and D H O'Leary for Accused Jeffries

Verdicts: 24 February 2012 at 10am

REASONS FOR VERDICTS OF DOBSON J

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Glossary of terms used in footnotes

LOM	Code used to identify documents produced by the Crown in electronic form, including three digit electronic file reference and four digit page number (eg LOM001.0001)
DV	Defence Volume, followed by volume number, tab number and page number (where used) (eg DV1/1/001)
T	Transcript of evidence. Page and, where appropriate, line numbers (eg T1/12-15).
[A-]	Appendix A to these reasons, regarding the major loans.

Introduction

[1] Lombard Finance & Investments Limited (LFIL) operated for some six years as a finance company. Its business involved raising money from the public, and making loans to borrowers, generally on a secured basis, and predominantly lending to property developers. As was common for finance companies, LFIL periodically issued prospectuses, which were registered as the source of information on which potential investors could rely, in making decisions to invest in LFIL. LFIL borrowed both on a secured basis, with investors receiving debenture stock secured over LFIL's assets, and on an unsecured basis. LFIL also publicly distributed investment statements promoting investment in its debenture stock and unsecured notes.

[2] LFIL was a wholly owned subsidiary of Lombard Group Limited (the parent company) which was a publicly listed company on the New Zealand exchange. LFIL was by far the major asset of the parent company. None of the securities issued by LFIL were listed for trading on the exchange.

[3] On 10 April 2008, the Trustee for debenture stockholders appointed receivers to LFIL. The receivers have subsequently identified a substantial shortfall in realisation of LFIL's assets, resulting in projected returns of less than 24 cents per dollar to secured investors. Unsecured investors in LFIL face a total loss of their investments.

[4] New investment in secured debenture stock after the issue of the amended prospectus on 24 December 2007 up to the date of suspension of repayments on 2 April 2008 amounted to $1,560,808. Maturing investments that were re-invested in the same period amounted to $10,052,521. In addition, investments and re-investments were made in unsecured notes and capital notes of some $844,000. The parent company rolled over a previously unsecured investment in LFIL of $2 million, into secured debenture stock in early April 2008. Excluding that

transaction, the extent of investments made during the currency of the December 2007 offer documents was some $10.45 million.[1]

[5] These proceedings determine five charges brought against each of the directors of LFIL alleging breaches of s 58 of the Securities Act 1978 (the Act) in respect of:

- allegedly untrue statements in an LFIL amended prospectus issued on 24 December 2007;

- allegedly untrue statements in each of three investment statements issued in respect of unsecured subordinated notes (count two), unsecured subordinated capital notes (count three) and secured debenture stock (count four), all of which were in materially the same terms and dated 28 December 2007; and

- an allegedly untrue statement in a DVD that the Crown alleges was distributed between about 3 March 2008 and 3 April 2008, and which allegedly constituted an "advertisement" for the purposes of s 58 of the Act.

(When referring to the amended prospectus and investment statements collectively, I will describe them as "the offer documents".)

[6] Each count in the indictment is the subject of extensive particulars. I will set out that detail when considering the elements of each charge. In essence, the first count alleges five respects in which the amended prospectus was said to be "untrue", namely:

- material omissions from the presentation of the liquidity risk;

- the quality and value of the loan book in that it omitted material adverse matters relating to impairment of major loans;

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[1] DV3/8.

- in relation to adherence to lending and credit approval policies;

- that the financial position of LFIL had not materially and adversely changed between the audited statement of its financial position as at 31 March 2007 and the date of an extension certificate relied on in the amended prospectus (ie 24 December 2007); and

- the statement that there were no other material matters relating to the offers of securities under the amended prospectus, apart from those set out in it.

[7] Somewhat differently expressed particulars were specified in relation to the terms of the investment statements in issue in counts two, three and four. Count five cited the omission from the DVD of material particulars that would have reflected a substantial deterioration in LFIL's financial position between that reported at 31 March 2007, and the alleged distribution of the DVD in March 2008.

[8] The charges were brought against all four of LFIL's directors. The amended prospectus described them in the following terms:

> **The Rt. Hon. Sir Douglas Arthur Montrose Graham (Chairman) KNZM, Hon D (Waikato) LLB**
>
> A former Minister of Justice, Attorney General, Minister in charge of the Serious Fraud Office, and other portfolios, Sir Douglas was responsible for major company law reforms including the financial reporting requirements for companies. Prior to his distinguished political career, he practised law in Auckland for over 20 years and has a wealth of legal experience. Sir Douglas serves on the Board of a number of companies and is a member of the Institute of Directors in New Zealand. He is also Deputy Chairman of the Guardians of the New Zealand Superannuation Fund. The Rt Hon Sir Douglas Graham is an independent Director.
>
> **Michael Howard Reeves (Chief Executive Officer)**
>
> Michael has a strong background in corporate finance, property lending, merchant banking and business management. Over the last 20 years he has held senior executive positions in a variety of public and private companies. He is currently a director of Lombard Group Limited and several private companies, he is also a member of the Institute of Directors in New Zealand. Michael Reeves is not an independent Director.

> **The Hon William Patrick Jeffries**
> **LLB (Victoria)**
>
> A former Cabinet Minister whose portfolios have included Justice and Transport. Mr. Jeffries currently practices [sic] as a barrister in Wellington. He currently holds the position of Chief Commissioner of the Transport Accident Investigation Commission and is also the Honorary Consul-General for Sweden. As of 1 July 2007 Mr Jeffries was appointed as chairman of the Real Estate Agents Licensing Board. The Hon William Jeffries is an independent Director
>
> **Lawrence Roland Valpy Bryant**
> **LVO**
>
> An experienced company director and public affairs counsel who has practised locally and internationally for more than three decades. He is currently a director of a number of private companies, following 10 years as chief executive of New Zealand operations of a London listed company, and executive director of the Royal Agricultural Society of New Zealand. He is a Fellow of the Institute of Directors in New Zealand. Lawrence Bryant is an independent Director.

[9] The response to these charges on behalf of all the directors has been to positively defend the standard of their governance as directors of LFIL, and the competence of their judgement in the decisions made up until the time at which the Trustee appointed receivers. Their decisions to issue the offer documents in the terms they did were explained as a part of that course of conduct. At numerous points in the trial, I raised a concern that the competence of the directors in the general sense could not be relevant to the issues I had to determine. However, until the full extent of the defence arguments was known, it was inappropriate to exclude any of the wide-ranging evidence going to the directors' conduct.

[10] The alleged offences are ones of strict liability so the Crown is not required to prove any form of mental intent to distribute documents that were false or misleading. Nor is it any part of the Crown's case that the conduct by the directors in issuing the offer documents was other than honest. In the relevant respects, the law has created criminal liability for what may be no more than a material misjudgement about the accuracy and adequacy of the description of the state of financial health of the company, as directors authorise it in offer documents.

[11] Except to the extent that it may inform an assessment of the reasonableness of a director's belief in the truth and accuracy of the content of an offer document

(and therefore have a bearing on that defence where it arises), the competence or otherwise of discharge of directors' duties is irrelevant. The primary issue is the adequacy and accuracy of disclosure.

Structure of the relevant statutory provisions

[12] On the implicit premise that "sunlight is the best disinfectant",[2] Part 2 of the Act imposes obligations on those seeking investment from members of the public to provide them with adequate and accurate information prior to them making any commitment to invest, with a statutory prohibition on raising money unless the prescribed forms of disclosure have been complied with.

[13] The most detailed information disclosure is that required for a prospectus. Compliance with requirements as to the extent of information to be provided was subject to scrutiny by the Companies Office before a prospectus could be registered. This has subsequently become a responsibility of the Financial Markets Authority. An issuer can only rely on a prospectus to allot securities for up to nine months from the end of the period to which audited financial statements accompanying the prospectus relate. However, a prospectus can be extended if directors certify within nine months after the date of the financial statements contained in the prospectus that the issuer's financial position has not changed materially and adversely from that reflected in the financial statements published in the prospectus. Such an extension certificate must also confirm that the prospectus is not false or misleading in a material particular by reason of failing to refer or give proper emphasis to adverse circumstances.[3]

[14] Section 33(2) of the Act also provides that an issuer cannot offer debt securities to the public unless the issuer has appointed a trustee in respect of the

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[2] A catch cry of the late Colin Patterson, original Chairman of the New Zealand Securities Commission, adapting the words of Louis D Brandeis writing in Harper's Weekly, December 20, 1913: "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman".

[3] Section 37A(1)(c) and 37A(1A)(c).

security, and the issuer and trustee have completed a trust deed that complies with the Act and regulations made under it.[4]

[15] Issuers are not required to provide a copy of a registered prospectus to every investor who subscribes for debt securities. Instead, issuers may use an investment statement that provides certain key information likely to assist a prudent but non-expert person to decide whether to subscribe for the securities. The investment statement also advises recipients that other important information about the securities is available to that person in the prospectus.[5]

[16] The third form of communications by issuers to the public that are provided for in the Act is "advertisements".[6] This definition includes investment statements, plus other advertisements that refer to an offer of securities to the public or are reasonably likely to induce persons to subscribe for securities of an issuer to which that advertisement relates.

[17] Part 2 of the Act provides for civil liability, with the prospects of both compensation and pecuniary penalties where there has been non-compliance with the requirements,[7] and criminal liability, in ss 58 and 59. The former of those sections provides:

> **58 Criminal liability for misstatement in advertisement or registered prospectus**
>
> (1) Subject to subsection (2) of this section, where an advertisement that includes any untrue statement is distributed,—
>
> (a) The issuer of the securities referred to in the advertisement, if an individual; or
>
> (b) If the issuer of the securities is a body, every director thereof at the time the advertisement is distributed—
>
> commits an offence.
>
> (2) No person shall be convicted of an offence under subsection (1) of this section if the person proves either that the statement was immaterial or that he or she had reasonable grounds to believe, and

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4 Relevantly to the period in issue, the Securities Regulations 1983.
5 Sections 38C-38E.
6 The subject of a separate definition in s 2A of the Act, set out at [301] below.
7 Sections 55A-57E of the Act.

did, up to the time of the distribution of the advertisement, believe that the statement was true.

(3) Subject to subsection (4) of this section, where a registered prospectus that includes an untrue statement is distributed, every person who signed the prospectus, or on whose behalf the registered prospectus was signed for the purposes of section 41(1)(b) of this Act, commits an offence.

(4) No person shall be convicted of an offence under subsection (3) of this section if the person proves either that the statement was immaterial or that he or she had reasonable grounds to believe, and did, up to the time of the distribution of the prospectus, believe that the statement was true.

…

[18] As to what constitutes an "untrue statement", the Act has a definition in s 55, as follows:

55 Interpretation of provisions relating to advertisements, prospectuses, and registered prospectuses

For the purposes of this Act,—

(a) A statement included in an advertisement or registered prospectus is deemed to be untrue if—

(i) It is misleading in the form and context in which it is included; or

(ii) It is misleading by reason of the omission of a particular which is material to the statement in the form and context in which it is included:

[19] The Act also recognises the potential relevance of omissions, in a section addressing restrictions on the distribution of prospectuses:

34 Restrictions on distribution of prospectuses

(1) No registered prospectus shall be distributed by or on behalf of an issuer,—

…

(b) If it is false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances (whether or not it became so misleading as a result of a change in circumstances occurring after the date of the prospectus).

Legal elements of the charges

[20] There are three materially similar elements required to be proven on each of the counts. Firstly, that the document in issue included an untrue statement. On the first count under s 58(3), the relevant document is the amended prospectus. On the remaining charges under s 58(1), the relevant documents are the investment statements (constituting "advertisements") for each of the three forms of investment involved, and the DVD.

[21] The second element is that the relevant document was distributed.

[22] The third element of the charge in relation to a prospectus was that each of the accused signed the prospectus or that it was signed on his behalf. The corresponding requirement for charges under s 58(1) is that the accused were directors at the time of distribution of the relevant advertisement.

[23] There is no issue about distribution of the relevant prospectus, or the advertisements comprised in the investment statements to which counts two, three and four relate. There is, however, a discrete challenge to the Crown's proposition that the extension certificate, on which the validity of the amended prospectus depended after 31 December 2007, was both registered and distributed in the period to which the charges relate.[8] Nor is there any issue that the prospectus was signed by each of the directors or on his behalf, or in the case of the investment statements that they were distributed at times when each of the accused were directors of LFIL. As to count five, some of the accused deny that the DVD constitutes an "advertisement" for the purposes of s 58.

[24] In its opening, the Crown distilled the legal principles applicable to a charge under s 58, as formulated by Heath J in the case of prosecution of directors of another finance company, Nathans Finance Limited.[9] The Crown's summary was as follows:[10]

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[8] See [58]-[85] below.

[9] *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011.

[10] Distilled from *R v Moses* at [38]-[51].

> An untrue statement can be an affirmative statement or material omission.
>
> The assessment of whether a statement is untrue is an objective one and must take into account context and should not be approached on a literal basis.
>
> The Crown is not required to prove any criminal intent on the part of the directors.
>
> Once the Crown has proved beyond reasonable doubt that an affirmative misleading statement has been made, the onus shifts to the directors to demonstrate, on a balance of probabilities, that it was immaterial or that he or she had reasonable grounds to believe that the statement was true.
>
> Where the Crown proves that a statement is misleading due to an omission, it must also prove that the omission is material. It is then for the accused to establish, on a balance of probabilities, that a statement that is deemed to be misleading is immaterial to any investment decision.
>
> A material omission is something that ought to have been disclosed because it could well have made a difference to the decision whether to invest.

[25] The Act contemplates that the audience for an investment statement is a "prudent but non-expert person". Heath J held that the target audience contemplated by the notion of a "prudent but non-expert person" is also the audience in respect of which an issuer is deemed to prepare a prospectus. Heath J described the attributes he contemplated for a "prudent but non-expert person" (he used the term "notional investor", which I will similarly adopt) as including:[11]

- The notional investor falls somewhere between one who is completely risk averse and someone who is prepared to take a high level of risk. They are expected to know that the higher the interest rate offered the greater the risk of loss.

- The notional investor understands the language employed in the narrative sections of both an investment statement and a prospectus. This extends to a general understanding of technical words such as "debenture" and financial jargon, such as "rollover". As non-experts, notional investors are expected to focus more on the narrative of offer documents than on financial statements.

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[11] Distilled from *R v Moses* at [64]-[67].

- Such notional investors seek assistance from financial advisers. While not expected to be financially literate, such persons are likely to have sufficient ability to comprehend competent advice about investment decisions.

[26] The only one of these characteristics attributed to a notional investor which I have reservations about is the third. Whilst Heath J pointed out that the regime permitting use of investment statements was introduced at the same time as the Investment Advisers (Disclosure) Act 1996, I would not confine the characteristics of the notional investor to those who would be guided in their consideration of investment statements by advice from investment advisers. Certainly, that may be a predictable pattern of conduct and the terms of offer documents complying with the statutory requirements urge investors to seek advice before making investment decisions. However, I would include within the range of those treated as the "notional investor" some who may not seek investment advice, despite realising that they are non-experts when it comes to weighing up investment decisions. Notwithstanding that the statutory provisions contemplate investors taking advice, I attribute to Parliament the practical recognition that a portion will not do so.

[27] Mr Davison QC for Messrs Graham and Bryant argued that the attribute of prudence meant that such readers of offer documents would appreciate the extent to which they did not understand the documents, and would seek professional advice in order to obtain an adequate understanding. Again, that is an appropriate ideal, but I do not treat Parliament as intending it as a given. The notional investor should extend to some who have less than a complete understanding of all content, but do not take advice.

[28] Mr Davison also argued for a different approach to some of Heath J's propositions on the law. The first of two aspects of the legal context as sketched in *Moses* to which Mr Davison took exception, was the scope of responsibilities attributed to directors.[12] This becomes relevant when directors claim reasonable reliance on the accuracy of information provided to them by management. The issue is the extent to which directors can reasonably rely on advice and analysis by others,

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[12] *R v Moses* at [74]-[87].

and the circumstances in which they would be obliged to undertake additional analysis, or seek additional information.

[29] Heath J began with the proposition that directors direct, and managers manage. Whilst directors are responsible for managing the business of a company, the practicalities in most corporate situations require delegation of those responsibilities to management.[13] Heath J observed:[14]

> Senior management will be delegated tasks by the directors. Subject to adequate monitoring of management by the directors or anything that may put a director on notice of the need for further inquiry, reliance on information provided by management in their delegated areas of authority will generally be appropriate. But every reliance inquiry will be fact specific, taking into account both the obligations and responsibilities of particular directors and the nature of the tasks delegated to members of the management team.

[30] The statutory context for that observation are the provisions of s 2B of the Act, and s 138 of the Companies Act 1993. Those sections provide:

> **2B Meaning of "due enquiry"**
>
> (1) For the purposes of this Act, a person who is required to make due enquiry about a matter does not fail to do so if—
>
> (a) He or she receives information or advice about the matter from another person whom he or she believes on reasonable grounds is reliable and competent; and
>
> (b) The information or advice received—
>
> (i) Is of the same kind and standard as that which it would be reasonable to expect to be supplied in the ordinary course of management of businesses of the same kind to persons in the same kind of position; and
>
> (ii) Does not state or indicate that further information, advice, or investigation is or may be required; and
>
> (c) He or she has no reason to believe that the information or advice is or may be incorrect.

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13 Heath J at [72]-[87]. His reasons cite s 128 of the Companies Act 1993, and observations of Thomas J from *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30 (HC) at [79] on the responsibilities of directors, and the realities of delegation.

14 At [82].

> (2) Nothing in subsection (1) of this section limits the ways in which a person may make due enquiry about a matter.
>
> …
>
> **138 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.

[31] Heath J's analysis continued:[15]

> … Both of those provisions envisage the possibility of the need for further inquiry by a director, on the basis of information already held or incomplete information on which further explanation is required. The protections afforded by s 2B and s 138 will be forfeited if appropriate inquiry is not made.

[32] Mr Davison argued that this approach would require directors to undertake detailed analyses that are appropriately left to management, so that the entitlement to rely on information provided by others is unreasonably narrowed.

[33] For the Crown, Mr Carruthers QC submitted that Heath J's version of the test is appropriate for directors of finance companies. Whilst each situation is

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15 At [86].

fact-specific, any circumstances that would lead a reasonable finance company director to question the reliability of what he or she is told triggers an obligation to make further enquiry and therefore brings to an end the entitlement of a director to rely on the information provided to him or her on a particular topic.

[34] Neither section can be read in a way that would relieve a director of the obligation to check on the competence of a delegate, in any circumstances where a signal occurs that would put a reasonable director on notice of the need to do so. It is not helpful to attempt a definition in abstract of the circumstances in which a director should not rely on information provided by management, in terms any more precise than those I have just attributed to the Crown's position.

[35] To the extent that Mr Davison proposes that directors can rely on the judgement of managers until the directors are on notice that something of substance has gone wrong, then that puts permissible reliance too highly. Directors are appointed to exercise judgement and that extends to testing the competence of management within areas in which managers are relied upon. Each circumstance of reliance on management needs to be assessed within its own context.

[36] The second aspect of Heath J's approach that Mr Davison urged me not to follow related to the level of detail expected to be disclosed when directors made an offer of securities to the public. Heath J had observed:[16]

> A strict liability offence is justified by the nature of an offer of securities to members of the public. The public rely on those responsible for making the offer to disclose everything of relevance that is likely to be material to the investment decision. Investors do not have insider knowledge. The need for a serious sanction for non-disclosure arises out of the prospect of loss being suffered by innocent investors through reliance on misleading statements, whether made deliberately or innocently.

[37] Mr Davison argued that an expectation of exhaustive disclosure of "everything of relevance that is likely to be material to the investment decision" set the bar too high. Rather, he proposed that the disclosure ought to be of everything relevant to the totality of the disclosure being true and correct. That would obviously be subject to an omission not being misleading, or leading to a false

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16 At [40].

impression, but would mean that the standard expected for disclosure of matters of relevance was not an exhaustive one.

[38] In his closing for Mr Jeffries, Mr Hurd argued correctly that it is not necessary for the directors to share all material information known to them. Rather, he argued that they are required to provide sufficient information on material matters to adequately inform an investment decision. In the context of debt securities, that investment decision focuses on the risks of not being paid interest, and repaid the capital invested.

[39] The requisite level of disclosure is also a point on which an absolute definition is neither possible nor helpful in abstract. In each factual situation, the pertinent issue will be what matters are likely to be material to investment decisions. I am not persuaded that the formulation used by Heath J does set the bar too high. If there is a misstatement or omission in relation to a point that is likely to be material to an investment decision, then the prospect of liability should be triggered. That is the part that s 58 plays in ensuring that those responsible for offering securities to the public discharge their obligation fully, to ensure that the market is indeed adequately and accurately informed.

LFIL's business from mid 2007

[40] By the third quarter of 2007, LFIL's lending was dominated by exposures to five major borrowing groups. Concerns held by the Trustee at LFIL's liquidity position led to it encouraging LFIL to retain the accounting firm, Ferrier Hodgson, to undertake a review of those major exposures in September 2007. Prior to that, in May 2007 concerns about the concentration of lending led the auditors to recommend to the audit sub-committee of the Board that LFIL establish a separate sub-committee including one or more independent directors, to monitor the larger loans. The auditors' principal focus at the time was the loan for a large development in Brooklyn, suburban Wellington.[17] Such a committee was formed, comprising Mr Bryant and Mr David Wallace who was a director of LFIL's parent company, plus LFIL executives.

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[17] See [A1]-[A20].

[41] The executive summary to the Ferrier Hodgson report, presented on 18 September 2007, began with an acknowledgement of the situation confronting finance companies at the time:[18]

> The New Zealand finance company sector has been under significant stress in recent times. Those with an exclusive or a predominance of debenture funding are under increasing pressure as reinvestment rates plummet from historical levels.

[42] In the months before that report, there had been well-publicised adverse events, including the appointment of receivers to other finance companies such as Bridgecorp on 2 July 2007, Nathans Finance Limited on 20 August 2007 and Five Star Consumer Finance on 29 August 2007.

[43] The minutes of LFIL's Board meeting on 26 September 2007 report the CEO (Mr Reeves) as:[19]

> …express[ing] his concern at the future viability of finance companies which relied on funding from the issue of debenture stock. He said that he believed the lack of investor confidence following the failure of so many finance companies over the past 12 months was serious and unlikely to be restored for some time…

[44] By 24 December 2007, loans to the five major borrower groups represented approximately 77 per cent of the projected repayments for all of the loans LFIL had outstanding. The Crown's case is that it was apparent, or ought to have been apparent to the accused, that the five major borrowers were not able to repay their loans as they fell due, or at the least had impaired abilities to do so. Further, that delays in loan repayments meant that there was substantial pressure on LFIL's liquidity, in terms of cash resources available to make payments as the company became obligated to do so.

[45] The period from January 2008 saw a deterioration in LFIL's financial position. The directors were acutely aware of liquidity pressures, but continued to accept assurances from management, to the effect that whilst significant loan repayments were delayed, that did not render the loans irrecoverable, and that

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18 LOM009.0143.
19 LOM007.0297, 98.

genuine reasons existed for the non-payments. Mr Reeves' CEO report for the February 2008 Board meeting stated:[20]

> It is clear that a managed well orchestrated wind down of Lombard Finance is an inevitable reality.

[46] During March 2008, the prospect of a moratorium was explored. That would involve obtaining consent from a majority of the investors to suspend LFIL's obligations to repay them, enabling the company to avoid or minimise the risk of losses by an orderly collection of the outstanding loans that comprised LFIL's assets.

[47] As part of the work on this proposal, Mr Reeves negotiated with Ferrier Hodgson (by now re-named KordaMentha) from early March 2008 to conduct a further review that would update the status of LFIL's major loans. KordaMentha began that assignment at the end of March, and they produced an interim report dated 7 April 2008.

[48] By that date, the directors of LFIL had engaged in discussions with representatives of the Trustee for debenture holders as to the desirability of a moratorium. The Trustee took its own advice, and on 10 April 2008 rejected the directors' proposal without conferring with investors. Instead, the Trustee appointed receivers.

The witnesses

[49] The Crown case depended primarily on the evidence of an investigating accountant, Michelle Peden, who was, throughout the period of the investigation, employed by the Securities Commission. She has subsequently continued as the Manager, Forensic Accounting with the successor to the Commission, the Financial Markets Authority. Ms Peden has Bachelor and Master of Commerce degrees, together with a Master of Business Administration, all from the University of Auckland. Prior to joining the Securities Commission, Ms Peden was a forensic accountant with the Serious Fraud Office from September 1997 until July 2008.

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[20] LOM007.0764.

[50] The Crown called as an expert Mr Charles Cable, who is a corporate finance partner with the accounting firm Deloitte. Mr Cable has a Master of Science with Honours degree, and has had a range of experience working with The Treasury, and for merchant banking and investment banking firms in the United States, Australia and New Zealand. He has provided expert evidence on a number of occasions in relation to share valuations and alleged breaches of securities law. Mr Cable had been asked to critique a report prepared by Ms Peden for the Securities Commission, and to opine on certain issues relevant to the adequacy and accuracy of the amended prospectus. In most respects, his opinion depended upon the accuracy of the factual analysis undertaken in Ms Peden's report.

[51] Because of a pre-trial ruling that certain categories of LFIL documents could not be adduced as business records without being produced by a witness able to confirm their status, the Crown called a former lending manager from the Auckland office of LFIL, Mr Michael Erskine, to produce documents within the relevant categories.

[52] The Crown also called:

- Mr John Fisk, one of the two partners of PricewaterhouseCoopers appointed as receivers of LFIL. Mr Fisk gave evidence about the financial state of the company as he found it to be after his appointment, plus an overview of the realisation of the securities held for the major advances.

- Messrs Andrew Dinsdale and Ross Buckley, partners of KPMG who were the auditors of LFIL who gave evidence of their work in relation to the audit and other dealings with LFIL.

- Mr Grant Graham, the partner of Ferrier Hodgson/KordaMentha, who was responsible for their report on LFIL's major loans in September 2007 and who commenced work on a further report in April 2008.

- Ms Stephanie McGreevy, the executive with the Trustee, Perpetual Trust Limited, who was responsible for monitoring LFIL's compliance with the obligations under the Trust Deed.

- Ms Renee Hart, an employee of the Companies Office who produced Companies Office records relating to LFIL and its parent company.

[53] Evidence for the Crown included statements from six investors in LFIL. Mrs Hooker of Hamilton gave evidence but was not cross-examined. She had decided in March 2008 not to renew an investment in LFIL debenture stock when it matured. She was contacted by an LFIL employee in early March 2008 and was persuaded to change her mind, thereafter renewing her investment with LFIL. She projected that she would earn $300 more per annum on her $30,000 re-invested with LFIL than if it was invested as a term deposit with Kiwibank. In the course of her dealings with LFIL in early March 2008, she requested and was sent copies of the DVD, which is the subject of count five, and the investment statement for secured debenture stock.

[54] Statements were read from five other investors in LFIL at the time it suspended the amended prospectus in April 2008. All of these investors were retired persons. Their investments in LFIL appear to have ranged from some $2,700 unsecured, to $170,000 in secured debenture stock. One of the five was contacted similarly to Mrs Hooker and persuaded to re-invest in March 2008. Another discussed re-investment in LFIL with an LFIL employee on 1 April 2008. The investor of the largest amount in LFIL described the amount lost as "most of my life's savings and most of my mother's inheritance".

[55] In addition to these statements, the parties agreed pursuant to s 9(2) of the Evidence Act 2006 on the admission of facts relating to the circumstances of another couple who were actual or potential investors in LFIL and who attended a presentation at the Crowne Plaza Hotel in Christchurch in September 2007. That couple recalls Sir Douglas Graham as the main speaker being supported by senior management of LFIL and they recall Sir Douglas speaking very positively about LFIL. Promotional materials available included copies of the DVD that is the

subject of count five. The couple involved took a copy of the DVD and subsequently watched it when they returned home.

[56] Each of the accused gave evidence. Sir Douglas also called an additional nine witnesses. In each case their evidence was relied on by all other accused. They were:

- Three employees of LFIL, Mr Warwick Thorpe (a loan manager), Mr Allan Beddie (CFO until October 2007, and previously an executive director), and Mr Michael Gray (internal accountant).

- Mr Peter Morpeth, the former company secretary who fulfilled that role as part of his independent practice as a chartered accountant.

- Mr Paul Foley, a commercial partner at Minter Ellison Rudd Watts, solicitors, who had acted for LFIL and advised on the terms of the amended prospectus and investment statements.

- Mr David Wallace, who was a director of LFIL's parent company and chaired LFIL's large loan sub-committee.

- Ms Carol Smith, a solicitor retained by Mr Tim Manning, the alter-ego of the largest borrowing entities from LFIL. Ms Smith supervised the due diligence process on behalf of Mr Manning in the third quarter of 2007 in respect of the Brooklyn development, which one of his companies acquired.

- Mr David Appleby, a senior chartered accountant with experience as a company director. Mr Appleby was called as an independent expert to review the relative quality of financial performance by LFIL, the standard of decision-making by its Board, and to opine on each of the areas in respect of which the Crown alleged there were untrue statements in the offer documents.

- Mr David Newman, an experienced director and co-director with Sir Douglas of the New Zealand Superannuation Fund, who gave evidence of the skills required of company directors, as well as character evidence lauding Sir Douglas's performance as a diligent company director. Mr Newman also expressed views about the situation confronting company directors in late 2007 and early 2008, dominated by uncertainty as to the nature, extent and possible duration of adverse changes attributable to the global financial crisis.

[57] In addition to his own evidence, Mr Reeves called evidence from Mr Chris O'Brien, another Minister Ellison Rudd Watts partner who had acted for LFIL in documenting the securities it took, in particular for advances to the Blue Chip group of companies.

Status of the extension certificate

[58] To prolong the life of its prospectus beyond 31 December 2007, LFIL resorted to the procedure provided for in s 37A, subsections (1)(c) and (1A), by completing and lodging with the Companies Office an amended prospectus and an extension certificate. Section 37A(1A)(c) required the directors to certify that the financial position shown in the audited financial statements to 31 March 2007, as contained in the September 2007 prospectus, had not materially and adversely changed between 31 March 2007 and the provision of their certificate, and that the registered prospectus was not, at the date of their certificate, false or misleading in a material particular by reason of failing to refer, or give proper emphasis, to adverse circumstances.

[59] Section 55(c) provides that any certificate registered under s 37A(1A), and any financial statements accompanying such a certificate, are deemed to be included in the registered prospectus to which that certificate relates.

[60] In this case, the amended prospectus and the extension certificate were both lodged with the Companies Office on 24 December 2007. On that day, Mr Foley, the Minter Ellison Rudd Watts partner responsible for dealing with the Companies

Office, received informal confirmation from the Companies Office that the amended prospectus would be treated as registered on that day. That conveyed, at least implicitly, reliance on the extension certificate. Mr Foley relayed that advice to LFIL and advised LFIL that it could therefore rely on the amended prospectus for the purpose of seeking investments, and allotting securities.

[61] Thereafter, on 1 February 2008, an accountant with the Companies Office emailed Mr Foley, raising concerns about the content of the unaudited, half-year financial statements to 30 September 2007 that had accompanied the extension certificate. He advised that:

> The financial statements require the following amendments before the [extension] certificate can be registered:

[62] The 1 February 2008 email concluded:[21]

> On receipt of these documents and assuming all is then in order, registration of the [extension certificate] will proceed as at 24 December 2007 – ie date of receipt at this office.

[63] LFIL's solicitors responded to the 1 February 2008 email by a further email on 27 February 2008, attaching a memorandum of amendments and amended financial statements. The email concluded:[22]

> Can you please confirm that these are acceptable for filing with the Companies Office and that registration will proceed as stated in your email of 1 February 2008 (ie as at 24 December 2007)?

[64] There was no evidence that the matter was actioned by the Companies Office prior to LFIL advising the Companies Office on 3 April 2008 that it had ceased accepting money, and requesting that its prospectus be suspended.

[65] A formal confirmation of registration of the extension certificate was issued in the name of the Registrar of Companies on 10 April 2008. That referred to the prospectus expiring on 24 September 2008, consistently with the extension certificate prolonging the life of the amended prospectus for nine months from the date it was filed. An internal Companies Office email on 16 April 2008 sent by the

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21 DV3/19.
22 DV3/19.

accountant responsible for the 1 February 2008 email to LFIL's solicitors commented:[23]

> [LFIL] had a "prospectus extension certificate" registered on 24 December 2007. This was backdated as the documents were put in the registration basket by myself on the 8th of this month.

[66] In the operational sense, LFIL depended on the amended prospectus, with the deemed inclusion of the extension certificate, being valid from 24 December 2007. It was relied on to promote investments in the company, and to allot securities to the investors who subscribed for debt securities until the company ceased receiving them. In cross-examination, Mr Foley readily accepted that it would be absurd to suggest that the circumstances in which the financial statements accompanying the extension certificate were the subject of subsequent requisitions by the Companies Office would mean that the company could not proceed to distribute the prospectus and allot investments.[24]

[67] However, all defence counsel argued that the commercial position pertaining at the time cannot override the requirement for the Crown to prove all elements of the charges. They argued that here, the Crown cannot prove that the extension certificate was one that was registered under s 37A(1A) throughout the period alleged in the charges, and further that its deemed inclusion in the amended prospectus was insufficient to establish that the extension certificate itself had been "distributed" for the purposes of s 58 of the Act. They argued that there is no provision in the Companies Act 1993 authorising the Companies Office to backdate registration of documents required to be filed with that office, and that the evidence establishes that the extension certificate was only registered after the company had ceased to rely on the amended prospectus.

[68] In particular, Mr Henderson for Mr Reeves submitted that it was irrelevant that allotment of securities in reliance on the amended prospectus may have been voidable under s 37A(3) because that created an election for investors to be exercised within 12 months. Similarly, it was no longer possible to bring a charge

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23 DV3/19.
24 T3166/9-15.

for issuing securities without a registered prospectus as more than three years had passed since the relevant time.[25]

[69] It was further argued that the deeming provision in s 55(c) depended on the status of the certificate as being "registered" and that that could accordingly not apply until the extension certificate was indeed registered.

[70] The wording of s 37A(1A) suggests that the steps required for "registration" include the delivery by the issuer of a document to the Registrar for the purposes of registration, and the Registrar taking the act of registering that document. Sections 42 and 43 of the Act in the form that applied at the time required the Registrar to forthwith register every prospectus or memorandum of amendments to a registered prospectus that were delivered to him, subject to a discretion to refuse to register in defined circumstances.[26]

[71] The circumstances in which the Registrar might refuse to register a prospectus or an amendment to a registered prospectus contemplated that registration would only occur after the contents of the document delivered to the Registrar had been considered for compliance with the Act and the presence of any content that was "contrary to law". Those steps would involve more than cursory consideration of what are generally extensive and relatively dense documents. However, the evidence suggested that potentially contentious content of documents would be referred informally to the relevant Companies Office personnel for comment, prior to their formal filing. Mr Foley did that in the present case.

[72] Section 362 of the Companies Act 1993 provides for the Registrar's responsibilities in relation to the registration of documents under that Act. Subsection (3) provides:

> **362 Registration of documents**
>
> …
>
> (3) For the purposes of this Act, a document is registered when—

25 See s 64 of the Act.
26 Sections 42 and 43 were amended by s 21 of the Securities Act Amendment Act 2011.

> (a) The document itself is constituted part of the New Zealand register or the overseas register; or
>
> (b) Particulars of the document are entered in any device or facility referred to in section 360(4) of this Act.

[73] The Companies Office employee, Ms Hart, said that documents such as prospectuses were, at the relevant time, checked and approved by the Securities Corporate and Compliance Unit and would then be passed to the National Processing Unit, which was responsible to "…actually process it or lodge that document onto the Register".[27] Ms Hart was unaware why it had taken from 24 December 2007 to 10 April 2008 for the extension certificate to be processed, and explained the subsequent delay between 10 April and 16 April 2008 for the extension certificate to be imaged and available on the website as involving the document being sent to Wellington for actual imaging.[28]

[74] Clearly, the terms conveyed to Mr Foley on 24 December 2007 led him to believe that both the amended prospectus and the extension certificate had been registered. Mr Foley would not have been alarmed by the 1 February 2008 email, stating that the extension certificate could not be registered until further steps were undertaken, because the Companies Office advised at that time that the registration of the certificate would proceed "as at 24 December 2007", assuming that certain matters were addressed. Although there was no detailed analysis of their impact, they are fairly described as mechanical matters, going to details of the financial statements.

[75] Reliance by LFIL on the statutorily presumed inclusion of the extension certificate in the amended prospectus cannot avail the Crown, by invoking some form of estoppel or election, to prove registration of the extension certificate. That must be so, notwithstanding references in the text of the amended prospectus to the

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[27] T742/15.
[28] T739/5-10.

majority of the figures from the financial statements to 30 September 2007 that would be likely to be relevant to a notional investor.[29]

[76] I find that the extension certificate was not "registered" on 24 December 2007 as contemplated by s 37A(1A) of the Act. The consequence is that whilst the deemed effect of the existence of such a certificate can be considered as an element of the amended prospectus, any aspects of the Crown case that rely discretely on the 30 September 2007 financial statements as annexed to the extension certificate cannot be made out.

[77] It is inappropriate in this context to address more generally the efficacy of Companies Office procedures, which I note have subsequently been changed to give the Financial Markets Authority responsibility for considering prospectuses in a five day period after they have been registered at the Companies Office.[30] My analysis need not be taken as a criticism of procedures which I infer were adopted to meet the exigencies of a relatively complicated filing on Christmas Eve, no doubt with some pressure on behalf of LFIL to get the documents accepted before the vacation, when the prospectus would otherwise expire on 31 December 2007. The task was further complicated by the recent application of new accounting standards which required a different approach to the content of the financial statements from that which had previously applied.

[78] My finding on the lack of registration is reinforced by the scope of charges under s 58 of the Act being confined to untrue statements in offer documents that are "distributed". The definition of "distribute" in s 2 of the Act includes:

(a) make available, publish, and circulate; and

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29 Those included in the amended prospectus: At 11 - shareholders' funds and provision for losses on loans. At 12 – extent of past due assets and cash surplus from operating activities. At 13 – extent of current loans outstanding. At 14 – a concentration risk comparison of related borrowers as a portion of shareholder equity and the proportion of total amounts receivable that were owed by the six largest debtors. At 15 – the percentage of the loan book by security type, geographical spread and type of loan.

30 Section 43C as introduced by the Securities Amendment Act 2011, and corresponding limitation on the Registrar's functions in the new s 43A.

(b) communicate by letter, newspaper, broadcasting, sound recording, television, cinematographic film, video, or any form of electronic or other means of communication.

[79] Defence counsel relied on the Court of Appeal's analysis in *R v Steigrad* for the proposition that the aspect of this definition contemplating communication must involve participation also by a recipient.[31] The analysis in *Steigrad* was in the different context as to whether statements in an offer document are to be assessed on an on-going basis as to the truth of their content, if the Crown cannot prove that they are untrue when first published, but subsequently become untrue. The Court of Appeal noted that the verb in s 58 has been amended from "issued" to "distributed", and continued:[32]

> The use of "distributed" in s 37A supports our view on the definition of "distribute" being concerned with two equal actors: the distributor and the recipient.

[80] Mr Davison in particular argued that the requirement for distribution in the sense of communication to recipients is important when a criminal charge can be made out without the Crown having to prove that the contents have in fact misled anyone. Given that absence, it would be unduly onerous if criminal liability were established for theoretical, rather than actual, availability to potential investors of statements in an annexure to an extension certificate.

[81] One consequence of the extension certificate being registered is that it would then promptly be made available electronically on the Companies Office website as part of the searchable documents filed on behalf of LFIL. That is the classic form of "distribution" which never occurred for the extension certificate during the currency of the amended prospectus. Nor is there any evidence that the extension certificate, or the financial statements to 30 September 2007, were available on LFIL's own website. In these senses, the extension certificate and those financial statements were not "distributed" so as to be available to readers of the offer documents.

[82] The upshot is that whilst the amended prospectus and the investment statements derived from it were inarguably distributed, the extension certificate

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31 *R v Steigrad* [2011] NZCA 304.
32 At [98].

which was required as a matter of law to exist, and which was deemed to be included in the amended prospectus to validate its continued circulation, was not actually available to be considered and relied upon by potential investors.

[83] In the course of his closing address for Mr Jeffries, Mr Hurd raised the prospect that acceptance of the defence arguments that the Crown could not prove registration and/or distribution of the extension certificate would lead to the broader proposition that the Crown also could not establish distribution of the amended prospectus when, as a matter of law, it could not be circulated in the absence of a registered extension certificate. Mr Hurd acknowledged that he had not had an opportunity to fully analyse the point, and he invited me to reserve the issue to enable counsel to file further written submissions on it. I declined to do so.

[84] The relevant elements required to be proven under s 58(3) of the Act are that a registered prospectus has been distributed that includes an untrue statement. There is no issue that here, the amended prospectus that is the subject of count one was registered on 24 December 2007 and thereafter distributed, until the company elected to no longer accept investments, and requested that the Companies Office treat it as being withdrawn on 2 April 2008. I do not accept that a discrete error as to the legal status of what was being distributed can exempt such an amended prospectus from being the subject of a charge under s 58(3).

[85] LFIL had unreservedly relied upon the validity of the amended prospectus as being deemed to include the extension certificate for the first three months of 2008. In those circumstances, the accused's denial of the Crown's ability to prove registration and distribution of the extension certificate, on which the validity of the amended prospectus depended, might be described as a technical point. I have upheld the denial because I am persuaded that both the acts of registration and distribution of the extension certificate are elements required to be proven by the Crown, and that is a burden that cannot be discharged. It would be an entirely different matter to treat that deficiency in proof as tainting the balance of the charges that relate to statements or omissions in the amended prospectus that are said to be

untrue in the statutory sense when the amended prospectus was registered, and inarguably was distributed.[33]

Count One

[86] The first charge alleged breach of s 58(3) of the Act, in that the amended prospectus dated 24 December 2007 was distributed in a form that included an untrue statement. The final form of the indictment alleged five respects in which the content either positively misstated LFIL's position or, by omission, constituted an untrue statement. The indictment cited the allegedly untrue respects in relatively detailed terms with further particulars in respect of each particular.

Count One, particular 1 - Liquidity

[87] This was alleged in the following terms:

> The presentation of 'liquidity risk' omitted material particulars namely actual and significant adverse liquidity issues including; the deterioration in the cash position from the balance of 30 September 2007, the failure to achieve forecast (internal and Ferrier Hodgson) cash receipts and loan repayments.
>
> **Further particulars to particular 1 (statements relied upon)**
>
> 1.1 *"The most significant lending risk is the risk of Lombard Finance not being able to recover its loans in full from its borrowers. There is also the risk that borrowers will not make repayments until after the date that they were due, adversely affecting Lombard Finance's expected cash flows"* (… the Amended Prospectus, page 10).
>
> 1.2 The entire statement set out under the heading "Liquidity Risk" in … the Amended Prospectus at pages 12 – 13.
>
> 1.3 *"...Liquidity risk is a risk of Lombard Finance not having enough cash liquidity to meet its obligations as they fall due. ...*
>
> *This statement* [ie the statement of cash flows in the accounts for the year ended 31 March 2007 attached to the prospectus] *shows that Lombard Finance's investing and operating activities produced a cash surplus for the year of $14.603 million ... ($1.453 million in the 6 month period to 30 September 2007 after adjusting for the $18.097 million decrease in loans and advances)". ...*

[33] The certificate of registration of the amended prospectus, dated 24 December 2007, forwarded by Mr Foley to LFIL on 22 January 2008, was in evidence: DV4/3/290.

Lombard Finance manages its liquidity by regularly updating its projections of:

- *The maturity dates of amounts owed to investors.*

- *The proportion of investors that will redeem, as opposed to reinvest, their investments.*

- *Loan repayments received from borrowers (often from the expected sales of completed developments).*

- *Further advances made to borrowers, including further advances made as part of funding developments. At the date of this prospectus Lombard Finance does not have significant commitments to fund ongoing developments (funds committed for ongoing development will vary from time to time).*

- *Reports are provided to the Board weekly and are available to the Credit Committee whenever it assesses a loan proposal or any other dealing with a borrower"* (… the Amended Prospectus, page 12).

1.4 *"... Lombard Finance is currently experiencing a reduced level of reinvestment by borrowers that applied 12 months ago.*

...

The Board remains confident that, based on a range of conservative scenarios, Lombard Finance will have the required cash resources to fund full repayments to investors when due and that are not reinvested.

...

Lombard Finance manages this risk [ie the risk of recovering all of its loans] *by assessing the loan to security value ratio before advancing the loan by taking into account the capitalised position at the end of the loan term"* (… the Amended Prospectus, page 13).

[88] To assess the impact of the statements cited in these further particulars, it is necessary to consider the context of the whole passages in the amended prospectus in which they appear. In particular, the section under the heading "Liquidity Risk" (all of which is relied on in particular 1.2) included the following additional statements:

> In the event that Lombard Finance failed to manage its liquidity, due to mismanagement of its own borrowings (deposits from investors) or matured loans failed to repay on time and should such loss of liquidity be of a magnitude to cause Lombard Finance to become insolvent, there could be insufficient funds to pay investors.
>
> …

> If market confidence in the finance sector continues to decrease (particularly if there are further failures of finance companies) new investment and renewals may decrease below the levels that Lombard Finance is currently achieving, which may impact on liquidity.

And then, in bold type:

> **There is a risk that a further loss of confidence in the finance sector could result in investors materially reducing their level of reinvestment below that assessed by Lombard Finance. If that was extreme, Lombard Finance would not be able to fund its repayment obligations unless other funding was available or asset realisations/borrower repayments were accelerated.**

[89] Ms Peden and Mr Cable took the view that the conditionality with which the references to liquidity risk were expressed (given the use of terms such as "if" or "in the event that") misrepresented LFIL's liquidity position. This was because such terms conveyed an impression that the company recognised the risks of such adverse conditions occurring some time in the future but, by implication, those risks were not currently affecting LFIL's business when the true position was that they were.

[90] The accused disputed that there was any incorrect impression given by the use of conditional terms in describing risks relevant to liquidity. It was argued for the directors that a reasonable interpretation of the relevant portions of the amended prospectus did sound an appropriate and accurate warning about the extent of the liquidity risk as it then existed.

[91] Mr Foley, as the solicitor responsible for vetting the amended prospectus, also did not treat the use of "if" as conveying conditionality. Rather, Mr Foley considered that it was appropriately used to introduce separate topics.[34] Further, that the risks being described would be experienced to a greater or lesser degree at different times, so that they were not a constant feature.[35]

[92] Reflecting on all the passages in the amended prospectus that bear on the issue of liquidity, I find that they do not reflect a concern at the time it was issued that there was an existing risk that LFIL might run out of money in the forthcoming months. I accept that the conditional language in which certain risks relevant to

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[34] T3169/11-19.
[35] T2986/28-30.

liquidity were described would reasonably have conveyed to readers of the amended prospectus that the directors were not concerned that the adverse circumstances described existed at the time, or were imminent.

[93] The nature of what constituted liquidity risk for a finance company was appropriately described on page 12 of the amended prospectus.[36] Although there was a substantial focus on LFIL's cash position, the company's liquidity position reflected more than whether it had enough cash to make payments as they fell due. A consideration of liquidity also reflects the ability that the company has at any time to turn what it treats as current assets into liquid cash assets to meet the cash requirements as they arise.

[94] The cash on hand at the end of March 2007 was $19 million and that amount had reduced to $7.66 million on 28 December 2007.[37] Between those dates, the cash on hand at 30 September 2007 was some $24 million. The accused did not accept that the amount of cash LFIL had at the bank on or about the date of the amended prospectus was relevant to potential investors. Their views were that because the amount of cash on hand fluctuated so much from day to day and week to week, stating the amount held on any particular day in a prospectus was likely to mislead readers as to its relevance. This view was shared by Mr Foley. There was no evidence that the prospect of including the extent of cash in the amended prospectus was discussed with Mr Foley, but had it arisen, it would have been his view that it was unnecessary.[38]

[95] Sir Douglas took the view that it would be more relevant for potential investors to assess where LFIL was by reference to its "rule of thumb" that LFIL would endeavour to hold an amount approximating 10 per cent of the company's secured deposits, in cash at any time.[39] He recalled that tracking that indicator would show that at the end of March 2007, the proportion had been some 12 per cent, that the ratio had peaked around the end of September 2007 at about

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36 As cited at the outset of further particular 1.3 at [87] above.
37 DV3/7, document MG7.
38 T2964-2965, 2984-2985.
39 Some documents also referred to a liquidity policy of holding at least 10 per cent of its assets in cash at all times, for example LOM033.0067.

17 per cent, and in early December 2007 was a bit less than eight per cent. On that proportionate basis, he did not accept that there was any basis for concern.[40]

[96] However, those percentages were not referred to in the amended prospectus, and nor was the raw data on which such calculations depended presented to readers of the amended prospectus. His analysis cited a figure from the half year accounts to September 2007, whereas his case in closing was that those financial statements had not been distributed.

[97] Others of the accused placed less store on this rule of thumb. It was not referred to in the amended prospectus. In essence, their position was that they remained very conscious of liquidity, monitored it closely and had reasonable grounds for accepting management's assurances that LFIL would not run out of money. In those circumstances, they considered that investors could reasonably make an investment decision by relying on the judgement that would be exercised by the directors, without the need for further detail that could be potentially misleading.

[98] From September 2007 on, management was monitoring LFIL's cash flow situation constantly and Mr Beddie reviewed cash flow forecasts for the coming months on a weekly basis. These were copied to the directors, and the cash flow position was also discussed at each of the monthly Board meetings.

[99] The Crown produced a schedule contrasting the cash flow forecasts in relation to loan repayments and further draw downs of loans, against the actual monthly outcomes once they had occurred. The Crown's schedule included calculations of the percentage of accuracy of the previous month's forecast, together with a cumulative calculation of the level of accuracy between September and December 2007.

[100] Mr Gray, an accountant formerly employed by LFIL, gave evidence of his review of that schedule. He criticised the omission from the numbers for October 2007 of the repayment of the previous advance for a subdivision in Mahia, and a

40 T1877.

new advance for a comparable amount to a new entity.[41] Once that repayment and draw down were included, they dramatically improved the percentage accuracy of the projections.

[101] The Crown rejected Mr Gray's criticism because the repayment of the old Mahia loan and draw down of the new one had not been included in the projected repayments in Mr Beddie's cash flow forecasts. The Crown argued that that was a logical exclusion because it had no impact on cash flows when the amounts received and paid out on the same day more or less matched. Mr Appleby, the accounting expert called for the defence, agreed with the Crown that the Mahia payments were appropriately excluded from its analysis.[42] The Crown made the point that the repayment and re-advance in relation to Brooklyn (which were for significantly larger amounts than in relation to Mahia) were also excluded, and that the analysis would be meaningless if they were included. Mr Gray did not contend for their inclusion.

[102] Given the Crown's purpose for the analysis being to measure the relative accuracy of management's projections as to loan repayments, then it is appropriate to exclude the repayment and re-advance of the Mahia loan. If the figures were analysed merely to reflect the amounts of money being received, and to net those off against the amounts paid out, then the accounting would be incomplete without both the Brooklyn and Mahia transactions.

[103] For present purposes, the issue is the relative reliability of the projections of loan repayments. On that measure, I accept the Crown's rationale for omitting the Mahia transaction.

[104] I find that the following circumstances were relevant to an assessment of LFIL's liquidity position on 24 December 2007:

- From around the middle of 2007, the directors had foreshadowed a period of tighter liquidity, and had decided to bolster cash reserves to preserve

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[41] "Gateway Mahia", described at [A52]-[A59] below.
[42] T3046/30.

the company's liquidity. On 24 August 2007, Mr Jeffries had described a strong cash balance as "…Good assets in this Darwinian liquidity contest which has begun".[43] This is notwithstanding that it cannot be profitable for a finance company to hold depositors' funds in a bank account because there is no positive margin (or a negative margin) between the interest cost to LFIL, and the amount it will earn on interest with a bank.[44]

- That initiative had resulted in unusually high cash reserves, reaching a maximum of some $39.6 million in August 2007, dipping to $7.2 million in December 2007.

- LFIL did specify the extent of cash on hand in communications with existing and potential investors in July and September of 2007.[45] The Crown cited these references as evidence of the company's recognition of the relevance of the extent of cash resources, and contrasted them with the lack of advice to potential investors in the amended prospectus and investment statements on this point, when the cash position had reduced substantially. At least a partial answer, as advanced by the accused, was that the earlier communications were addressing the situation at the time to reassure investors likely to be concerned about the loss of confidence in the finance company sector generally, whereas the prospectus was a longer term communication that had to serve as an accurate statement for a lengthy period.

- Board papers for the LFIL Board meeting on 26 September 2007 included a consolidated balance sheet with actual figures to the end of August, and projections thereafter. The cash figure projected for each of the months of September to December 2007 was more than $35 million, with slightly lower figures projected for the months of January to March 2008, projecting a financial year end of some $34.9 million. A cash flow

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43 DV5/14.

44 Mr Grant Graham put it in terms that a finance company cannot maintain a cash buffer: T1612. Mr Foley referred to funds placed on deposit as "lazy money": T2984/34.

45 LOM033.0067, LOM033.0103.

projection generated in September 2007, and used by Ferrier Hodgson for their report, projected cash balances of some $20.6 million for September, rising to $26.4 million, $28.3 million and $30 million by the end of each of October, November and December 2007.[46]

- The cash flow projection circulated for the 6 November 2007 Board meeting, applying numbers as known on 26 October 2007, projected cash balances of approximately $16.3 million at the end of November, and $15.7 million at the end of December 2007.[47]

- The same form of consolidated balance sheet for the meeting on 28 November 2007 (adopting figures as at 21 November 2007) projected cash for the end of November of $23.6 million and $22.9 million for December 2007.[48]

- By the time of the preparation of Board papers for the 19 December 2007 Board meeting (using figures as at 12 December 2007), the actual extent of cash at the end of November was reported at $9.47 million (compared with projections used by Ferrier Hodgson, and since then, of $28.3 million, $16.3 million, and $23.6 million). The projection for December 2007 was $8.8 million,[49] (compared with equivalent projections of $30 million, $15.7 million and $22.9 million).

- The actual amount of cash on 24 December 2007, the date of the prospectus, was $8.133 million.[50]

- The worse than projected cash position was caused for the most part by delays in loan repayments. Management was monitoring the prospects of repayments on LFIL's major loans closely, and reported regularly to the Board. Those forecasts erred substantially with LFIL receiving 13.9 per cent of the repayments projected in the previous month for

46 LOM007.0310, LOM009.0162.
47 LOM007.0435.
48 LOM007.0557.
49 LOM007.0557, LOM007.0639.
50 LOM007.0702.

September 2007, 36.4 per cent for October 2007, 69.7 per cent for November 2007 and 55 per cent for December 2007. Cumulatively, the repayments over those four months were 46 per cent of the amounts projected.[51]

- LFIL's directors were relying on assurances from the lending managers responsible for the respective loans, to the effect that the delays incurred with repayments were explicable, and that the borrowers would still be able to perform, despite payments being made later than had previously been projected. The directors assessed the loan managers to be competent, but did not attempt to independently vet the reasonableness of assessments made by those managers.[52]

- That liquidity conditions would be tight, and potentially very tight, for a period in early 2008. The Chairman had observed, in an email to Mr Reeves addressing liquidity on 15 November 2007, that LFIL was:[53]

  > …sailing very close to the wind now and the next two or three months will be critical. Some of our exposures are difficult and depend on a number of positive events occurring. If they do not, or there are delays, we run the risk of running out of cash.

- Mr Reeves recalled in his evidence that he did not consider that liquidity was tight at Christmas 2007.[54] However, that reconstruction is inconsistent with the preponderance of contemporary documents, and LFIL's focus on preserving its liquidity position.

- Management's projections were for liquidity to ease again after March 2008.

[105] I am satisfied that notional investors would assess the risk of investing in LFIL's debenture stock differently in a material respect, had they been given the

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51 Ms Peden's schedule, using numbers from Board papers, Crown opening index folder, tab E.
52 See analysis at [236]-[237] below.
53 DV5/40.
54 T3458/25.

essence of these points, rather than the extent of commentary that was included in the amended prospectus on the issue of LFIL's liquidity.

[106] The amended prospectus could have disclosed that LFIL's liquidity depended substantially on the level of loan repayments, that the loan managers most familiar with the major loans had projected substantially larger recoveries than had been received in the last four months of 2007, but that the directors retained confidence in those loan managers to accurately report on the projected timing of recoveries. If it had done so, then the fact of continued reliance on such projections notwithstanding a pattern of errors that substantially overstated repayments would have been material information. Potential investors would be likely to question the prudence of the directors' judgement in continuing to rely on the loan managers in this regard, or might take from such information that conditions in the market were so unpredictable that projections could not reliably be made. In either event, such prospects render the omission of information on the topic from the amended prospectus a material one, in respect of a matter that is adverse to the financial standing of LFIL.

[107] Sir Douglas made two points that might tell against the requirement for inclusion of such information. First, he expressed the view that the occurrences of management's overstating projected loan recoveries had not occurred for a sufficient length of time by December 2007 to constitute a pattern that might reasonably be relied upon.[55] I do not accept that view. Timing of loan recoveries was critical to LFIL, and however credible individual explanations for delay on payments for particular loans might have been, the over-estimations were substantial to an extent that was important to the survival of the company. By the time the amended prospectus was issued there was a discernible pattern that constituted information that would be important to potential investors.

[108] The second point raised by Sir Douglas was that investors relied on the directors to make commercial judgements, so that investors would decide to invest on the basis of the commercial decision-making judgement they attributed to the directors. On that approach, matters of detail such as the relative reliability of

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[55] T1950/20-27.

projections on loan repayments from loan managers was a matter to be left to the directors and not appropriately addressed in the amended prospectus.

[109] However, such an approach misunderstands the rationale for the disclosure regime. It is intended that investors be in a position to make decisions for themselves by being adequately informed on material matters, rather than making an investment decision in reliance on an assessment of the quality of judgement of those who would become custodians of their investments.

[110] Mr Appleby did not consider that the extent of variance between projections relied upon by the Board from month to month and the actual outcomes, was a matter of interest to investors. Mr Appleby urged that changes were inevitable, and so long as the directors analysed the reasons for the extent of variances and accepted them as valid, then it ought not to be material to investors that the variances had occurred.[56] Again, that approach suggests that potential investors do not need to be told information that is relevant to an assessment of one important aspect of LFIL's business. In the circumstances of tightening liquidity generally in late 2007, investors were entitled to know the quality of performance by LFIL in managing its major loan exposures. One useful barometer of that level of success would be how accurately LFIL was able to predict the timing of repayments.

[111] The Crown case treated the fact that LFIL had failed to achieve the forecasts relied on in the September 2007 Ferrier Hodgson report as a relevant item of information, the omission of which rendered the amended prospectus "untrue". The cash flow forecasts used by Ferrier Hodgson adopted the internal LFIL cash flow forecast that was current at the time their report was prepared. I accept arguments for the accused that failures to meet the particular projections included in that forecast are not of themselves critical because the timing of receipts contemplated in that forecast were not "drop dead dates". What is more relevant is the pattern of each subsequent months' projections all being substantially overstated to the point that a prudent evaluation of the cash flow forecasts in December ought to have acknowledged that they were unreliable.

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[56] T3070-3072.

[112] I have also had regard to arguments for the accused that the Crown's analysis of discrepancies between projections and monthly outcomes was distorted to appear worse than it was because it measured only projected receipts that were not received, when the net differences were reduced by lower than projected additional advances. That does not lessen the proportionate extent to which the loan managers erred, month by month, in their projections of the amounts that were expected to be received.

[113] It was also argued for the accused that projections as to loan repayments were merely forecasts that were bound to change, so that their relative accuracy or inaccuracy could not rate as a matter material to potential investors. I do not accept that characterisation. The extent of loan repayments was critical to LFIL's survival, and projections each month for the following month's receipts dictated whether LFIL would be able to meet its commitments.

[114] A detailed cash flow projection provided to the directors included an additional column reflecting the position if no further loan repayments were received at all. The form of that projection prepared for the directors' meeting on 19 December 2007 showed on that pessimistic projection that LFIL would run out of money on 16 January 2008.[57] That projection was not given any serious consideration. However, if, for example, the directors had recognised the pattern of over-estimation of loan recoveries by the loan managers, and added a further column to the projections in that document at, say, 50 per cent of the loan managers' predictions (reflecting approximately the average level of recoveries over the previous three months), then it would have projected LFIL as briefly running out of money shortly before 18 January 2008, thereafter having sufficient cash to survive until the end of February, but being unable to meet its commitments from then on.[58]

[115] In fact, LFIL had sufficient cash to meet its obligations for another month after that. However, eliminating hindsight and reflecting on a reasonable prospective view as at 24 December 2007, some such projection applying the company's recent

[57] LOM007.0627-29.

[58] A negative cash position would be reached on 28 February 2008 on the numbers in that projection, which included a further drawdown anticipated for Bayswater on that day of $3.66 million.

experience would have been prudent. Any acknowledgement of the poor quality of projections about loan repayments would have raised doubts about the confidence expressed in the adequacy of cash resources.

[116] The Crown also criticised the omission from the amended prospectus of the extent of cash held by LFIL at the time the amended prospectus issued. The expectation that a cash balance would be included arose in part from a number of references LFIL had made to the extent of cash held some months previously, during periods when that detail suggested a far healthier financial state.

[117] It was argued for the accused that the vast majority of the reduction in cash on hand had been applied to repay investors in LFIL. Accordingly, the apparent deterioration in LFIL's cash position should be balanced against the reduction in its liabilities. I am not satisfied that the amended prospectus was misleading by virtue of the omission of reference to the specific cash balance on the date it was issued, or any other date around that time. Given the extent of fluctuations, and other factors impacting on the relative adequacy of a cash balance, reference to the cash held on any particular date could not, without some context, be material in offer documents such as the amended prospectus.

[118] However, that does not relegate the trend in the company's cash position to immateriality, given its importance as a component of the liquidity position which was of paramount importance in December 2007. The directors knew, and were seriously concerned about, the deteriorating cash position. In the end, the prospect of a cash crisis was just that: the less cash LFIL had, the more vulnerable it was to not being able to meet its obligations. The trend in recent months showed the extent of cash dropping consistently, to the extent that the chairman perceived the company as "sailing very close to the wind". It was inarguably material to investors that the cash available to the company had reduced markedly in recent months, and was a cause of concern to the directors.

[119] In *Moses*, Heath J included his own statement of what he considered was necessary to avoid the content of the prospectus in that case being untrue.[59] Here,

[59] *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [225].

the Crown closing submissions included a version of what, on the Crown case, was necessary to provide adequate and accurate disclosure about liquidity. I am not satisfied that all the points made in the Crown's version were reasonably necessary. For instance, it referred to the declining property market "…as indicated by a decline in the volumes and values of sales". This reflected a view suggested by Mr Beddie in a note he added to one of the drafts of the amended prospectus, inferentially reflecting his personal view about the state of the property market at the time.[60]

[120] The Crown version also included:

> Lombard Finance is currently seeking alternative means of providing capital to the company in conjunction with changing its long-term business model, but should a capital injection from those efforts not be forthcoming shortly, a well-orchestrated wind-down of Lombard finance is an inevitable reality.

Whilst the first part of this statement was accurate, I am not persuaded of its relevance in the context of the risks to be assessed by readers of the amended prospectus. The second aspect picks up the view expressed by Mr Reeves, most starkly at the February 2008 Board meeting, and it would be premature to attribute it to all the directors in December 2007.

[121] Adapting some of the remaining aspects of the Crown's proposed statement, and adding a measure of balance that I consider the directors could justify, an appropriate comment in the amended prospectus might have read along the following lines:

> Since mid 2007 LFIL has sought to build and maintain cash reserves to guard against the reduced investment and reinvestment rates likely to be caused by the loss of investor confidence in the finance company market. The company's cash reserves reached a high of approximately $40 million in August 2007, and although the amounts fluctuate, the downward trend during December 2007 has been to around 22-18 per cent of that high point. A substantial majority of the cash reserves have been applied to repay maturing investments.
>
> The adequacy of LFIL's cash resources is a source of concern to the directors. The company's ability to meet its obligations to investors in the coming months depends upon receipt of loan repayments as forecast. The directors are dependent on the respective loan managers for projections as to the timing and amount of loan repayments. Since September 2007 there has been a substantial extent of over-estimation in the projected loan

[60] His comment is addressed at [173]-[177] below.

> repayments, month by month. However, the directors continue to have confidence in the competence of the loan managers and provided there is a material improvement in the accuracy of their projections, LFIL will be able to continue meeting its obligations as they fall due.

[122] In the commercial sense, marketing advisers might suggest that there was little point in issuing a prospectus in such cautionary terms. That consideration cannot influence the analysis of what was required to provide adequate and accurate disclosure.

[123] I am satisfied beyond reasonable doubt that the combined impact of the omission of statements describing the lack of reliable forecasts about the timing of loan repayments on which LFIL's liquidity depended, plus the omission of any acknowledgement about the reduction in the cash on hand, and the directors' concerns on that topic, rendered the amended prospectus misleading in relation to LFIL's liquidity position.

Reasonable grounds for belief in truth of statements

[124] If the Crown made out this allegation, each of the accused sought to invoke the statutory defence that he had reasonable grounds to believe, and did believe, that the combined effect of the statements in the amended prospectus rendered it true on the topic of LFIL's liquidity.

[125] I am satisfied on the balance of probabilities that each of the accused considered that the statements addressing the company's liquidity in the amended prospectus were true at the time it was issued. They had confidence in the respective loan managers providing the forecasts for loan repayments in and after December 2007. The accused considered that the loan managers had an established track record of expertise, and that the explanations provided by them for non-compliance with projections over the preceding months were reasonable.

[126] However, the accused's approach depended on their view that monitoring the accuracy of loan repayment projections was a matter of detail on which investors would trust the directors' judgement. I do not find that a sufficient approach to justify the omission of any reference to the relative inaccuracy of such projections as

"reasonable". The timing of loan repayments was critical, and adequately informed investors could well take a different view from the directors about the extent of risk that arose from reliance on those projections. It was not reasonable for the accused to take the view that they could leave readers of the offer documents in the dark on that matter.

[127] Similarly, on the omission of any reference to the trend of reduced cash on hand, and the level of the accused's concerns over liquidity. In essence, the accused's claim to reasonable grounds for the belief that their concerns did not need to be acknowledged depended on their view, to the effect that "yes, it's likely to be very tight and we are worried about it, but we think we'll squeeze through, so we needn't raise unnecessary concerns". Readers of the offer documents ought not to have been reliant on directors' judgement on that matter, and I am not persuaded that it was reasonable for the accused to believe that they could omit any such reference.

[128] A number of issues were raised that applied more generally to the resort by the accused to the defence of reasonable belief in the truth of the offer documents. They are conveniently considered at this point.

Inadequate consideration

[129] First, the Crown argued that the accused had given inadequate consideration to the content of the amended prospectus, to an extent that they could not assert that that analysis could give them reasonable grounds for belief in its accuracy. This argument invited analogy with an approach adopted by Heath J in *Moses*, where the reasoning raised the scope of a non-delegable duty for directors to determine for themselves whether the offer documents were true.[61]

[130] The Crown argued that Messrs Jeffries and Bryant had not seen the terms of the amended prospectus until the directors' meeting on 19 December 2007 at which it was approved, and that the larger opportunity Sir Douglas and Mr Reeves had to consider a draft of the amended prospectus still left the Board short of opportunities for adequate analysis of its content.

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[61] *R v Moses* at [394](a), [421].

[131] The accused rejected the Crown's reconstruction of what had occurred. Mr Jeffries was adamant that on a day before the 19 December 2007 meeting (most likely 18 December), he had sat in the LFIL boardroom and gone line by line through a draft, which he discussed with Mr Foley.[62] Mr Foley had no record of such a meeting, but acknowledged "some recollection", although "hazy", of a discussion with Mr Jeffries some time in the week in which the amended prospectus was prepared.[63]

[132] Mr Bryant gave evidence of seeing Mr Jeffries at LFIL's offices, before the day of the December 2007 meeting, in circumstances consistent with Mr Jeffries considering a draft of the proposed prospectus.

[133] For his own part, Mr Bryant had a clear recollection of having received by courier a draft of the amended prospectus at his Wellington apartment, and having considered its content prior to the 19 December meeting.[64]

[134] As against these recollections, the email exchanges between Mr Foley and LFIL executives involved in preparation of the amended prospectus, mostly copied to Mr Reeves, suggest that the task was undertaken in a rushed manner, no doubt in light of the pending closure of the Companies Office for Christmas and the need to have an amended prospectus in place by the end of December. One of Mr Foley's emails acknowledged and apologised for the absence of opportunity for "the rest of the Board" to consider the terms of the amended prospectus prior to the Board meeting, with a decision required that day.[65] At the time of that email, the various exchanges that included Mr Foley attributed an awareness of the drafting of the prospectus only to Mr Reeves and Sir Douglas.

[135] The content of the contemporaneous documents justifies the challenge that the Crown mounted to the accuracy of the directors' recollection on this point. However, reflecting carefully on the evidence given by all the accused on this topic, I am not prepared to reject that evidence. Consequently, I do not accept that the

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62 For example, in questions from the Court, T3314-3316.
63 T2977/21-25, T3158/6-8.
64 T3340.
65 DV4/3/265.

defence of reasonable grounds for belief in the accuracy of the content of the offer documents is rendered unavailable to the accused by virtue of inadequacy of their scrutiny prior to signing it.

A balancing of considerations?

[136] Secondly, each of the accused raised the notion that their assessment of what had to be disclosed in relation to the risks of investing in LFIL was, in the commercial sense, influenced by their obligations to existing investors and possibly parent company shareholders, in not being any more pessimistic about risks when to do so might jeopardise LFIL's on-going business. None of them argued that this balance between full disclosure in offer documents, and protecting the reputation of their on-going business, could affect an analysis of the extent of disclosure required for the offer documents not to be misleading. However, it was suggested that the dilemma in balancing these different interests affected the reasonableness of the directors' belief as to the adequacy and accuracy of what was stated in the offer documents.

[137] I do not accept that the interests of existing investors, be they the holders of debt securities or shareholders, can validly be taken into account in assessing the reasonableness of views formed by the directors as to the absence of any misleading content in the offer documents. The standard imposed by s 58 of the Act is absolute in the sense that criminal liability will follow from the issue of documents containing untrue statements or omissions. The statutory defence of reasonable belief in the truth of content is not a variable standard of reasonableness, depending on other pressures acknowledged by directors in forming the views that they do.

Reasonable belief bolstered by involvement of others?

[138] Thirdly, the accused's evidence of the work involved in preparing the offer documents emphasised the extent of reliance on external professional advisers. Mr Henderson described Mr Reeves as being "almost profligate" in the use he made of external advisers. It was argued that the extent and nature of involvement by others bolstered the claims of the accused to have reasonable grounds for belief in

the truth of the offer documents, when none of the advisers or other external considerations of the offer documents suggested any concerns.

[139] KPMG, LFIL's auditors, had a measure of involvement in settling the form of the six months financial statements to 30 September 2007. They were the first set of accounts prepared under new, IFRS, accounting standards. In the last quarter of 2007, senior KPMG personnel were also in discussion with LFIL personnel about issues likely to be relevant to the audit of the financial statements to 31 March 2008. Mr Dinsdale emphasised that his firm had no audit responsibility for the half year financial statements, and that their involvement in the last quarter of 2007 did not give rise to opportunities for them to opine on the state of financial health of LFIL.

[140] Nonetheless, it was submitted for the accused that the absence of any warning signals from the auditors, when they could reasonably expect that a warning would be provided if grounds existed for doing so, is a matter that bolsters the reasonableness of the views the accused came to, about the truth of disclosures in the offer documents.

[141] A similar stance was suggested in relation to reporting to the Trustee. LFIL was providing regular detailed reports on its cash flow position to the Trustee, and in the latter part of 2007 the extent of those reporting obligations increased. The Trustee's statutory responsibility was to monitor LFIL's performance on behalf of the investors. Mr Hurd went so far as to suggest that the increased reporting obligations to trustees that were imposed by the 2007 Regulations[66] should be treated as reflecting a legislative choice to insist on greater disclosure to the Trustee, rather than to investors. Mr Hurd submitted that that choice reflected the Trustee's enhanced ability to analyse the risk to which investors are exposed, rather than requiring more detailed disclosure to readers of offer documents, who were not as likely to have the expertise needed to analyse the impact of the information disclosed. I do not accept that those increased reporting requirements reduced in any way the situation-specific obligations to make adequate disclosure in offer documents.

66 Securities Amendment Regulations 2007 (SR2007/274).

[142] The accused also raised their use of solicitors with specialist expertise in preparation of securities documents. Mr Reeves' case was that he instructed Mr Foley in preference to solicitors previously involved because of an expectation that Mr Foley would apply enhanced expertise to draft the fullest appropriate disclosure. The accused were not seriously challenged in their claim that, had Mr Foley urged that greater or different disclosure was required, they would have followed such advice.

[143] Mr Foley's own view was that the amended prospectus addressed relevant risks for investors in substantially greater detail than the September 2007 prospectus, and that the level of disclosure exceeded what he perceived to be the industry norm for finance companies, in prospectuses that had been approved for registration in the period up to December 2007.[67]

[144] So, too, with the acceptance of the amended prospectus by those within the Companies Office responsible for vetting the content of prospectuses.

[145] Certainly in the negative sense, had the accused proceeded to issue the offer documents whilst a professional adviser questioned the need for different or additional content, then that would adversely affect the reasonableness of their belief in the accuracy of the offer documents. I am not satisfied that the same relevance can be attributed in the positive sense to the absence of warning signals from competent external advisers, as supporting a positive finding that there were reasonable grounds for the directors' belief in the accuracy of the offer documents. The directors' obligations in relation to the accuracy of content of offer documents are non-delegable. As a matter of context, I accept that where LFIL retained competent outside advisers, respected their views, and completed the offer documents without those advising LFIL raising any relevant concerns, that it is marginally easier for the accused to make out reasonable belief. It would not, however, be sufficiently material to establish a basis for reasonable belief, if it did not independently exist.

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[67] T2953, T2956.

[146] I have had regard to all of these wider considerations that might affect the analysis of the accused's reliance on the defence of reasonable grounds for belief in the accuracy of the amended prospectus. Having done so, I remain of the view that they cannot make out, on the balance of probabilities, that such a belief was reasonable in relation to the material omissions as to liquidity. Accordingly, I find that each of the accused is guilty on count one, in respect of particular 1.

Count One, particular 2 – Impairment of major loans

[147] This was alleged in the following terms:

> **Particular 2**
>
> The presentation of the quality and value of the loan book omitted material particulars including the significant and adverse impairment and recoverability issues for the loans of the five major borrower groups.
>
> **Further particulars to particular 2 (statements relied upon)**
>
> 2.1 The interim unaudited Financial Statements for the six month period ended 30 September 2007 present the value of the loan book as being accurate, together with notes 2(p) and 12.
>
> 2.2 The positive statements as to the loan book in their entirety as set out under the following headings in the Amended prospectus:
>
> (i) Investment Risks, pages 9 – 10;
>
> (ii) Lending Risks, pages 10 – 12;
>
> (iii) Liquidity Risks, pages 12 – 13;
>
> (iv) Capitalising Loans, pages 13 – 14;
>
> (v) Concentration Risk, pages 14 – 15;
>
> (vi) Geographic and Portfolio Industry Risk, pages 15 – 16;
>
> (vii) Activities of the Borrowing Group, pages 25 – 25C;
>
> (viii) Summary of Financial Statements, pages 25C – 25D.
>
> 2.3 *"Lombard Finance may make selected second mortgage advances to borrowers. There is no limit on the portion of Lombard Finance's loan book which can be lent on second mortgages. ...*
>
> *The Board of Lombard Finance has adopted loan policies and guidelines, which it reviews and may change from time to time. These policies and guidelines currently include:*

- *Mortgages over commercial property will not exceed 80% of market value;*

- *Mortgages over rural property will not exceed 70% of market value;*

- *Mortgages over residential property will not exceed 90% of market value;*

- *The spread of the security assets of Lombard Finance will be concentrated predominantly in areas where it is considered that there is a higher economic growth and higher concentration of population"* (… the Amended Prospectus, Additional Statutory Information, at pages 25A-B).

[148] This particular focused on statements in the amended prospectus as to the quality and value of the loan book, given what the Crown alleged to be significant and adverse impairment and recoverability issues. The Crown's position was that the amended prospectus conveyed the impression that there were no issues as to impairment of the major loans, relative to the values of those loans reflected in the financial statements where they were recorded at their full value. Instead, the Crown alleged that additional disclosure was required of impaired values of some or all of the major loans, and that material risks existed as to their recoverability. On the Crown case, these were matters that were likely to be material to a decision by potential investors.

[149] The Crown materials analysing LFIL's business included the following schedule:

Loan balances as at 31 March 2007, 31 December 2007 and 10 April 2008 for the Five Major Borrowers

Lombard Finance & Investments Limited			
Loan Book			
(NZ$ in 000s)	Loan Balance as at 31 March 2007	Loan Balance as at 31 December 2007	Loan Balance as at 10 April 2008
Manning Group			
- Albert Street Projects Limited	-	8,519	8,831
- Norwich Investments Limited	-	3,121	3,233
- Brooklyn Rise Limited/Brooklyn	30,437	40,633	42,627
	30,437	52,273	54,691
Austin Group			
- Bayswater Apartments Limited	12,005	15,867	9,961
- Gateway Mahia Limited		12,118	12,457
	12,005	27,985	22,418
Blue Chip Group			
- Blue Chip and companies	7,421	3,765	4,632
- Mide Limited (In Liquidation)		4,816	5,532
-Odonn Limited	17,191	5,086	5,222
	24,612	13,667	15,386
George Group			
- Bayview Raglan Wellington	2,057	1,529	1,623
- Bayview Raglan Auckland	6,193	7,443	7,978
	8,250	8,972	9,601
Der Rohe Group			
- UND Investments	922	1,083	1,122
- Der Rohe Holdings Limited	8,027	7,898	7,169
	8,949	8,981	8,291
Total	84,253	111,878	110,387
Total Loan Book	160,999	144,075	136,713
Percentage of total loan book	**52.3%**	**77.7%**	**80.7%**

[150] Particular 2 also alleges omissions in respect of the recoverability of major loans. The recoverability of major loans, at least in the short term, is an aspect of the analysis on liquidity. Given that I have found that there was a material omission in relation to the unpredictability and extent of delays in loan repayments as an aspect of "liquidity risks" addressed in the amended prospectus, I am concerned not to double up the analysis of potential omissions. At some point, consideration of medium to long-term recoverability of loans substantially overlaps with impairment. My analysis on this second particular of count one therefore focuses on whether there was impairment of the major loans, without distinct analysis of any omission in relation to their recoverability in light of the finding I have made that the material omissions in relation to liquidity extends at least to short-term recoverability.

[151] Further particular 2.1 to particular 2 pleads references to the interim financial statements for the six month period ended 30 September 2007. Apart from the inclusion of specific figures from those financial statements cited in the text of the amended prospectus in parentheses next to the same data from the financial

statements to 31 March 2007, the interim financial statements were only accessible as attached to the extension certificate.[68] In light of my earlier finding as to the absence of registration and/or distribution of the extension certificate, it is not appropriate to consider whether the Crown can make out this particular by reference to those financial statements.

[152] The accused denied that any of the major loans were impaired as at 24 December 2007. Loan managers treated by the directors as competent were monitoring the major loans closely, and the directors' oversight of their management enabled them to accept the assessments provided by the loan managers. The advice from management to the directors was to the effect that delays in projected repayments on the major loans were explicable, the borrowers' projects over which the advances had been made remained on track, and that there was no need to treat any of the loans as impaired.

[153] Earlier in 2007, the auditors' consideration of the major loans for their May 2007 audit report of the position as at 31 March 2007 did not propose that any of those loans be treated as impaired. Nor did Ferrier Hodgson's September 2007 report or the unaudited financial statements to 30 September 2007.

[154] In order to determine whether there were any untrue statements in the amended prospectus on this particular, it is necessary to consider:

- In light of the state of the major loans at the date of the amended prospectus, and other relevant information then available, what assessment of value of the major loans ought to have been communicated in the amended prospectus?

- If the determination on values reveals that there were material inadequacies or inaccuracies in what was conveyed by the amended prospectus, then did one or more of the accused have reasonable grounds for believing the version that was conveyed?

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[68] See footnote 29 which lists figures from the 30 September 2007 financial statements that were included in the amended prospectus.

- There was a continuing requirement for the amended prospectus not to contain untrue statements in relation to the financial state of LFIL. Accordingly, if the Crown does not make out beyond reasonable doubt a materially untrue statement as at 24 December 2007, then arguably an alternative form of this particular arises if the amended prospectus became materially untrue in respect of impaired loans some time before it was withdrawn.

[155] First, however, the interpretation of what was reasonably conveyed as "impaired" in the amended prospectus needs to be addressed. In a passage describing LFIL's process of regularly reviewing loans, the text included:[69]

> As part of the loan review process Lombard Finance assesses whether a loan is impaired and after considering the nature of the security held whether a provision for loss is required. The scale of impaired loans can be seen in note 26 of the March 2007 financial statements and note 27 of the September 2007 financial statements.

[156] The notes to the financial statements for the year ended 31 March 2007 (and in those for the six months ended 30 September 2007) included a definition of "impaired assets" in the following terms:[70]

> Loans and advances where all principal and interest amounts owing by the counterparty may not be recoverable in full.

[157] The minutes of a directors' meeting on 29 August 2007 suggest that the directors also applied this concept of "impairment" in an assessment at that time. In the context of responding to a Securities Commission inquiry on the financial strength of the company, a minute noting that none of the loans were impaired included the definition of an impaired loan as "…one where there was a lack of confidence that there would be a full recovery of all principal and interest".[71]

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[69] Amended prospectus at 11.
[70] At 14 of the full year financial statements.
[71] LOM007.0255.

[158] For his part, Sir Douglas defined impairment as a reduction in the expected discounted cash flows from all the securities held on any given loan to a measurable figure less than the outstanding debt. He commented:[72]

> In other words there is good objective evidence a loan will not be fully recovered.

[159] In closing submissions, Mr Davison accepted the formulation from the August 2007 Board minutes, with the caveat that a lack of confidence in full recovery needs to be an informed lack of confidence, so that a decision on impairment is only made when the directors are properly informed and such a decision has a sufficient basis.

[160] It was argued for Messrs Reeves and Jeffries that any consideration by readers of the amended prospectus of the concept of "impairment" ought to apply the test for impairment as provided in the relevant accounting standards. NZIAS 39 requires determination of whether there has been a loss event, which it is believed will result in a reasonably measurable shortfall in recovery. That is a process involving assessment of all the securities held, and an estimate of the extent of shortfall that is likely to result.

[161] It was argued for Mr Jeffries that a meaningful analysis of the requirement to treat any loan assets as impaired would generally involve obtaining valuations of the security held, as was KPMG's practice in the course of the annual audit.

[162] Mr Jeffries was adamant that any consideration he undertook of the prospect of impairment at the time the amended prospectus was prepared would have reflected the need for a formal analysis as contemplated by NZIAS 39. This was essentially because of the perspective he brought as chair of the Audit Committee. On such an approach, there was no basis for recognising impairment of any of the major loans at the time.

[163] Defence counsel argued that the Crown case on why impairment ought to have been recognised had shifted during the trial, and was unfairly vague in terms of

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[72] T1766/6-9.

the case they had to answer. Mr Hurd took the point that the Crown did not seek to make out any impairment by reference to the standard in NZIAS 39, with the consequence that this aspect of the alleged material omission from the offer documents must fail.

[164] I do not consider that a notional investor would consider the amended prospectus by reference to the standard in NZIAS 39. The definition of "impaired assets" in the notes to the financial statements, in light of the description of the process for regularly reviewing loans, contemplates a prospective assessment throughout the life of a loan as to whether it may not be fully recoverable (implicitly at the end of its term). If impairment was confined to formal recognition after detailed analysis quantifying the likely shortfall on the basis of external valuations, then the definition would have been expressed in terms such as "…amounts owing by the counterparty have been established as not recoverable in full".

[165] I accept that some reasoned projection of the extent of impairment is implicitly a part of the analysis. However, that does not mean that recognition of the status of a loan as impaired need await the ability to provide a provable quantification of the write down. The steps taken in early 2008 in relation to the Bayswater loan illustrate the process working without the need for precision.[73]

[166] In addition, the description of LFIL's process of "regularly reviewing loans" contemplates reviews more frequently than on the completion of annual or six monthly financial statements. The context of that description as to how LFIL monitored its loans conveys an assurance that the process of review, if not continuous, was undertaken with at least sufficient frequency to observe promptly any changes in the circumstances affecting the value and recoverability of the major loans. The evidence of Mr Morpeth, the company secretary, was that he observed the directors at Board meetings undertaking reviews of the need to recognise any impairment on major loans, consistently with the interpretation I attribute to the terms used.[74]

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[73] See [A38]-[A50] below.
[74] T2598.

[167] To the extent that any of the accused make out that their consideration of impairment during the preparation of the amended prospectus was by reference to NZIAS 39, then that approach would be relevant to the reasonableness of their belief in the accuracy of the amended prospectus.

[168] I have annexed as Appendix A to these reasons a review of the major loans, and their position as at December 2007.

The impairment analysis

[169] The analysis for the Crown treated the fact that a loan had not been repaid when due, and had run on overdue before being extended, as a "red flag" that should have caused more thorough analysis as to whether the loan was impaired.

[170] That approach was not adopted by LFIL. Instead, it used relatively short renewal periods for its advances as an opportunity to reconsider the position with each loan. If necessary, LFIL used the expiry of a term as a source of pressure on the borrower to repay or provide additional security, or to take other initiatives intended to facilitate partial or complete repayment to LFIL. Fee income constituted a not insubstantial part of the revenue generated by LFIL, and each review of loan afforded an opportunity to charge additional fees.

[171] On one view, a history of a loan running on past its due date, and the apparent inevitability of LFIL granting an extended term because the borrower had no realistic means of repaying the advance at that time, might be treated as an indication of impairment. However, that was not the approach adopted for LFIL in managing these loans. The focus was on the ultimate capacity to completely repay, in light of analyses of the prospects of bringing the projects to successful conclusions. In these circumstances, I do not accept that the extent to which loans ran on overdue, and in a number of cases had to be renewed because of the absence of any realistic alternative, was, of itself, a circumstance that ought to have been treated differently by LFIL in assessing the possible impairment of the loans.

[172] LFIL uniformly capitalised interest on its large loans, so that all interest was paid on the eventual repayment of the loan. This was a practice alluded to in the amended prospectus. That practice removed the opportunity which would otherwise arise if the terms of an advance required interest payments monthly or quarterly, to monitor the financial performance of the borrower. Whilst the practice lessened the opportunities for default by borrowers, I am not persuaded that this feature of the lending arrangements required LFIL reasonably to recognise impairment any more readily than it did.

[173] The Crown also argued that by December 2007, there were numerous examples of delays in sales by developers of the properties in respect of which LFIL had made advances. Coastal sections in developments in Raglan and Mahia had incurred such difficulties, as had the apartment development in Eden Terrace, Auckland, by the Der Rohe borrower. The Crown cited a note by KPMG audit partner, Mr Dinsdale, from a 26 November 2007 meeting that "people are not settling".[75] In addition, the Crown attributed significance to a note inserted into one of the drafts of the amended prospectus by Mr Beddie, as a query about the need to acknowledge signs that property sales and values were down. That was in the following terms:[76]

> We need a comment on possible falling property values due to market conditions worsening (there are already signs that volume of property sales is down and values as well) and possibly affect on property values due to failed finance company property books being dumped on the market.

[174] The accused denied that there was any general pattern of delayed sales or reduced sale activity, sufficient to require them to question the need for an impairment across all their major loans. They pointed to a graph produced originally by Quotable Value, tracking New Zealand house prices. That suggested a peak in that market in late 2007, with a drop observed from about February 2008.[77] That exhibit was confined to houses, the market for which may have moved somewhat differently to the Auckland apartment market, and that for residential sections. Further, it reflected prices rather than volumes of sales.

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[75] LOM044.0032.
[76] DV6/29/12.
[77] DV3/15.

[175] As to the view raised by Mr Beddie's note, the accused denied that that was a generally held view within LFIL and argued that it was inappropriate for the Crown to rely on it as establishing, as a fact, that volumes and values in relation to property sales were down, certainly without any empirical data on volumes of sales or expert valuation evidence establishing the point.

[176] Mr Beddie's comment in the draft of the amended prospectus is appropriately treated as a reflection of his view at the time. He was a senior executive with extensive experience in monitoring loans to property developers, and his is a view that I find the accused, at least generally, respected. His view was consistent with other LFIL executives who saw a tightening market occurring from November 2007.[78]

[177] There is no evidence of any debate about this view expressed by Mr Beddie. Whilst it does not have standing as the view of an appropriate expert, it does constitute "a flag" that raised the issue of dropping property values and level of sales for those of the accused who saw the draft of the amended prospectus in which the note appeared. I am satisfied on the evidence that all of the accused, with the possible exception of Mr Bryant, did see that draft.

[178] Once the influence of hindsight is removed, I am not satisfied that as at December 2007, there was any sufficient pattern of delayed sales or drop off in activity affecting developments of the type over which LFIL had security, for it to require the recognition of impairment affecting all, or a majority, of the major loans.

[179] Another factor supposedly signalling an impairment of the value of LFIL's loan book was that the price of the shares in its parent company had dropped below the reported net tangible assets per share by November 2007. Mr Cable considered that this occurrence should have been seen as a signal by the accused that the market treated LFIL's assets (ie its loan receivables) as impaired. There are far too many industry-wide and other influences on the parent company's share price that are

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[78] For example, the CFO, Mr Burke's 26 November 2007 email "…a more difficult environment with reduced investor funding and consequently a reducing loan book" (DV4/3/62) and Mr Thorpe's observation about the "finance industries' season of discontent", 10 September 2007 (DV1/5/27).

unrelated to an informed and reasoned analysis of the value of LFIL's loan book for this to be a credible indicator of impairment.

[180] The accused argued that the situation of each loan had to be assessed on its own circumstances, and that they reasonably accepted the explanations offered by LFIL's lending managers, for reasons specific to each development as to why such delays were occurring. Turning then to a review of the individual loan exposures.

Brooklyn

[181] The size of this loan and the unsatisfactory history of it whilst Mr James was the developer would reasonably cause LFIL to assess its recoverability carefully.[79] In prior years, it had been poorly managed by LFIL executives. Mr Thorpe's September 2006 analysis painted a bleak picture, that recognised any attempt to sell up the partially undertaken development would result in a write off of more than $5 million.[80]

[182] It is arguable that LFIL's monitoring of its exposure to Brooklyn during 2007 had focused too much on the difficulties created by Mr James' personality, without analysing the potential impediments to a successful recovery caused by the challenges to successfully developing the sites. LFIL's auditors had concerns beyond Mr James's limited capabilities.[81]

[183] An Auckland-based developer, Mr Manning, who was considered by LFIL to be competent, had committed substantial resources between August and October 2007 to a thorough due diligence of the viability of the Brooklyn development. He was prepared to take over all of the existing indebtedness, including assumption of a $3 million liability re-allocated from another of Mr James's projects, Complex Properties. The due diligence included input from numerous independent professionals and Mr Manning's commitment after a thorough analysis of the prospects could reasonably be treated by LFIL as confirmation of the viability of the whole project. I am satisfied that Mr Manning was only prepared to take the project

[79] See Appendix A at [A1]-[A18].
[80] LOM013.0145.
[81] See [A15] below.

over because his acquisition was 100 per cent financed by LFIL. There was a relatively recent valuation of the whole staged development that supported the advance.

[184] A pre-condition of the advance to Mr Manning was that he procure a substantial first mortgage, the proceeds of which would be applied to reduce LFIL's advance that was to be secured by a second mortgage. The pre-condition was waived on settlement when funds from an alternative lender were not available, and that became the subject of testy exchanges between Messrs Reeves and Manning in early 2008.[82]

[185] As with a number of LFIL's major loans, its exposure to the Brooklyn development had increased incrementally, through the relatively early stages of a large-scale development where there was a requirement for significant expenditure by the developer, but little prospect either of major sales, or recognition by another buyer of enhanced value commensurate with the amount that had been spent. As Mr Wallace acknowledged, there was not a lot of choice for LFIL to be able to extract repayment other than to provide continuing support for the project.[83]

[186] In December 2007, the fresh advance to Mr Manning's company had only recently been made. Apart from his inability to procure first mortgage funding to reduce LFIL's exposure, there was no suggestion of the loan being in default and LFIL personnel monitoring the loan most closely were confident that Mr Manning would be able to produce a profitable outcome.

[187] In those circumstances, I am not satisfied that this advance ought to have been treated as impaired at the time of the amended prospectus.

<u>Norwich Investments Limited and Albert Street Projects Limited</u>

[188] The Crown's analysis grouped other entities controlled by Mr Manning as part of the same borrower group as LFIL's exposure to the Brooklyn development.

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[82] LOM001.0048-9.
[83] T2816/27-30.

These were Norwich Investments Limited and Albert Street Projects Limited, responsible for separate developments of apartment buildings in Auckland. The circumstances of those loan advances were traversed quite extensively in evidence. Ms Peden analysed them as having loan to valuation ratios in excess of LFIL's policy, and treated successful completion of the respective developments as suspect by December 2007 because of vulnerability in the nature of the commitments procured from purchasers, as later demonstrated.[84] However, beyond an incidental reference that both were "high risk advances", the Crown did not advance submissions in its closing as to reasons why these loans ought to have been treated as impaired by LFIL in December 2007.

[189] There were no issues about performance of Mr Manning's entities on the obligations they had under these loans, and the projects to which they related were still reasonably perceived as being "on track". Accordingly, I would not be satisfied that these loans ought to have been treated as impaired at 24 December 2007.

Bayswater

[190] By 24 December 2007, there were numerous "red flags" that suggested LFIL's advance in respect of Bayswater was not fully recoverable.[85] Marketing of the development had been unsuccessful over a reasonably lengthy period. The first mortgagee, Structured Finance Limited, had issued Property Law Act notices in late 2007. That initiative may have reflected a concern by that mortgagee over its own liquidity position, but for whatever reason it constituted a destabilising of the funding of the project. In a tightening market, it rendered Bayswater a forced seller once Structured Finance extended the first mortgage only to the end of February 2008, unless LFIL was prepared to take over the remainder of the first mortgage. Despite the impression held by LFIL management that the developer, Mr Austin, was a competent operator of rest home businesses, he was in ill-health and not committing positively to marketing the development. Mr Erskine's evidence was that Mr Austin was leaving it to LFIL to deal with potential purchasers.[86]

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84 Peden brief at [94]-[104], T58.
85 See Appendix A at [A38]-[A50].
86 T1369/7-15.

[191] Perhaps most importantly, after LFIL's further advance in December 2007, and including capitalised interest on loan facilities until the end of February 2008, the combined total of Structured Finance and LFIL's advances were some $24.8 million. This was substantially in excess of the then current valuation of the apartments of $15.4 million. LFIL's calculations of its security included $7.9 million for the "business component".[87]

[192] There was no ability to realise any material value in the "business component" until substantially all, or all, of the apartments had been contracted to occupiers, and there had been no success in marketing the apartments over a substantial period. Given these circumstances, where the "bricks and mortar" valuation of the property was substantially less than the combined secured debt owed to Structured Finance and LFIL, those involved for LFIL in assessing this major exposure ought to have acknowledged the prospects of a substantial loss on sale of the property.

[193] Messrs Erskine and Thorpe were aware of this prospect in late 2007. I am satisfied that they would have spelt it out for the directors, had they been asked. From the non-executive directors' perspective, they remained unaware, they say because they were not told. It is one respect in which I am satisfied they should have asked, given the circumstances of the advance, and the extent of the exposure.

[194] LFIL's analysis of its security position included $3 million for collateral security over a separate business of Mr Austin's, Olive Tree in Palmerton North, and $500,000 for a boat over which LFIL may not have had enforceable security. The boat was apparently sold with the proceeds applied by the ANZ Bank.[88] On one view, that sale was contrary to LFIL's rights, and steps may have been possible to pursue recovery of the proceeds. Had any thorough review been undertaken of the collateral securities, it should have become apparent that the extent of available security in other assets that had been offered by Mr Austin via other entities was unlikely to be realisable for LFIL to the extent that Mr Austin had attributed to them.

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87 That is, NPV of future cash flows from managing the aged-care facilities. See Appendix A at [A42].

88 LOM010.0145, 0146.

Again, given the prospect of a significant shortfall on sale of the principal security, due enquiry ought to have extended to such a review.

[195] One feature of LFIL's credit policy was to have certain maxima for the extent of loans, relative to the valuation of the security obtained (loan to value ratio, or LVR). The maximum for apartments, which would apply in the case of Bayswater, was for 85-90 per cent of the valuation, depending on the apartment size. If, as in this case, the security was not a first mortgage, then the lending would have to take account of the sum for which any prior mortgagee had priority. The most recent valuation of Bayswater, dated April 2007, assessed its value on completion (including the business component) at some $23.36 million, which would give an LVR of 110 per cent.

[196] Accordingly, as matters stood on 24 December 2007, I am satisfied beyond reasonable doubt that LFIL should have treated the Bayswater loan exposure as impaired.

Mahia

[197] LFIL had made a fresh advance to an entity controlled by Mr Austin, as developer of a coastal subdivision at Mahia in September 2007 for some $11.67 million. The monitoring by LFIL of its loan recognised that sales opportunities were far more likely to arise in the summer than in the winter.[89] Marketing initiatives from Labour Weekend 2007 on appeared to be credible. The history of unsatisfactory performance of the loan over the preceding years was attributed to the behaviour of Mr Austin's co-developer, Mr Nisbet, who had been excluded in September 2007. Therefore, as matters stood in December 2007, that prior history was not relevant to an assessment of potential impairment.

[198] There were indications of current interest in the sections, and loan managers were projecting full repayment of the loan. In those circumstances, it is not a loan that ought reasonably to have been treated as impaired as at December 2007.

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89 See Appendix A at [A52]-[A59].

Blue Chip

[199] Transactions promoted by the Blue Chip group of companies and their alter ego, Mr Mark Bryers, have subsequently attracted a degree of notoriety. The circumstances of LFIL's loans to that group are described in Appendix A at [A23]-[A37].

[200] I find that by December 2007, the Auckland apartment market was "tightening". However, there was no sufficient foundation for concluding that there would be wholesale refusals to settle, or other circumstances that might (and subsequently did) lead to the failure of the developments on which repayment of the advances to the Blue Chip group depended. LFIL loan managers took substantial comfort from the fact that Westpac had thoroughly assessed the projects and had advanced substantial sums on first mortgage. LFIL assumed that the analysis for Westpac extended to confirmation of the enforceable nature of the commitments that Blue Chip entities had procured from individual apartment buyers. That led to reasoning that the source of repayment to LFIL (ie the developers) was not dependent on Blue Chip's continued existence. Although it was less than conservative for LFIL to assume successful completion and sale of all the apartment developments as the means by which sufficient profits would be generated to enable its advances to be repaid, that does not lead to a conclusion that the loans ought to have been treated as impaired at 24 December 2007.

[201] Thereafter, there was substantial adverse publicity about Blue Chip's activities. Sir Douglas stated on 14 February 2008 that:[90]

> I wouldn't put much credence on statements by Blue Chip. It will be something of a miracle if they survive.

By that time, the general hardening in the property market was more apparent, and added to the specific adverse issues with Blue Chip clearly required a further careful review.

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[90] LOM004.0218.

Bayview Raglan

[202] Property Law Act notices had been served in respect of the advances to Bayview Raglan,[91] and had expired without the position being resolved. In traditional, conservative lending practices, that may have rendered it appropriate for a lender to treat the Bayview Raglan Limited exposures as impaired in December 2007. However, defence counsel urged the view that issuance of Property Law Act notices by finance companies was not an act of last resort, and nor was it by any means the only avenue that was used to pressure repayments from borrowers. I accept, having considered all the contemporaneous documents in evidence about the Bayview Raglan loans, that issuing Property Law Act notices, and then not following through with the exercise of powers of sale, did not have the significance within LFIL's management of its exposures, that may have been appropriate in other lending situations.[92]

[203] Certainly, realisations were slower than anticipated, but in December 2007 I am not satisfied that LFIL was on notice that the market for residential sections in coastal subdivisions had diminished to the extent that required LFIL to recognise this exposure as impaired.

Der Rohe

[204] The analysis for the Crown treated the sales to LFIL staff or associates in December 2007 at 60 per cent of valuation (subject to the entitlement of Der Rohe or LFIL as mortgagee to buy the properties back for up to six months) as a recognition that the development could not succeed on the terms previously projected.[93] Consequently, it was argued that the directors ought to have recognised that the loan advance to Der Rohe was impaired.

[205] There was no evidence that that view had been considered at LFIL. I find that the non-executive directors were not aware of the terms for the sale of

91 See Appendix A at [A60]-[A64].
92 For example, Large Loan Sub-Committee minutes for 13 December 2007 implicitly treated the issue of the Property Law Act notices as a routine matter: LOM011.0017.
93 See Appendix A at [A65]-[A69].

14 apartments at a discount to their valuation, and subject to buy-back rights for six months from December 2007. Although Mr Reeves stated that he was also unaware that the sales were at a discount to valuation, that recollection depended on his having initialled both pages of a two page internal memorandum to indicate his approval for the terms of the transactions, without having read it.[94] If, indeed, this was a lapse from standards of Mr Reeves' attention to important detail, then it is a matter of which he certainly should have been aware, given that the information was specifically provided to him, and did not even require due enquiry.

[206] It is understandable, particularly with hindsight, that these arrangements might smack of desperation to reduce LFIL's exposure, and put off realisation of a loss in the hope that re-sales at higher prices could be achieved in the ensuing six months.

[207] However, assessing the arrangements prospectively in late December 2007 does not justify a finding that LFIL ought to have treated the Der Rohe advance as impaired. The LFIL executives who were responsible for the sale and buy-back arrangements saw them as an elegant, if unusual, solution to a problem caused by the delay in obtaining code compliance certificates for the development. It prevented a substantial number of the apartments flooding the market at one time, reduced Der Rohe's holding costs by the extent of the borrowings repaid, and lessened the pressure for LFIL to secure repayments. Der Rohe and LFIL then had six months to explore re-sales of the apartments on better terms. There was no evidence that LFIL should have dismissed that as an unrealistic prospect in December 2007. Indeed, a small number of the buy-back rights were exercised, both before and after LFIL passed into receivership.

[208] The UND development was, on its own, a relatively small exposure for LFIL. There was a "web" of collateral securities and I am not persuaded that there was any deficiency on the accused's part in not separately assessing that loan for potential impairment.

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[94] DV2/2/48.

[209] Accordingly, I am not satisfied that the circumstances of the underwriting arrangements and other aspects of the loan exposure ought to have required LFIL to treat the Der Rohe and UND investments advances as impaired as at 24 December 2007.

Summary on impairment

[210] In summary, the Crown has satisfied me beyond reasonable doubt that as at 24 December 2007 LFIL should have recognised the loan in relation to Bayswater as "impaired". One of the arguments against doing so is that at that time LFIL could not identify the extent to which that loan was impaired. However, the process of impairment, as referred to in the amended prospectus, did not require any high level of probability about exact projections of loss. The point of assuring investors about on-going monitoring of loan exposures is that LFIL would not await an adverse outcome, before signalling a concern that it was likely to occur. In those circumstances, precision could not be expected.

[211] The extent of impairment had to be material to LFIL's state of financial health, before an omission to refer to it could be relevant in the present context. Part of the accused's justification for the absence of acknowledgement of impairment on the major loans was that impairment would only become relevant if it was to an extent that eroded the shareholders' funds retained within LFIL, which the directors saw as a buffer against the prospect of a loss on any particular loans.[95] The Board had adopted a policy of retaining earnings rather than paying dividends, to increase the strength of the company's balance sheet, and thereby provide a measure of comfort for investors that LFIL could absorb the consequences of losses on individual loans. I accept that the extent of any provision prudently made in respect of Bayswater in December 2007 would be substantially less than the extent of shareholders' funds so that the Crown cannot make out that it was material to acknowledge impairment of just that loan.

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[95] Amended prospectus at 11 stated "The shareholders' funds (equity) of a company provide a degree of buffer against liabilities." The text then cited the extent of shareholders' funds as at 31 March and 30 September 2007, with the percentages that those numbers represented of secured debenture stock liabilities and total liabilities at those dates.

[212] The next issue is whether circumstances changed in the period between 24 December 2007 and early April 2008, in respects that required the directors to acknowledge a material extent of impairment of the major loans.

[213] Mr Grant Graham, the Ferrier Hodgson/KordaMentha principal who undertook a review of LFIL's major loans in September 2007 and commenced a further review in April 2008, considered that at least most of the major loans were clearly impaired by the end of March 2008.[96] The defence expert, Mr Appleby, treated the Mahia loan as "distressed" by February/March 2008.[97]

[214] In early March 2008, the extent of loss on Bayswater was crystallised by sale of the property, leaving an outstanding balance of some $11.95 million. Management were more conservative in their projections of the extent of appropriate write off than Mr Reeves, recommending a provision for $7 million. Mr Reeves considered that a write off of $2 million was sufficient. The optimistic rationale was that a larger write off could be avoided by virtue of the prospects of recovering existing indebtedness by some combination of enforcing collateral securities, and by financing Mr Austin into other ventures which it was hoped would generate profits from which he could discharge more of the existing liability.[98] That seems unrealistic when Mr Austin had been unco-operative and was in ill-health.

[215] The environment in which LFIL was operating also deteriorated generally. The continuing pattern of substantial errors in the projections as to level of loan repayments in January and February 2008 rendered the accused's continued reliance on the projections by management less than reasonable by, at the latest, the end of February 2008. Sir Douglas acknowledged grounds for doubting the reliability of management projections by then, and Mr Reeves had stated that a wind-down of LFIL was an inevitable reality.

[216] However, on this part of the case, the accused argued that the Crown should be required to identify a series of events or milestones in the period between the end of December 2007 and the end of March 2008 which signalled a sufficient change in

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96 T1580/25, interim report 7 April 2008, LOM025.0117.
97 Brief at [13.61].
98 DV1/6/58-61.

conditions to require acknowledgement of loan impairment, if the Crown had not made out the need for impairment at 24 December 2007. I had questioned Crown counsel on whether, if it could not make out a material omission in respect of impairment at 24 December 2007, the Crown relied on any milestones in the period thereafter as triggering such a requirement. Mr Carruthers did not do so but submitted that the alternative form of this particular could nonetheless be made out because of the directors' obligation to appreciate the general state of deterioration in both the market and the level of risk to which its major loans were exposed.

[217] Predictably, defence counsel argued that this approach was inadequate. I was referred to the requirements as to the content of counts in s 329(4) of the Crimes Act 1961, and I have had regard to the approach to the continuing nature of offences under s 58 in the reasoning of the Court of Appeal in *Steigrad*.[99] In the context of these particular charges, I am not satisfied that the Crown can make out an alternative form of relevant omission in respect of impairment at some unspecified point after the date of issue of the amended prospectus on 24 December 2007, without stating the events or dates or circumstances of deterioration that allegedly ought to have been recognised by the directors as requiring further disclosure. Conceptually, the stance for the Crown could require the accused to reflect on the prospect of material deterioration on each day that the prospectus remained before the public. Defending that position in respect of LFIL without the Crown being committed to the events or circumstances that individually or cumulatively required reconsideration does not meet the Crown's obligation under s 329(4) of the Crimes Act.

Count One, particular 3 – Adherence to lending and credit policies

[218] This was that the amended prospectus included an untrue statement in relation to adherence to lending and credit approval policies. The further particulars as to the statements relied upon were as follows:

> 3.1 *"...Lombard Finance manages this risk* [ie credit risk] *by requiring all loans to meet established credit approval policies and approvals under which all credit approvals are signed off by the company's*

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[99] *R v Steigrad* [2011] NZCA 304.

credit committee. Under these policies Lombard Finance scrutinises loan approvals to ensure it only lends to those borrowers meeting its criteria and who it assesses has the character, capacity and collateral to repay monies advanced" (… the Amended Prospectus, page 10).

3.2 *"Lombard Finance uses its credit policy to manage its exposure to risk. As part of this policy, limits are placed on exposures, lending is subject to defined criteria and loans are monitored on a regular basis.*

...

Lombard Finance regularly reviews loans, and if the borrower fails to meet its obligations, takes corrective and recovery action where required" (… the Amended Prospectus, page 11).

3.3 The statement [in further particular paragraph 2.3 to particular 2, as quoted at [147] above].

[219] In its closing submissions, the Crown's case was put in terms that the overall impression conveyed by the offer documents was that LFIL had a conservative lending policy that minimised the risk to investors inherent in its business, whereas that was untrue. It was acknowledged for the Crown that while individual breaches of lending policy may not of themselves have been material, the overall impression was untrue. This stance relied upon the analysis by Mr Cable. Having reflected on the issues in light of additional information and the proposed terms of Mr Appleby's evidence, Mr Cable acknowledged that he would have put less weight on the credit policy aspects. He treated the overall impression from reading the amended prospectus as being one of an investment "…of either modest underlying risk or where those risks are managed through the credit policies…".[100]

[220] Although the commentary in the DVD included a claim by Sir Douglas that LFIL had a "very conservative lending policy", there was no reference in the amended prospectus to a conservative lending policy. It was submitted for the accused that the extent of description of risks in the offer documents was inconsistent with readers gaining any impression that the lending policy was "conservative". Further, that if the references to lending policy were assessed in the context of other commentary about the nature of risks involved, then there was no misstatement as to the application of lending policies. It was submitted that readers

[100] T1492/10-30.

of the offer documents could not treat LFIL's credit policies as a rigid set of requirements, but rather as guidelines that might be amended from time to time. It was also suggested as apparent from the terms of the offer documents that credit policies were applicable primarily to the loan approval stage, not to subsequent management of loans once advanced.

[221] The terms of LFIL's current credit policy were not made available to potential investors. However, the Crown relied on examples of what it treated as breaches of the credit policy as conduct that rendered the assurance of adherence to it untrue.

[222] The credit policy had included a provision that the total of loan advances secured by second mortgages was not to exceed 50 per cent of total assets. However, after foreshadowing change in November 2007, on 19 December 2007, the Board authorised an amendment to the credit policy to increase the ratio of second and subsequent mortgage securities up to 80 per cent of the total loan book.[101]

[223] The amended prospectus specified that LFIL's loan securities at 16 December 2007 comprised 42 per cent first mortgages and 56 per cent that were second or subsequent mortgages, as percentages of the total lending.[102] At a different point in the document, the amended prospectus also specified that:[103]

> …[LFIL] may make selected second mortgage advances to borrowers. There is no limit on the portion of [LFIL's] loan book which can be lent on second mortgages.

[224] On the Crown's calculations, the relative percentages by 16 December 2007 were 29.19 per cent secured by first mortgage, and 63.12 per cent secured by second or subsequent mortgages. The trend thereafter reflected increased percentages of second and subsequent mortgages, so that they were almost 65 per cent by the end of December 2007.

[225] Ms Peden, who had been responsible for these calculations, was cross-examined about the source of the discrepancies. The largest contributor to the

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[101] LOM007.0617.
[102] Amended prospectus at 11, 15.
[103] Amended prospectus at 25D.

discrepancy was the security held in respect of Gateway Mahia Limited. She treated it as a second mortgage, whereas the company's calculations included it as a first mortgage. LFIL also included some $3.6 million of advances to Blue Chip companies as secured by first mortgages, whereas Ms Peden's calculations treated those advances as secured only by general security agreements granted by the borrower companies.

[226] Ms Peden had relied on informal indications of LFIL's intention to cede priority to Hallmark Securities Limited, for a new first mortgage in relation to Gateway Mahia.[104] As a matter of proof, Mr Hurd had her accept that there was no evidence of LFIL documenting its commitment to cede priority to Hallmark until mid February 2008. On this basis, Ms Peden accepted that her percentages would not be correct.[105]

[227] She was not tested in the same way in respect of her treatment of the security for Blue Chip advances, but acceptance of Mr Gray's reconciliation[106] does account for virtually all of the discrepancy as alleged on the basis of Ms Peden's analysis. Accordingly, a misstatement as to the proportion of various types of mortgage security cannot be made out.

[228] Further particular 3.2 focused on the statement in the amended prospectus to the effect that limits are placed on exposures, and that lending is subject to defined criteria. The Crown alleged that lending in breach of the LVRs stipulated in LFIL's credit policy meant that the assurance given by the statement in the amended prospectus that such criteria are adhered to was incorrect.

[229] On the Crown analysis, the LVR for Brooklyn and another advance to entities controlled by the then developer, Mr James, in May 2007 led to an LVR of 99.35 per cent. That exposure had been brought to an end by the transfer of the Brooklyn development from Mr James to Mr Manning's interests, so was not an exposure relevant to the statement of position at the time of the amended prospectus.

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104 See [A57] below.
105 T473-475.
106 DV3/9, MG9.

[230] The Crown calculated that LVRs for Norwich of 83.9 per cent (compared with a maximum for commercial property of 80 per cent) and Albert Street with an LVR of over 100 per cent. It also calculated the Bayswater advance as having an LVR of some 110 per cent and Gateway Mahia with an LVR of 86 per cent compared with a maximum LVR for bare land of 70 per cent according to the credit policy. Each of these was alleged to be a breach of the policy.

[231] The accused argued that LVRs applied to consideration of a proposal at the time that the making of the loan was under consideration. Given that interest and costs were to be added to the principal sum, and given also the prospect for changing property values, they argued that adherence to LVRs could not be expected necessarily to continue to apply throughout the whole of the life of a loan.

[232] I am not persuaded that the references to LVRs in the offer documents can reasonably be interpreted in that light. If compliance with LVRs is to be a reliable source of assurance on the level of risk involved, it would be cold comfort for investors to appreciate that LVRs applied at the outset, but were likely to be exceeded during the term of the loans. The relevant provisions in the offer documents do not make that distinction in the timing at which LVRs were applicable.

[233] It was also argued that LVRs were not intended to apply rigidly, and that the references to them in the offer documents did not suggest that lending outside such ratios was not going to occur. Further, the use of the LVRs as guidelines, with loans that exceeded LVR being identified and monitored with reasons provided for non-adherence, meant that the company's practice did conform to the impression reasonably given by the relevant passages in the amended prospectus.

[234] Certainly, there was more monitoring of loans relative to LVRs, and explanations for non-compliance, in the documents produced by the accused, than that suggested by Ms Peden's analysis in her evidence-in-chief. There were examples of lending in excess of LVRs. However, I am not satisfied that it was occurring to an extent or in circumstances that rendered the impression given by the offer documents as to adherence to lending policies, misleading.

[235] The last aspect of the first quotation in further particular 3.2 was that loans were monitored on a regular basis. On its own, there is no prospect of the Crown making that out as untrue. The work of the lending managers, their reporting to the credit cell and to the sub-committee of the Board that monitored large loans, together with the reference of the analyses in those fora to the Board, mean that LFIL can justify the representation that its loans were monitored on a regular basis.

[236] The non-executive directors were unable to be specific as to how the loan managers were tested on the opinions they provided to the Board on the state of the loans. Particularly for Messrs Bryant and Jeffries, I find that their supervision did not extend meaningfully beyond an assessment of the attributes of the loan managers in the sense of asking how thoroughly they had reviewed matters material to their opinions and the managers' level of conviction supporting the views they expressed. The directors did not attempt to test the loan managers' opinions by any analysis of the risks of losses, that was independent of the information and advice received from the lending managers.

[237] Sir Douglas volunteered that he had never met a borrower, sighted a valuation or inspected any property relied on as security.[107] In commenting on their role as the non-executives on the large loans sub-committee, Mr Bryant stated that he and Mr Wallace were "…strangers to the loan files".[108] Each of the non-executive directors acknowledged that they relied on the respective managers.

[238] By the time of the February 2008 Board meeting, the pattern of errors in the projections of performance by borrowers over the preceding six months should have caused the Board to question the adequacy of management of the major loans. The Crown would argue that that point was reached sooner. However, I have treated the extent of errors in projections of loan repayments separately from management of those loans more generally. There is no justification for attributing a separate misleading consequence to the directors' oversight of the employees who were monitoring the loans.

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[107] T1747/2-5.
[108] T3397/32-35.

[239] The balance of the allegedly untrue statement in further particular 3.2 describes LFIL's response when a borrower has failed to meet its obligations. Although there were a number of examples of LFIL tolerating breaches of borrowers' obligations in the history of the major loan exposures, there was no on-going pattern of non-compliance with the major loans at the time of the amended prospectus.

[240] The reality, in particular with development loans, was that LFIL had to allow the borrower to pursue the originally intended course of conduct, in order to optimise the chances of recoveries. There was something of a pattern of LFIL pursuing additional security from other sources, which could "correct" a perceived inadequacy in security, but no instances of LFIL seeking recovery by realising the principal security it relied upon.

[241] Threats of "recovery action" where LFIL only had a second or third mortgage security would not be compelling because, in practical terms, LFIL could not deal with the secured properties without accounting to the prior mortgagees. In the majority of cases, any initiative to sell secured properties would have resulted in a substantial loss and possibly no recovery to LFIL. The reality is that in the last year of LFIL's operations, it appears to have resorted to the threat of exercising powers of sale only once in relation to a major loan, that being Bayview Raglan. That threat had not been carried through prior to receivership.

[242] On a detailed analysis of the implications of the allegedly untrue statement in this particular, I attribute less relevance to the representation of LFIL's preparedness to take corrective and recovery action, than I do to the impression conveyed by those statements that LFIL was in a position to protect investors' interests by doing so. I am satisfied from all the evidence that the directors were prepared to do everything they could to optimise the prospects of ultimate repayment of loans made. There could be no suggestion that they were compromised by conflicts of interest such as might arise in related party lending situations, and nor were they hampered by a lack of appropriately qualified personnel.

[243] However, the more difficult issue is the extent to which a representation about the capacity and commitment to take such action carries with it an assurance that there would be utility in doing so. On an analysis of the context in which the statement is made in the amended prospectus (and in the investment statements), I consider that this additional implication does arise. The immediately following passage in the investment statements is:

> If the security taken for a loan proves inadequate for any reason, including fluctuations in value due to changes in interest rates or market prices, Lombard Finance may be unable to recover the loan in full.

The text then describes LFIL's assessing loans for impairment as part of the loan review process.

[244] Therefore on a detailed analysis of the implications of these statements, a reader would be assured that LFIL's security position in relation to its loans meant that there was utility in taking corrective and recovery action.

[245] However, whilst a misleading omission on this point was touched upon in the course of argument, it is not squarely raised by the terms of this particular. To the extent that it raises a discrete criticism, I am not satisfied that the particular adequately put the accused on notice that they needed to answer it.

[246] Further, in the end I am not satisfied that the relatively refined analysis involved is appropriately attributed to a notional investor. It is at a level of detail that might not occur to such a reader, and it is therefore not a meaning that I can be satisfied beyond reasonable doubt can be attributed on this particular.

[247] I have reached the same conclusion on another implication arising from the passages about adherence to lending policies, and that is on the value of securities held by LFIL. Its projection of value in the mortgage securities it held routinely depended upon assumptions that increased values would ensue from successful completion and sale of the developments. That approach introduced a material risk because of the sequence of events still to occur at the time the advance was made, before the value of the secured property could increase to the extent anticipated.

[248] This "development risk" was regularly assumed in LFIL's assessments of its loan exposures. It raises an issue of whether the amended prospectus adequately conveyed that valuations relied upon did not reflect the value of real property present at the time of advance, but rather anticipated increases in the value of secured property that depended on events that were still to occur.

[249] On my analysis of the amended prospectus, putting myself as best I can into the shoes of a notional investor at the end of December 2007, I was concerned that this risk to the creation of value relied upon when LFIL made advances might not adequately be explained. I raised the concern more than once during evidence in the trial, and had a number of exchanges, principally with Mr Davison, about it.

[250] The arguments for the accused against this constituting a material omission from the amended prospectus were, first, that the risk was indeed adequately described in the amended prospectus, and secondly that in any event it was not an omission that had been alleged by the Crown, so that the concern I had raised was irrelevant.

[251] As to the description of this risk, Mr Davison relied on passages at the bottom of page 10 and top of page 11 of the amended prospectus, including the following:

> Lending against property has the benefit of tangible security but it also has risks as well. These risks are in two main categories; … and the value of development property incurs development risk, which is the risk of completing the development within an expected cost and a sale of the completed development for an acceptable price. Specific risk elements are possible cost overruns, possible time delays, adverse changes in regulatory requirements, quality of construction and a decline in property values or tenancies.
>
> …
>
> The value of Lombard's security depends on its ranking (first, second or other), … or *the assumed value of the completed development* …[emphasis added]

[252] Defence counsel argued that the notional investor ought to be credited with a sufficient understanding of these passages to appreciate the development risk involved in LFIL advancing monies against projected values of real estate that did not exist at the time the advance was made.

[253] I have reservations that this risk would not be appreciated by a material part of the constituency coming within "prudent but non-expert investors". In the context of the description of all risks involved, a careful and analytical reading is required to appreciate the point. However, I accept that the relevant risk is touched upon, and I would therefore not be prepared to find that the topic constituted a material omission.

[254] I also accept Mr Davison's second point, that it is not an omission that has been particularised in any of the counts, and is accordingly not a criticism that the accused had been required to answer. Mr Carruthers submitted that the absence of any adequate description of this development risk underpinned the substratum of the Crown case. I do not accept that that articulates it sufficiently to require an answer, and it is not the type of criticism that could be left as implicitly subsumed in the omissions that were explicitly alleged.

[255] A further provision in LFIL's credit policy was to limit exposure to any single borrower or group of related borrowers, to no more than 20 per cent of the company's total tangible assets (TTA) or five times shareholders' funds. At the date of the last financial statements before the amended prospectus, as at 30 September 2007, LFIL's TTA were approximately $177 million, which would suggest a limit on any single borrower exposure of approximately $35 million. If those financial statements were ignored, going back to the annual accounts to 31 March 2007 (prepared in accordance with earlier accounting standards) TTA was some $187 million. However, the Brooklyn loan was just short of $40 million at that balance date, and after the new advance to Mr Manning's entity, reached some $52 million at the end of December 2007. It increased further between then and receivership to a total of $54.692 million, so at those two dates represented 33 and 38 per cent of TTA respectively, on the current numbers that would have been applied for the company's own purposes.

[256] The LFIL credit policy on monitoring single borrower exposure provided a guideline that there should be either a maximum of 20 per cent of TTA, or five times shareholders' funds. The Crown treated this second alternative measure for limiting single borrower exposure as a constraint that would have been appropriate in LFIL's

earlier days, whilst it was building up its portfolio, and its shareholders' funds. It was dismissed as no longer being an appropriate measure to gauge the prudent limit on single borrower exposure. That approach was not accepted by the accused, and they cited passages in the amended prospectus where the concentration risk was commented on when measured against the company's equity (ie its shareholders' funds). The acknowledgement of a relatively high exposure to one counterparty was expressed as a percentage of shareholders' equity. In those circumstances, the Crown cannot make out an untrue statement in relation to adherence to policy when the offer documents adopt one of two guidelines, but do not repeat the calculations by reference to the other.

[257] The relative concentration of risk is likely to be more material to expert analysts, than to the notional investor. Perhaps more material to a notional investor is the fact that the directors saw fit to have a policy that limited single borrower exposure, but then allowed a lending situation to develop in which policy limits were not complied with.

[258] However, a misstatement in relation to this concentration of risk and the flip side of it, that LFIL made diversified investments (the subject of the allegation in particular 4 to counts two, three and four), was not pursued by the Crown in its closing. That is appropriate given the terms in which the amended prospectus addressed concentration risk, acknowledging a greater concentration than might be desirable, stating that the company was comfortable with its exposures, and was working towards reducing its exposure to any one individual borrower.[109] Accordingly, this is not an aspect of alleged non-compliance with lending policies that the Crown could make out.

[259] I am not satisfied that any difference between the impression reasonably given by the relevant passages in the offer documents as to adherence to lending or credit policies, and the practices adopted by LFIL constitutes a material misstatement. Accordingly, the Crown cannot make out any material aspect of the criticisms raised by particular 3 to count one.

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109 Amended prospectus at 15.

Count One, particular 4 - Extension certificate

[260] This alleged that the following statement contained in the extension certificate was untrue, namely that:

> (a) the financial position shown in the statement of financial position referred to in the Amended Prospectus has not materially and adversely changed during the period from the date of that statement of financial position to the date of this certificate.

[261] My finding that the Crown cannot prove either registration or distribution of the extension certificate in the relevant period means that this allegation, which depends on those steps having occurred, cannot be made out.

Count One, particular 5 – No material omissions

[262] This alleged as untrue:

> The statement there were no other material matters relating to the offer of securities offered under the Amended Prospectus other than those set out in the Amended Prospectus.
>
> **Further particulars to particular 5 (statements relied upon)**
>
> 5.1 *"There are no other material matters relating to the offer of securities offered under this Prospectus other than those set out in this Prospectus"* (… the Amended Prospectus, page 25E).

[263] This particular relies on the Crown making out one or more of the earlier particulars that depend on omissions. To the extent that the allegation in particular 1 has been made out, then it follows that this statement assuring readers of the amended prospectus that there are no other matters that are material to them is wrong. This last particular in count one adds only the criticism of an explicit assurance from the issuer that the reader has been told everything, when, to the extent that the earlier allegation of omission has been made out, the readers have not been told everything that is likely to be material to their decision. Although included as a matter of statutory form,[110] that is an assurance that readers could, if it was not stated, reasonably assume to be the case. In the present circumstances, I am not

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[110] Negating the requirement under Schedule 2, clause 34 of the Securities Regulations 1983 to state particulars of any material matters.

persuaded that it adds materially to the seriousness of the extent of untrue statements in the amended prospectus.

Counts Two, Three and Four – The investment statements

[264] Counts two, three and four allege breaches of s 58(1) of the Act in relation to distribution of an advertisement, namely investment statements dated 28 December 2007 that were distributed by LFIL respectively for unsecured subordinated notes, unsecured subordinated capital notes and secured debenture stock. Each of the investment statements described the particular features of the type of investment on offer. However, the content of each investment statement relevant to the charges was the same. These counts included four particulars in which the content of the investment statements was alleged to contain an untrue statement.

[265] The investment statements were more likely to be considered by potential investors, than the prospectus. Application forms to invest with LFIL were printed in the back of the investment statements. Those forms included an acknowledgement that the investor had read and understood the investment statement. The text was abbreviated, but the commentary on various risks included extracts from the amended prospectus expressed in identical or materially similar terms.[111] No financial statements were included. Accordingly, readers of the investment statements assessing the prospect of investing would do so on the basis of commentary about the state of the company's business, with no analysis of their own of what they might have gained from considering the financial statements.

[266] The investment statements included at the outset:

> Read all documents carefully, ask questions and seek advice before committing yourself.
>
> …
>
> In addition to the information in this document, important information can be found in the current Registered Prospectus for the investment. You are entitled to a copy of that Prospectus on request.

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[111] Including statements on "Investment risks", "Lending risks" and "concentration risks" set out in the amended prospectus at 9-14, and in the investment statements at 14-16.

[267] I treat the readership of the investment statements as including notional investors who would have understood the recommendation that they take advice from an investment adviser. They would also have understood that they could obtain further information about the investment by obtaining a prospectus. This group would include those who nonetheless made investment decisions solely in reliance on the investment statements relevant to the form of investment made.

Counts Two, Three and Four, particular 1 – Adherence to credit policy

[268] This alleged as untrue the statement:

> … That LFIL used its credit policy to manage its exposure to risk, limits were placed on exposures, lending was subject to defined criteria and loans were monitored on a regular basis.

[269] A further particular as to the statement in the investment statements relied upon cited a passage from page 15 of them, in the following terms:

> *"Lombard Finance uses its credit policy to manage its exposure to risk. As part of this policy, limits are placed on exposures, lending is subject to defined criteria and loans are monitored on a regular basis."*

[270] The passage relied on in this further particular was followed immediately by this further statement:

> If its credit policy and guidelines are not adhered to, or if those policies and guidelines are inadequate, this may result in loss of principal and interest to Lombard Finance and should such losses be of a magnitude to cause Lombard Finance to become insolvent, this in turn may cause loss to investors.

[271] This particular alleges substantially the same untrue statement as that in count one, particular 3.[112] The Crown case is that this statement assured investors that the risks of loss from the advances made by LFIL were managed by imposing limits on the exposures to various forms of borrowing, that the extent of lending was confined by a policy of defined criteria, and that once loans were made, they were monitored on a regular basis.

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[112] See [218]-[259] above.

[272] This allegation covers ground already dealt with in determining particular 3 of count one. I am not satisfied that there are any relevant differences. Accordingly, on the basis of my earlier reasoning, this particular cannot be made out.

Counts Two, Three and Four, particular 2 – Impairment of major loans

[273] This alleged as untrue, statements:

> That LFIL regularly reviewed loans and if a borrower failed to meet obligations it would take corrective and recovery action omitting a material particular being information about the apparent or likely substantial impairment of its five largest loans and action taken following the borrowers' failures to meet obligations.

[274] Further particulars as to the statements in the investment statements relied upon cited passages from pages 15 and 16 of them, in the following terms:

> 2.1 *"Lombard Finance regularly reviews loans, and if the borrower fails to meet its obligations, takes corrective and recovery action where required."*
>
> 2.2 *"The Board has taken due account of the six largest exposures and remains comfortable that they are being adequately managed by the Company."*

[275] I have found that the Crown could not make out any untruth in a claim that LFIL regularly reviewed loans it had made.

[276] As to the second extract in particular 2.2, it raises the issue of possible impairment of the major loans. I have dealt with that in determining particular 2 of count one above.[113] I am not satisfied that in relation to a majority of the major loans, LFIL ought to have treated them as impaired as at 24 December 2007. In respect of Bayswater where the Crown has made out its case on that point, I am satisfied that its impairment was not on its own material.

[277] I find that as at 28 December 2007, the Crown cannot make out as untrue the expression of opinion by the directors that the six largest exposures were being adequately managed. In terms of impairment thereafter, the circumstances allegedly

[113] See [147]- [217] above.

giving rise to it were not specified, so it cannot be made out, as with the parallel issue on count one. Accordingly, this particular cannot be made out.

Counts Two, Three and Four, particular 3 – Liquidity concerns

[278] This alleged as untrue:

> That LFIL managed its liquidity by regularly updating projections omitting a material particular being information about LFIL's deteriorating cash position.

[279] The further particulars of the passages alleged to give rise to this material omission were:[114]

> 3.1 *"Lombard Finance manages its liquidity by regularly updating its projections of:*
>
> - *The maturity dates of amounts owed to investors;*
> - *The proportion of investors that will redeem, as opposed to reinvest, their investments;*
> - *Loan repayments received from borrowers (often from the expected sales of completed developments);*
> - *Further advances made to borrowers, including further advances made as part of funding of developments. At the date of this investment statement Lombard Finance does not have significant commitments to fund ongoing developments (funds committed for ongoing development will vary from time to time)"*

[280] This passage followed immediately after a heading "Liquidity Risk" in the investment statements, and the following paragraph:

> Liquidity risk is a risk of Lombard Finance not having enough cash liquidity to meet its obligations. In the event that Lombard Finance failed to manage its liquidity, due to mismanagement of its own borrowings (deposits from investors) or matured loans failed to repay on time and should such loss of liquidity be of a magnitude to cause Lombard Finance to become insolvent, there could be insufficient funds to repay investors.

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[114] Investment statement at 15-16.

[281] The passage relied on in the further particulars was then followed by further comments including the following:[115]

> … Cash flow projections are completed on a conservative basis (meaning that a lower level of reinvestment is used for this purpose than is currently being experienced and allowances are made for delays in borrowers repaying their loans which recognise that in current circumstances the sales of properties are being delayed).
>
> … The Board remains confident that, based on a range of conservative scenarios, Lombard Finance will have the required cash resources to fund all repayments to investors when due and that are not reinvested.

[282] LFIL's systems for managing its loans included the maintenance of details of the type described in the four bullet points in further particular 3.1. The essence of the Crown's case is not that it was a misrepresentation to say that such practices were undertaken. Indeed, they were.

[283] Rather, the Crown case was that the terms of assurances about liquidity risk were materially incomplete without an acknowledgement about the reduced extent of cash available to meet the company's obligations, and doubts as to the timely receipt of anticipated loan repayments. This is the essence of count one, particular 1. An issue is whether the comments on liquidity risk in the investment statements convey a different meaning on this subject to that conveyed by the passages focused upon in the amended prospectus. None of the parties sought to draw such a distinction.

[284] The context is different from the amended prospectus because the investment statement does not contain or annex any financial statements. The reader therefore has no means of testing the qualitative commentary against quantitative data from financial statements. Whereas the text of the amended prospectus cites figures from the financial statements, such references are absent from this part of the investment statements.

[285] The commentary on liquidity risks in the investment statements invites readers to accept the directors' judgement about the company's liquidity position.[116]

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115 Investment statement at 15 and 16.

116 See second extract in [281] above.

Notwithstanding the different context of the investment statements, I am satisfied that the Crown has established beyond reasonable doubt that they are also sufficiently material in the qualitative context of the commentary in the investment statement to be a material omission.

[286] The matters I have suggested should have been included in the amended prospectus[117] were similarly appropriate for the investment statements, to avoid a material misstatement. I accordingly find that the Crown has established an untrue statement on particular 2 of counts two, three and four. The accused cannot make out the defence of reasonable belief in the truth of the relevant aspect of the investment statements.

Counts Two, Three and Four, particular 4 – Investments were diversified

[287] This alleged as untrue a statement:

> That investments made by LFIL were diversified.

[288] This particular was not pursued.

Count Five – The DVD

[289] The fifth count alleged that there were untrue statements included in a DVD sent with a letter to investors on or about 3 March 2008. The Crown case is that the DVD constituted an advertisement for the purposes of the Act, and alleged that it contained an untrue statement, described as follows:

> Positive statements as to LFIL's governance, conservative lending policy and liquidity management. These omitted a material particular being the substantial deterioration of LFIL's financial position from that reported at 31 March 2007 such that LFIL was at risk of not being able to meet its investor repayment obligations as they fell due.

[290] The further particulars as to the statements in the DVD that were relied on are as follows:

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[117] At [121] above.

1.1 **Governance**

"[Mr Jeffries]: Our role as, ah, set by law and procedure is governance, and what's meant by governance is that the shareholders and people who participate with the company, ah, expect that the regulatory standards of the country are met by the directors, that the, ah, company is meeting the laws of New Zealand, the regulations, ah, that are relevant to its activities, that it has business plans which are appropriate, that it has a strategic vision, ah, and that there is a very open culture in which information, ah, is given to the board, the appropriate information, and accountabilities" (Verified Transcript of DVD "Meet Our People page 2").

1.2 **Conservative lending policy**

"[Sir Douglas Graham]: We have a very conservative lending policy and we manage our liquidity demands very carefully" (Verified Transcript of DVD "Meet Our People page 3").

"[Mr Reeves]: Well we have to feel comfortable with the, um, our perception of their integrity, do they honour their historical agreements, are they competent, do they have the proficiencies to take on, um, what they're proposing to do, whether or not it be to invest money in something or to develop something, they have to have adequate money to come into the development or into the investment in the first instance, so if we don't feel comfortable about their track record or capabilities, um, or we simply don't feel comfortable, we say no" (Verified Transcript of DVD "Meet Our People" page 3).

1.3 **Liquidity Management:** Refer to the statements at 1.2.

[291] The DVD had been produced for LFIL in late 2005. Its content was vetted by LFIL's then solicitors, who raised (among other matters) the prospect that the proposed content would constitute the DVD an advertisement for the purposes of the Act. Mr Reeves did not want the DVD to constitute an advertisement, and accordingly modified the content to remove the majority of the aspects perceived by the solicitors as likely to give it that status. There was one exception to acceptance of the suggested changes. Statements by existing investors in LFIL were identified as likely to contribute to its status as an advertisement, but Mr Reeves directed that such statements should remain in the DVD.

[292] The solicitors still provided a certificate under reg 17 of the Securities Regulations 1983, which was required on the basis that the DVD constituted an advertisement for the purposes of the Act.

[293] Seventy five of the DVDs were produced. In early 2006, after viewing the completed DVD, Mr Bryant advised firmly against the use of it. He understood that, with the concurrence of the other Board members, his view would be respected. He anticipated that the DVD would no longer be used on the basis of observing Mr Reeves noting, at the conclusion of the discussion about it at a Board meeting, something in respect of it. Mr Bryant anticipated that that would translate into a direction from Mr Reeves to the appropriate staff to not use the DVD.[118]

[294] Mr Jeffries and Sir Douglas had the impression that the Board's acceptance of Mr Bryant's view had resulted in the DVD not being used. No documented record of such a direction was produced. None of the non-executive directors had any further awareness of the DVD until the issue was raised by the Securities Commission.

[295] The DVD was available to attendees at an investor seminar in Christchurch in September 2007. Although distribution of the DVD at that time is not relevant to the terms of the charge, that use of the DVD for promotional purposes raises questions about the form in which any direction had been given on behalf of the Board to management, that the DVD should not be used.

[296] Mr Reeves was at the Christchurch seminar. His evidence was that he did not take any personal interest in the promotional materials being used. He was involved in passing to Sir Douglas some speech notes that he recalls being prepared by the marketing manager for LFIL, without considering the content of them. He was conscious that Sir Douglas did not use them.

[297] The DVD includes statements by Sir Douglas, Messrs Reeves and Jeffries, and Mr Hugh Templeton, who was also a director of LFIL when the DVD was made. Mr Templeton resigned as a director in March 2007. The DVD also included interviews with investors in debt instruments issued by LFIL, in which the investors reflect on the reasons why they had chosen those investments, and in general terms why they had confidence in LFIL. The essence of the statements by directors is also

[118] T3442/32-3443/12.

reassuring about relatively how safe it was to invest in LFIL, and in general terms encouraging of such investments.

[298] There was no reference to the terms of particular investment opportunities with LFIL. A printed endorsement screened at the end of the DVD included:[119]

> If you would like further information on any of our investment products, or if you would like to talk to one of our client support officers, please call …
>
> **Investment information**
>
> ….
>
> All forms of investing involve an element of risk. Please refer to a current investment statement of Lombard Finance for information on the risks associated with investment in the securities of Lombard Finance.
>
> Please call Lombard Finance on freephone 0800 229 229 to request a copy of our current investment statement.

[299] The unchallenged evidence from Mrs Hooker was that she received a copy of the DVD at the time of correspondence from LFIL that encouraged her to renew an investment in early March 2008, rather than redeeming the investment as she had indicated was her intention. An admission of facts pursuant to s 9 of the Evidence Act 2006 specifies that Mrs Hooker had requested that she be sent a copy of the DVD together with the investment statement for secured debenture stock. Two letters were despatched to her, dated 3 March 2008. Both appear to be standard form letters, one purporting to enclose the investment statement, and the other a generic publication by LFIL called "A Guide to Investing Wisely". I was invited to infer that the DVD was enclosed with the second of these.[120]

[300] Messrs Reeves and Jeffries denied that the DVD constituted an advertisement.[121] Messrs Graham and Bryant disavowed reliance on that argument, and instead submitted that there was total absence of fault on their parts, so that they could not be found guilty notwithstanding the strict liability nature of the charge. Messrs Reeves and Jeffries also relied on this argument, as an alternative.

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119 LOM039.0328.

120 LOM033.0046, LOM063.0006.

121 The legal submission was advanced notwithstanding Mr Reeves' attitude that he treated any document going to an investor as an advertisement: T3479/23.

[301] The scope of “an advertisement” is defined in s 2A of the Act in the following terms:

> **2A Meaning of “advertisement”**
>
> (1) In this Act, unless the context otherwise requires, advertisement means a form of communication—
>
> (a) That—
>
> (i) Contains or refers to an offer of securities to the public for subscription; or
>
> (ii) Is reasonably likely to induce persons to subscribe for securities of an issuer, being securities to which the communication relates and that have been, or are to be, offered to the public for subscription; and
>
> (b) That is authorised or instigated by, or on behalf of, the issuer of the securities or prepared with the co-operation of, or by arrangement with, the issuer of the securities; and
>
> (c) That is to be, or has been, distributed to a person.
>
> (2) The following are also advertisements:
>
> (a) A statement relating to an interest in a contributory mortgage required to be distributed to a person by regulations:
>
> (b) An investment statement.
>
> (c) documents, information, and other matters required to be made publicly available under section 54C.]]
>
> (3) None of the following is an advertisement:
>
> (a) A registered prospectus:
>
> (b) Repealed.
>
> (c) A statement or report made in accordance with section 3(7) of this Act:
>
> (d) A disclosure statement published by a registered bank under section 81 of the Reserve Bank of New Zealand Act 1989.
>
> (4) A communication is an advertisement whether or not consideration is to be, or has been, paid for the distribution of the communication.
>
> …
>
> (6) Where—

(a) An advertisement within the meaning of this section appears in association with another advertisement that is not an advertisement within the meaning of this section; and

(b) Both advertisements are authorised or instigated by, or on behalf of, the same person or prepared with the co-operation of, or by arrangement with, the same person,—

those advertisements are deemed to be a single advertisement within the meaning of this section.

(7) Unless this Act or regulations provide otherwise, nothing in this Act or regulations limits the information, statements, and other matters that may be contained in an advertisement.

[302] In support of their argument that the DVD did not constitute an advertisement, Messrs Henderson and Hurd invited an analogy with the analysis undertaken by Heath J in *Moses* of a letter despatched by the issuer to prospective investors.[122]

[303] In the case of that communication, Heath J was not satisfied that the Crown could prove to the required standard that the letter constituted an advertisement where it did not explicitly solicit funds, but rather had the apparent purpose of reassuring investors that Nathans' business had not been affected by the then recent receivership of Bridgecorp. Further, there was no reference to an investment statement or anything else that would strike an investor as an offer to subscribe for securities. There was a reference to "secured debenture stock" in a footnote to the letter, but that was not seen as sufficient to constitute it an offer of securities to the public.

[304] The printed endorsement at the end of the DVD is as close as the DVD comes to soliciting funds. For it to be useful for that purpose, LFIL representatives would need to use it in conjunction with other materials.

[305] I am not satisfied that the content of the DVD, when assessed on its own, constitutes an advertisement within the definition in s 2A of the Act. The fact that solicitors considered it appropriate to provide a reg 17 certificate in respect of its contents cannot be determinative of its status. The endorsement of text at the end of

[122] *R v Moses* HC Auckland CRI-2009-004-1388, 8 July 2011 at [252]-[260].

the DVD inviting viewers to refer to a current investment statement does not constitute a reference to an offer of securities. Whilst the content is, for the purposes of s 2A(1)(a)(ii) "reasonably likely to induce persons to subscribe for securities…", that likelihood cannot be linked to any specific securities to which the DVD related and that were, or were to be, offered to the public.

[306] However, the Crown can establish it as an advertisement for the purposes of the Act if it appeared in association with an advertisement that did come within the statutory definition.[123] Mr Henderson argued that this provision required the Crown to prove that the copy of the DVD was distributed to Mrs Hooker in the same letter as the investment statement, for it to be distributed "in association" with the investment statement. He argued that the terms of the two letters despatched on 3 March 2008 did not enable the Crown to prove that extent of "association", with the preferable inference being that the copies of the DVD and the investment statement were despatched in different letters.

[307] I am not persuaded that the requirement for the two items to be "in association" with one another requires them, in the present context, to be distributed in the same envelope to the recipient. That involves an artificially narrow approach to the concept of the two items being associated, inconsistent with the evident purpose of the additional aspect of the definition of advertisement in s 2A(6). I acknowledge Mr Henderson's points that the concept of "in association with" is not defined in the Act, and has, in an entirely unrelated context, been characterised as imprecise.[124]

[308] The purpose of s 2A(6) is to extend the range of promotional statements made on behalf of an issuer to those which may not of themselves have the requisite characteristics, but are made available to a recipient for potential consideration, together with an advertisement that does have the requisite characteristics. Here, Mrs Hooker had asked for the DVD to be sent to her as well as a current investment statement, in the context of dialogue with LFIL staff about renewal of a maturing investment she had with LFIL. The response to her request on behalf of LFIL was to

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[123] Section 2A(6).
[124] *Stewart v Ranford Enterprises Ltd* CA181/93, 19 May 1995 at 6.

despatch both items she asked for, within the same day, even although despatched in separate envelopes. Those circumstances reasonably suggest the prospect of both items being considered together, and those are circumstances intended to be covered by s 2A(6).

[309] I am accordingly satisfied that, in the context of the distribution of a copy of a DVD to Mrs Hooker, its despatch on the same day as the despatch of an investment statement also requested by her constitutes this instance of distribution of the DVD an advertisement.

[310] Before considering whether the Crown can make out any of the allegedly untrue statements in, or material omissions from, the DVD, it is appropriate to consider whether any of the directors could, in any event, defend this charge on the basis that any use of the DVD occurred without any fault on their part. It is well settled that in certain forms of strict liability offences, it will be open to an accused person to defend a charge on the basis of total absence of fault. As offences under s 58(1) of the Act involve the element of distribution of an advertisement, I am satisfied the elements of the *actus reus* involve conscious behaviour on the part of an accused, before strict liability might arise. An analogy can be drawn with the situation in *Starkey*, which concerned a requirement that a document be published. On appeal from the District Court, Barker J treated the word "published" as connoting an element of knowledge.[125]

[311] Defence counsel cited the Court of Appeal's decision in *Steigrad* for recognition of the availability of a no fault defence to charges under s 58 of the Act.[126] The application of the defence was not directly in issue in that case. However, its potential availability was recognised in rejecting the prospect of an otherwise undesirable consequence of treating offences under s 58 as arising throughout the period in which an offer document is before the public.

[312] There is no basis for attributing to either of Messrs Bryant or Jeffries, any participation in, or awareness of, the distribution of the DVD in March 2008.

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125 *Police v Starkey* [1989] 2 NZLR 373, and see Bruce Robertson (ed) *Adams on Criminal Law* (looseleaf ed, Brookers) at [CA20.46].

126 *R v Steigrad* [2011] NZCA 304 at [111]-[113].

Mr Bryant was entitled to believe that the DVDs had been discarded from the time of his recommendation that that occur in early 2006. There was no evidence that the continued availability or distribution of the DVDs did, or ought to have, come to his attention thereafter. There was some doubt as to how readily the DVD could be accessed on LFIL's website, but no suggestion of circumstances in which non-executive directors should have been monitoring the content of the website to the extent necessary to become aware of the availability of the DVD from that source.

[313] The same position pertains to Mr Jeffries. There was no challenge to his own recollection of supporting Mr Bryant's recommendation that the DVD not be used. Nor is there any evidence that he was, or ought to have been, aware of the use or distribution of the DVD thereafter.

[314] Sir Douglas was present at, and addressed, the seminar for existing and potential investors in Christchurch in September 2007. Copies of the DVD were among the promotional materials made available to attendees, and there was evidence from one couple who confirmed taking a copy of the DVD and playing it after attending the seminar. Sir Douglas's evidence is that he was not conscious of the nature of promotional materials available to attendees of the seminar, and that he did not see DVDs at that time.

[315] As with the other non-executive directors, there is no evidence suggesting that Sir Douglas was, or ought to have been, aware of the continued availability of the DVD up to March 2008.

[316] On the defence of complete absence of fault, Sir Douglas bears the onus in establishing, on the balance of probabilities, that there was no fault in his not appreciating the continued availability of the DVD. I am satisfied he can discharge that burden. Whilst the chairpersons of some companies in dealing with potential investors in the situation confronting Sir Douglas may have been more careful in monitoring the total range of information being made available to potential investors, I accept that no fault can be attributed to Sir Douglas in not undertaking that step in September 2007, in the circumstances that pertained. He was accompanied by

Mr Reeves who, as chief executive and an executive director, might reasonably be expected to monitor the detail of all information being made available, or ensure that it was otherwise properly supervised. Other LFIL employees with responsibility for marketing were also present. The purpose of Sir Douglas's participation was to fly the flag. There being no basis for suggesting its continued use ought to have come to Sir Douglas's attention at that time, and no opportunity for him to become aware of it thereafter, I am satisfied that his position is ultimately the same as those of Messrs Bryant and Jeffries.

[317] As for Mr Reeves, there is no documentary record of his directing that the DVD not be used, or any record of his monitoring the marketing personnel within LFIL or its parent company who would be dealing with the promotional material as to their continued use of the DVD.

[318] There is evidence of one instance in which Mr Reeves countermanded the wishes of Sir Douglas in relation to the content of promotional material. In November 2007, Sir Douglas was sent a draft of a letter intended to be distributed to existing and potential investors. The draft contemplated that both Sir Douglas and Mr Reeves would sign it. Sir Douglas responded in an email to Mr Reeves' personal assistant that he was generally not in favour of the letter, and specifically objected, among other things, to content that referred to Ferrier Hodgson's then recent assessment of LFIL's financial position.[127] Mr Reeves and the marketing personnel dealing with the issue could not have been under any impression other than that Sir Douglas did not want a letter of the type contemplated to be distributed.

[319] Notwithstanding the stance by the chairman of directors, a re-drafted letter that removed only the specific references to the Ferrier Hodgson involvement was produced and distributed to the intended audience, signed only by Mr Reeves.[128] That suggests a preparedness by the chief executive and marketing staff to disregard the wishes of directors when determining the nature of promotional material for LFIL.

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[127] DV5/42.
[128] LOM034.0303. Mr Reeves cross-examined about it at T3620-3622.

[320] There was no satisfactory explanation in the evidence as to how copies of the DVD continued to be available to staff for distribution, when Mr Reeves had attempted to comply with a direction from the Board that it not be used. After a lapse of some 18 months from that time, copies of the DVD were then made available to attendees at the Christchurch seminar. It is more difficult for Mr Reeves to reasonably dismiss the presence of the DVD at that function simply on the basis he was not aware of it, than it is for Sir Douglas. I accept his evidence that he was not aware of the DVD on that occasion, but as the senior executive present, I question whether the competent discharge of that role ought to have extended to a basic monitoring of the form of promotional materials made available to attendees.

[321] On the one hand, Mr Reeves acknowledged that he was extremely careful about the accuracy and lawfulness of all promotional material conveyed to the public,[129] but he did not have any specific explanation as to why he was not aware of copies of the DVD being amongst the materials available at the Christchurch seminar, or subsequently still be available for dispatch in March 2008. Further, the content of the DVD remained available via links on the company's website. Given the legal and practical importance attributed to materials promoting investments in a finance company, arguably these were details that should not have been beneath the chief executive.

[322] Ultimately, however, I have to measure his lack of awareness of the use of the DVD in the context of a no fault defence which is available because, notwithstanding the strict nature of liability imposed, findings of guilt ought not to be imposed if the accused has no mental awareness of his involvement in the *actus reus*. I am satisfied that that was Mr Reeves' position in relation to despatch of the DVD to Mrs Hooker, and accordingly I accept that the no fault defence is also available to him.

[323] Given the finding that all four accused would be entitled to invoke the defence of complete absence of fault, it is unnecessary to analyse whether the content of the DVD contained untrue statements, as alleged. All accused are not guilty on count five.

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129 T3479/23-3480/10.

Criticisms of the investigation

[324] Throughout the trial and in closing addresses, counsel for all of the accused were trenchant in their criticisms of perceived inadequacies in the investigation carried out by the then Securities Commission, leading to the laying of these charges. The criticisms included inadequacies in identifying relevant documents and analysing their effect, Ms Peden forming views before interviewing the directors, and then conducting those interviews without putting to the directors her concerns that were subsequently alleged to constitute untrue statements in the offer documents. There were also criticisms of the inappropriately confined basis on which Mr Cable was instructed to provide an opinion, essentially peer reviewing the views already reached by Ms Peden and relying on her investigation of the factual circumstances.

[325] Some aspects of these criticisms are justified. In other respects, the criticisms did not take appropriate account of the difficulties facing a regulator in investigating such matters. The criticisms cannot influence the analysis of the elements required to be proven by the Crown on the present charges or, to the extent they become relevant, the availability of defences for the accused. None of the criticisms have impinged materially on the entitlement of the accused to a fair trial. The very extensive work involved in mounting the defences that were presented was, to an extent, required because of the nature of the charges, and also because of the thorough manner in which all the directors elected to adduce evidence of their standard of governance at LFIL.

Summary

[326] In this case, the Crown has alleged "untrue statements" in the statutory sense by misstatement or material omission, in relation to offer documents distributed by Lombard Finance in December 2007. The allegations raise five matters:

- first, on the company's liquidity;
- second, on the impairment of major loans;

- third, on the existence of and adherence to lending and credit policies as a means of limiting risk;

- fourth, on the absence of adverse change in the company's financial position since 31 March 2007; and

- fifth, on an assurance that there were no other matters material to the offer of securities, beyond those referred to in the amended prospectus.

[327] On the first of these, as to the descriptions of the liquidity risk, I am satisfied there was a material discrepancy between the liquidity squeeze confronting LFIL in December 2007, and the more confident comments on liquidity conveyed in the offer documents. On 15 November 2007, Sir Douglas had commented in an email to Mr Reeves that the company was "sailing very close to the wind now and the next two or three months will be critical". The comment was justified at the time, and liquidity conditions continued to tighten thereafter.

[328] Although the actual number of dollars in the bank on any given day was not important in itself, the trend of the amounts of cash available was significant when that trend was substantially downwards. Generating sufficient cash depended on anticipated loan repayments occurring, and in that regard the accused relied entirely on loan managers to predict when payments would be received. Since September 2007 the loan managers' projections had been astray by somewhat more or less than half the predicted repayments in each month. I am satisfied that readers of the offer documents in late December 2007 and thereafter would be likely to see the liquidity risk associated with investing in LFIL materially differently, if the extent of the company's concerns, plus the downwards trend in cash and the extent of error in management projections of loan repayments, had been described to them.

[329] As to the statutory defence of reasonable grounds for believing in the truth of the offer documents, on this and other aspects, I am satisfied that the accused genuinely believed in the accuracy and adequacy of the content of the offer documents when they were issued.

[330] However, on the matters going to liquidity risk, the accused have not established, on the balance of probabilities, that it was reasonable for them to omit descriptions of the features I have identified, and that were known to them but not acknowledged in the offer documents.

[331] On the second topic of alleged impairment of LFIL's major loan advances, stripped of hindsight as matters stood in late 2007, I am not satisfied beyond reasonable doubt that LFIL ought to have treated the majority of its major loans as impaired. There is an issue, especially for Mr Jeffries, as to the standard by which possible impairment should be measured. The amended prospectus referred to a simpler test than the then recently introduced formal accounting standards under IFRS. In measuring the adequacy of disclosure on any impairment of major loans, I have applied the test suggested in the amended prospectus.

[332] The only loan in respect of which the Crown can establish impairment should have been recognised in late December 2007 was that in respect of Bayswater. On its own, a failure to disclose impairment of that loan could not be material. Accordingly, the Crown has not made out a material omission in relation to impairment of the major loans at the date of the offer documents.

[333] Undoubtedly, all the major loans, or at least a majority of them, were impaired by the end of March 2008. However, I am not satisfied that the Crown can make out a sufficient change in the status of the major loans, so as to make out a material omission after the issue of the offer documents, without pleading events or circumstances that caused or contributed to the need to recognise impairment in those loans at given points after the issue of the offer documents. The Crown did not particularise its case on that basis, so cannot establish a material omission on impairment, on the alternative basis that it arose at some point after the issue of the offer documents.

[334] On the third topic of the accuracy of statements in relation to credit and lending policies that applied to limit the risks of not achieving full recovery of loans, I am not satisfied beyond reasonable doubt that the statements cited in the Crown's

particulars on this criticism rendered the offer documents materially untrue in the respects alleged.

[335] I have had concerns that references to credit and lending policies did not alert readers of the offer documents to two aspects of risks. First, that the reliance on "as completed" valuations, when that stage could be years away, exposed LFIL as lender to the risks that the enhanced valuation would not ensue in the period between making advances, and the completion of the respective developments over which security was taken.

[336] Secondly, that statements as to LFIL's commitment to exercising powers granted under the securities it took overlooked the point that in many situations there would be no utility in exercising formal powers under the securities, because it would not lead to recovery of the loan.

[337] However, these two concerns were not sufficiently covered by the terms of the pleaded particulars, and accepting defence objections that the issues had not been identified as requiring an answer, I have decided that such concerns should be excluded from the analysis on references to adherence to credit policies.

[338] As to the fourth topic of alleged untrue statements that there had been no adverse change in LFIL's financial position since 31 March 2007, this was alleged specifically in relation to an extension certificate allegedly registered as of 24 December 2007. That involves the elements "registration" and "distribution" of the extension certificate. For reasons I have set out, I am not satisfied beyond reasonable doubt that the extension certificate was distributed, or indeed registered, prior to LFIL withdrawing the prospectus.

[339] That reasoning does not affect the amended prospectus itself, which clearly was distributed. In the commercial sense, the amended prospectus relied upon and presumptively included the content of the extension certificate for its validity after 31 December 2007. However, that does not answer the requirement for the Crown to prove, in the criminal context, that the extension certificate was actually registered and distributed before it can found a component of a criminal charge.

[340] On the fifth topic of an assurance that there were no other matters material to the offer of securities, beyond those referred to in the amended prospectus, this depended on the Crown making out its case on an omission raised by one of the other topics. To the extent that the Crown has made out a material omission on the liquidity risk, it means that this last allegation in respect of the offer documents is also made out. That arises as a consequence of the earlier finding, and does not add materially to the criminal conduct involved.

[341] In count five of the indictment, the Crown alleged that a DVD, allegedly distributed in March 2008, constituted an advertisement in terms of the Act, and that it contained an untrue statement. In the particular circumstances in which one copy of the DVD was sent to one investor in association with a current investment statement, I have found that the DVD did constitute an advertisement for the purposes of the Act. However, on grounds that vary somewhat for some of the accused, I have found that each of them would be entitled to invoke the defence of complete absence of fault. In those circumstances, I have not determined whether or not the Crown could make out an untrue statement in the content of the DVD.

[342] Accordingly, the Crown has established two out of the five respects in which it alleged the offer documents were untrue. Applying these findings to the counts in the indictment, my verdicts are:

(a) On count one: I find each of you, Douglas Arthur Montrose Graham, Michael Howard Reeves, William Patrick Jeffries and Lawrence Roland Valpy Bryant, guilty in respect of particular 1. That leads to a consequential finding that each of you is guilty in respect of particular 5 of count one, but that is not a finding that I treat as adding anything to the criminal conduct.

(b) On counts two, three and four: I find each of you guilty in respect of particular 3.

(c) On all the remaining particulars alleged in counts one to four, and on count five, I find each of you not guilty.

Dobson J

Solicitors:
Crown Solicitor, Wellington for Crown
Morrison Daly, Wellington for Graham and Bryant
Henderson Reeves Connell Rishworth for Reeves
Gibson Sheat, Wellington for Jeffries

Appendix A – LFIL's major loan exposures

Brooklyn

[A1] LFIL's largest exposure was to the development of a large-scale residential subdivision in Brooklyn, Wellington. LFIL had first provided secured advances in February 2003 for an amount up to $6 million. In the period to mid 2007, the development had been under the control of a Wellington developer, Lance James.

[A2] A September 2006 report to the LFIL directors about Brooklyn from Mr Thorpe had painted a bleak picture. He raised the prospect of selling one part of the subdivision as a means of reducing LFIL's exposure, but considered it would result in an unacceptable write off of $5 million plus. He did not consider that a provision for loss was necessary at that time, but saw LFIL as effectively locked in for a lengthy period with the likelihood of a relatively low level of eventual return. His view was that LFIL had little choice other than to stay with the project.[130]

[A3] An inter-office memo from Mr Reeves to Mr Thorpe in April 2007 expressed serious concerns at the lack of effective controls over Mr James and the prospect that Mr James might "vastly over-capitalise […] on infrastructure".[131] The accused were inclined to accept that the loan had been poorly managed in prior years.[132] An initiative on behalf of LFIL to interpose two independent directors within the development entity that was intended to control Mr James' behaviour had ended with those directors resigning in June 2007. They had become uncomfortable with Mr James' conduct, and were not prepared to assume responsibility for certifying that additional value had been added to the development, commensurate with the extent of further drawdowns on the advances LFIL was making to the borrower. There was no evidence that these specific concerns were known to the directors, but the Crown case was on the basis that they were significant matters that ought to have been known to the directors, had they made due enquiry.

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[130] LOM013.0144.
[131] DV10/14.
[132] T3405-3407, 3631-3633.

[A4] The advances to Mr James' entities had been for relatively short periods, typically six to 15 months. There was a pattern of the loans going into default, before an extension would be granted. This, and other unsatisfactory aspects of performance by Mr James, were cited by Ms Peden and Mr Cable as indications that the loan for the Brooklyn development should have been treated as impaired.

[A5] In the second six months of 2007, LFIL's focus on Brooklyn reflected concerns about Mr James as the developer in charge of it, rather than the feasibility of the development itself. A report by Mr Thorpe, by then the responsible lending manager, to the Trustee dated 4 July 2007, recorded:[133]

> Please note that the risks identified by the new account manager and in turn audit, were focused on reputational questions to do with Lance James the developer not the project.

[A6] Shortly before that report, an internal file note dated 27 June 2007 included the observation by Mr Thorpe:[134]

> There is no magic bullet, the project is okay but our desire to be much reduced will without doubt take patience and continued careful management with a six month target in mind as a point where we might be significantly reduced from $20m anyway.

[A7] In mid 2007, LFIL management came to the firm view that Mr James's continued involvement was jeopardising progress with the development. It appears that Mr James had got off-side with the local authority and interested groups in the area, and absence of resource consents was apparently holding back progress with the subdivision. There were also doubts as to his ability to direct a project of this substantial scale.

[A8] LFIL encouraged an Auckland developer, Mr Tim Manning, to take over the Brooklyn development, and in July 2007 an agreement was entered into between Mr James's entities as vendor and Mr Manning's entities as purchaser. It appears that any equity Mr James may have had in the venture had evaporated. The process of sale of the development by Lance James' interests to those of Mr Manning took

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133 DV1/5/14.
134 DV1/5/13.

longer than envisaged. The terms on which LFIL would finance Mr Manning also changed throughout the August to November 2007 period.

[A9] In a credit application completed by Mr Thorpe and dated 10 September 2007, the proposal was for 100 per cent funding of Mr Manning's acquisition and development costs, with LFIL being subordinated behind a first mortgage of $20 million. The tightening of the availability of mortgage finance for such developments was reflected in Mr Thorpe's comment:[135]

> It is unfortunate that the current climate has meant that other funders who might normally have taken bigger stakes in it are all sitting on cash and to raise $20m will mean a syndicate not one 1st mortgagee. This is no fault or reflection on the project or the business case, it can't be helped. As ill-informed as I feel the current sentiment is, we can't do much about it for the moment. That said, Manning has numerous offshore funders and his business plan won't be hampered by the Finance industries season of discontent.

[A10] Nearer to settlement, the amount to be repaid from a new first mortgage was reduced to $10 million and then to $5 million. That requirement was treated as a condition precedent to LFIL's advance that was not enforced and the proposed repayment did not occur. Mr Thorpe accepted that LFIL's larger priority was to be shot of Mr James, to the extent that it was prepared to fund Mr Manning's acquisition by advancing his entity 100 per cent of the purchase price, even although LFIL's analysis of the new lending exposure had factored in a substantial reduction from that position.[136]

[A11] The Crown argued that in introducing a new developer for the Brooklyn development, and therefore terminating the outstanding loan to Mr James and creating a new one, LFIL was motivated by a wish to avoid having to report to the Trustee that its significant exposure to the Brooklyn development was "past due" in terms of reporting obligations under the trust deed.

[A12] Any such motivation cannot be made out. The pattern of contemporaneous internal LFIL documents, consistent with the evidence given by Mr Thorpe and the

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135 DV1/5/27.

136 This point is also reflected in the Large Loans subcommittee minutes of meeting of 7 September 2007: LOM007.0349.

accused, satisfies me that LFIL pursued a change of developer for Brooklyn because of serious concerns that Mr James' personality and limited skills were causing material harm to progress. LFIL was sufficiently confident that the decisions it made were the best it could to recover the amount it had invested with the developers of Brooklyn, to deal openly with the Trustee about them.

[A13] Although other loan managers had previously been responsible, by the date of the amended prospectus on 24 December 2007, the LFIL Board was relying on Mr Thorpe's assessment of it. He did not consider any need to treat recovery of the loan that had been advanced to Mr Manning the previous month, as in any way "impaired". From Mr Thorpe's perspective, the dramatic post-receivership drop in the value of the Brooklyn development was primarily attributable to the fact of receivership.

[A14] The auditors were concerned about LFIL's exposure to Brooklyn because of its size and its history. In May 2007, LFIL's advance to Mr James's entities for Brooklyn was assessed together with a much smaller development he was undertaking in Khandallah, suburban Wellington, using the name "Complex Properties".

[A15] Mr Buckley, the second of the audit partners involved, recalled his concerns about Brooklyn as not being confined to Mr James as the inappropriate developer attempting to run it. He also had concerns at the feasibility of a subdivision of the scale involved. He saw it involving a huge amount of initial investment in infrastructure and roading, with a staged development that made it more difficult to assess the overall feasibility.[137] Both audit partners, Messrs Dinsdale and Buckley, had visited the site and Mr Dinsdale found it "a little surprising" that the directors had not visited the site.[138]

[A16] The auditors had not been sufficiently concerned to treat the Brooklyn loan as impaired in the course of the audit of LFIL's financial statements to 31 March 2007. Their report was produced in May 2007. KPMG had no formal responsibility for the

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[137] T1244.
[138] T1170.

financial statements for the six months to 30 September 2007. In preparation for the 2008 audit, they had flagged with the company that recoverability of large loans, and more generally the ability to confirm the going concern status of LFIL for the ensuing 12 months, would be important audit issues.

[A17] Ferrier Hodgson's September 2007 analysis of LFIL's exposure to Brooklyn was inconclusive. Their review was undertaken when the replacement of James as the developer with Manning was pending. Ferrier Hodgson invited the Trustee to discuss the situation of the Brooklyn loan directly with KPMG as LFIL's auditors. Ferrier Hodgson did note the size of LFIL's exposure as a portion of its total lending, and that the loan to value ratio (LVR) was around 100 per cent.

[A18] KordaMentha's interim report of 7 April 2008 considered it was not possible without specialised valuation advice to be precise as to what extent of provision for loss might be necessary. The report urged that whilst LFIL had an existing valuation from Wellington valuers, Bilborough Tiller, KordaMentha considered it essential to get a further and more detailed analysis of the likely recovery in "what is unquestionably a hardening market".[139]

[A19] The Brooklyn development presented a number of difficulties for valuation purposes. These arose because of its size, the extensive period over which the development was intended to be undertaken, and remaining uncertainties as to the form of resource consents, plus the extent of capital costs involved in developing residential sections. In September 2007, Mr Thorpe had identified a Bilbrough Tiller valuation completed in March 2007 at some $42.3 million as the best assessment of the net present value of the development. There are either explicit or implicit acknowledgements of the difficulties of valuing the Brooklyn development from Mr Thorpe, Ferrier Hodgson and KPMG.

[A20] The size of this loan relative to LFIL's total loan book warranted its position being scrutinised closely by the directors, particularly as the market conditions tightened. Although the LVR was high, it was supported by an independent valuation and (in circumstances where LFIL had recently committed to a new

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[139] LOM025.0124.

advance) it was not "overdue". One indication of non-compliant behaviour by Mr Manning as the new borrower was his company's failure to obtain a meaningful first mortgage advance to enable partial repayment to LFIL. When this matter was raised with Mr Manning by Mr Reeves in early 2008, Mr Manning was adamant that the absence of first mortgage monies was caused by matters beyond his control.

[A21] Mr Manning's company had purchased the development only after thorough independent research, and Ms Smith gave evidence of the view taken at the time that the development would ultimately produce a substantial profit, with some prospect of Mr Manning being able to realise that in a semi-developed state within a relatively short period. His commitment to purchase was backed by a personal guarantee of $1 million. On the other hand, shortly after obtaining practical control of the site, he commented in an email to Mr Reeves on 20 November 2007 that the development was a "complete shambles".[140]

[A22] As at 24 December 2007, the directors did not have any specific signal from the auditors, Ferrier Hodgson, or any other advisers to the effect that Brooklyn ought to be treated as "impaired".

Blue Chip Companies/Mark Bryers

[A23] Advances had been made over various periods to Blue Chip Financial Solutions Limited, and associated companies MIDE Limited and Odonn Limited. LFIL treated Mr Mark Bryers as the driving force behind each of these entities. Advances had been made pursuant to a Revolving Advances Facility Agreement with Blue Chip dated 1 November 2006, a Term Loan Facility Agreement in relation to MIDE Borrowers dated 30 October 2007, and a Revolving Advances Facility Agreement in respect of Odonn Borrowers dated 8 December 2006.

[A24] At the date of receivership, the exposure to the so-called Blue Chip Group totalled some $15.3 million, split as to some $5.532 million to MIDE Limited, $5.222 million to Odonn Limited, and $4.632 million to Blue Chip entities.

[140] LOM028.0050.

[A25] Relevant advances to the Blue Chip group were not to fund the acquisition of interests in, or for development of, properties. Rather, the advances were made to provide working capital for promotional activities by Blue Chip in procuring commitments from buyers of apartments in developments that were yet to be undertaken (pre-sales). The Blue Chip entities promoted acquisition of apartments to potential investors who would commit to ownership of apartments in developments that were subsequently to be constructed, in return for which the actual developer (whose own funding may well have depended on the existence of commitments to buy the completed apartments, as procured by the Blue Chip entity) committed to pay an underwriting fee or commissions to the Blue Chip entity.

[A26] The arrangements generally involved a first tranche of underwriting fees being payable to Blue Chip once all, or a substantial portion, of the apartments in a proposed development had been pre-sold. A second (and generally larger) tranche of underwriting fees became payable when sales of the completed apartments were settled. In some of the arrangements, Blue Chip entities guaranteed the rentals to be received from renting the completed apartments, as an inducement to purchasers to make commitments before the apartments were constructed.

[A27] At the time LFIL funded these promotional activities by Blue Chip entities, it appears that the security it obtained that was attributed the highest value was an assignment by the Blue Chip entity of its entitlement to receive the underwriting fees to which the respective developers were contractually committed. In at least one case, Blue Chip had previously been the owner of the development site and had left a certain amount of money owing on a vendor mortgage. LFIL also took assignments of the mortgagee's interest in such mortgages, which were either third or fourth mortgages, behind the substantial borrowings for acquisition and development of the sites.

[A28] LFIL took a third mortgage over Mr Bryers' Auckland home, to support the personal guarantee he had given in respect of the borrowings by Blue Chip entities.

A January 2008 valuation of that property valued it at $3.55 million.[141] In late 2007, there was prior secured indebtedness against the home of some $2.4 million.

[A29] In addition, LFIL took assignments of the contractual rights that Blue Chip entities had, to manage certain of the apartment developments. Those management rights were seen as having positive value because of the on-going income they could generate, once the developments were completed and assuming that they would be operated as either short or long-term rental prospects on behalf of the individual apartment owners.

[A30] The main securities available to LFIL were dependent on the developments being successfully completed. The developers could only repay the prior secured advances plus LFIL, if the development had been successfully completed. So too with general security agreements over the (usually single purpose) development companies.

[A31] From around the middle of 2007, LFIL management explored means of reducing its exposure to these borrowers. The Blue Chip facility matured on 20 October 2007. In anticipation of that, Mr Thorpe proposed an extension to 28 February 2008 on terms that would become substantially punitive if repayment was not effected before the end of February 2008.[142]

[A32] That extension did not occur. Instead, the Blue Chip facility was extended to 15 December 2007. In a further review dated 17 December 2007, Mr Thorpe reviewed the prospects of being repaid the Blue Chip, MIDE and Odonn facilities. He recognised significant hurdles to that being achieved, with the source of comfort being Mr Bryers' personal guarantee.[143]

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[141] DV1/1/96.

[142] Mr Thorpe proposed a late fee of $500,000 up to 10 March 2008, and thereafter $1 million for the balance of March. From the rollover date in October, he proposed charging a further $100,000 fee and $110,000 as an additional charge comprising five per cent per annum for five months.

[143] DV1/1/25.

[A33] In December 2007 and early 2008, LFIL was applying pressure for Mr Bryers' entities to on-sell their entitlements to be paid the underwriting fees, at a discount. No tangible progress had been made on that front by 24 December 2007.

[A34] I am not satisfied that the non-executive directors were aware that Mr Bryers and/or Blue Chip entities had undisclosed stakes in some of the companies responsible for the respective developments. Mr Thorpe explained the existence of a confidential arrangement that capped the extent to which the developer of a project in St Martin's Lane, Auckland could retain profits from the completed development, with the residue reverting to Mr Bryers' interests.[144] In another context, Mr Thorpe was also unconcerned that Mr Manning was allegedly fronting another company for Mr Bryers, and thereby hiding potential related party issues between Blue Chip and Mr Bryers.[145]

[A35] Management assured the directors in December 2007 that the sources of repayment of LFIL's advances did not depend on the survival of the Blue Chip entities involved. They considered that the commitments assumed by the developer companies to pay the underwriting fees to Blue Chip companies were completely watertight in all circumstances. Given that the Blue Chip entities had assigned the benefit of those commitments to LFIL, it was considered that no further aspect of performance by the Blue Chip entities would be required.

[A36] The Crown's analysis on impairment of these loans relied substantially on the view that, in December 2007, LFIL ought to have been sceptical of the value of the securities held. The Crown's approach relied heavily on the subsequent history of widespread disputes, and refusals by the buyers under the pre-sales to settle on their commitments. All the accused argued that they could not have foreseen the subsequent difficulties. They understood that the terms of those commitments had been vetted by the prime lenders who funded the respective developments, in particular Westpac Bank. LFIL considered it was entitled to rely on their enforceability when other lenders who also relied on the pre-sales had been satisfied on the point. Both Mr Thorpe and Ms Smith emphasised that the contractual

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[144] T2223.
[145] LOM003/0382, T2155-2161.

commitments procured by Blue Chip entities have subsequently been held to be enforceable by both the High Court and the Court of Appeal.

[A37] The Crown cited the management projection in September 2007 (included in the Ferrier Hodgson report) that there would be full repayment by the end of 2007, whereas by the time the amended prospectus was issued, it was apparent that would not happen. The Crown was also dismissive of repayments made during 2007 as evidencing the capacity of Blue Chip to meet its commitments, when such repayments were only made when matched by re-advances to Blue Chip entities. An analysis produced for the accused suggested that during calendar 2007, receipts of some $36.5 million were off-set by further advances of $17.7 million. Mr Grant Graham observed, in light of his wider experience with the circumstances of the Blue Chip failures, that LFIL had apparently been more successful in procuring repayments from Blue Chip entities, than other creditors.

The Austin Group: Bayswater

[A38] LFIL had made advances to two entities under the control of another developer, Mr Alistair Austin. Mr Austin and his wife were perceived as competent business people by LFIL, predominantly on the basis of their successful operation of aged care residential facilities. The first advance related to conversion of a former private hospital in Bayswater, Auckland, into 35 residential units. The property had previously been owned by an associated company of LFIL and was sold to Bayswater in November 2003. At that time, LFIL had made an advance of some $8.1 million, secured by a second mortgage. The original advance went into default in late 2004. In May 2005, it was replaced with a facility of $18,560,000.

[A39] In December 2005, LFIL had agreed to Bayswater undertaking additional borrowings from another financier, Structured Finance Limited, which became the first mortgagee. Part of that additional borrowing was used to reduce Bayswater's indebtedness to LFIL to a balance of some $7.3 million. By September 2007, LFIL had agreed to priority in favour of Structured Finance of $10.8 million.

[A40] The developers intended to sell licences to occupy the apartments, pursuant to which the occupiers would commit to a level of serviced care to be provided by a management company. The terms of the licences would also oblige the occupiers to pay levies to the management company, and subsequent occupiers would be required to commit to the same terms.

[A41] The maturity of LFIL's loan had been extended in June, September and November 2006, and in March 2007. A marketing assessment commissioned in November 2006 on account of the failure to that date in marketing the apartments noted that marketing of the complex had begun in December 2005, and since then no apartments had been sold.[146]

[A42] In April 2007, the real estate component of the development was valued at $15.462 million, and the "business component" was valued at $7.9 million. That business value reflected a calculation of the net present value of discounted cash flows for the business opportunity of managing the apartments, assuming that they were fully occupied on the proposed licence to occupy basis. As ought to have been apparent to those responsible for the loan exposure throughout, and was subsequently acknowledged in an internal LFIL paper,[147] the "business component" valued at $7.9 million would only have value once all (or at least substantially all) of the apartments had contracted occupiers on terms committing them to generate the cash flows that represented the value of the "business component".

[A43] In early December 2007, Structured Finance Limited threatened to exercise powers as first mortgagee, and only agreed to stay its hand by extending its loan facility until the end of February 2008, on being paid $2.5 million in reduction of its secured indebtedness. That sum was advanced by LFIL in return for Structured Finance agreeing to reduce its priority over the property by the same amount.

[A44] LFIL had increased the borrower's credit limit in March 2007 to $11.97 million.[148] The indebtedness exceeded that amount from April 2007 and the additional advance of $2.5 million in December 2007 took the balance outstanding to

146 DV1/6/1-15.
147 17 January 2008, DV1/6/53.
148 DV1/6/22.

$15.7 million. On 10 December 2007, the credit limit was increased to $16.18 million, but by 7 February 2008, the loan balance was again in excess of the credit limit.

[A45] LFIL's collateral securities included guarantees from Mr Austin and another of his companies, Olive Tree Holdings Limited, which was limited to $3 million. That guarantee was supported by a registered second mortgage over the rest home business operated by Olive Tree Holdings Limited, in Palmerston North. Reviews of LFIL's security position, including one in November 2007,[149] attributed a value of $5.5 million to the Olive Tree business.

[A46] Email exchanges between Messrs Erskine (the loan manager responsible for the Bayswater advance) and Thorpe on 23 November 2007 reflected a relatively pessimistic view agreed between them, about the options for realising LFIL's security. Mr Erskine described the options as "limited as they are", recognising numerous risks if they continued to support the developer and waited for what might be a slow sell-down of licences to occupy the apartments that would take 18 to 24 months. Mr Erskine confirmed to Messrs Reeves, Thorpe and Beddie that a sale at that time for $13 million would leave a shortfall of $10.9 million, which he projected as being reduced by $1 million available from collateral (Steep Hill) security.[150]

[A47] It was argued for the non-executive directors that they were not aware of those views, and that Mr Erskine's recommendation at that time should not be treated as the company's view.

[A48] In February 2008, LFIL pursued a sale of the whole of the Bayswater property. Settlement of the sale was achieved on 10 March 2008 for the sum of $12 million plus GST. At that time, Mr Austin was in ill health and appeared to be at least inconsistent in his commitment to co-operating with realisation of the assets. The sale proceeds were applied mostly to discharge the first mortgage and after settlement of the transaction and application of the residue of the sale proceeds, LFIL

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[149] DV1/6/32.
[150] DV1/6/33.

was still owed just short of $12 million. Mr Erskine proposed that a provision of $7 million against that outstanding amount be made, on the basis that the difference would be recovered by LFIL finding further projects for Mr Austin, financing him into them, and then recovering the balance of the existing debt from the profits assuming that such future projects were successfully completed.[151]

[A49] The non-executive directors were unaware of the extent of the shortfall on the sale, until after it had occurred.[152]

[A50] Subsequent attempts by the receivers to realise the Olive Tree security revealed that individual units comprising the substantial portion of the Palmerston North rest home business were not covered by the security, which secured only the common areas which the receivers assessed were not independently saleable for any substantial sum. Mr Beddie recalled the security over the Olive Tree business as having substantial value on the same approach as that used in respect of the business component at Bayswater. There was no satisfactory explanation as to why any on-going value in the business could not be realised by the receivers.

[A51] In a post-receivership analysis Mr Thorpe completed for the receivers, dated 23 April 2008, he pointed out that all the assets Mr Austin had listed in a statement of position to support his guarantee were in fact held by long-established trusts. Mr Thorpe was pessimistic about the prospects of those sources generating any meaningful payment to the receivers.[153]

The Austin Group: Gateway Mahia

[A52] LFIL provided a loan advance to Hawke’s Bay Property Holdings Limited from March 2005, for an initial limit up to $9.75 million. This was a project of which the principals were Mr Austin, and another individual, a Mr Nisbet. The project was to develop 46 residential lots in a coastal subdivision at Mahia, in northern Hawke’s Bay. By mid 2007, there was a falling out between the principals

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151 DV1/6/59.
152 For example, Sir Douglas email, 8 February 2008, DV5/55.
153 LOM004.0269.

with Mr Austin seeking to remove Mr Nisbet from the project. At that time, buyers were yet to be found for 38 of the sections.

[A53] In July 2007, Mr Austin sought $12.636 million for a new first mortgage, to enable him to take over the whole of the development and exclude Mr Nisbet's interests. Lending to that extent would represent 86 per cent of LVR, in excess of LFIL's credit policy of 70 per cent LVR for bare land.

[A54] An internal credit memo dated 4 September 2007 completed by Mr Thorpe expressed relief that Mr Nisbet was being excluded. The proposal was for a new facility to fund the acquisition by a company controlled by Mr Austin, Gateway Mahia Limited. Mr Thorpe's note blamed bizarre behaviour on Mr Nisbet's part for having alienated locals and impeded marketing of sections in the development.[154]

[A55] Mr Thorpe was at that time confident of a complete recovery on LFIL's advance. An initial advance to Gateway Mahia Limited was made on 11 September 2007 for some $11.67 million. Thereafter, interest and other costs increased the sum advanced to some $12.45 million at the beginning of April 2008.

[A56] A valuation of the subdivision in October 2007 valued the development on the basis of 45 lots at $16.04 million, providing a first mortgage recommendation for half of that at $8.02 million.

[A57] LFIL agreed to cede priority to a new first mortgagee, Hallmark Mortgage Securities Nominees Limited, which was to be given priority for $10 million, plus interest and costs. This was on terms that all amounts advanced by the first mortgagee would be applied to reduce LFIL's existing indebtedness. It appears that in February 2008, a single amount of approximately $180,000 was advanced by Hallmark and applied in reduction of LFIL's debt.[155]

[A58] In a somewhat similar pattern to the position with the Bayswater advance, maturity dates for the first loan had repeatedly been extended, often when the loan

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[154] DV2/3/1.
[155] LOM005.0506, DV2/3/35.

was in default as past its due date. The amount advanced also exceeded the credit limit on the first loan between July and October 2006 and June and September 2007.

[A59] The receivers' projections of subsequent recoveries were between $1.7 million and $4 million. In reviewing all of the loans, I have disregarded post-receivership values and saleability. That eventuality was not one the directors ought to have had regard to in December 2007. In any event, the fact of receivership is itself likely to have had a substantial adverse impact to an unquantifiable extent in a generally deteriorating market.

Bayview Raglan

[A60] LFIL had also made a series of advances to entities under the control of another developer, Mr Richard George. The advances related to subdivisions of residential sections at Raglan. LFIL had advanced some $1.7 million to Mr George's company, Bayview Raglan Limited, in December 2003 under a Revolving Advances Facility Agreement. It was secured by a first mortgage and was intended to refinance an existing first mortgage as well as providing development funding for part of the residential subdivision.

[A61] In July 2005, a second loan facility for some $5.34 million was entered into. The two facilities were distinguished by the first being referred to as the Bayview Raglan Wellington facility, and the second the Bayview Raglan Auckland facility (ie reflecting the respective LFIL offices that were responsible for administering each of the loans).

[A62] There were delays in repayment on dates that had already been extended to 2007, and in December 2007 LFIL issued Property Law Act notices in respect of both the Bayview Raglan Wellington and Bayview Raglan Auckland facilities. By December 2007, some $8.9 million was outstanding, and this had grown to $9.6 million by the date of receivership in April 2008.

[A63] Mr Thorpe as the lending manager involved corresponded with a second mortgagee, indicating LFIL's intention to pursue a resolution, and if necessary to exercise its rights under the securities.

[A64] LFIL continued to assess the sections that were on the market as reasonably saleable, but the LVR rose to 90 per cent (compared with 70 per cent in relation to bare land pursuant to LFIL's credit policy).

Der Rohe/UND Investments

[A65] LFIL also made substantial advances in respect of developments being undertaken by Mr Simon Turnbull and Ms Monica de Magalhaes. The project undertaken by their company, Der Rohe Holdings Limited, consisted of 42 apartments in Eden Terrace, Auckland and one by an associated entity, UND Investments Limited, involved a proposal to construct 40 commercial units in Glen Eden.

[A66] LFIL had provided a loan facility in May 2005 to Der Rohe for some $9.2 million. There were numerous extensions to this advance between February 2006 and the middle of 2007, by which time the facility had been increased to $9.5 million. In December 2007, LFIL learned that pre-sales of 20 of the units being developed by Der Rohe would not proceed, so that anticipated cash flows in December 2007 were unlikely. Those purchasers had arranged finance with Trustees Executors that withdrew funding, apparently because of its own funding situation, when delays in obtaining code compliance certificates meant that those contracts could not be settled by the date stipulated in them.

[A67] LFIL then participated in arrangements for some of its own staff and associates to purchase 14 of the apartments in the Der Rohe complex at 60 per cent of valuation, subject to a buy-back arrangement. Those transactions reduced the Der Rohe indebtedness to LFIL by $3 million towards the end of 2007. There were further modest reductions in the amount outstanding, which was some $7.1 million at the date of receivership.

[A68] The UND development was the subject of numerous extensions of time, and periods in which the amount owing exceeded facility limits. It also remained outstanding at the date of receivership, with LFIL owed some $1.12 million at that time.

[A69] The analysis for the Crown was to the effect that the failure of previous contracts arranged by Der Rohe for sale of a number of the apartments, and the need to step in to have "buyers" linked to LFIL underwrite sales of the apartments, should have signalled to LFIL's directors that Der Rohe's ability to complete sales of the apartments, and therefore repay the LFIL advance, was in doubt. No such consideration was undertaken. LFIL held collateral securities over some seven other properties owned by entities associated with the principals of the borrower. LFIL management did not flag concerns about the ultimate recovery of the advances, up to December 2007.