IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2014-404-001682
[2015] NZHC 2825

BETWEEN	ARCADIA HOMES LIMITED (IN LIQUIDATION) First Plaintiff
	MORE TO THIS LIFE LIMITED and ANDREW GEORGE CLARK as TRUSTEES OF THE ULTIMATE LIFESTYLE TRUST Second Plaintiffs
AND	CRAIG RAYMOND ANDREWS & ORS trading as MCVEAGH FLEMING First Defendant
	ANDREW JOHN DEXTER GUEST Second Defendant

Hearing:	30 October 2015
Appearances:	C S Withnall QC and C Lucas for Plaintiffs M Atkinson and L Fraser for First Defendant P R Cogswell for Second, Third, Second and Third-named Fourth and Sixth Defendants M J Dennett for First Named Fourth Defendant
Judgment:	13 November 2015

JUDGMENT OF ASSOCIATE JUDGE J P DOOGUE

This judgment was delivered by me on
***13.11.15 at 4 pm**, pursuant to*
Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date……

AND	WILLIAM JAMES DEXTER GUEST Third Defendant
AND	WYNDHAM TRUSTEES LIMITED and ANDREW JOHN DEXTER GUEST and JOINT FAMILY TRUSTEES LIMITED Fourth Defendant
AND	JOINT FAMILY TRUSTEES LIMITED Fifth Defendant
AND	TOMS PROPERTIES LIMITED Sixth Defendant

Background

[1] The second defendant and the second-named fourth defendant, Mr A Guest, and the first-named fourth defendant, Wyndham Trustees Ltd, are the shareholders of the first plaintiff, Arcadia Homes Ltd ("Arcadia"). They hold shares as trustees of the Guest Family Trust.

[2] In December 2007, the second plaintiff, Ultimate Lifestyle Trust ("ULT"), owned a property at 21 Waimana Place in Wanaka ("Waimana Place property"). On or about 24 December 2007, an agreement for sale and purchase was entered into between ULT (as vendor) and Arcadia (as purchaser). This is known as the "Waimana Agreement".

[3] The Waimana Agreement was subject to a directors' approval clause. A dispute arose on 24 January 2008 after the first plaintiff purported to cancel the Waimana Agreement pursuant to the directors' clause ("Waimana Dispute"). In 2012, the second plaintiff obtained judgment in the High Court against the first plaintiff in the sum of $1,016,576.[1] A subsequent appeal to the Court of Appeal was dismissed.[2]

[4] In August 2008, the principal assets of the first plaintiff were four properties in Queenstown, Wanaka and Auckland.

[5] After the Waimana Dispute, the first plaintiff sold its four properties and distributed funds from Arcadia's reserves to its shareholders via two dividends. Sales and distributions took place between 1 August 2008 and on or about 3 March 2009 and/or after that period.

[6] At relevant times there was a retainer between Arcadia and the first defendant, McVeagh Fleming, for the provision of legal services.

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1 *More To This Life Ltd v Arcadia Homes Ltd* [2012] NZHC 165, [2014] 2 NZLR 339.
2 *Arcadia Homes Ltd (in liq) v More To This Life Ltd* [2013] NZCA 286, [2014] 2 NZLR 339.

[7] On 2 April 2012, Arcadia was placed in voluntary liquidation. It is insolvent and does not have any means of paying unsecured creditors, including the second plaintiff whose judgment obtained in the High Court remains unsatisfied.

[8] The liquidator of Arcadia has brought the present proceeding to recover the distributions that were made by the company or to compensate the second plaintiff in regard to them. The claims are broadly based upon the proposition that the first and second distributions were made in breach of directors' duties, were received by shareholders with knowledge of those breaches (or otherwise not in good faith) and were negligently or knowingly assisted by the company's former solicitors, the first defendant.

[9] Arcadia has entered into a funding agreement with the second plaintiff which has been placed in evidence for the purposes of the current application. The funding agreement essentially provides for the second plaintiff to meet the costs of Arcadia in bringing the present proceedings and also indemnifies Arcadia against costs orders that might be made against it.

[10] All of the defendants have now made applications against the plaintiffs for orders for security for costs. The plaintiffs oppose the application.

Plaintiffs' claims

[11] Sixteen causes of action are pleaded in total. Reference will be made to some of the causes of action, but not all. They include a claim that the distributions from Arcadia were irregular, in that the directors wrongly issued a solvency certificate before paying two dividends, totalling approximately $1,000,000. It is said the solvency certificate was defective in that it was issued on an incorrect basis because there was a need for Arcadia to make provision for a contingent claim being brought against it by ULT arising out of the Waimana Agreement.

[12] A claim is made against the first defendant, Arcadia's then solicitors, McVeagh Fleming, that they breached the obligations owed to Arcadia under the retainer, which are broadly described as contractual duties to protect and not harm

Arcadia; a duty of professional care, skill and diligence; and duties of independence. It is alleged that the first defendant advised Mr A Guest, the principal of Arcadia, and subsequently facilitated a concerted set of transactions designed to strip Arcadia of its assets. The solicitors knew or ought to have known, it is alleged, that it was acting to the detriment and harm of its client, Arcadia. It is also claimed that the solicitors gave incorrect advice which assisted the directors in justifying the breach of fiduciary duties they owed to Arcadia. Another way in which the allegations are framed is that the first defendant owed an obligation to advise that the scheme adopted (with an objective to strip the assets out of Arcadia) involved the directors breaching their fiduciary duties to Arcadia.

[13] The first defendant is also said to have given defective advice to the effect that Arcadia ignored the possibility that ULT would bring proceedings under the Waimana Agreement. It is said that it was not possible for the first defendant to give advice consistent with its obligation of care in circumstances in which it could not be foretold how the court might, amongst other things, resolve disputed questions of fact that would arise in that proceeding. Further, it is alleged that it was not possible for the first defendant to give unqualified advice about the prospects of a successful claim being made against the first plaintiff arising out of the Waimana Agreement when the law in that area was unclear and uncertain.

[14] A further aspect of the advice which is said to have been defective concerned the sale of other properties (that is, properties other than the Waimana Place property) which Arcadia owned and which were transferred to the fourth defendants, the trustees of the Guest Family Trust, in return for a debt. Specifically, it is said that the solicitors failed to advise that the debt in regard to those properties at 22B Marquet Place and 49 Ridgecrest ought to be secured and to take steps to ensure that proceeds of sale of those properties were paid more securely to Arcadia.

[15] These various occurrences are said to have amounted to breaches of contract, negligent breach of duty of care and breaches of fiduciary obligations on the part of the first defendant.

[16] The plaintiffs also bring claims for alleged breaches of directors' duty on the part of Mr A Guest and Mr W Guest. Essentially they say, the breaches arose from settling on or agreeing to a scheme to move assets out of Arcadia and to transfer them to the Guest Trust pursuant to powers which they exercised otherwise than in good faith and in the best interests of Arcadia. There are similar breaches of fiduciary obligations which they owed as directors, such as the duty to exercise their powers in the best interests of Arcadia; duty to avoid conflict; duty not to profit personally from their position as directors.

[17] A claim is made against the first defendant for dishonest assistance of the alleged breaches of fiduciary obligation by the directors and assisting with what is described as a dishonest scheme and failing to make enquiries about the nature of the schemes. These included the transfer of properties which were owned by the companies and also the paying out of dividends, reflecting the sale of the company's assets. The particular activities included drafting documents and implementing property transfers.

[18] Another group of causes of action is based upon the Property Law Act 2007, part six, which relates to powers of the court to set aside dispositions that prejudice creditors.

The amount of security that is sought

[19] The next point concerns the amount of security which is sought and the basis upon which the applicants have arrived at their assessment of that amount. The estimate which has been provided by the first-named fourth defendant is that the trial might be expected to have an estimated duration of trial of 15 hearing days. On that basis, the applicants assert that the 2B costs together with disbursements for items such as expert witnesses would come to $150,000 for each of the groups of defendants which are sued.

[20] The plaintiffs' position is that the likely duration of the trial will be 7 to 10 days and that the approximate costs payable would be $35,820 for each applicant, a total of $107,460. Counsel for the plaintiffs says that a reasonable amount at which to fix security would be 50 per cent of the above figure.

[21] It would appear that the plaintiffs' position is also that a Milton property could be given as security for such an amount. Reference is made to that property below.

The offer of security for costs over the Milton property

[22] In the course of negotiations concerning possible agreed security for costs, the plaintiffs offered a mortgage over a property in Milton which has a GV of $165,000.

[23] The defendants were not minded to accept this offer. Essentially, they did not consider that the value of the property meant that sufficient security was being offered to cover their costs. While the property had a GV of $165,000, they believe that may not be its market value and it may be difficult to sell.

[24] The counter-offer which the defendants put forward was that the plaintiffs provide a bank guarantee of $165,000. That, in turn, has been rejected by the plaintiffs, stating that $165,000 is an unreasonable amount. This would seem to implicitly recognise that the Milton property may not achieve $165,000 in the event that security for costs is called upon.

[25] Mr Withnall QC explained to me that the offer of the mortgage over the Milton property was put forward in the first instance in order to avoid the trouble and expense of dealing with an application for security for costs. Notwithstanding that the offer of the mortgage security has not been accepted by the defendants, the plaintiffs are prepared to leave that offer open as the means of providing security for costs, if ordered. The plaintiffs, however, oppose the making of an order for security for costs.

Principles

[26] I accept that the statement of principles set out in Mr Atkinson's submission accurately states the law regarding applications for security for costs:

The general approach to be followed on an application for security for costs involves four steps;3

11.1 Has the Applicant satisfied the threshold test under r 5.45(1)?

11.2 How should the court exercise its discretion under r 5.45(2)?

11.3 What amount should security for costs be fixed at?

11.4 Should a stay be ordered?

[27] I intend to be guided by the following passage in *McGechan on Procedure*:[4]

HR5.45.03 Exercise of the Court's discretion – relevant factors

A S McLachlan Ltd v MEL Network Ltd (2002) 16 PRNZ 747 (CA), while recognising a threshold test, emphasises the highly discretionary nature of security for costs. In *Hamilton v Papakura District Council* (1997) 11 PRNZ 333 (HC) at 335, (since doubted in other respects: see Jupiter Air below) Hammond J expressed agreement with other authorities which had held that "what is required is a broad overall assessment under (this) head". In *Lunn v Fourth Estate Holdings Ltd* (1997) 11 PRNZ 316 (HC) at 318, Master Faire urged "the discretion is not … to be put into a straightjacket by considerations of burden of proof".

Nothing turns on the difference between the previous formulation of the discretion in r 60(1)(b) – that the Court might make an order "if it thinks fit" and the current wording in r 5.45(2) permitting an order "if the Judge thinks it is just in all the circumstances": *Westpac New Zealand Ltd v Adams* [2013] NZHC 3112 at [25].

The Court of Appeal's warning in *A S McLachlan Ltd v MEL Network Ltd* (2002) 16 PRNZ 747 (CA) against "constructing 'principles' from the facts of previous cases" is not to be overlooked. Nevertheless, the following factors are regularly regarded as relevant in dealing with applications for security for costs:

(1) Balancing

Balancing the interests of plaintiff and defendant is the overriding consideration: *Highgate on Broadway Ltd v Devine* [2012] NZHC 2288, [2013] NZAR 1017 at [24](c). It was authoritatively summarised in *A S McLachlan Ltd v MEL Network Ltd* (above) in these terms at [15] and [16]:

> "The rule itself contemplates an order for security where the plaintiff will be unable to meet an adverse award of costs. That must be taken as contemplating also that an order for substantial security may, in effect, prevent the plaintiff from pursuing the claim. An order having that effect should be made only after careful consideration and in a case in which the claim has little chance of success. Access to the courts for a genuine plaintiff is not lightly to be denied.

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3 *Busch v Zion Wildlife Gardens Ltd (in rec and in liq)* [2012] NZHC 17 at [2].

4 *McGechan on Procedure* (online looseleaf ed, Brookers) at [HR5.45.03].

> "Of course, the interests of defendants must also be weighed. They must be protected against being drawn into unjustified litigation, particularly where it is over-complicated and unnecessarily protracted."

As Kós J said in *Highgate on Broadway Ltd v Devine* (above) at [23](b): "Access to justice is an essential human right. The cost of exercising that right is the payment of costs in the event of failure. The right of a successful defendant to costs in that event is arguably subordinate to the plaintiff's right to be heard. Strong policy considerations favour the use of Courts as an accessible forum for the resolution of disputes and grievances of almost all kinds." See also *Westpac New Zealand Ltd v Adams* [2013] NZHC 3112 at [67]. Judges are slow to make an order for security that will stifle a claim: *Reekie v Attorney-General* [2014] NZSC 63, [2014] 1 NZLR 737, (2014) 21 PRNZ 776 at [3] citing A S McLachlan (above).

A defendant's desire to prevent the plaintiff from pursuing its case is not a proper factor for the Court to take into account: *Tri Media International Ltd v Wellington Co Ltd* HC Wellington CIV-2008-485-2768, 6 August 2009.

(2) Merits

As far as possible, bearing in mind the early stage of the proceeding, the Court will endeavour to assess the merits and prospects of success of the claim… There is, of course, a very real limit as to how far such an inquiry can be made, particularly at an early stage of the proceeding: *Meates v Taylor* (1992) 5 PRNZ 524 (CA). In a complex matter, any assessment will be no more than impression and cannot be a definite indicator of the ultimate outcome after trial: *A S McLachlan Ltd v MEL Network Ltd* (above) at [21]. Only where a clear impression can be formed that the plaintiff's claim is altogether without merit — so that in the alternative it would be amenable to being struck out — would it be right for security to be ordered where to do so would bring the plaintiff's claim to a dead halt: *Highgate on Broadway Ltd v Devine* [2012] NZHC 2288, [2013] NZAR 1017 at [23](b). See also *Athendale Property Ltd v Western BOP District Council* [2014] NZHC 635 in which Cooper J, reviewing an Associate Judge's decision, formed a more favourable view of the merits and set aside the Associate Judge's order to provide security because it would have had the effect of bringing the proceeding to an end. However, Cooper J directed his orders to lie in court pending receipt of a written undertaking from the plaintiff's shareholders that they would be personally liable to the defendant for costs awarded against them up to the amount of the original order for security, $60,000.

Those seeking security need to exercise caution to ensure the Court has all relevant evidence for its assessment of the merits. If not, the Court can later rescind the order under r 7.51, as occurred in *Elvidge v ASB Bank Ltd* [2015] NZHC 44, see [HR7.51.01] below.

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(5) Other factors

In addition to the factors identified above, Kós J identified the following factors as relevant to the exercise of the Court's discretion, in *Highgate on Broadway Ltd v Devine* [2012] NZHC 2288, [2013] NZAR 1017:

(a) additional factors tending in favour of an order against an impecunious plaintiff:

- if the plaintiff is nominal so that it is representing the interests of others who will thus be spared exposure to costs;
- if there is cogent evidence of the plaintiff disposing of assets to avoid meeting an adverse costs order (a pre-judgment charging order under r 17.41 may be another option);
- if the plaintiff has access to third party funding;

(b) additional considerations of a general nature:

- the conduct of either party: see *Sharda Holdings Ltd v Gasoline Alley Services Ltd* HC Auckland CIV-2008-004-539, 13 November 2009 at [7];
- whether the litigation has public interest overtones.

In *Wishart v Murray* [2013] NZHC 540 at [139], Courtney J indicated that if the impecuniosity threshold had been met, she would nevertheless have exercised her discretion against requiring security because the case was novel, tenable, and not excessively long or difficult to defend at trial.

[28] As well, in *Totara Investments Ltd v Abooth Ltd*, the High Court said that an applicant does not have to prove an inability to pay but it can be sufficient to adduce evidence of the surrounding circumstances from which an inference can be reasonably drawn that the plaintiff will not be able to meet any order for costs that is likely to be made against it.[5]

Threshold question

[29] The parties referred to the "threshold question" in this proceeding as being whether there is reason to believe the plaintiffs will be unable to pay costs of the defendants if the plaintiffs are unsuccessful in their proceedings.

[30] The plaintiffs' position is that the fact they are able to offer security over the Milton property shows that there is no question about the ability of the plaintiffs to meet an adverse costs order. However, the Milton property is owned by an entity that is not a party to the proceedings, the Otago Future Trust (OFT). If the proposal that the defendants take security over the Milton property in satisfaction of their entitlement to security for costs does not proceed further, as is now the case, the

5 *Totara Investments Ltd v Abooth Ltd* HC Auckland CIV-2007-404-990, 4 March 2009.

Milton property will not be available and the successful defendants would not be able to execute any judgment against it because it does not belong to the plaintiffs. While Mr Withnall told me that the offer to give security over the Milton property was still open, I am not entirely clear that the Court can conclude that it would be able to direct the enforcement of that offer as though it were, for example, an undertaking to the Court. I therefore put the Milton property offer to one side for the purposes of deciding whether there is reason to believe the plaintiffs will be unable to pay the costs of the defendants.

[31] The fact that the company is in liquidation means that it is self evidently insolvent.[6] Arcadia could, however, resist the making of a security order if it was able to establish that, notwithstanding its insolvency, it has the means by reason of an arrangement, such as the funding agreement, to meet any adverse costs order. That is the significance of the funding agreement in the present context.

[32] Whether or not the funding agreement between the first and second plaintiff displaces concerns that the first plaintiff will not be able to meet an order for costs depends upon the robustness or otherwise of the funding agreement, in the sense that one has to enquire how realistic it is that the funding agreement will secure the position of the defendants so far as any order for costs against the first plaintiff is concerned.

[33] Whether that is so or not depends upon the party providing the indemnity, ULT, and the trustees of that trust, Mr Clark and More To This Life Ltd (MTTLL). I shall return to that issue below.

[34] The first step in assessing whether or not the plaintiffs are unlikely to be able to meet the costs order is to identify what the costs to be awarded against the plaintiffs (if they fail) are likely to be. I assess the proceedings in this case are likely to involve a 10 day trial. I further assess the likelihood of costs being ordered on a 2B basis. I am prepared to accept that the figure of $150,000 in regard to each of the

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[6] The funding agreement that Arcadia has entered into expressly recites that the company is insolvent.

three groups of defendants is likely to be the upper limit of any costs order made. I consider that the estimate that the plaintiffs make is too low.

[35] While Arcadia plainly cannot meet that amount, the ability of the second plaintiffs, trustees of ULT, MTTLL and Mr Clark to meet a costs order requires separate assessment. Both of those parties will be personally liable in regard to any costs order. They will no doubt be able to obtain an indemnity from the assets of the trust whose interests they are representing in the litigation. Those assets seem to consist of debts which are owed to MTTLL by OFT and perhaps other entities under Mr Clark's umbrella. It would appear that the funds that ULT received from eventually selling the Waimana Place property (which appears to have been about $1.4 million) found its way to OFT and other entities which are controlled by Mr Clark.

[36] The evidence is that OFT has used the funds advanced to purchase properties in Milton, which includes the one that was offered by way of security. Of course, OFT, itself, is not required to meet the obligations of ULT. The indemnity that the trustees of ULT would seem to be limited to such assets as ULT is able to recover from borrowers, which include OFT. The value of those assets is not clear. But given that ULT realised approximately $1.4 million on the sale of the Waimana property and, in the absence of any evidence of dissipation for loss of the amounts received, commonsense suggests that considerable funds or property representing the proceeds of sale remained in existence and available to ULT.

[37] The next question is whether the overall trust structure has adequate assets. In addition to the property which was offered by way of security under the suggested agreement, OFT owns three other properties in Milton. One of those properties, a lifestyle property, has a CV of approximately $0.6 million. It is true that OFT has established a credit facility with a finance company called Advantage Finance Ltd for the sum of $200,000. It is not clear to me what, if any, of that facility has been drawn against. However, even if the full amount of the facility were owing, together with interest, I do not consider that the conclusion is open to the Court that the plaintiffs will be unable to meet any costs order of the scale that I have estimated earlier in this judgment. I accept that Mr Clark, as a trustee of ULT, has only an

entitlement to an indemnity against the assets of that trust and not to the assets of OFT. However, it seems likely to me that Mr Clark would, as the person in control of the overall structures, be supported by both the assets of ULT (that is, the residue of the amount from the sale of the Waimana property which has been advanced to OFT and possibly other entities) and also the assets of other trusts and the group.

[38] Taking what I consider is a commonsense view of the matter, it would appear that Mr Clark/MTTLL would be able to recover funds to meet any liability for costs. Mr Clark appears to control the structure of companies/trusts and there is no reason to suppose that he would, for example, permit himself to be bankrupted because of an unpaid costs order in circumstances where the trust, to which he is entitled to look for on an indemnity, has sufficient funds to meet the terms of the order. That comment would seem to be valid irrespective of whether what is under consideration is an order for costs directly imposed upon Mr Clark/ULT or where it is concerned with a costs order that the liquidator of Arcadia wishes to pass on, pursuant to the costs indemnity agreement.

[39] A further point that requires attention is the submissions by the defendants to the effect that the funding agreement into which ULT/Mr Clark have entered with the first plaintiff and the liquidator could be evaded by ULT/Mr Clark. Taking a robust view of the matters, I regard such assertions as being theoretically possible but practically unlikely. The fact is that the liquidator of the company will no doubt be watchful to ensure that its entitlements under the agreement are fully complied with. He is unlikely to permit a situation to arise where the company is exposed to costs orders in circumstances where ULT and/or Mr Clark have given notice that they do not accept further liability under the indemnity agreement pursuant to cl 10. An important point is, too, that while ULT is able to disengage from the funding agreement, it cannot escape liability which it would have accrued under the funding agreement.

[40] Overall, I consider that the defendants have failed to establish that there is reason to believe that the plaintiffs will be unable to pay the costs of the defendants.

Discretion to order security for costs

[41] Against the possibility that my conclusion relating to the threshold point is wrong, I will briefly consider whether, in any case, the Court would be justified in exercising its discretion to order security for costs in circumstances where there is reason to believe that the plaintiffs will be unable to meet any costs order made against them.

[42] It is usual for the court to carry out a balancing exercise when deciding if an order ought to be made that a plaintiff provide security for costs. This approach has been recognised in a leading High Court judgment on the question of security for costs where it was said that:[7]

> In New Zealand a prima facie lack of merit will be weighed and the balance; the less apparently meritorious, then the more likely security is.

[43] I do not consider that this is the type of case where, if security for costs in the likely range that ought to be ordered is in fact directed, it will result in the plaintiffs being unable to proceed with their claim. It is not therefore necessary to consider the types of consideration that arose in *McLachlan v MEL Network Ltd*, where the position was summarised in the following terms:[8]

> [15] The rule itself contemplates an order for security where the plaintiff will be unable to meet an adverse order of costs. That must be taken as contemplating also that an order for substantial security may, in effect, prevent the plaintiff from pursuing the claim. An order having that effect should be made only after careful consideration and in a case in which the claim has little chance of success. Access to the courts for a genuine plaintiff is not lightly to be denied.
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> [16] Of course, the interests of the defendants must also be weighed. They must be protected against being drawn into unjustified litigation, particularly where it is over-complicated and unnecessarily protracted.

[44] But it is still necessary to make a judgement about the merits of the plaintiffs' claims. If the plaintiffs enjoy a reasonably high prospect of success, there is less reason to invoke the security for costs regime to protect the defendants because,

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7 *Highgate on Broadway Limited v Devine* [2012] NZHC 2288 at [22].
8 *McLachlan v MEL Network Ltd* (2002) 16 PRNZ 747 (CA).

assuming the assessment of the prospects of success are correct, it is less likely that any order for costs will ultimately be made in favour of the defendants.

[45] The impression of strength of claim varies depending upon which part of the claim, and against which defendant, is under consideration. The principal allegation is that Mr A Guest obtained the assistance of the first defendant in order to devise a scheme whereby assets of the first plaintiff would be divested from the first plaintiff in order to put them beyond the reach of the second plaintiffs, in the event that those parties elected to attempt to enforce the Waimana Agreement. The objective, therefore, is characterised as being one of defeating the creditors of Arcadia.

[46] The plaintiffs also bring claims against the first defendants on the broad ground that they breached their obligations to their client, the first plaintiff, in numerous respects. Further, it is said the advice given about the prospects of success enjoyed by Arcadia in regard to the Waimana claim were misplaced. The first defendant did not factor in the uncertainties inherent in the situation which might affect the outcome of the Waimana claim, including uncertainty as to the state of the law and the difficulty of predicting how issues of credibility of witnesses might be assessed by the court hearing the action. In all of the circumstances, it is said that the first defendant's advice did not reach the required standard. Specifically, it is apparently claimed for the plaintiffs that the advice wrongly concluded that the second plaintiffs could be ignored as contingent creditors of the company, thus enabling Mr A Guest to resolve upon the liquidation on the assumption that the company was insolvent when it was not.

[47] The first defendant is also criticised for assisting Mr A Guest and contriving the back-dated appointment of his brother as a director of the company in order to shore up a defence that Arcadia intended to put forward at trial to the effect that the directors' approval condition inserted into the Waimana Agreement was inserted so as to give Arcadia the right to avoid the agreement if, on reflection, it determined that it did not wish to proceed with the agreement for sale and purchase. In such a context, it was thought to be desirable to strengthen Arcadia's defence to expedite the appointment of an additional director, which actually occurred, but with the alleged date of the appointment being backdated to make it appear as though the

additional director, the third defendant, had been in office at the relevant time when the company was allegedly reviewing the desirability of proceeding with the Waimana Agreement. The part that the first defendant played in this matter is part of the basis of the claim against the first defendant. There does, however, appear to be a concession by the plaintiffs that the first defendant formed a view that it had been misled regarding this aspect of the matter and therefore would not act further for Arcadia/Mr A Guest.

[48] It must be said that the plaintiffs seem to be in a reasonably strong position to prove that the objective of Mr A Guest, the director of Arcadia, who was providing instructions to the first defendant, was, as the plaintiffs describe it, to remove assets from Arcadia and to place them beyond the reach of its creditor. This was achieved by the sale of properties which Arcadia owned and the paying of the dividend to the shareholder and also by transferring the property to a trust associated with Mr A Guest, with the value of the property being represented as an unsecured debt back to Arcadia. There are contemporaneous documents which appear to support the allegations which the plaintiffs make, including emails originating from Mr A Guest.

[49] However, insofar as the first defendant is concerned, Mr Atkinson made the point that applying the correct test to the question of whether the solicitors were negligent in the advice that they gave, the Court must ask whether the advice was such that no reasonable solicitor would have given it. Mr Atkinson's submission was that the advice may have turned out to be wrong but that does not mean that it was given negligently.

[50] In considering this question, I intend to focus on the advice that the first defendant gave on the issue of whether the company would be justified in distributing its assets in entering into a voluntary liquidation. The evidence on this question is somewhat mixed. Mr Withnall took me through the timeline which, he said, showed that the advice which the first defendant gave to the company did not meet the required standard.

[51] Arcadia was potentially exposed to claims by ULT from the point where it indicated that it would not be proceeding with the agreement to purchase the

Waimana property. That point was reached around about January or February 2008. Of course, just because a party resiles from a contract does not necessarily mean that there is a substantial likelihood of it being sued. It all depends on the circumstances.

[52] In this case, there were indications that ULT was going to pursue its remedies against Arcadia as a result of the failure on the part of Arcadia to settle the agreement for sale and purchase. The settlement notice, itself, warned of a potential damages claim on 9 June 2008.

[53] Thereafter, the first defendant obtained the expert opinion of Mr DW McMorland, concerning the question of the validity of the avoidance for failure of a condition of the contract for purchase relating to Waimana. This opinion was provided on 23 June 2008. On any reading, Mr McMorland's opinion was not encouraging of a view that Arcadia had a strong case for resisting any claim that ULT might bring. He warned that it was difficult to give definite answers on a matter of interpretation. He pointed out that if Mr A Guest was the sole director, then the clause in question would only support the position of Arcadia if it could be interpreted as giving the sole director of the company a further chance to consider the advisability of the transaction after the contract had been entered into. Otherwise, there was a danger that there might be no substance to the condition at all. He pointed out that the interpretation which Mr A Guest would contend could run into difficulty because the courts traditionally took the view that some limits had to be placed upon conditions which enabled a party to escape the consequences of entering into an agreement (otherwise their contract were meaningless). He concluded that it was not possible to give a firm answer on the question of whether the clause would permit Arcadia to escape liability. Because of the uncertainty, he recommended that:

> On a falling market, and with contractual terms as are involved in this contract, thought needs to be given to the possibility of litigation in the consequences of an adverse judgment before placing reliance on the purported avoidance of nine January.

[54] On 4 July 2008, ULT gave notice that it was cancelling the agreement and that it reserved its remedies against Arcadia.

[55] In July 2008, Mr A Guest, as director of Arcadia, sought advice from the solicitors and his accountant as to how to extract the equity in Arcadia. On 15 August 2008, a distribution was made of $457,906.75. Such a distribution could not properly be made unless the company was insolvent.

[56] It is clear that, throughout this period, the first defendant appreciated that there was a realistic chance that a claim might be brought against Arcadia arising out of its failure to perform the Waimana Agreement. On 5 August 2008, Mr Cullen who was apparently the primary advisor, expressed concern that the proposals for extracting the equity from Arcadia might not be completed "before any litigation/judgment ever eventuated". Notwithstanding the implicit acknowledgement of a risk that Arcadia would be sued, serious consideration was given by the first defendant as to how the equity could be taken out of Arcadia. There is no doubt that the motivation for such proposals was to put the assets of Arcadia beyond the reach of its creditors and, more immediately, the reach of ULT.

[57] On 23 September 2008, solicitors acting for ULT advised that the proceedings were under preparation. On 3 March 2009, Arcadia's directors, Messrs Guest, resolved, amongst other things, as follows:

> The directors, having obtained legal advice from McVeagh Fleming and having to date vigorously defended the action by Clarke (sic) regarding the alleged unconditional purchase by the company of a second property in Wanaka, believe on the basis of that legal advice and the facts to date that Clarke's (sic) action will either not be continued or if continued will be successfully defended by the company. The directors accordingly resolved that no contingent liability is required to be included in the company's financial accounts, and the company's solvency certificate is signed on this basis.

[58] On the same date, the directors signed a solvency certificate. It seems likely that they could not have properly or conscientiously done so had the potential claim by ULT been recognised as a contingent liability for several hundred thousand dollars.

[59] It is not known on what basis the first defendant gave the advice that the directors' resolution refers to. It seems unlikely, though, that the resolution would have made reference to such advice if it had not been given.

[60] The question is whether, as a matter of the impression, it appears to the Court that the negligence claims which the plaintiffs bring against the first defendant could be said to be viable claims.

[61] In the circumstances of this case, there were strong indicators that a contingent claim should be allowed for. First, there was a consistent series of communications from ULT and its legal advisors that legal remedies were to be pursued. Secondly, the directors' approval clause was of uncertain effect. Thirdly, there was the opinion of Mr McMorland warning of the doubts about whether Arcadia would be able to successfully invoke the clause. For the first defendant to take a contrary view to that which Mr McMorland took was not completely out of the question but one would have thought that such a step would only be taken after careful briefing of the evidence and a careful analysis of the legal position. In the end, this was not a question of the legal advisors having to be in a position of saying that they thought ULT's claim was unlikely to succeed. The question was whether the directors could be certain that that the claim would not succeed. Unless they could, they would not be in a position where they could properly rule out a claim as a contingent liability of the company and it would be imprudent to proceed to recommend that arrangements be put in place and actions taken which could only be done on the assumption that there was no substantial threat of a successful claim being brought by ULT.

[62] As it turned out, any confidence that a claim by ULT would fail or would not proceed was unjustified. Both the High Court and the Court of Appeal reached contrary conclusions on the effect of the directors' approval clause.

[63] I accept that, as Mr Atkinson submitted, the fact that a lawyer's advice proved to be an error does not necessarily mean that he or she was negligent. However, given the uncertainties with the contract and the advice that Mr McMorland had given, there will no doubt be close scrutiny at the trial on just what factors led the solicitor acting, who I believe was Mr Cullen, to apparently give advice that the chances of a successful claim on the part of ULT could be ruled out. It was obviously open to the solicitor to advise that there were three possibilities: one, that there was a substantial claim available to ULT; a contrary position that

there was no claim at all; and a third position that the solicitor could not be clear about what was likely to happen if ULT proceeded. There may also be another issue which is whether the solicitor is responsible for the apparent opinion that Mr A Guest formed which is that there was little likelihood that UTL would in fact be bringing a claim. That is a different matter from whether they had a viable claim to bring. So far as that contingency was concerned, it is plausible that Mr A Guest could have relied upon his own assessment of the situation.

[64] What is of paramount importance when considering the quality of the advice is to look at the process by which the first defendant arrived at the point where he was able apparently to advise that a viable claim on the part of ULT could be ruled out. Subsidiary questions that will arise include whether he identified correctly the issues that were going to arise. There are indications in the limited material which I have viewed to the effect that attention was focused on the importance of adding a second director to the board of Arcadia on the assumption that, by doing, so doubts about the efficacy of the directors' approval clause could be laid to rest. Whether there was attention given to what was identified ultimately as being the correct issue is unknown. Whether the evidence available on the point was carefully briefed is another issue that would arise.

[65] It might be that no reasonable solicitor could even reach the point where he or she could take the view that advice could be given with confidence about what the effect of the directors' approval clause meant in the context of the present case and what its implications were for the rights of Arcadia to cancel the agreement. In such a circumstance, and in the absence of advice in the expert opinion that was obtained, a firm position being taken on the meaning of the clause may not have been justified. It may have been incumbent upon the solicitors to urge caution and to advise that a negotiated withdrawal should be sought (even if the price for that outcome was a high one and not commercially very attractive).

[66] It is beyond the scope of the present judgment to review other questions concerning causation of loss and other matters which the plaintiffs will have to negotiate in due course if they are to succeed in this litigation. The material commented on to this point, though, persuades me that the claim which the plaintiffs

bring is not to be regarded as having no prospects of success. To the contrary, my impression is that part of the claims, at least, would seem to be sound.

[67] Criticisms have been made of other parts of the plaintiffs' claim. It may well be that the alleged breach of fiduciary obligation on the part of the first defendant to act with undivided loyalty to the company (as opposed to the directors of the company) depends upon a distinction which cannot readily be drawn. As Mr Atkinson noted, how could the solicitors advise the company other than by giving advice to the directors? On the other hand, if the advice of the first defendant gives the appearance of favouring the private interests of the directors/shareholders, rather than the interests of the company as a whole, including the obligation of the company to safeguard the interests of creditors, then the first defendant may have been in breach of its retainer to provide disinterested advice to its clients and not to be distracted by the interests of directors/shareholders. It may be that even if the first defendant gave appropriate advice its clients, the directors could ignore that advice anyway. But that would not excuse the solicitors from giving appropriate advice about what the company's duties were in the first place.[9]

[68] It is not entirely clear what the limits of the claims are which the plaintiffs bring against the first defendants but it seems that the claims include assertions of providing for knowing assistance to the director(s) as fiduciaries in breaching their obligations (if indeed that occurred.) That, however, leaves open the question of whether, if there was assistance given in the matter of divesting Arcadia of its assets, any part which the solicitors played resulted from a miscalculation about what the correct legal position of Arcadia was and what the strength was of the case in answer to such claim as ULT might bring. That is, the case is to be explained on the basis of alleged negligence rather than breach of fiduciary duty.

[69] It has to be said that some of the claims against the other defendants are less clear as to their merits. The strength of the claims against the trustee of the Guest Family Trust, for its part in receiving transfers of property or distribution of

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[9] There is some similarity to the situation which arose in *Fletcher v Eden Refuge Trust* [2012] NZCA 124 at [50], where a solicitor unsuccessfully attempted to justify his actions which were harmful to the trust on the basis that those actions had been a the subject of instructions that he received from the relevant trustee (notwithstanding that that trustee had a dishonest purpose).

company assets, is less evident. This part of the claim would seem to raise questions about whether it is incumbent upon the trustees of a trust to make enquiries about the legitimacy of the circumstances in which the property that is proposed to be settled upon them was acquired by the settlor. On the other hand, one of the trustees of the trust, Mr A Guest, had full knowledge of the circumstances in which assets were being transferred out of Arcadia. The effect of his knowledge on his co-trustees, if any, may be an issue that will need to be explored at trial.

[70] Subject to the limitations of the comprehensiveness or accuracy of the evidence and the legal arguments that will be mounted, my impression is that this is a case which has substance. In exercising my discretion to determine whether security ought to be ordered, the strength of case issue would point away from ordering the plaintiffs to provide security for costs and it is likely that the application would have been defeated on that ground alone.

Cause of Impecuniosity

[71] Because I have concluded that the defendants are unable to establish the threshold issue of inability on the part of the plaintiffs to meet the costs orders, it is not strictly necessary to consider whether the actions of the defendants were the cause of such a state of affairs arising in the first place.

[72] It is very difficult to correctly identify the principles which ought to guide the Court in this area. Does a demonstrated subtraction of wealth from the plaintiffs, such as by misappropriation of their funds, qualify as a relevant cause of impecuniosity, responsibility for which rests with the defendant? Does the failure to honour a contract which results in loss of an expected profit similarly represent a cause of impecuniosity?

[73] Had it been necessary for me to decide the issue, my conclusion would have been that it has not been demonstrated that the actions of the defendants relevantly caused the impecuniosity of the plaintiffs.

Conclusion

[74] As I have indicated, I do not consider that the defendants have succeeded in establishing the threshold issue in this case, namely that the plaintiffs are unlikely to be able to meet an order for costs. I do not consider that on a discretionary basis, the Court ought to order security for costs. This is not a case where the defendant is being vexed by a claim of little merit in circumstances where the claimant is unlikely to be able to pay costs if it does not succeed. I do not consider that any order for costs is justified. The application is declined.

[75] The parties are to confer on the question of what, if any, costs order should be made. If they are unable to agree, the applicants are to file any submissions (not exceeding seven pages in length) within 10 working days of the date of this judgment and the respondents' submissions subject to the same restrictions within a further 10 working days.

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J.P. Doogue
Associate Judge