IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA531/2021
[2023] NZCA 383

BETWEEN	ADAM DAVID BANKS Appellant
AND	WILLIAM ROBERT FARMER First Respondent
	SIMON MATHEW GAMBLE Second Respondent
	CHRISTOPHER JAMES MASSAM Third Respondent
	DOUGLAS LEROY FREDERICK Fourth Respondent

CA164/2022

BETWEEN	WILLIAM ROBERT FARMER Appellant
AND	ADAM DAVID BANKS First Respondent
	SIMON MATHEW GAMBLE Second Respondent
	CHRISTOPHER JAMES MASSAM Third Respondent
	DOUGLAS LEROY FREDERICK Fourth Respondent

Hearing:	18–19 May 2022
Court:	Cooper P, Gilbert and Katz JJ
Counsel:	J W A Johnson, W L Porter and G D Simms for Mr Banks R J Hollyman KC, A J Steel and N B Lodder for Mr Farmer A J Peat for Second to Fourth Respondents

Judgment: 23 August 2023 at 3 pm

JUDGMENT OF THE COURT

A The application to adduce further evidence in CA531/2021 is granted in part, but only in respect of the liquidator's updating affidavit.

B The appeal in CA531/2021 is dismissed.

C The appellant in CA531/2021 must pay costs to the respondents for a complex appeal on a band A basis and usual disbursements. We certify for second counsel.

D The appeal in CA164/2022 is dismissed.

E The appellant in CA164/2022 must pay costs to the first respondent in the sum of $2,500.

REASONS OF THE COURT

(Given by Gilbert J)

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Introduction

[1] During the period from 4 February 2011 to 24 April 2014, Mr Banks made various unsecured advances to Mako Network Holdings Ltd (Mako), a company that had developed and patented an innovative network security management system. Mr Banks' advances were made pursuant to three agreements and totalled approximately $3.5 million. The respondents were directors of Mako. Unfortunately, due to a lack of capital, Mako was unable to realise the significant commercial potential of its technology. It was placed in receivership and liquidation in August 2015 owing creditors more than $30 million, including almost $27 million to its sole secured creditor, Telecom Rentals Ltd.

[2] The receivers sold Mako's assets for around $3 million. The liquidators filed their final report in January 2018 and Mako was removed from the Companies Register in February 2018. Unsecured creditors received nothing. Mr Banks lost all of the money he had invested in the company.

The claims

[3] In the meantime, in 2016, Mr Banks issued proceedings in the High Court seeking recovery of his losses from the directors. The central feature of his claim was that he was misled about the true financial state of Mako and its business prospects at the time he made each of his investments.

[4] In his second amended statement of claim, he advanced four causes of action:

(a) Breach of s 37 of the Securities Act 1978 — Mr Banks alleged that the agreements constituted allotments of debt securities to the public without a registered prospectus in breach of s 37(1) of the Securities Act. He claimed that the allotments were accordingly void and the respondents were jointly and severally liable as directors to repay the subscriptions with interest.

(b) Breach of s 9 of the Fair Trading Act 1986 (FTA) — Mr Banks alleged that Mr Farmer made 53 oral or written misrepresentations which

variously induced him to enter into each of the three agreements. He sought orders under s 43(3)(e) and (f) requiring the respondents to refund or pay the amount of his advances and interest at the contractual rate under the first agreement.

(c) Breach of directors' duties under the Companies Act 1993 — Mr Banks alleged the directors failed to act in good faith and in the best interests of Mako (s 131), agreed to or allowed Mako to carry on business in a manner which created a substantial risk of serious loss to creditors (s 135), agreed to Mako incurring obligations to Mr Banks and the secured creditor without a belief on reasonable grounds that Mako would be able to perform its obligations when required (s 136), and failed to exercise due care, diligence and skill in performing their duties as directors (s 137). Mr Banks sought orders under s 301(1)(c) requiring the respondents to pay him the amount of his advances and interest. Alternatively, he sought an order under s 301(1)(b) requiring the respondents to contribute approximately $30 million to Mako. Mr Banks also sought an order pursuant to s 383(1) permanently banning the respondents from acting as directors or promoters of any company or taking part in the management of any company without leave of the court.

(d) Breach of s 55G of the Securities Act — Mr Banks alleged that he subscribed for securities on the faith of advertisements that included untrue statements. He sought compensation from the respondents for the amounts lost together with interest.

High Court trial

[5] The claims were heard in the High Court over a three-and-a-half-week period before Moore J in July 2019. After the hearing, but before the judgment was delivered, the respondents obtained an order from the Judge requiring Mr Banks to deliver up for inspection various electronic devices in his possession. This was to enable the respondents' experts to investigate their concerns that Mr Banks had fabricated

28 emails he had produced in evidence at the trial.[1] These emails were purportedly between Mr Banks and Mr "Chris Nuves" concerning a project allegedly being undertaken at the University of Auckland's business school researching the utility of software relating to "people, money and/or online shopping". The emails purported to show that deposits Mr Banks made exceeding $500,000 between September 2011 and January 2012 with CMC Markets and Vantage FX Pty Ltd were for the purposes of the research project and were not true investments. These emails were produced by Mr Banks to support his contention that he was not a habitual investor and this exemption from the requirement for a registered prospectus under the Securities Act could not be relied on by the respondents.

[6] After the devices were delivered up and further investigations undertaken, the hearing resumed in October 2020 to consider the evidence as to the authenticity of the emails. For reasons set out in his Substantive judgment delivered in July 2021, the Judge was satisfied that Mr Banks forged the emails at some stage after the proceedings commenced to provide an explanation for the significant advances he had made to CMC Markets and Vantage FX.[2] The Judge considered this finding had wider implications for Mr Banks' claims because it was relevant to his credibility.[3] It supported the Judge's findings that Mr Banks also lied in other parts of his evidence.[4]

Substantive judgment

[7] The Judge dismissed each of Mr Banks' causes of action for reasons which we briefly summarise as follows.

First cause of action — breach of s 37 of the Securities Act

[8] The three agreements were not the product of any offer of securities to the public and accordingly there was no need for a registered prospectus in terms of s 37.[5]

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1 *Banks v Farmer* [2019] NZHC 3415.
2 *Banks v Farmer* [2021] NZHC 1922 [Substantive judgment] at [180]–[190].
3 At [191].
4 At [200].
5 At [300], [322] and [328].

Second cause of action — breach of s 9 of the FTA

[9] Nineteen of the 53 alleged misrepresentations were made after the transfer of funds under the third agreement (Agreement 3) and, accordingly, Mr Banks suffered no loss in consequence of any such misrepresentation.[6]

[10] Of the remaining 34 alleged misrepresentations, 14 were verbal. The Judge did not believe Mr Banks' evidence concerning the verbal representations where it differed from that of Mr Farmer.[7] The Judge considered that material aspects of Mr Banks' claims of misrepresentation were implausible.[8] Mr Banks said he had no independent recollection of the various meetings and discussions at which these representations were allegedly made and he urged reliance on his brief of evidence which he claimed had been prepared with the benefit of detailed contemporaneous notes.[9] However, none of these notes had been discovered and counsel for Mr Banks knew nothing about them.[10] In rejecting Mr Banks' evidence about these verbal misrepresentations, the Judge said:[11]

> It beggars belief that such detailed notes would have been maintained and used as the foundation for the particulars under the second cause of action and the preparation of Mr Banks' brief of evidence only to be destroyed, lost or otherwise misplaced between then and the time of trial. This is yet another example of Mr Banks' facility for bending the truth when it comes to the evidence he is prepared (and not prepared) to adduce in pursuit of his claim against the defendants.

[11] As to the written representations, three were too general and remote in time to have been causative of Mr Banks' loss.[12] The Judge found that the written representations concerning Mako's prospects contained in a private placement memorandum (PPM) received by Mr Banks prior to the advances made pursuant to the first agreement (Agreement 1) were not actionable because they represented the honest and reasonably held views of the directors at the time.[13] Likewise, Mr Farmer's written representations prior to the second agreement (Agreement 2), including that

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6 At [626].
7 At [636].
8 At [629].
9 At [630]–[633].
10 At [634].
11 At [635].
12 At [641]–[643].
13 At [658].

Mako was likely to list on the NZX, were his honest and reasonably held opinions and were not misleading or deceptive.[14] The remaining five written representations also concerned the possibility of an initial public offering (IPO) and Mako's financial position. The Judge considered it was "inconceivable that Mr Banks was not fully aware of Mako's situation before he made his last advance", although he accepted Mr Banks still believed an IPO was possible.[15] Even if any such representation was misleading or deceptive, the Judge was satisfied it did not cause Mr Banks any loss because his evidence was that the prospect of an IPO did not cause him to enter into Agreement 2 or Agreement 3.[16] The Judge found that Mr Banks would have advanced the funds regardless and there was therefore no causal nexus between the alleged representations and his loss.[17]

Third cause of action — breach of directors' duties

[12] The Judge accepted that the directors breached their duties under s 135 in continuing to trade from around late-April to mid-May 2014. By this time, the directors could not have had a reasonable expectation that Mako would be able to secure a significant agreement (expected to generate revenue of USD42.5 million over two years) with Sprint Corporation, a United States telecommunications giant and mobile network operator. Mako's other prospects for generating cashflow at that time would not realistically have been sufficient to fill the funding gap to allow it to continue to trade.[18]

[13] The Judge reached the same conclusion in respect of the claim under s 137.[19]

[14] The Judge rejected the claim that the respondents breached s 136, finding that they believed on reasonable grounds at the time each of the three agreements with Mr Banks was entered into that Mako would be able to meet its obligations when they fell due.[20]

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14 At [664]–[668].
15 At [675].
16 At [676].
17 At [677].
18 At [452].
19 At [539].
20 At [505].

[15] However, despite establishing a breach of ss 135 and 137 from around late-April to mid-May 2014, the Judge found that Mr Banks was not entitled to relief pursuant to s 301. This section relevantly provides:

> **301 Power of court to require persons to repay money or return property**
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> (1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—
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> (a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and
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> (b) order that person—
>
> (i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or
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> (ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or
>
> (c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.

[16] The Judge considered that Mr Banks was unable to recover directly under s 301(1)(c); any recovery could only be ordered under s 301(1)(b), by way of compensation to the company.[21] However, the liquidation of Mako had concluded, and it had been removed from the Companies Register.[22] Although the proceedings commenced before this occurred, Mr Banks had not notified the liquidators of his claim or applied for orders restoring the company to the register and reversing the final report. He was therefore not able to apply for any remedy under s 301.[23]

[17] The Judge did not consider there was any proper basis to make banning orders against any of the respondents. While they had breached their duties under ss 135 and 137, these were not gross departures from the required standards and did not cause

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21 At [585].
22 At [544].
23 At [556].

loss to Mr Banks. The decision to trade beyond the point where the Judge considered Mako should have been placed in liquidation did not materially add to creditors' losses. There was no need to protect the public or those dealing with companies from the respondents' conduct.[24]

Fourth cause of action — breach of s 55G of the Securities Act

[18] This cause of action overlapped with the FTA claim.[25] Mr Banks accepted that it could not succeed if the FTA claim failed.[26] It necessarily failed in any event because the Judge found that Mr Banks did not subscribe for any security.[27]

Costs judgment

[19] In his subsequent Costs judgment, the Judge ordered Mr Banks to pay indemnity costs for post-trial steps relating to the forged emails and scale costs for the balance with an uplift of 40 per cent on the remaining steps, principally to recognise Mr Banks' misconduct, and a further uplift of 20 per cent to account for the additional time incurred and complexity involved in running a case for multiple defendants.[28]

Grounds of appeal against Substantive judgment

[20] Mr Banks appeals against the Substantive judgment arguing that the High Court "erred on the entirety of its reasoning: fact, law and procedure". In summary, he argues that the Judge:

(a) erred in making credibility findings that he says were not available on the evidence;

(b) placed inappropriate weight on the credibility findings and paid insufficient regard to the documentary records;

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24 At [590]–[591].
25 At [592].
26 At [593(b)] and [597].
27 At [596].
28 *Banks v Farmer* [2022] NZHC 458 [Costs judgment].

(c) conflated the analysis under ss 9 and 43 of the FTA leading to erroneous findings on both breach and causation;

(d) misapprehended the law in relation to the Companies Act claims, paid insufficient regard to objective financial metrics on which such cases are typically decided, gave excessive leeway to the directors, and erred in its jurisdictional findings; and

(e) wrongly conflated the expansive concept of an offer to the public with the restrictive exceptions under the Securities Act, confused the relevant burdens and ought to have found that the respondents failed to prove that all persons to whom offers were made were exempt.

Grounds of appeal against Costs judgment

[21] Mr Farmer appeals against the Costs judgment. First, he argues that the award of indemnity costs should not have been limited to post-trial steps. He says that indemnity costs should have been awarded for all steps taken in the proceeding after the forged emails were first provided by Mr Banks. Secondly, Mr Farmer contends that a separate costs award should have been made in his favour, not just one set of costs for all respondents.

Application to adduce further evidence

[22] Mr Banks applies to adduce further evidence in support of his appeal against the Substantive judgment.

[23] First, Mr Banks seeks to produce an affidavit from Ms Emily Moreton, a solicitor employed by the solicitors acting for him in this proceeding. Ms Moreton produces evidence of three unrelated proceedings brought against Mr Farmer (and others):

(a) In 2016, a prosecution initiated by the police in the District Court at North Shore against Mr Farmer for aiding and abetting Mako Networks Ltd to apply deductions of PAYE to other company purposes.

Mr Farmer pleaded guilty to this offending and was sentenced in December 2016 to 120 hours of community work and four months of community detention.[29]

(b) In 2019, a prosecution initiated by Auckland Council in the District Court at Auckland against Mr Farmer and his company, Radius Contracting Ltd, for contraventions of the Resource Management Act 1991 and the Building Act 2004. Mr Farmer pleaded guilty and in January 2021 he was fined a total of $45,000 for this offending.[30]

(c) In 2021, proceedings filed in the High Court at Auckland by the Commissioner of Police under the Criminal Proceeds (Recovery) Act 2009 against Mr Farmer and others seeking a restraining order over a property in Manurewa. The alleged "significant criminal activity" underpinning this application was said to be a scheme to derive income from the use of property as residential accommodation when the relevant zoning only permitted it to be used for light industrial purposes.[31]

[24] We are not prepared to receive this affidavit as it does not provide any material assistance on any of the issues we must decide on this appeal. The latter two proceedings are wholly unrelated to the present proceedings and post-date the events forming the basis of Mr Banks' claims. They also post-date the substantive hearing in the High Court. The evidence relating to these proceedings comes nowhere near satisfying the narrow gateway available for the introduction of fresh evidence in the context of a civil appeal.[32] While the evidence of the proceedings commenced by the police relating to non-payment of PAYE has some limited connection to the present case, it is debateable whether this evidence is fresh. However, even if that criterion is

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29 *Commissioner of Inland Revenue v Farmer* [2016] NZDC 25721.
30 *Auckland Council v Radius Contracting Ltd* [2021] NZDC 938.
31 *Commissioner of Police v Farmer* [2022] NZHC 965.
32 Court of Appeal (Civil) Rules 2005, r 45; and *Paper Reclaim Ltd v Aotearoa International Ltd (Further Evidence) (No 1)* [2006] NZSC 59, [2007] 2 NZLR 1 at [6] and [8] confirming *Rae v International Insurance Brokers (Nelson Marlborough) Ltd* [1998] 3 NZLR 190 (CA) at 192.

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met, the relevance of the evidence is questionable. Mr Banks made his final advance on 24 April 2014. The non-payment of PAYE occurred later. It appears to have related to the six-month period ended 31 December 2014. If anything, this evidence supports Moore J's finding that Mr Farmer breached his duties as a director of the company by allowing it to continue to trade while insolvent from mid-May 2014. The evidence cannot have any material bearing on the outcome of this appeal. In other words, we do not consider the evidence is cogent.

[25] Secondly, Mr Banks seeks to rely on an updating affidavit from Mr Kieran Jones, one of the liquidators of Mako. Mr Jones deposes that Mako was restored to the Companies Register on 18 August 2021, after the Substantive judgment was delivered. The liquidators then filed a proceeding against Mr Farmer and the other directors in the High Court at Auckland. By agreement, those proceedings have been stayed pending the outcome of this appeal. The secured creditor, Spark New Zealand Trading Ltd, was served with a notice under s 305(8) of the Companies Act requiring it to elect whether it wished to enforce its security. Mr Jones advises that Spark New Zealand Trading has elected to surrender its security and would claim in the liquidation of Mako as an unsecured creditor. Mr Jones says that the liquidators abide the decision of this Court as to whether it makes an award to Mr Banks subject to him accounting for their outstanding fees and disbursements and so long as the amount awarded does not exceed the amount Mr Banks would otherwise be entitled to under cl 1(e) of sch 7 of the Companies Act.

[26] We are prepared to receive this updating affidavit. It is clearly fresh and credible. It is also cogent in that it addresses questions as to whether relief can and ought to be granted if Mr Banks succeeds on appeal with his claims under the Companies Act.

The issues

[27] The parties have agreed the issues to be determined. In respect of the substantive appeal, they can be summarised as follows:

(a) FTA claims

(i) Did the High Court err in finding that the representations made prior to each of the three agreements were not misleading or deceptive in breach of s 9 of the FTA?

(ii) If so, is Mr Banks entitled to relief under s 43 of the FTA?

(iii) Did the High Court err in failing to find that Messrs Gamble and Massam were liable as principals or as accessories?

(b) Companies Act claims

(i) Did the High Court err in its analysis of s 138 of the Companies Act (reliance by directors on information and advice)?

(ii) Did the High Court err in finding that the directors did not breach s 135 of the Companies Act prior to late-April/mid-May 2014 (reckless trading)?[33]

(iii) Did the High Court err in finding that the directors did not breach s 136 of the Companies Act (incurring obligations without reasonable grounds to believe the company will be able to perform)?.

(iv) Did the High Court err in finding that it had no jurisdiction under s 301 of the Companies Act to make the orders sought?

(v) If so, should the High Court have made an award either directly to Mr Banks or to Mako, and if so, what is the appropriate award?

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[33] Mr Banks acknowledged that the factors relevant to ss 135 and 137 largely overlap in this case. The focus of his appeal on this aspect is confined to s 135.

(c) Securities Act claims

(i) Did the High Court err in finding that Mr Banks' investments did not result from offers of securities to the public for the purposes of s 37 of the Securities Act?

(ii) Did the High Court err in finding that Mr Banks was a habitual investor?

(d) The "Nuves emails"

(i) Did the High Court err in finding that Mr Banks had forged the Nuves emails?

(ii) If so, was the High Court entitled to have regard to this finding in assessing Mr Banks' credibility generally and in supporting its finding that Mr Banks was a habitual investor by way of an adverse inference?

[28] The agreed issues on the costs appeal are:

(a) Did the High Court err in finding that indemnity costs were not payable for steps taken after 24 April 2019 when the Nuves emails were provided?

(b) Did the High Court err in not making separate costs awards?

Factual background

[29] We will commence by summarising the factual background. This will broadly map Mako's trajectory and provide the context in which Mr Banks' advances were made.

[30] The following summary of the key factual narrative is largely drawn from the reasonably comprehensive documentary record. It is desirable to focus primarily on

the documents for two reasons. First, this will facilitate scrutiny of Mr Banks' complaint that the Judge was unduly swayed by his adverse credibility findings. Secondly, this approach is preferable because the relevant events occurred many years before the trial. We will address the contest relating to the Nuves emails at the end.

Company formation and key personnel

[31] Mako was incorporated in September 2002 as the holding company for various wholly owned subsidiaries in the group. The main operating company and New Zealand arm of the business, Mako Networks Ltd, was formed a year earlier. Mr Farmer was the chief executive officer, Mr Gamble was the business development director, and Mr Massam was the technical director. Mr Frederick entered into a services agreement with the company in February 2010. He was later appointed a director and served as chairman at all relevant times.

[32] Messrs Gamble and Massam had previously worked together in the email and security teams in Telecom's Xtra division. By the end of 1999, Mr Gamble was looking for a new challenge. He had known Mr Farmer for many years, having originally met him through his father. In early 2000, Mr Gamble accepted an offer from Mr Farmer to take on the role of IT manager for one of his companies. Soon after accepting this offer, Mr Gamble arranged for Mr Massam to become involved as well. Messrs Gamble and Massam worked for this business for about a year before forming Mako Networks Ltd in February 2001.

[33] Mr Farmer has a business background. He had previously developed and sold two large and successful companies in New Zealand. One of these operated nationwide with 26 retail outlets and the other was an import/export business with annual revenue in excess of $45 million operating in New Zealand, Australia, China, and the United States.

[34] Mr Michael Frawley joined the board in December 2011. He had recently returned to New Zealand from England having worked in the legal profession for 25 years. His last position was as the managing partner of a large law firm in London, with offices worldwide. Mr Frawley resigned as a director at the end of 2013.

Mako's network security system

[35] Mako developed and patented a network security management system which comprised hardware that connected a customer's business premises to the internet and a cloud-based centrally managed server platform. The two key functions performed by the system were, first, to monitor incoming and outgoing network traffic to prevent hackers from diverting data streams, and secondly, to respond in real-time to security threats by sending alerts and other commands to other parts of the network as soon as any threat arose. Mr Farmer described the second function as effectively being an early version of "artificial intelligence" or "machine-learning". The Mako system was designed to protect against internet misuse by employees, guest users, hackers, and other external parties as well as viruses, identity theft and reputational damage caused by security breaches. Mako sold the hardware to its customers and an annual licence to use the system.

Initial commercialisation in New Zealand

[36] Mako achieved considerable early success in commercialising this technology. In October 2005, it entered into a supply agreement with Telecom (now Spark) which marketed the Mako system to its customers under the name SecureMe. The product continues to be successful under the ownership of Spark, which acquired it from Mako in February 2014. The Mako system was purchased by a number of key customers including the Ministry of Health, Fonterra, Z Energy, Mobil, Lotto, and the New Zealand Racing Board.

Expansion into overseas markets

[37] In 2007, Mako entered the Australian market selling exclusive rights to the Mako system to NetComm, a technology manufacturer and distributor which marketed the product in Australia as NetAssure.

[38] In 2009, Mako identified an opportunity for its system in the potentially lucrative credit card security market. In February 2010, Mako obtained certified compliance with the Payment Card Industry Data Security Standard (PCI-DSS). This standard was developed in 2006 by the five major credit card companies based

in Japan and the United States as a means of improving cardholder data protection and reducing credit card fraud. Obtaining PCI-DSS compliance was a major coup as Mako was the first network security provider to achieve this certification. It opened up opportunities for it to offer its system to the vast number of businesses that accept payment by credit card. Mako looked to capitalise on this achievement by expanding globally, particularly in the United States market. Mr Frederick became involved in the business to assist with this expansion.

[39] Mr Farmer had met Mr Frederick in London through a mutual acquaintance in late 2009 and he attended the launch of Mako's PCI-DSS certified product in Auckland in February 2010. As noted, Mr Frederick joined the board as chairman a short time later. This was to help facilitate Mako's entry into the United States market utilising Mr Frederick's contacts and considerable experience in the information technology sector.

[40] Mr Frederick is American and lives in Texas. After graduating from university, he joined The Boeing Company as a research analyst in 1979. In 1997, he joined the BAAN Company, a major software technology company, as executive vice president and relocated to the Netherlands. His role was to manage and coordinate services for the company's worldwide customer care and support operations. He also served on the boards of BAAN's subsidiaries in Israel and Japan. In 1999, Mr Frederick was recruited by EDS, one of the largest technology services companies in the world. He was appointed president of the Information Solutions Group and executive vice president of EDS corporate. In this role, he was responsible for some 80,000 technical and service professionals, revenue of over USD15 billion and 80 per cent of the core IT service outsourcing business. In 2003, he started his own consulting company to reduce his workload and partially retire. In 2008, he was offered the position of chief executive officer of a small technology start-up company, Whitney University Systems, which owned and operated colleges and universities in Colombia, Argentina, Brazil, Panama, and the United States. The company created distributed technology system solutions that allowed it to offer degree programmes to underserved, less wealthy populations. Mr Frederick retired from this position in 2010, shortly before he joined Mako.

Funding from Telecom Rentals

[41] Mako primarily funded its business through an equipment finance facility between Telecom Rentals and Mako Networks Finance & Leasing Ltd, one of Mako's subsidiaries. This facility comprised a master rental agreement dated 22 October 2010,[34] a general security agreement (GSA) dated 26 October 2010 between Mako Networks Finance & Leasing Ltd as grantor and Telecom Rentals as the secured party, and various rental agreements detailing specific items of equipment and referred to as rental schedules to the master rental agreement. Telecom Rentals financed the purchase of the hardware and rented it to Mako Networks Financing & Leasing with rental payments spread over a three-year term.[35] The master rental agreement was varied on 5 August 2011 to authorise the financed equipment to be used by Mako's customers offshore. At the same time, Mako, which owned the intellectual property, guaranteed the obligations of Mako Networks Finance & Leasing to Telecom Rentals.

Private placement memorandum

[42] In late 2010, Mako sought to raise capital from wealthy investors and the PPM was prepared for this purpose. The proposal was to raise $7.5 million by issuing 3.75 million new shares. At the same time, the total number of shares would be increased from approximately 110,000 shares to 25 million shares. The PPM stated prominently on the first page of the introductory section that the offer would be open only to persons excluded from being members of the public pursuant to s 3(2) of the Securities Act, namely relatives or close business associates of Mako or a director of Mako, persons whose principal business is the investment of money or who, in the course of and for the purpose of their business, habitually invest money, or any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public. The offer to subscribe for shares on the terms set out was to open on 1 November and close on 30 November 2010. Mr Banks did not participate in this capital raising.

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[34] There is also reference to an earlier agreement dated 26 July 2010 called the Telecom Master Rental Agreement.

[35] There were also "Finance Leases" for up to five years and "Equipment Sales Schedules" for shorter terms.

Introduction to Mr Banks

[43] Mr Farmer's first introduction to the Banks family was through Mr Dave Winslade. Mr Winslade was Mr Banks' mother's then partner. He lived nearby and the two met at a local social event where Mr Farmer told him about Mako and its plan to raise capital. Mr Winslade indicated that Ms Banks had family money to invest and could be interested. Mr Farmer subsequently met with Ms Banks and Mr Banks, on separate occasions, in late 2010. Mr Farmer sent Mr Banks a copy of the PPM on 22 December 2010. This contained considerable information about Mako including its historical and projected financial performance and business prospects. Mr Banks relies on this document to found some of his misrepresentation claims. We will discuss these in more detail when addressing the FTA claims.

Agreement 1 — 4 February 2011

[44] Rather than subscribing for shares, Mr Banks proposed advancing monies to Mako on terms tailored to meet his personal circumstances and tax position. These were negotiated over the following weeks and led to the execution of a loan agreement dated 4 February 2011 (Agreement 1). This provided for an advance of £1,177,000 in three tranches, all to be made on 10 March 2011. The first two tranches (£130,000 and £547,000) were for a minimum term of two years and the third tranche of £500,000 was for a minimum term of three months. All three tranches were otherwise repayable on demand with prior notice (six months for the first two tranches and three months for the third). Interest (expressed as an "increase [in] the debt magnitude") would accrue at a rate of 10 per cent per annum.

[45] The agreement provided that Mako would not, without Mr Banks' prior consent, undertake any external borrowings or give security over any of its assets other than in the ordinary course of business where the secured assets were not more than 15 per cent of its total assets. Mr Banks would also be entitled to the same information provided by Mako to its shareholders and to regular informal updates on the business.

[46] In the course of the negotiations leading to the agreement, Mr Banks made various claims about his commercial acumen. For example, in an email he sent to Mr Farmer immediately after receiving the PPM, he added a postscript: "[i]n case it is

of interest in the future: I'm a good proof-reader of legal and financial documents and to a lesser extent, computer code." It was thought that Mr Banks might be able to provide some assistance to Mako utilising his skills in these areas. It was in this context that one of the terms of the agreement envisaged that Mr Banks would provide advice to Mako regarding capital raising and other financial advice as may be agreed:

> **4. Other terms**
>
> (a) [Mr Banks] shall provide advice to [Mako] regarding capital raising of [Mako] and shall provide financial advice to [Mako] as agreed between [Mr Banks] and [Mako].

[47] This section of the agreement also contained an entire agreement clause and an acknowledgement by Mr Banks that in entering into the agreement he had relied on his own judgment and not on any representation:

> (f) This letter agreement is the entire agreement between the parties and supersedes all prior agreements, negotiations, representations and the like concerning its subject matter. [Mr Banks] confirms [he] has entered into this agreement on [his] own judgment and has not relied on any representation of [Mako] or its agents, officers and personnel.

Business development 2011–2013

[48] Between 2011 and 2013, Mako extensively promoted its product overseas, particularly in Asia, the United States and the United Kingdom.

[49] In December 2011, Mako Networks Ltd achieved a significant milestone by signing a three-year non-exclusive distributor agreement and a companion hardware supply agreement with Phoenix Managed Networks Ltd, a company based in the United Kingdom that supplied secure payment systems globally. The distribution agreement extended to any country where Phoenix had a presence, which included North America and Europe, and required it to purchase at least 10,000 Mako licences and 4,000 hardware devices in the first 12 months. This agreement was varied in December 2012 to require Phoenix to purchase 10,000 devices and associated licences by the end of July 2015 at the latest.

[50] Mako opened an office in San Francisco in February 2012 and Mr Gamble relocated there to support the opportunities presented by the Phoenix relationship and pursue other business opportunities.

[51] In December 2012, Mako Networks Sales & Marketing Inc, Mako's American subsidiary, entered into a service provider agreement with Chevron with a view to the Mako system being rolled out to Chevron sites across the United States. At the time, Chevron was the third largest listed company in the world and had approximately 9,000 fuel stations across America. By the end of 2014, the Mako system had been deployed to around 4,500 of these sites.

[52] In May 2013, Mako entered into a non-exclusive reseller agreement for the United States and Canada with BullsEye Telecom Inc, a business-to-business telecommunications company based in Michigan. By April 2014, BullsEye had on-sold the product to a number of its customers including Triton Management (70 sites), Fisher Auto Parts (100 sites) and Title Max (30 sites).

[53] Also in May 2013, Mako entered into a non-exclusive reseller agreement with Aperia Solutions Inc for distribution of Mako's system in the United States. Aperia was based in Dallas and provided electronic banking services. Although initial trials were successfully completed, this agreement did not ultimately bear fruit.

[54] Cashflow remained tight throughout this period as Mako expanded into overseas markets. The directors closely monitored Mako's financial position to ensure there would be sufficient cash to meet its commitments. Telecom Rentals remained the primary source of funding. Mr Farmer maintained a good relationship with Mr Geoff Hamilton, the general manager of Telecom Rentals, and they kept in contact on a regular basis.

Proposed IPO

[55] In late 2012, the possibility of an IPO was discussed by the board. Mr Farmer took some preparatory steps to progress this initiative including by engaging with Cameron Partners, an independent investment bank based in Wellington. Around this time, Norcal Growth Partners, a business development consultancy in California

specialising in IT services, was retained to prepare a comprehensive independent market analysis for the purposes of the intended IPO. Mr Farmer also held preliminary discussions with Telecom Rentals about the possibility of it becoming a cornerstone shareholder through a debt to equity conversion in the context of an IPO.

[56] In an email sent on 18 January 2013, Mr Dragan Gasic, business development manager at Telecom Rentals, confirmed that Telecom Rentals would continue to provide a short to mid-term financing facility to support Mako's sales until alternative funding was available through the intended IPO. He expected this would require Telecom Rentals to provide an additional $5 to $7 million over the next six to eight months. A new general security deed was entered into by Mako Networks Financing & Leasing Ltd in February 2013, increasing the priority amount to $35 million to reflect the expected increase in the level of funding.

[57] Norcal provided a preliminary report in January 2013 setting out its findings on the size of the target market and its likely development over the next five years, its assessment of Mako's competition and prospects, and the range of valuation multiples for similar companies trading in that market. Drawing from independent research conducted by Gartner Inc, a technological research and consulting firm based in Connecticut, Norcal reported that the overall market for security software currently stood at approximately USD18 billion, network management software and appliances at USD2.5 billion, IT operations management software at USD18 billion, and security and vulnerability software at USD3.8 billion. Compound growth rates in these areas ranged from seven to nine per cent. In North America alone, managed security services revenues exceeded USD3 billion annually.

[58] Norcal observed that other similar companies were typically trading at values reflecting revenue multiples ranging from a low of four to a high of 10. The market for Mako's products was described as "extremely healthy, vibrant and steadily growing". Norcal considered that Mako had "a unique opportunity to expand [its] market penetration by many orders of magnitude over current sales". Norcal assessed Mako as having a good culture with quality personnel and concluded that it had the "tools, resources, people and ability to pursue and win in a highly lucrative market".

[59] Cameron Partners advised Mr Farmer in an email in late February 2013 that they were "very enthusiastic" about Mako's growth opportunity and the potential IPO. The key tasks to be undertaken were set out and they advised that it would be realistic for the listing to occur in August or September 2013. Deloitte was engaged in August 2013 on Cameron Partner's recommendation to act as Mako's accountants, to prepare audited accounts, and to assist with the IPO.

[60] On 28 February 2013, Mr Farmer was contacted by Mr Nick Peace of Starfish Ventures, an Australian venture capital manager with investments in the information technology sector ranging from early stage start-up companies through to established technology businesses seeking capital for expansion or development. Mr Peace said he understood that Mako had been growing strongly over the past few years and expressed interest in assisting with any capital raising to fund future growth.

[61] Norcal finalised its independent market analysis and sent this to Mr Farmer on 18 March 2013. This 37-page report entitled "Mako Market Survey" contained five sections and included an analysis of the size and dynamics of the market, the current and future potential for Mako's products, the competitive landscape within the market, an analysis of Mako's strengths and weaknesses, and comparable valuation metrics. This report was very positive.

[62] Mr Farmer had discussions with senior executives of two other venture capital companies around this time, Mr Timothy Dick, a general partner at Startup Capital Ventures in California, and Mr Sean Joyce, the principal of a New Zealand boutique venture capital firm. Mr Joyce raised the possibility of an acquisition by a listed shell company in the United States associated with parties who were interested in making an acquisition in the tech sector and had the ability to raise significant new capital. Mr Dick said that his firm had good relations with many large venture capital firms that may find Mako an attractive proposition and he offered to help raise the capital Mako required to achieve major growth.

[63] The formal terms of Cameron Partners' engagement were recorded in a letter signed by Mr Farmer on 8 April 2013. Its primary role was to advise the board on the intended IPO which was expected to be launched in the second half of 2013.

Cameron Partners advised that it would not be appropriate for Mako to list with any debt on its balance sheet, including the debt to Telecom Rentals. The first step in the process was therefore to seek to equitise all existing debts, including shareholder loans. One of Cameron Partners' responsibilities was to support the board in its negotiations with Telecom Rentals.

[64] Mr Farmer met with Mr Gasic on 11 April 2013. In a follow-up email to Mr Farmer later that day, Mr Gasic referred to the recent launch of Telecom Digital Ventures, a new business unit, and suggested that Mako could be a good fit with this new strategy. He said the "[t]hree pillars of current IT hype" were mobility, security, and cloud and that Mako was "ahead of the curve" on all three, globally and locally. Mr Gasic noted that Mako's current exposure to Telecom Rentals was approximately $23 million including interest and the agreed debt ceiling for the short to medium term was $35 million.

[65] In April and May 2013, Norcal provided drafts of a further report entitled "Mako Pipeline Assessment". The purpose of this report was to provide an independent, objective, and realistic assessment of the opportunities available to Mako in the light of existing sales activities, market conditions and end user buying preferences. In preparing this assessment, Norcal conducted interviews with business development managers in each sales region, researched Mako's opportunity with each target taking account of capabilities and alignment with selected performance metrics and applied weighted assessment criteria designed to predict likely future sales. The resulting analysis projected global sales of the order of 500,000 units over the next three years, primarily in the United States but also taking account of expected sales in Europe, Asia, Australia, and New Zealand. A little over half of all projected sales in Europe were expected to be achieved through the Phoenix relationship. By comparison, existing contracts with Phoenix, Chevron, BullsEye and Aperia were each predicted to contribute only two per cent (eight per cent in total) of all projected sales over the three-year period in the United States. One of the prospects identified was with telecommunications giant, Sprint, to which we have already briefly referred. Norcal's analysis forecasted that 13 per cent of total sales in the United States over the next three-year period would be derived from Sprint. On that basis, it would be the

third largest contributor globally and was expected to account for the sale of 55,000 units over the three-year period.

[66] On 13 May 2013, Cameron Partners prepared a draft investor presentation. This referred to the mandate by major credit card schemes requiring all credit card merchants worldwide (around 58 million merchant sites) to achieve PCI-DSS compliance by December 2015. It was noted that 10 states in the United States had already regulated that merchants must attain PCI-DSS compliance. These developments were occurring in the context of an increasing incidence of credit card fraud (estimated to cost around USD5.5 billion annually and growing) and cybercrime fuelling demand by larger corporates for higher levels of digital security. The investor presentation described Mako's network security offering, the global market opportunity, Mako's strategic positioning, and set out Mako's plan to raise $20 million through an IPO to scale the business as an emerging global leader in the secure payment networks market.

[67] In late May 2013, Cameron Partners produced a proposal for Mako to present to Telecom Rentals for conversion of its debt to equity. Supported by Norcal's market analysis and sales pipeline validation, future operating revenue was projected to be $11 million in the first year, $75 million in year two and rising to $158 million in year three. These projections assumed sufficient capital would be raised to fund the company's growth.

[68] In early June 2013, Mako entered into preliminary discussions with Time Dotcom Berhad, a listed telecommunications company in Malaysia which expressed interest in forming a strategic partnership with Mako. It indicated a preparedness to invest USD50 million subject to gaining a better understanding of the product offering, the company's long-term plans and its risk profile.

[69] The minutes of the meeting of the board on 20 June 2013 recorded that Mako had agreed in principle to a new financing structure with Telecom Rentals for the next five-year period. It was expected that this would improve Mako's short to mid-term cashflow by substantially reducing its interest payments to Telecom Rentals. It was also expected to result in an additional advance of $3 million which would assist Mako

to expand its business in the United States. Telecom Rentals' security position would be improved as part of the restructure. The board minutes summarised the discussions on this topic and a related recommendation from management that the IPO be delayed until March 2014:

> Mr McGregor went on to update Directors on managements rationale for extending the timing of the capital raising to March 2014. With the financing from TRL in place this provides certainty for the short term and would allow the company to focus on growing revenues from executed contracts. Revenue growth would drive valuation for purposes of an IPO and provide scope for an increased offer size from $30 million to $50 million. Mr Farmer added that an extended timeline would allow other sales prospects to materialise these included; Telestra, Time, Riverbed, Aperia and Airtight. Extending the timeline would also allow personnel and infrastructure to be better implemented.
>
> Directors went on to have a general discussion on the merits of an extended timeline. Mr Frawley agreed to an extended timeline and acknowledged that the new funding arrangement would strengthen [Telecom Rentals'] security interest. The reduced monthly cash outflow was also beneficial. Mr Farmer mentioned the extended timeline comes at a cost of circa $5m. However the responsibility to the Shareholders to maximise value warranted this extension and increase cost

[70] Two deeds of assignment, each dated 28 June 2013, were subsequently executed with Telecom Rentals. The first assigned rights and obligations of Mako Networks Finance & Leasing Ltd under the Telecom Master Rental Agreement (as varied) including the associated rental schedules to Mako Networks Ltd. The second assigned to Mako the rights and obligations of Mako Networks Finance & Leasing under the general security deed. Mako covenanted with Telecom Rentals to perform Mako Networks Finance & Leasing's obligations under that deed. Mako's agreement to provide security to Telecom Rentals was in breach of Agreement 1. Mr Banks' consent ought to have been sought but the need for this was overlooked.

Agreement 2 — 30 June 2013

[71] In the meantime, in March 2013, Mr Banks indicated that he wished to invest further monies in Mako on the same terms as the existing agreement but with the option of converting the debt to equity in the event of an IPO. In an email to Mr Farmer on 14 March 2013, Mr Banks said he expected to have a further £243,000 coming soon with the possibility of a further $1.5 million, but this would be more

difficult to access. He indicated that if the debt was able to be converted to equity at a discount of 20 per cent or more, he would investigate whether he could access this money.

[72] On 30 June 2013, a second agreement (Agreement 2) was executed recording the terms on which Mr Banks made two further advances, £237,722.43 on 14 May 2013 and £24,779.14 on 3 June 2013. These advances were made on the same terms and conditions as Agreement 1 except that all advances, including those made under Agreement 1, would be converted to equity in Mako at a discount of 15 per cent upon completion of the anticipated listing on the New Zealand Exchange (NZX).

July to December 2013

[73] In early July 2013, Mako engaged Bell Gully to act as its solicitors on the proposed IPO.

[74] Cameron Partners introduced Mr Farmer to Mr Mark Weldon, the former chief executive of NZX and an experienced company director. Following an initial briefing, Mr Weldon sent an email to Mr Farmer on 9 July 2013 expressing an interest in assisting with the IPO, personally investing between $1 and $3 million in Mako, and contributing his skills by joining the board as a director. Mr Weldon proposed undertaking a detailed investigative process with a view to providing a report to the board on how it should organise the business to allow "supercharged sales growth". The report would address a wide range of issues including governance; organisational structure and reporting lines covering matters such as supply chain, operations, finance and legal; compliance; risk management with a specific focus on risks over the next 12 months; finance function, including accounting policies, financial reporting, board support, and investor relations; and IPO preparation and timing. It was agreed that Mr Weldon be engaged to carry out this work.

[75] Mr Ian McGregor, Mako's chief financial officer, prepared a detailed board paper addressing the solvency test as at 30 June 2013. He circulated this paper to the directors on 18 July 2013. Mr McGregor stated that the paper had been reviewed by Bell Gully and Deloitte, although he noted that Deloitte had not yet reviewed the financial information. The primary objectives of the paper were set out at the outset.

These were to demonstrate to the directors that Mako had sufficient cash resources to meet its obligations in the normal course of business, and secondly, to provide the directors with adequate information to determine a true and fair view as to the value of Mako on a going concern basis and satisfy them that the value exceeded the equity deficit and could settle outstanding liabilities.

[76] Mr McGregor reported that Mako satisfied the cashflow solvency test because it had adequate cash surplus of $3.9 million as at 30 June 2013 plus additional liquidity via access to the $35 million financing facility with Telecom Rentals currently drawn to $24.5 million as at 30 June 2013.[36] In considering balance sheet solvency, Mr McGregor assessed the enterprise value range as being between $52.8 million (based on the last twelve months' revenue) and $101.6 million (based on revenue projections for the next twelve months). He adopted a multiple of eight times revenue in arriving at these assessments. He noted that the mid-point of $77.2 million exceeded the equity deficit of $8.667 million.

[77] Mr Weldon and Ms Claire McGowan subsequently presented a detailed report dated 7 October 2013 (the Weldon report) in which they sought to identify the strengths and weakness of Mako's business and made recommendations to enable substantial growth in shareholder value over the next 12 to 18 months. They considered that Mako had reached the point where its sales prospects were "strong and exciting" and, if executed profitably, would "create real value for shareholders". They noted that Mako had focused to date on its product, associated research and development, and developing a significant sales pipeline. They said Mako had "developed excellence" in these areas and they rated its product as being in the top decile. However, they considered that Mako's future growth would require significant improvements in the areas of supply chain and delivery, operations, capital structure and management.

[78] Mr Weldon and Ms McGowan warned that if Mako's debt was not kept under control, the company could "grow bust" despite its promising sales pipeline. They said that Mako's net debt position was too high for the near term (24 months)

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[36] There were various versions of this solvency paper. We refer to the one discussed by Mr Hussey in his evidence.

and some form of equity would need to be issued to ensure the business can "navigate the next 12–18 months and deliver the customer pipeline". They made comprehensive recommendations to improve Mako's managerial, operational, and financial competence. These changes were considered necessary to enable Mako to meet the demands of the next phase of its development and facilitate careful management of its cashflow over the near term.

[79] The report concluded by likening Mako to "a weightlifter with strong arms, strong legs, but with weak core strength". The authors described Mako as a company possessing some "extremely world class aspects" but having others that are "the counter to that". They considered that if their recommendations were implemented, the increase in Mako's valuation over the 12–18 month period would be a minimum of $30 million, and could be up to $100 million, above its current value.

[80] By this time, Mako had secured two other potentially valuable business relationships in the United States. The first was with Spacenet Inc, an IT service management company based in Virginia. This agreement, dated 28 August 2013, was styled as a business partner agreement, and conferred non-exclusive rights to sell Mako's products and services anywhere in the United States. The second, executed on 18 September 2013, was a "Teaming Agreement" with Sprint. Under the teaming agreement the parties agreed to explore potential co-marketing opportunities, and Sprint agreed to promote and sell the Mako system throughout the United States.

[81] Mr Farmer produced a briefing paper for the directors to consider at the board meeting on 30 October 2013. The paper covered various matters including present sales initiatives, the Weldon report, the draft audited financial statements, and the current status of the relationship with Telecom Rentals. Mr Farmer had previously circulated to the other directors an email he and Mr McGregor had received from Mr Hamilton setting out his view of the funding challenges Mako currently faced and a follow-up email from him. Because of the critical importance of the relationship with Telecom Rentals and its ongoing funding and support, we set out some of the key points Mr Hamilton made in his first email:

> Our assessment on the draft information and conversations to date are:

- The business is seriously undercapitalised;
- Mako is growing at an extraordinary rate, having reached the tipping point of product conversion in the US;
- The Mako [PCI-DSS] solution offering has significant value and is gaining in market penetration;
- The anticipated balance sheet capitalisation of newly signed contracts (Bulls[E]ye / Chevron etc) was not included in the audited accounts as planned. Without this planned asset, the draft accounts show a negative equity position of $13m;
- Mako may require continued funding for two more years before the business becomes cash-flow positive, or recurring revenue is sufficient to cover overheads;
- Large US sales pipeline opportunities provide the potential to "up-front" the revenue from new Nodes, significantly reducing external funding requirements (nothing contracted to date however);
- The $35m figure included in the guarantee document, was based on an expected Fair Market Valuation of the [PCI-DSS] solution Intellectual Property of around $30m. This IP is valued in the draft accounts at $6.2m;
- [Telecom Rentals] has principal outstanding of $26.3m and a total exposure of $34.53m once future interest payments are included;
- There does not appear to be an alternative funder in place for now, or when [Telecom Rentals'] maximum exposure is reached (whatever that is);
- Without [Telecom Rentals'] support, or an alternative funding source available, the business is technically insolvent;
- We expect a further loss in FY14 will mean the equity position will be roughly $20m in the red by June 2014;
- The business has a lot of work to do to be ready for an IPO. This not only includes improving the financial processes and governance, but also delivery of the already signed contracts. It does not seem like the March IPO timeframe is achievable;

[82] Mr Hamilton queried why the intellectual property had not been re-valued and suggested this would result in a much healthier balance sheet. He said the negative equity position would make it difficult to keep "things ticking over as before". Alternative funding options needed to be explored urgently in the event Telecom Rentals was not able to continue to lend. He said that a $20 to $50 million injection of cash/equity needed to occur by 14 March 2014 to cover the losses to date and fund some of the future growth. He expected this would likely be a private placement rather than an IPO. Mr Hamilton acknowledged that some of this would

be "challenging to read" but he wanted to ensure the seriousness of the situation was fully grasped by Mako's board. He concluded by saying that Mako had done "a fantastic job of building an internationally marketable product", and that Telecom Rentals was "proud to be part of this fantastically successful Kiwi business". He said Telecom Rentals would "do everything in [its] power to continue to support the Mako team".

[83] Mr Farmer said this email came as a shock. Mako had been relying on Telecom Rentals' continued support up to a debt ceiling of $35 million. Following further discussions, Mr Hamilton clarified Telecom Rentals' position in an email on 27 October 2013:

> My comment that Mako needs to source between $20m–$50m of cash / equity by March 2014 is not a request or demand that [Telecom Rentals'] debt is repaid by that date.
>
> We believe that the business is undercapitalised and has an ongoing need for working capital, probably for a further 2 years. FY14 will likely show another loss, compounding the negative equity position and further exposing [Telecom Rentals]. An injection of say, $35m, will not only address the negative equity position in the balance sheet, but will also go a long way to funding future growth.
>
> We do not expect, nor have we asked for, our debt to be repaid from this cash injection. That will need to be an economic decision made by the Mako Board at the time.

[84] The board discussed these matters at a directors' meeting on 30 October 2013. The directors noted that it was difficult to assess accurately Mako's working capital requirements in the "changing sales environment". A best endeavours assessment was the only practical option. After some discussion, the directors considered there were reasonable grounds to conclude that the company could continue on a going concern basis until October 2014 but noted that the position would have to be closely monitored. It was agreed that Telecom Rentals be provided with regular reports to maintain its confidence. The directors resolved unanimously to approve the audited financial statements and the representation letter to the auditors.

[85] In November 2013, Telecom Rentals unexpectedly and without forewarning did not advance $5 million that Mako had anticipated receiving that month. As a result, in order to meet immediate cashflow requirements, Mako's shareholders

(including Mr Farmer's trust, Mr Gamble and Mr Frederick) advanced approximately $1.1 million to the company.

[86] On 19 December 2013, Mr Hamilton wrote to Mr Farmer advising that he had been "working hard behind the scenes" to see if a solution could be found but Telecom senior management had requested an independent review of the business before any decisions were made regarding Telecom's further involvement. Agreement was sought for the appointment of insolvency specialists, KordaMentha, to carry out this review at Telecom's expense. Mako's board agreed to this. On 27 December 2013, Telecom Rentals formally suspended all further advances to Mako under the existing facility agreement pending KordaMentha's report which was expected at the end of January 2014.

[87] These developments led Mr Frawley to resign as a director on 29 December 2013.

Restructure of Telecom Rentals' debt

[88] Mr Farmer sought legal advice on the directors' duties and potential liabilities, including from Mr Murray Tingey, a senior insolvency partner at Bell Gully. Mr Tingey attended part of the board meeting held on 18 January 2014 to provide further guidance. Numerous attempts were made to urgently secure further investment from a venture capital funder or other large investor, but these endeavours were hindered by the debt to Telecom Rentals.

[89] On 24 January 2014, Telecom put forward a proposal to restructure the debt. Mako had limited options. Agreement was reached and the documentation was executed on 7 February 2014. The terms of the restructure were broadly as follows:

(a) Telecom would acquire for $3 million the assets required to ensure continuity of current and future New Zealand business operations including the provision of products and services to its New Zealand customers (the "SecureMe" business).

(b) Telecom Rentals agreed to advance $2 million to Mako and Mako Networks for the purpose of repaying part of the existing indebtedness ($26,876,372.92).

(c) Mako Networks and Telecom Rentals entered into amended finance lease arrangements in terms of which the amended indebtedness ($24,876,372.92) would be repaid with interest by equal monthly instalments of $838,183.32 commencing in two years' time, with the first payment due on 29 February 2016.

(d) Mako, Mako Networks and Mako Finance & Leasing gave cross-guarantees and securities over their assets in favour of Telecom.

(e) All intercompany debt in the Mako group was subordinated to the debt owed to Telecom Rentals.

[90] As part of the restructure, approximately half of the company's personnel in the areas of research and development, operations, and administration had to be let go. Mr Farmer described this as "gut wrenching". He wrote to the majority shareholders (Messrs Gamble, Massam and Dennis Monks) on 13 February 2014 to discuss future strategy and identify options. He said that the New Zealand capital markets were unlikely to provide the required funding and all indications were that United States venture capital investors were very unlikely to participate in a New Zealand-based IPO. Mako's future lay offshore and he suggested the business needed to be driven from the jurisdictions that were providing the revenues. He said that the company was at a crossroads and must consider how to move forward. In his view, the company's administration should move to the United States.

Agreement 3 — 24 April 2014

[91] Mr Banks and Mr Farmer remained in contact from time to time after Agreement 2 was completed. At that time, an IPO in the second half of 2013 was being worked towards. Mr Banks was informed after this timing was pushed out to 2014. He was concerned that he could be prejudiced by this delay because it extended the period over which interest would not be paid in terms of Agreement 2.

He discussed this with Mr Farmer at a meeting over lunch on 17 September 2013. They had a further catchup meeting at a café on 23 October 2013. Following this meeting, Mr Banks sent an email to Mr Farmer in which he commented:

> I have the feeling that we're going to be chuffed in about 5y. I'm now a lot clearer re the benefit of waiting longer for the float.

[92] On 5 November 2013, Mr Farmer sent Mr Banks a link to a United States business news article dated 4 November 2013 announcing the new teaming agreement concluded between Mako and Sprint. This appeared to be a very positive development for Mako. The article referred to Sprint's strong market presence, serving more than 54 million customers, and being widely recognised for developing, engineering, and deploying innovative technologies, including the first wireless 4G service from a national carrier in the United States, and offering industry-leading mobile data services. Sprint was quoted as describing Mako's technology as "leading the way in secure, PCI-compliant networking for the distributed enterprise".

[93] The possibility of Mr Banks providing further funds to assist Mako's liquidity was discussed around this time. To put this in context, this was not long after Telecom Rentals had failed to advance the $5 million expected in November 2013 and around the time Mako's shareholders, including Mr Farmer's family trust, made additional advances to cover the short-term cashflow deficit.

[94] Mr Banks sent an email to Mr Farmer on 15 November 2013 which provides some insight into his understanding at that time:

> If it happens, great, if not, I'll simply assume that I'll have [a] big smile post-float.
>
> I don't have any mortgages but if you ever needed me to apply for one and provide Mako with liquidity I'd be happy to. I know you said you don't need this but I just wanted to remind you that I'm here to do whatever little I can for Mako.

[95] Mr Farmer, who was then in Bangkok on the Prime Minister's trade mission, responded on 18 November 2013:

> With the opportunities building in [Australia] and the US we may look to list earlier and require extra capital to ramp up as quickly as we can. This could

> also play a little better into your hands with a more robust story and greater opportunity of uplift.
>
> Could I ask if you were to provide further capital what level you would feel comfortable with.

[96] Mr Banks replied by email on 20 November 2013 with the subject heading "Mako - investment 3" seeking further information and indicating that he could be prepared to invest $1 million at a discount of 16 per cent if and when debt was converted to equity, or $2 million if the discount was 20 per cent:

> Ages ago you said that we will go to the market and discover what they are willing to pay per share. That plus my discount would yield the share price that I will buy in at. I understand how this works and am happy with it. On 23.10.13 you said I would get my shares then we would go to the market; in that case how is the price set?
>
> I assume you have already personally borrowed and lent to Mako as much as you reasonably can. Perhaps I could match the amount then any extra could come from other investors. Obviously I need to see how readily the bank will lend to me. Some are too conservative and difficult to deal with. If it's not private: who did you use? At the moment my gut is saying if you could offer a discount re this investment (#3) of 16% I would consider $1m. For 20% I would consider $2m.
>
> Could you please tell me the current and est. 2y from now revenue? Please feel free to state that the latter is conditional e.g. upon securing deals with 75% of desired clients.
>
> Clearly there are some issues that I'd like to sort and that takes time. If you can get the money quicker from the other investors then please do that. It might be a good idea to deal with us in parallel and go with the one that agrees first.

[97] It appears that Mr Banks experienced difficulty raising the money from his bank, so he again asked Mr Farmer on 2 December 2013 who his mortgage provider was. He said he would not ordinarily ask but it was "for Mako and [his] bank [was] already giving [him] a very hard time".

[98] The next recorded communication was on 24 December 2013 when Mr Farmer advised Mr Banks by email to "hold off on transferring funds to Mako at this time". Mr Farmer added that he would come back to him "when we are all clear to accept the same". This followed shortly after Telecom sought the appointment of KordaMentha and was three days before all further lending by Telecom Rentals was formally suspended.

[99] On 21 January 2014, Mr Farmer sent an email to Mr Banks to arrange a catchup meeting. He said there were some "real challenges at the moment" which he wanted to talk through.

[100] Mr Farmer wrote to all shareholders and Mr Banks on 5 February 2014 providing an update on the debt restructure with Telecom Rentals which required shareholder approval:

> Dear Shareholders
>
> As you will see [from] the attached documents the last 6 weeks [have] been a challenging time for the Board and Management of the Company as we have dealt with the severance of funding to support the business from Telecom Rentals. Circumstances have changed on literally a daily basis from one where Directors have had to consider various options as cash reserves have been depleted.
>
> Ultimately we have come to an arrangement with Telecom Corporate for a Sale of the SecureMe business to Gen-i and a complete restructuring of our current debt arrangement. This agreement was finally reached on Monday and full Documentation received last evening.
>
> Further to this the Management have completed a comprehensive review of all expenses in the business and initiated a major restructuring of the same. This will result [in] a significant reduction in personnel in research and development and absolute alignment of sales resources to take advantage of the opportunities in the US and Australia with the UK being covered by Phoenix Managed Networks.
>
> To complete the arrangements agreed with Telecom I am requesting an urgent Special Meeting is convened to discuss and if agreed approve the transaction as outlined in the Draft Resolution attached. I realise this is very short notice but time is of the essence with funds depleted.

[101] The resolution was passed, and the debt restructure and other transaction documents were executed on 7 February 2014.

[102] Mako continued to make progress in its overseas markets in the first quarter of 2014.

[103] In November 2013, Mako engaged in negotiations with Sprint with a view to concluding a "productisation agreement" to augment the recently completed teaming agreement. This agreement would be very attractive to Mako because Sprint indicated it would commit to supplying 50,000 sites over two years (better than Norcal forecast

in its three-year pipeline assessment (see above at [65]) with an initial drawdown of hardware and licences for 5,000 sites to be paid for upfront. Leaving aside the value of this major source of business, an obvious and immediate benefit would be a significant improvement in Mako's cashflow. Unfortunately, as we will come to, Sprint unexpectedly reversed its position on making upfront payments and withdrew from these negotiations around the time Mr Banks made his final advance on 24 April 2014.

[104] On 11 February 2014, Mako's Australian subsidiary concluded a procurement and reseller agreement for a three-year term with Telstra Corporation Ltd, the largest telecommunications company in Australia. Telstra agreed to purchase Mako's products and services for its own use and for provision to its customers under the reseller agreement. Telstra was the most significant opportunity identified by Norcal in the Australasian market, expected to account for just over half of all Mako's sales in that region.

[105] In arranging a further catchup meeting, Mr Banks made the following comments to Mr Farmer in an email on 19 February 2014:

> It's a shame that we had to panic-sell that business chunk. Will the IPO cash eliminate the reliance on a credit provider?
>
> I hope that you have put out the fire and things have changed such that if I put my $500k in now it would be as safe as my existing money was 6m ago.

[106] The further meeting between Mr Farmer and Mr Banks took place on 4 March 2014. Mr Farmer followed up with an email on 5 March 2014:

> Thanks for getting together yesterday. I still feel the best option for Mako would be for you (or your Nominee) to become a Mako Shareholder. We will discuss again but could you please review the Shareholder Agreement attached in anticipation of going down that track.

[107] Mr Banks responded to Mr Farmer on 8 March 2014:

> The agreement looks good. Let's do this when you're ready.

[108] On 15 March 2014, Mr Farmer sent an email to all existing and proposed shareholders (including Mr Banks) stating that he was finalising the deed of accession

for the issue of new shares and seeking confirmation that relevant details had been recorded correctly in an attached table. Mr Banks replied by email on 16 March 2014 indicating that he was reconsidering his position:

> I've had some 2nd thoughts. Our arrangement was that I'm a creditor and the debt increases by 10%/y. We then entered into an agreement that stated that the debt would cease to increase and I'd get a share price discount. I was looking forward to things happening as per that agreement and am used to agreements being adhered to unless both agree to dissolve them. Unfortunately that agreement has been effectively dissolved without my say. Circumstances have changed so I guess I'm ok with that. One would imagine that we'd revert to how things were before but it seems we are keeping just one part of the agreement: the part re the debt ceasing to increase. If you can find the time I'd like to sort this before handling the below.
>
> As per my email of a while ago I would prefer shares to be in the name of Beta Trust and for my name to not appear anywhere public. If it appears as a "key person" in a list viewable by senior Mako people that's fine. If it's a bother then my name will do.

[109] Mr Farmer was in the United States at the time but proposed a meeting early the following week to discuss. He gave Mr Banks his assurance that while there had been a number of changes, he was working to get the best arrangement available for him. He confirmed that there would be no problem for the Beta Trust being the owner of the shares, adding that he and his wife owned shares through their trust. Mr Farmer sent a follow-up email later that day:

> Just so we are on the same page the public offer shareholding value was $100m less the discount whereas the current proposal is at $50m with the expectation of a better upside.

[110] Mr Banks replied on 18 March 2014:

> That's all good re the trust and names.
>
> I was happy not having my money grow in exchange for a discount. I now have the option of buying in @ $50m but it seems that that is something that any investor has had the option of doing for a while: on 29.11.13 we chatted about the then latest capital raising of $5m. You said that we would use the same valuation as was used in the capital raising before that: $50m.
>
> If I have misunderstood sure perhaps we should chat. Maybe there's a simpler way of looking at it: you've already done some legwork re the IPO and ascertained that the market was prepared to buy in @ $100m. If that's true then I'm getting a great discount and I'd be happy to buy in (to keep things simple we'll forget about the extra $500k).

[111] The two met at a café on 25 March 2014. There is no record of what was discussed at this meeting, but it appears Mr Banks decided to proceed with a further investment of $500,000.

[112] On 2 April 2014, Mr Farmer sent an email to Mr Banks:

> I am back from [Hawai'i] now. Before I went away I checked my emails and for the life of me can't find the one relating to the Beta Trust Co. No biggie at the moment as I have noted the allocation and held it in the shareholder reserve account. If you wouldn't mind re-sending and then I will complete the arrangements.
>
> Whilst I was away one of the other shareholders committed the proceeds of a building sale he has ~$700k so that will help as well. If you could let me know when you will transfer the $500k that would be appreciated. I remember you had it in a 14 day call account.

[113] On 10 April 2014, Mr Banks advised Mr Farmer that he should receive the money around 24 April 2014. The next recorded communication was on 24 April 2014, when Mr Farmer sent an email to Mr Banks thanking him for the investment funds received that day ($500,000). No formal documentation was ever prepared setting out the terms of this investment, but Mr Banks pleaded the terms of this agreement as follows:

> 61 Agreement 3 was discussed further on 4 March 2014 on the basis that a written agreement would be entered into recording that:
>
> (a) [Mr Banks] would invest a further $500,000.00, adding to the existing debt;
>
> (b) conversion of [Mr Banks'] total advances into shares would occur at a valuation of $50 million (when Mako listed on the NZX, as under Agreement 2); and
>
> (c) future investors would invest at a valuation of at least $100 million.

Failure of Sprint deal

[114] The Judge found that the directors should have ceased trading "at about the time successfully concluding the Sprint deal looked unlikely", referring to the productisation agreement. The Judge assessed that to be in "late April to mid-May

2014".[37] Because this was so proximate to the time of Mr Banks' last advance on 24 April 2014, it is necessary to examine in a little more detail the circumstances in which that deal failed.

[115] As noted, negotiations for this agreement commenced in November 2013. The negotiations progressed in a positive manner until April 2014 with the involvement of senior personnel including legal, project management, sales, and operations. The key terms involved the purchase by Sprint of a minimum of 50,000 units in the first two years with a minimum of 5,000 units and licences being purchased and paid for immediately. It appears that the first indication of a possible retreat from this position by Sprint was around 12 April 2014 when Mr Gamble was asked whether the initial upfront order of 5,000 units could be dropped to 4,000 units and whether Mako could fund the first order. He was also asked how much Sprint would need to fund if it ordered 4,000. Mr Gamble replied that the cost would be USD3,404,000 but he emphasised that Mako required the 50,000 unit two-year commitment from Sprint on the terms discussed, as this was the basis for the pricing offered.

[116] In his report to shareholders dated 25 August 2014, Mr Farmer explained the key developments since his last report in February 2014 following the Telecom Rentals debt restructure. This contemporaneous report summarises the key events in the period from February to April 2014 when negotiations with Sprint for the productisation agreement collapsed:

> At the time, [of the Telecom Rentals debt restructure] the Chevron rollout was gaining momentum, [BullsEye] was starting to deliver product to their customer base, and engagement with Sprint following on from the teaming agreement in November was looking to extend to a full productisation agreement with significant purchasing commitments by April.
>
> A number of firms we approached when looking for the emergency capital continued to show interest in the company and we elected to retain GR Partners (Pooj Preena) as advisors to work through options with a view to recapitalising. Interest from New Zealand funding providers had been withdrawn following the Telecom arrangement. To further assist Mr Preena, Brett Sharenow (a respected Silicon Valley financial planner) was engaged to work up a US-centric financial model which, when populated with then current data indicated a market value for the Company of around $100m – not too dissimilar to the expectation for the NZ IPO.

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[37] Substantive judgment, above n 2, at [452]

> A great portion of this value was attributed to the commitment that Sprint was continuing to negotiate, namely 50,000 sites over two years with an initial drawdown of hardware and licences for 5,000. A number of Mako senior management [were] involved in negotiations through February, March and April as legal, project management, sales and operational teams were assembled within Sprint. I can personally verify the expectation from calls I was present on. *For no apparent reason* on 20th April, Sprint advised they would not continue with any arrangement with Mako as "they did not pre-purchase product for anything other than cellular phones that they sold in very high quantities" and would not commit to any sale quantity.
>
> Over the same period (February through April), the Chevron rollout was ramping up significantly and some difficulties were being experienced. Internally these had been expected and processes and procedures were being refined on a weekly basis. Externally a split between our contractors for installation and project management (HighWire on one part and D&S Communications on the other) was materially affecting both our ability to deliver and our reputation with Chevron. During the time, Chevron communicated a final required completion date of all installations of 30 September. To mitigate the issues with installation and HighWire we engaged two further installation firms to accelerate installations. Project management and associated operational input from Mako personnel to support this was consuming well over 50% of our personnel's daily time and still needed to be addressed.

[117] Because of the Judge's finding that the directors should have ceased trading in mid-May at the latest, it is not necessary to traverse the subsequent events leading to the directors' decision on 19 August 2015 to place Mako in liquidation and invite Telecom to appoint receivers. The receivers sold Mako's business to D&S Communications for approximately $3 million and the product continues to be successful. Mr Gamble was, and at the time of the trial in the High Court continued to be, employed by D&S Communications in the United States.

Financial statements

[118] Despite the huge potential of its innovative product offering, Mako was unable to convert this to profitable financial performance. The group financial statements disclose a steadily deteriorating net equity position:[38]

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[38] The financial statements were not audited until Deloitte was engaged for the purposes of the IPO to audit the financial statements from and including the FY13 year. The FY12 figures shown in the table are as restated following the audit of the FY13 financial statements. The revenue for FY12 was restated from $10,262,262 to $4,469,000. The comparative unaudited figure before restatement for FY11 was $4,780,446.

Financial year ended	Revenue	Profit/(loss)	Shareholders' funds
30 June 2011	$2,670,751	($2,063,149)	$1,982,390
30 June 2012	$4,469,000	($5,471,000)	($6,149,000)
30 June 2013	$3,174,000	($5,913,000)	($13,906,000)
30 June 2014	$4,343,000	($9,683,000)	($23,038,000)

[119] Having set out that factual narrative, we now turn to address the appeal with reference to the specific claims.

FTA claims

[120] It is evident that Mr Banks has left no stone unturned in his efforts to recoup his losses. He pleaded an extraordinarily large number of alleged written and oral misrepresentations in his second amended statement of claim (set out over 17 pages, in 65 paragraphs and many subparagraphs). These representations were said to have induced him to enter Agreements 1, 2 and 3, including by silence and omissions. To cover the possibility that something may have been missed, the pleading of the list of representations Mr Farmer allegedly made to Mr Banks was non-exhaustive (the representations were said to "include, but [were] not limited to" the expressly pleaded representations).

[121] The alleged misrepresentations were somewhat refined and narrowed by the conclusion of the trial and the number reduced to 53. These are set out in appendix 1 to the Substantive judgment.

[122] As a general observation, such a widely-cast net creates its own challenges for the parties and the judge because it can make it difficult for everyone to identify and maintain a proper focus on the key issues, evidence, and submissions. The issues on appeal have been considerably refined, appropriately so. However, this context explains why some of the issues placed to the fore on appeal received less attention in

the Substantive judgment than might otherwise have been the case. Even as it was, the Substantive judgment is very lengthy, comprising 685 paragraphs.

[123] Mr Banks has not appealed against the dismissal of his claims to the extent they relied on alleged oral representations. Attention can therefore be confined to the alleged written misrepresentations. These have also been narrowed down and, to some extent, the emphasis has changed.

Representations prior to Agreement 1

[124] The Supreme Court summarised in *Red Eagle Corp Ltd v Ellis* the proper approach to be taken in cases alleging misleading or deceptive conduct in breach of s 9 of the FTA:[39]

> [28] It is, to begin with, necessary to decide whether the claimant has proved a breach of s 9. That section is directed to promoting fair dealing in trade by proscribing conduct which, examined objectively, is deceptive or misleading in the particular circumstances. Naturally that will depend upon the context, including the characteristics of the person or persons said to be affected. Conduct towards a sophisticated businessman may, for instance, be less likely to be objectively regarded as capable of misleading or deceiving such a person than similar conduct directed towards a consumer … The question to be answered in relation to s 9 in a case of this kind is accordingly whether a reasonable person in the claimant's situation – that is, with the characteristics known to the defendant or of which the defendant ought to have been aware – would likely have been misled or deceived.

[125] The written representations relied on for the purposes of the appeal are those set out in the PPM, specifically the revenue forecast for the year ended 30 June 2011.

[126] The PPM was relied on in the pleading, but the focus was on the claimed representation that Mako would be generating "pre-tax net profit in the tens of millions for 2013, 2014 and 2015". There was no specific mention of 2011. There was, however, a general claim that Mr Farmer did not bring to Mr Banks' attention at any stage that Mako's actual financial performance was worse than that predicted in the PPM forecasts.

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[39] *Red Eagle Corp Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 (footnote omitted).

[127] The corresponding representations in appendix 1 to the Substantive judgment make no specific reference to the revenue projection for any year (the focus was on pre-tax net profit). There was again no reference to 2011:

> 1 Providing Mr Banks with the PPM dated November 2010.
>
> 2 An email on 22 December 2010 reporting that according to the PPM:
>
> (a) Mako's financial performance from 2007 to 2010 was acceptable; and
>
> (b) Mako was projected to have a pre-tax net profit of $8 million in 2012 and tens of millions in 2013, 2014 and 2015.

[128] In his notice of appeal, Mr Banks contends that Mr Farmer misled him by giving him the PPM in December 2010, halfway through that financial year, without advising him that there was little prospect the revenue forecast for that year would be met. He also complains that the Judge erred in concluding that the revenue forecasts in the PPM were reasonably held opinions, given the evidence that the forecasts were based on general extrapolations rather than binding commitments, and were provided without an assessment of the associated working capital required to fulfil the growth.

[129] It can be seen that the complaints advanced on appeal on this aspect of the claim do not reflect, other than at a very general level, the way the claim was pleaded in the High Court, or even as it was refined by the time of closing submissions at the trial. The focus has shifted on appeal from the profit projections in the PPM for 2012 and beyond to the revenue projection for 2011. This no doubt explains why the Judge did not specifically address the revenue projection for 2011 in the judgment. This context needs to be borne in mind when considering Mr Banks' complaints about this part of the judgment.

Submissions

[130] Mr Johnson, for Mr Banks, says that Mako ultimately achieved revenue of $2.67 million for the financial year ended 30 June 2011 (FY11) and he contrasts this with the figure of $17 million projected in the PPM. It should be noted at the outset that this comparison ignores that the FY11 revenue figure was subsequently restated from $4.78 million to $2.67 million, but the difference between the actual and

projected revenue was significant on any view. Mr Johnson argues it was misleading for Mr Farmer not to tell Mr Banks that the FY11 projection would not be met at the time he provided him with the PPM in December 2010, or at least prior to Agreement 1 being entered into 4 February 2011. He submits that a reasonable person would have been led to believe that the forecast was at least within the realms of possibility.

[131] Mr Johnson says the Judge failed to engage in any objective analysis of the reasonableness of the projections, simply finding that they were the honestly and reasonably held opinions of the directors. He argues that the Judge erred in focusing exclusively on the directors' subjective views about Mako's potential based on their attendance at trade shows and sales pitches to potential customers. He contends that reference to "uncontracted and speculative" sales figures without any analysis of what was needed to achieve those sales was "essentially meaningless". He says there was little or no documentary evidence of any analysis of the further working capital required to secure commitments from the target market at the projected levels.

[132] Mr Hollyman KC, for Mr Farmer, counters that the projections in the PPM were based on assumptions set out on the same page, which he says were justified by credible information available to the directors at the time. They were also explained by Mr Gamble in his evidence. He says neither the assumptions nor Mr Gamble's explanation were seriously challenged at trial.

Analysis

[133] The projections in the PPM were for the period 2011 to 2015. Total projected revenue for FY11 (as at the date of the PPM) was $17,036,707 and expected to come from three sources — resellers ($1,171,196); node operators ($15,660,251); and ancillary ($205,260). The assumptions underpinning the forecasts were set out immediately below:[40]

> Assumptions
>
> Sales of 1 x 3000 unit licence block in NZ, 1 x 10,000 in Australia and 1x 20,000 in the UK in 2011 with projected growth for business outlined from there[o]n.

[40] Emphasis omitted.

> Maintaining operations in the three regions until 2012 before further expansion
>
> Continuing personnel capability hiring throughout 2011 to achieve competent base for expansion and further hiring as it occurs

[134] Mr Gamble, who assisted Mr Farmer in preparing the projections, explained in his evidence that the 3,000 unit licence block in New Zealand was for Telecom and was based on forecast meetings with them. He said that customers they were working with at the time included the Ministry of Health and Fonterra.

[135] Mr Gamble said that the 10,000 unit licence block in Australia was based on expected sales through Gen-i Australia to National Australia Bank and Commonwealth Bank of Australia. In support of this, Mr Gamble referred to an email from Gen-i sent on 9 November 2010 following a meeting the previous week between Mako, Gen-i and Commonwealth Bank of Australia. The Mako PCI-DSS solution was presented at that meeting for use by the bank's merchant customers. The Gen-i email reported that the bank had asked for its support to prepare a business case to fund such a project in FY10/11. Urgent assistance (by 19 November, the following Friday) was sought to enable pricing to be submitted to the bank on indicative terms including a contract for a three-year term and supply of 10,000 Mako units and licences.

[136] As best he could recall,[41] Mr Gamble said that the 20,000 licence block for the United Kingdom was to service Royal Bank of Scotland, BarclayCard, British Telecom and FirstData UK. These were only some of the many prospective partners he spoke with at this time. He said that proof of concept trials were being conducted with Royal Bank of Scotland at that time.

[137] The PPM contained considerable information about Mako's opportunities, described as "an outline to demonstrate the quality and quantum of business opportunities that Mako is actively working on". While specifics were withheld as being commercially sensitive, there was a general discussion of existing business opportunities in various markets, specifically New Zealand, Australia,

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[41] The projection was prepared some six years before proceedings were issued and nine years before the trial.

United Kingdom, United States, China, Malaysia, and the Middle East. Given that the assumptions adopted for the purposes of the projections related to New Zealand, Australia, and the United Kingdom, we summarise the discussion about the opportunities being actively pursued in those three markets at that time.

[138] The PPM stated that one of Mako's major existing customers would be transitioning around 2,500 of their customers to the Mako solution in the 2011 calendar year. This transition was expected to be the catalyst for the business to grow exponentially in the following years. It stated that Mako was currently working on a special initiative with the credit card schemes, acquiring banks, the New Zealand government, and others to ensure as many merchants as possible would become PCI-DSS compliant prior to the Rugby World Cup in 2011 to be hosted in New Zealand. Senior executives of Visa, Mastercard and the PCI Council were said to be closely monitoring this initiative. Mr Banks has not suggested that any of these statements were untrue.

[139] As for Australia, the PPM noted that Mako currently had two distributors, NetComm and Gen-i. NetComm was working with its reseller base and second-tier telecommunications companies. Gen-i, a Telecom New Zealand subsidiary, was reported as having a specialist team working with all four major banks to supply a total PCI-DSS compliant system using the Mako service for merchants and ATMs. They were working to transition a total of 75,000 merchants from dial-up point-of-sale terminals to IP-based terminals that connect to a bank via the internet. All merchants transacting over the internet were required to be PCI-DSS compliant which could be achieved through installation of the Mako system. The budget allowed for 10,000.

[140] Current initiatives being pursued by Gen-i were recorded as follows:

> One Australian bank currently has [request for proposals] in the market to transition 75,000 merchants from [dial-up connections] to [internet-based connections]. Another has also requested pricing to adopt the solution with a view to a 2011 financial year rollout. The sales team is targeting specific customers with US stock exchange reporting requirements that mandate PCI-DSS compliance disclosure. Prospective customer trials are planned to start within the next 30 days.

[141] Again, Mr Banks does not claim that any of these statements were untrue.

[142] The opportunities being pursued in the United Kingdom were outlined in the PPM as follows:

> The Mako regional sales office has been promoting the PCI-DSS capability since July 2009 and is currently actively working with three of the major acquiring banks. Mako will partner with one of its system integration resellers for installation, support and billing of the service. Two of the three banks have indicated they will move to deployment in early 2011. One bank has 100,000 merchants another 40,000 in one division and a further 180,000 across another two. Proof of concept trials are currently being undertaken as part of the sales process.
>
> Further to this the company is in advanced discussions with a major trans-continental banking services system integrator for inclusion in their product suite. Initial projections are for 10,000 units per annum starting Q2 2011.
>
> The UK merchant acquiring sector is going through significant changes at present with many acquirers planning for or in the process of separating from their parent banks. Mako is positively engaged with three major acquiring institutions currently going through separation procedures and expects to be able to benefit from these relationships within the next six months.
>
> Along with other regions, extra effort is being made to target specific customers with US stock exchange reporting requirements as previously outlined above.

[143] Given there is no challenge to the truth of any of these statements, they would appear to provide reasonable support for the assumptions stated in the PPM and adopted in formulating the projections, including as to timing. Leaving aside for now his point about the working capital required, Mr Banks has not shown that the revenue projections had no reasonable foundation despite the correctness of the stated facts and assumptions upon which they were based.

[144] Mr Johnson is correct that the revenue projections were largely based on uncontracted and therefore speculative sales figures, but that would have been obvious from reading the PPM. The projections were plainly not based on contracted revenues and there was no suggestion that they were. This was not a mature company with stable and highly predictable revenue streams coming from an established client base. Rather, the PPM painted an accurate picture of Mako as a company that had progressed beyond the initial start-up stage but was still in the early stages of attempting to

commercialise its product at scale, particularly in the overseas markets where the most lucrative opportunities were. It would have been clear to anyone reading the PPM that the global opportunities for Mako's innovative and leading-edge product were vast but still uncertain. The necessarily speculative nature of the projections was also made clear in one of the opening paragraphs:

> This Memorandum and specifically the financials have been prepared on the basis of numerous assumptions, projections and best estimates. Because projections involve risk and uncertainties actual results are likely to vary and such variations could be material. No representations are made by [Mako], its directors or its management that the results set out in this Memorandum will be achieved.

[145] While superficially attractive, we do not consider there is, on analysis, anything in the point that Mr Banks ought to have been told that the projections were beyond the realms of possibility by the time he was given the PPM in December 2010. This submission is based on the premise that Mako was not on track to achieve these projections and it ought to have been obvious by then that they would not be met. However, this overlooks that the forecasts were prepared as at November 2010 (the date shown on the PPM), which was already five months into the financial year. The forecasts took account of Mako's performance to date and the revenues expected to be generated in the second half of the year through the realisation of the significant market opportunities being actively pursued at that time. The FY11 revenue projection was based on the assumption that these opportunities would be realised at the levels stated and boost revenues in the second half of that financial year. The expectation of high growth was evident from a comparison between the projections and the summary of the consolidated financial statements which were also included in the PPM showing the actual financial performance achieved in each of the years from 2007 to 2010.

[146] Mr Gamble rejected the suggestion in cross-examination that the FY11 projection was unreasonable given it was prepared in November 2010, partway through the financial year. It was put to him that he would have known that Mako was not on track to achieve $17 million in revenue. He said that at that time they believed that the channel to the market was through the banks and the credit card schemes. He said they had received significant expressions of interest from Royal Bank of Scotland, BarclayCard, Visa Asia Pacific, Mastercard USA, and Visa United States of America among others. The credit card schemes had mandated that retailers must

obtain PCI-DSS compliance and the Mako system provided a solution to that difficult problem. Based on the meetings he attended with key players, Mr Gamble described the opportunities at that time as being "massive", with potentially "thousands and thousands of customers" of these banks and credit card companies using the Mako system. He accepted that there can be time lags, but he strongly rejected the core allegation that the FY11 projection had no reasonable foundation:

> Q. So you're saying that when you prepared this in November of 2010 you honestly believed that that revenue projection of 17 million for the financial year 2011, was correct?
>
> A. Absolutely.
>
> Q. There was no reasonable basis for that was there?
>
> A. There was a huge amount of reasonable basis for that, I just explained a decent part of it.

[147] Mr Banks' claim that the FY11 revenue projection had no reasonable foundation because Mako had insufficient working capital to achieve it does not feature in the particulars of the pleading or in appendix 1 and it was not addressed in the Substantive judgment. In any case, we are not persuaded the criticism is made out. The SWOT analysis in the PPM identified as one of Mako's three key weaknesses that it required significant working capital to enable it scale up significantly. That was why it was seeking to raise $7.5 million of capital at that time. When cross-examined on this topic, Mr Farmer confirmed that was his estimate of the capital required at that stage to grow the business in accordance with the projections in the PPM, but it was expected that there would be a need to raise further capital later on.

[148] The hindsight knowledge of Mako's actual end of year results does not prove that Messrs Farmer and Gamble ought to have known that fulfilment of these projections lacked a reasonable foundation at the time they prepared them in November 2010. Mr Banks does not suggest that anything had changed in any material way from November to December 2010 such that a correction was required to the FY11 revenue projection at the time he received the document.

[149] In summary, we are not persuaded the Judge was wrong to conclude that there was a reasonable factual foundation for the projections at the time they were prepared.

There was no serious suggestion that the forecasts did not represent the honestly held opinions of the directors at that time. Mr Banks has not shown there was no reasonable factual basis for the projections. He has not pointed to any material change in the position in the period from November to December 2010. Nor has he proved that by the time he received the PPM in December 2010 (or as at 4 February 2011) there was "little or no prospect the forecast for [FY11] would be met". We agree with the Judge's conclusion that the representations said to have induced Agreement 1 were not actionable under the FTA because they were not misleading or deceptive.

Representations prior to Agreement 2

[150] Agreement 2 is dated 30 June 2013, but the relevant advances were made earlier — £237,722.43 on 14 May 2013 and £24,779.14 on 3 June 2013. The Judge addressed the alleged misrepresentations said to have induced Agreement 2 in three categories.

[151] The first category involved statements made by Mr Farmer to Mr Banks in email correspondence and at meetings between the date Agreement 1 was signed on 4 February 2011 and 15 May 2013, the day after the first advance under Agreement 2. The Judge noted Mr Farmer's acknowledgement that during this period he portrayed Mako as a company that was "doing well with growing investor and customer interest and strong financial projections".[42] These representations, collectively categorised in the judgment as "good news", were drawn from appendix 1 and summarised as statements made by Mr Farmer remarking "positively on Mako's business, progress with capital raising, meetings he was attending, events he had attended, and investments or contracts which were being finalised or confirmed".[43]

[152] The Judge considered there was a reasonable basis for these expressions of confidence.[44] He found that Mr Farmer was simply "reporting on Mako's business as he then knew and experienced it". His emails reported on Mako's successes and informed Mr Banks of the outcomes of negotiations and meetings he was attending. The Judge found that the emails, individually and collectively, were either accurate

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42 Substantive judgment, above n 2, at [53].
43 At [661] (footnotes omitted).
44 At [53].

statements of fact or conveyed Mr Farmer's honest and reasonably held opinion of Mako's business at the time.[45]

[153] The second category was the breach of Agreement 1 when Mako gave security over its assets to Telecom as part of the 28 June 2013 debt restructure. The Judge found that this was an inadvertent and inconsequential breach and Mr Banks would likely have waived his rights had he known about it.[46]

[154] The third category of representations concerned the possibility of an IPO. Mr Banks said that Mr Farmer made repeated representations that an IPO was likely. However, Mr Banks claims this was patently incorrect, principally because of the implications of the debt to Telecom Rentals and the unlikelihood that this would be converted to equity. The Judge rejected this claim, observing that the only professional advice Mako had received about a possible listing at that time was from Cameron Partners and they had not suggested that an IPO was unrealistic. On the contrary, Cameron Partners advanced a number of strategic proposals which they considered could be implemented to achieve a successful listing. The Judge took the view that they would not have done so if they believed an IPO was unlikely. The Judge also noted that Agreement 2 recorded Cameron Partners' recommendation that any debt on the balance sheet should be removed prior to listing, so Mr Banks was aware of that.[47]

Submissions

[155] Mr Banks appeals against this aspect of the judgment on two main grounds. First, he claims the Judge erred in not finding that the positive statements Mr Farmer made in emails (the "good news") were misleading because they only told one side of the story. In particular, he claims that Mr Farmer ought to have disclosed that the FY12 financial statements required material adverse restatement and that Mako "had, or would shortly", grant security to Telecom Rentals. Mr Banks says the Judge was wrong to find that the restatement of the accounts was not in contemplation prior to June 2013, and he says the breach of Agreement 1 by granting security could not be

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45 At [664].
46 At [665].
47 At [667].

characterised as inadvertent or inconsequential. He says the Judge's finding that he would likely have waived his rights in relation to that breach had he been given the opportunity was not correct and this proposition was not put to him in cross-examination.

[156] The second ground raised in Mr Banks' notice of appeal concerns the Judge's finding that an IPO was a reasonable prospect as at 30 June 2013, the date of Agreement 2. He says that Mako was advised in March 2013 that an IPO was not possible while the Telecom Rentals' debt remained unpaid. He says there was no evidence that the debt could be repaid or that Telecom Rentals had agreed to equitise its debt. In these circumstances, he claims it was misleading for Mr Farmer to represent that an IPO was likely.

[157] Mr Johnson submits that the "good news" representations led Mr Banks to believe that Mako was going from strength to strength. However, Mr Johnson says this was misleading because Mr Banks was not told about Mako's allegedly "serious financial difficulties", including:

(a) ongoing cashflow shortages;

(b) a fundamental term of Agreement 1 had or would shortly be breached;

(c) the FY12 accounts sent to Mr Banks in September 2012 were in need of restatement; and

(d) Mako was trading "drastically below" the forecasts in the PPM for FY12 ($41.5 million) and FY13 ($63 million).

[158] We note in passing that the first and last of these matters were not referred to in the notice of appeal. While the second amended statement of claim pleaded that Mr Banks was induced to enter into Agreement 2 by the positive representations, cashflow shortages were not mentioned in the particulars as to why the representations were said to be misleading or deceptive. The only specifically pleaded non-disclosure concerned the liability to Telecom.

Analysis

[159] Leaving aside for the moment the "one side of the story" submission, there was no real challenge to the accuracy of the statements Mr Farmer made to Mr Banks, which are mostly in his emails. Twelve emails in the period between Agreements 1 and 2 are listed in appendix 1 to the Substantive judgment. Almost all of them referred to the business opportunities being pursued by Mako at the time or the recently concluded contract with BullsEye. The tenor and correctness of the information conveyed in these emails can be illustrated by reference to a few examples.

[160] One was a reply sent by Mr Farmer on 13 January 2012 in response to an email from Mr Banks that day reporting on his residency application to Immigration New Zealand and seeking proposals for compensation for work he had carried out for Mako on a manual:

> Hi Adam
>
> All the best for the festive season and congratulations with INZ.
>
> I am currently in the UK and off to the US after getting back into NZ in the first week of [February]. [T]he company had a great finish to the year end with 3 significant contracts confirmed.
>
> Let's get together mid [February] for an update. I will find out from [the research and development director] his ongoing plans for documentation
>
> Kind Regards
>
> Bill

Mr Farmer was not cross-examined on this email. There was no suggestion that this statement was false, namely that three significant contracts were confirmed prior to the end of the 2011 calendar year, supporting the "great finish" comment.

[161] Another example is an email Mr Farmer sent to Mr Banks on 4 March 2013 in which he commented "[b]usiness is quite encouraging currently" and suggested they catch up over a coffee later in the week. Mr Farmer was not cross-examined about this email either. At that time, Mako appeared to be making good progress, particularly in the United States, including with Phoenix and BullsEye. The "quite encouraging" comment appeared to be justified at that time.

[162] Appendix 1 also lists an email Mr Farmer sent on 24 June 2013, shortly before Agreement 2 was signed. Mr Farmer reported further progress in this email:

> Last week we completed a contract with Bulls[E]ye Telecom in the US and they already have their first customers lined up. We also got the first full version of a product supply agreement with Sprint. They too have their first customers lined up but it may take another 30-45 days to finalise the contract.

Again, Mr Farmer was not cross-examined on this email. There was no suggestion the information contained in it was untrue.

[163] We have reviewed all the other written communications in this period and listed in appendix 1. These include generalised comments such as, "[h]ad a very encouraging show at Earls Court the past few days" (15 March 2012) and "[g]reat week this week with the team refining our strategy and working with the merchant bankers" (5 April 2013). We have seen no evidence to suggest the Judge was wrong in finding that the statements made by Mr Farmer were either factually correct or represented his honestly and reasonably held opinions.

[164] As noted, the complaint advanced in submissions on appeal is that the positive comments about Mako's business opportunities and successes in concluding contracts were misleading because Mr Farmer did not disclose adverse information which revealed Mako's serious financial difficulties, including its cashflow constraints. This was not pleaded in the second amended statement of claim and was not referred to in the notice of appeal. Mr Farmer was not cross-examined on this topic in connection with the period between Agreements 1 and 2 and the Judge did not address the issue in his judgment. Although Mr Hollyman did not take the point, there are obvious limitations on the extent to which it is appropriate for this Court to entertain claims not addressed at trial. In any event, Mr Banks must have known that Mako needed to raise capital to fund the expansion of its business. That was the purpose of the initial capital raising and the proposed IPO. It is also why Mako was borrowing money from him. Agreement 2 specifically recorded that Mako had engaged Cameron Partners to assist with the capital raising and had strongly recommended that any debt be repaid or converted to equity prior to listing. We are not persuaded Mr Banks was misled into believing that Mako did not require additional capital to fund its growth at this time. On the contrary, it is clear that he knew this.

[165] It will be recalled that a condition of Agreement 1 was that Mako would not give security over its assets (other than in the ordinary course of business and limited to 15 per cent of its net value) without first obtaining Mr Banks' consent. This condition was breached when the general security deed in favour of Telecom Rentals was assigned from Mako Networks Finance & Leasing to Mako as the holding company on 28 June 2013. Mr Farmer acknowledged that he did not seek Mr Banks' consent to the arrangement and should have done so. He said this was a mistake.

[166] That Agreement 1 was breached is not disputed. The question on appeal is whether the breach assists Mr Banks' claim based on misleading and deceptive conduct, there being no claim for breach of contract. As we have discussed, the statements of past or present fact contained in the relevant emails generally concern the business opportunities being pursued by Mako at the relevant times or the contracts recently secured by it. The relevant emails all preceded the assignment of the security. It seems to us that the correctness of the underlying statements of fact or opinion in the emails about business opportunities and customer contracts were not called into question or rendered misleading when viewed in the light of the renegotiated security arrangements with Telecom Rentals. Mako plainly ought to have sought Mr Banks' consent before granting the security because that was a term of the agreement. But it does not follow in our view that Mr Farmer needed to correct any of his earlier statements in the light of this development. In short, we do not accept that this breach supports Mr Banks' claim under the FTA because it did not render the earlier statements of fact or opinion misleading or deceptive.

[167] Even if, contrary to our conclusion, the failure to advise Mr Banks about the security was a breach of s 9 of the FTA, we are not persuaded we should interfere with the Judge's finding that the misleading conduct was inconsequential. First, Mr Banks made his advances under Agreement 2 on 14 May and 3 June 2013, prior to this breach occurring. Secondly, Mr Banks must have been aware of the Telecom Rentals debt restructuring by March 2014 at the latest. He did not express any concern about the giving of security and agreed to lend a further $500,000 with knowledge of this.

[168] That Mr Banks must have been aware of the giving of security by March 2014 is evident from the documents that were sent to him on 5 February 2014. Mr Farmer sent Mr Banks the same documents he sent to the shareholders detailing the terms of the proposed debt restructure and sale of the SecureMe business. These included the draft shareholder resolution which attached a term sheet, business transfer agreement, loan agreement, general security deed, and deed of priority and subordination of debt. The term sheet set out the background and the key terms of the proposed debt restructure and purchase of the New Zealand SecureMe business and made specific reference to the security to be granted to Telecom:

> **Security:** In order to secure all future payment and performance obligations (including the New Loan) owing by [Mako Networks Ltd] and/or [Mako] to [Telecom] and/or [Telecom Rentals], [Mako Networks Ltd] and [Mako] will each also grant new cross-guarantees and new first ranking general security over all their respective present and after-acquired assets in favour of [Telecom Rentals] (including for the benefit of [Telecom]) (the "**New Security**"). [Mako] will subordinate any other existing securities it has to achieve this. These documents will be substantially in the form of the guarantee/security and deed of priority documents already proposed by [Telecom Rentals] in connection with its earlier offer of [an] urgent liquidity facility to [Mako Networks Ltd].

[169] Mr Banks acknowledged that Mr Farmer discussed the debt restructure and grant of security at their meeting on 4 March 2014.

[170] Mr Johnson is correct that it was not put to Mr Banks in cross-examination that he would have waived his rights if he had been asked prior to 28 June 2013 to consent to the grant of security by Mako. However, it can reasonably be inferred that he would have done so given his reaction to the more significant implications of the arrangements entered into with Telecom in early 2014, including the disposal of a major part of the business. Mr Banks did not raise any complaint about the breach of Agreement 1 when he became aware of this. His only reaction was to say it was "a shame that we had to panic-sell that business chunk" and he hoped that Mr Farmer had "put out the fire".

[171] We turn now to the issue regarding restatement of the FY12 accounts. Duns Ltd, chartered accountants in Christchurch, completed the financial statements for Mako and its subsidiaries up to and including the financial year ended 30 June 2012. These were compilation accounts prepared in accordance with

New Zealand generally accepted accounting practices and were not audited. The board recognised that audited accounts would be needed for the proposed IPO and Deloitte was engaged to carry out this exercise. On 28 March 2013, Mr Farmer received from Mr McGregor a draft engagement letter prepared by Deloitte which referred to the intended adoption of the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for the first time in the current financial year. The draft engagement letter noted that the adoption of this standard might have a significant impact on the financial statements and would require the restatement of the comparative period financial statements including the preparation of an opening statement of financial position.

[172] This matter was discussed at the Mako board meeting which Mr Farmer attended on 4 April 2013. The minutes record Mr McGregor's advice to the meeting that a restatement of revenue recognition for certain sales in FY12 would be required but the quantum of the likely restatement was not indicated. Any adjustment would be confirmed after the external auditors had been engaged and had reviewed the accounting assumptions previously applied. Mr McGregor advised that any restatement and adjustment of retained earnings would be reported to the board for approval in due course.

[173] Mr McGregor's advice was repeated in the minutes of the next board meeting held on 14 May 2013 but there was no further discussion or elaboration. There is no further mention of the topic in the minutes of the meeting held on 20 June 2013. Deloitte sent a planning report to the directors of Mako on 6 August 2013. This noted that revenue may be misstated because sales invoices issued and recorded may not relate to a valid sale of goods or services in the relevant period. Deloitte advised that this would be one area of focus in the audit. Deloitte was formally engaged on 8 August 2013.

[174] It appears from the evidence that the first Mr Farmer became aware of the likely extent of the required revenue restatement was when Mr McGregor copied him in on an email to Mr Weldon on 25 June 2013 attaching a "pro forma set of financials for Mako" for FY13. These accounts do not appear to have been produced in evidence, but they will have shown comparative figures restating FY12 revenue and operating

loss. Mr Farmer was not questioned about this email or the attached pro forma accounts. In any case, this email was sent to him after Mr Banks had made both of his advances under Agreement 2. There is nothing in the evidence to which we were referred that shows that Mr Farmer or the other directors were aware of the extent of the restatement required, or even that it would be materially adverse, at any time prior to these advances being made. We are therefore not persuaded that the Judge erred in dismissing this aspect of the claim.

[175] Mr Banks complains that Mr Farmer did not tell him prior to entering into Agreement 2 on 30 June 2013 that Mako was trading drastically below the projections in the PPM. However, those projections were more than two and a half years out of date by the time Agreement 2 was signed. We do not consider these projections could reasonably be relied on as providing a reliable indication of the company's actual performance in May or June 2013. Mr Farmer sent Mako's financial statements for FY12 to Mr Banks on 3 September 2012, as soon as they were available. These financial statements disclosed retained earnings of $1.6 million and total equity of $5.2 million. Those figures do not appear to be reconcilable with the November 2010 revenue forecast for FY12 of $41.5 million. Mr Banks did not state in his evidence that he understood that Mako was tracking in accordance with the projections in the PPM. We doubt he could credibly have done so.

[176] The second ground of appeal under this heading concerns whether Mr Banks was misled by Mr Farmer about the likelihood of an IPO at the time Agreement 2 was entered into. The Judge found that an IPO was "certainly a reasonable prospect" as at 30 June 2013.[48] Mr Banks contends in his notice of appeal that the Judge erred in this assessment.

[177] In addressing this part of the claim, the Judge considered that it could not be said that an IPO was not "an unattainable or unrealistic ambition" or "a forlorn or deluded aspiration".[49] However, merely because a prospect is better than unattainable, unrealistic, forlorn, or deluded does not necessarily mean it is "likely". Even the more positive finding by the Judge that an IPO was "certainly a reasonable prospect" might

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48 At [490].
49 At [667].

not justify a statement that an IPO was likely. Given this potential disconnect in the reasoning, we commence by identifying what representations were actually made and then consider whether there was a reasonable factual foundation for them.

[178] The pleaded representations concerning the intended IPO which are said to have induced Agreement 2 were made at two meetings Mr Banks had with Mr Farmer:

(a) A meeting on 30 November 2012 when Mr Farmer told Mr Banks that a public listing of Mako was *expected* to occur in 2013. Mr Farmer admitted that allegation in his amended statement of defence.

(b) A meeting on 8 March 2013 at which Mr Farmer confirmed that Mako *intended* to list on the New Zealand Exchange. Mr Farmer also admitted this allegation and it is common ground that at that meeting they discussed the need to convert Mr Banks' debt to equity on Cameron Partners' advice.

[179] The representation at the meeting on 30 November 2012 accurately reflected the directors' expectation at that time. There is ample evidence to support this, none of which was seriously challenged. Similarly, the statement of intent conveyed at the 8 March 2013 meeting was correct; that is clearly what the directors intended. This is why they had engaged with Cameron Partners to assist them with the IPO and were taking other steps to further that intention.

[180] The statement of claim makes a general and unparticularised allegation that all of the pleaded representations were misleading and deceptive, including by silence and omissions. However, the notice of appeal clarifies the basis for alleging that the representation about the IPO was misleading. Mr Banks says that Mako was advised in March 2013 that an IPO was not possible while the Telecom Rentals debt remained unpaid and there was no evidence that Mako could repay this debt or that Telcom Rentals had agreed to convert the debt to equity. In those circumstances, Mr Banks argues that there was no reasonable factual basis for any representation that an IPO was likely.

[181] The advice Mr Banks relies on was recorded in a letter from Cameron Partners to Mako dated 22 March 2013. This letter set out the terms of Cameron Partners' engagement by Mako for the intended IPO. The letter recorded that Mako was currently targeting an IPO launch (or an alternative transaction) in the second half of 2013. The first step in the process was as set out below. This makes reference to the alternative transaction envisaged if step 1 could not be completed satisfactorily:

> ***Step 1***
>
> Mako and Cameron Partners have agreed that it is not appropriate for Mako to list on the NZ stock market with any debt on its balance sheet, including the Telecom Rentals … debt of c. NZ$25 million (the "Debt"). Mako has confirmed that the existing shareholder loans will be equitised prior to the IPO. Thus, the first step ahead of any IPO process will be to address the Telecom Rentals Debt. Telecom Rentals may require any equitisation of the Debt to be conditional on an IPO of Mako taking place to provide assurance of liquidity.
>
> If Mako is unable to achieve a satisfactory outcome for Step 1, then it will need to assess its strategic options, such as raising capital privately from the international markets, or potentially a strategic sale above a reserve value. We assess that it may be challenging for Mako to raise the entire NZ$25 million from the NZ private capital markets to repay Telecom.
>
> This engagement letter assumes Step 1 achieves a satisfactory outcome and Mako proceeds with an IPO.

[182] One of the key services to be provided by Cameron Partners at step 1 in terms of the engagement was to support Mako's negotiations with Telecom Rentals. This would include preparation of a paper detailing the "Mako opportunity" to encourage Telecom Rentals to convert its debt to equity prior to or at the time of the IPO. Cameron Partners stated that they had existing relationships with the chairman, CEO and other key executives of Telecom which might assist in this process.

[183] We make three points about this letter. First, it came after the pleaded representations. Secondly, although the possibility was recognised that the intended IPO could fail at the first hurdle, there is nothing in this detailed 10-page engagement letter to suggest that the IPO Mako was actively working towards at that time was considered unlikely to succeed. Thirdly, the letter does not provide support for Mr Banks' claim that either of the pleaded representations was misleading or deceptive. On the contrary, Cameron Partners engagement letter provides support for

Mr Farmer's statements on 30 November 2012 that a listing was expected to occur in 2013, and on 8 March 2013 that an IPO was intended. That remained the position at the time Mr Banks made his advances on 14 May and 3 June 2013.

[184] We have dealt with the pleaded representations that an IPO was *expected* in November 2012 and *intended* in early March 2013. The reference to an IPO being *likely* is found in the wording of Agreement 2 itself, not in the prior pleaded representations claimed to have induced it. Agreement 2 is in the form of a letter dated 30 June 2013 signed by Messrs Farmer, Gamble and Massam as well as Mr Banks. It commences by recording the advances made by Mr Banks under Agreement 1 and stating that the two further advances on 14 May and 3 June 2013 were made on the same terms and conditions. Mr Banks' agreement to convert his debt to equity at a discounted price is then set out. This was to meet the requirement of cl 4(h)(i) of Agreement 1 which stipulated that the agreement could only be amended in writing:

> **3. Equitisation**
>
> [Mr Banks] and [Mako] wish to amend [Agreement 1] subject to clause 4(h)(i) as follows:
>
> [Mako] has indicated to [Mr Banks] that it has initiated a further capitalisation program and is likely to list on the New Zealand Stock Exchange ("NZX"). [Mako] has engaged the services of Cameron Partners ("Cameron") to assist with the capital raising. Cameron have strongly recommended that any debt currently on [Mako's] Balance Sheet is either repaid or transferred to equity prior to the NZX listing and agreed prior to the close of [Mako's] financial year end. [Mako's] financial year end is 30th June 2013.
>
> [Mr Banks] has agreed to transfer the total of advances and interest due as at 30 June 2013 in New Zealand dollars to equity in Mako upon completion of the NZX listing. As compensation for agreeing the transfer at the current stage of planning and foregoing interest until the listing [Mr Banks] will receive a discount on issue of 15%. For clarification sake, if the Prospectus share value is $1.00, [Mr Banks] will buy shares at 85c each.

[185] Mr Banks says that an IPO could not occur without agreement from Telecom Rentals to convert its debt to equity. Therefore, in the absence of any written commitment from Telecom Rentals to do so, an IPO was at best a "chance" and not "likely".

[186] Mr Farmer discussed with Mr Hamilton the possibility of an IPO as early as January 2013. Mr Johnson asked Mr Farmer about an email he received from Mr Hamilton on 23 January 2013 in which he stated "[t]he other conversation is a long shot really" and suggested this was a reference to the possibility of Telecom Rentals agreeing to convert its debt to equity in the context of an IPO. Mr Farmer rejected that proposition, adding that it would be inconsistent with the way both parties (Mako and Telecom Rentals) were conducting themselves at that time. Mr Farmer could not recall specifically but said he believed the "long shot" comment referred to another proposal, one potentially involving Telecom. The Judge made no specific finding on this point although he appears to have accepted Mr Farmer's evidence. One of the difficulties is that Mr Farmer was being asked about a discussion that took place six and a half years earlier. We are not prepared to make a finding that Mr Hamilton was conveying to Mr Farmer in this email that the prospect of Telecom Rentals agreeing to convert its debt to equity was a long shot.

[187] Mr Johnson also asked Mr Farmer about an email he sent to his contact at Cameron Partners on 1 March 2013 reporting on a discussion he had had with Telecom Rentals two days earlier. He reported that "initial feedback from their Head of Strategy was we were not a fit" but that Telecom Rentals "will continue to gently socialise the opportunity". Mr Farmer explained that this was a reference to the head of strategy at Telecom, not Telecom Rentals. Mr Johnson then asked Mr Farmer to identify the person at Telecom Rentals who was telling him at that time that they were open to a debt to equity conversion. Mr Farmer replied that it was Mr Hamilton and Mr Gasic (who was part of the Telecom Rentals management team). Mr Farmer said he took from his discussions with them that they were both positive about the prospect. In cross-examination, Mr Farmer said he considered it "probable":

> Q. So during this time your assessment of the situation was that Telecom Rentals conversion was likely to happen, not likely to happen?
>
> A. Probable, yes.
>
> Q. You thought it would probably happen because of what Mr Gasic and –
>
> A. Particularly Mr Hamilton and the representations he'd made to us about his association with, particularly the then CEO, [who] was

> Paul Reynolds and [Gen-i] how the business had grown then and his general support for Mako.

Mr Farmer said the first he knew that a debt to equity conversion was a non-starter was around October or November 2013.

[188] Having reviewed all the relevant evidence, we are satisfied the Judge was entitled to conclude that Mr Farmer genuinely believed that an IPO was likely at the time Agreement 2 was signed. Further, there was sufficient evidence to justify the Judge's conclusion that this belief was a reasonably held one. In summary, we are not persuaded we should interfere with the Judge's finding that Mr Banks had not proved his claims of misleading or deceptive conduct prior to Agreement 2.

[189] We also accept Mr Hollyman's submission that the representation concerning the intended IPO would not have altered Mr Banks' decision to enter into Agreement 2. In cross-examination, Mr Banks stated:

> When making investments 2 and 3 I had in my mind the possibility of an IPO, that certainly motivated me but it was never more than a bonus, given how complex IPOs are no one can guarantee when they are going to happen. I never banked on that happening. It was just, it was a nice addition ...

Representations prior to Agreement 3

[190] Mr Banks paid a further $500,000 to Mako on 24 April 2014. Receipt of these funds was acknowledged by Mr Farmer in an email sent that day. No formal agreement relating to this payment was ever signed.

[191] Many significant developments, some positive and some negative, occurred in the 10-month period between the completion of Agreement 2 and this further advance. Mr Banks was generally made aware of these through his email correspondence and meetings with Mr Farmer. The more significant negative developments included:

(a) The IPO was deferred following receipt of the Weldon report — October/November 2013.

(b) Telecom Rentals did not make an anticipated payment of $5 million — November 2013.

(c) Mr Farmer's family trust, Mr Gamble, Mr Frederick and other shareholders needed to advance $1.1 million to cover short-term cash requirements — November/December 2013.

(d) Telecom Rentals formally suspended all further advances pending the report from KordaMentha — 27 December 2013.

(e) Approximately half of the company's research and development, operations, and administrative personnel were laid off — December 2013/January 2014.

(f) Telecom Rentals' debt was restructured and the SecureMe business in New Zealand was sold — 7 February 2014.

[192] There were also some positive developments during this period, including:

(a) Spacenet business partner agreement — 28 August 2013.

(b) Sprint teaming agreement — 18 September 2013.

(c) Telstra Corporation procurement and reseller agreement — 11 February 2014.

[193] The possibility of Mr Banks making a further advance to Mako was first discussed in mid-November 2013, after Telecom Rentals withheld further funding. Mr Banks sent an email to Mr Farmer on 15 November 2013 advising that he did not have any mortgages and would be happy to provide Mako with liquidity if that were ever needed. He said, "I know you said you don't need this but I just wanted to remind you that I'm here to do whatever little I can for Mako" (quoted in full at [94]). After Mr Farmer asked on 18 November 2013 what level he would "feel comfortable with", Mr Banks advised two days later that he would consider $1 million if this could be converted to equity at a discount of 16 per cent, or $2 million if the discount was 20 per cent.

[194] The matter was discussed further at a meeting between the two of them on 29 November 2013. Mr Farmer said he advised Mr Banks that all the directors, including himself and his family, had introduced further funds into Mako to help keep the business going. Mr Farmer said he was "very frank" with Mr Banks that the situation was "very challenging" and there was "a possibility we might lose all our money". Mr Farmer was not challenged on this evidence in cross-examination. Despite knowing this, Mr Banks expressed interest in making a further advance himself to assist Mako.

[195] Given the uncertain position regarding Telecom Rentals, Mr Farmer wrote to Mr Banks on 24 December 2013 asking him to "hold off" on transferring any funds to Mako in the interim. He said he would come back to him when the company was in a position to accept any further investment.

[196] Mr Banks was sent a copy of the letter Mr Farmer wrote to all shareholders on 5 February 2014 regarding the Telecom Rentals debt restructure (quoted at [100] above) and proposing an urgent special meeting to approve the transaction. This letter referred to the "challenging time" faced by the board and management following the "severance of funding" from Telecom Rentals which "support[ed] the business" and advised that the directors had been required to address options "on literally a daily basis" as "cash reserves [had] been depleted".

[197] After receiving that letter, Mr Banks sent his email of 19 February 2014 (quoted at [105] above) saying it was "a shame that we had to panic-sell that business chunk" and asking whether capital raised in the IPO would eliminate reliance on a credit provider. Mr Banks met with Mr Farmer on 4 March 2014. The discussion included whether Mr Banks might convert his advances to equity and become a shareholder in Mako. The following day, Mr Farmer sent Mr Banks a copy of a shareholders agreement and asked him to review it "in anticipation of going down that track". Mr Farmer said he thought the best option for Mako would be for Mr Banks to become a shareholder.

[198] The draft shareholders agreement summarised the background and objectives in the recitals:

BACKGROUND

A. The Shareholders are all the shareholders of the Company and wish to enter into a shareholder's agreement to:

(i) safeguard their interests in the Company (whether as minority or majority shareholders), protect the value of the Company, and provide flexibility for the Company to develop its business;

(ii) ensure they benefit from the Company's business in proportion to their shareholdings and respective contributions; and

(iii) confirm they will exercise their rights, and perform their responsibilities, in a manner conducive to the orderly operation of the Company's business and to maximise value for the benefit of all Shareholders.

B. The Shareholders, Key Persons and Company now enter into this Agreement to record their mutual rights and obligations in respect of the Company and its business.

[199] The existing shareholders, including the number of shares held, were listed in schedule 1 of the agreement. These were the same 10 shareholders as recorded in the 30 June 2010 financial statements and were current at the time Mr Banks first became involved in Mako.

[200] Clause 6.2 of the draft shareholders agreement addressed the likely need for the company to raise further capital but made no specific reference to an IPO:

6.2 Further investment and capitalisation

The Shareholders agree and acknowledge that:

(a) the growth of the Company's business may require funding beyond the resources of the Shareholders, and that the Company may, as appropriate, solicit third party investment by way of new share issues (including preferential and redeemable shares) or other financing sufficient to meet the Company's needs;

(b) further capital raising may dilute their current shareholdings (including voting and dividend rights) and lessen their relative benefits in relation to the Company; and

(c) If 75% of the Shareholders agree, new shares do not have to be offered to existing Shareholders first in proportion to their shareholdings (as might otherwise be required under section 45 of the [Companies Act]).

[201] Mr Banks replied to Mr Farmer by email on 8 March 2014, saying:

> The agreement looks good. Let's do this when you're ready.

[202] In the meantime, on 7 March 2014, Mr Farmer sent an email to Mr Frederick, copied to Messrs Gamble, Massam and Monks (the main shareholders), with a proposed share allocation for all people who had introduced funds or provided services to Mako and who were thought to be willing to accept payment by the issue of shares. Mr Banks was at the top of this list with cash contributed recorded as $3.073 million. Other cash contributions by the directors in December 2013 were shown, including $375,000 from Mr Gamble, $240,964 from Mr Frederick and $202,654 from Mr Farmer. Salary foregone was also listed, including $246,154 for Mr Farmer, $96,578 for Mr Frederick (director's fees) and $86,340 for Mr Sidorenko of Norcal. In each case, the proposal was to allocate additional shares pro rata to recognise these contributions.

[203] On 16 March 2014, Mr Farmer sent existing and proposed shareholders a table showing the indicated shareholdings. Mr Farmer asked all recipients to check the details and confirm their accuracy or otherwise. Mr Banks was shown as the fifth largest shareholder, to be the holder of a total of 1,536,500 shares at $2 per share. This would represent approximately six per cent of the total shareholding of just over 25 million shares.

[204] Mr Banks replied on 16 March 2014 expressing second thoughts. We have already quoted this email and the further exchanges through to 18 March 2014 at [108]–[110] above. It appears that Mr Banks' main concern at this time was to preserve the benefit of the agreed debt increase (10 per cent per annum) which ceased by agreement on 30 June 2013. He said he would prefer his shares to be held in the name of Beta Trust, as he did not want his name to appear on any public document.

[205] As noted, Mr Banks advanced a further $500,000 on 24 April 2014, evidently on the existing terms and in the expectation that he would become a shareholder at some stage. However, the terms of the advance were never documented.

[206] In rejecting Mr Banks' claim that he was induced by misleading or deceptive conduct in making this further advance (Agreement 3), the Judge concluded it was "inconceivable that Mr Banks was not fully aware of Mako's situation". However, the Judge accepted that Mr Banks still believed an IPO was possible.[50]

Submissions

[207] In his notice of appeal, Mr Banks challenges this finding on three bases:

(a) First, he contends that the Judge erred in the same respects relied on in relation to Agreement 2, namely Mr Farmer did not tell him that Mako's FY12 accounts required material restatement or that Mako had granted security to Telecom Rentals. He also repeats that it was misleading for Mr Farmer to represent to Mr Banks that an IPO remained likely.

(b) Secondly, he says the Judge erred in not finding it was misleading for Mr Farmer not to disabuse Mr Banks of his understanding in February 2013 that if he advanced $500,000 it would be as safe as his existing advances were six months' earlier (a reference to Mr Banks' email on 19 February 2014 quoted at [105] above).

(c) Thirdly, he claims the Judge erred in not finding it was misleading for Mr Farmer not to tell him that an agreement with Sprint was unlikely and that this would have a material adverse impact on Mako's future prospects.

Analysis

[208] We have already addressed the first of these grounds — restatement of FY12 accounts and security granted to Telecom Rentals — and need not say anything further other than to note that any such representation could not reasonably have remained operative at the time the final advance was made in late April 2014.

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50 At [675].

[209] It appears that Mr Banks was still expecting an IPO at the time he sent his email to Mr Farmer on 19 February 2014. However, we are not persuaded that the Judge was wrong to conclude that Mr Farmer did not mislead Mr Banks about this. It is unclear from Mr Banks' email where or when he expected this IPO might occur. He knew that the IPO earlier planned to occur in New Zealand in 2013 had not been able to proceed. He also knew about the Telecom Rentals debt restructure and the sale of the SecureMe business and that Mako was now focusing on business opportunities in overseas markets. Mako was not at that stage pursuing an IPO with Cameron Partners or anyone else and there was no reference to this prospect in the draft shareholders agreement sent to Mr Banks. Nor was there any other evidence to indicate that Mr Farmer led Mr Banks to think that an IPO was on the immediate horizon at that stage, contrary to the true position. Mr Banks must have known that any IPO could not occur until after Mako's constrained financial position could be turned around. Even before Telecom Rentals withdrew funding in late 2013, he was aware that any IPO had to be deferred for an indefinite period. We have already quoted at [91] Mr Banks' email following his meeting with Mr Farmer on 23 October 2013 saying "I have the feeling that we're going to be chuffed in about 5y. I'm now a lot clearer re the benefit of waiting longer for the float".

[210] The second ground — Mr Banks' expressed "hope" that his further advance would be "as safe as his existing [advances]" — did not feature in any of the 65 paragraphs of the second amended statement of claim which set out the alleged misrepresentations said to have induced Agreements 1, 2 and 3. Nor did it find its way into the list of 53 alleged misrepresentations set out in appendix 1 to the Substantive judgment. There is no reference to it in the section of the judgment where the misrepresentations claimed to have induced Agreement 3 were discussed. In these circumstances, we are not prepared to entertain what would in effect be a new claim of misleading and deceptive conduct arising out of Mr Banks' comment in this email which was not responded to or discussed.

[211] We turn to the third ground, that Mr Banks ought to have been told that Mako was unlikely to be able to complete an agreement with Sprint. The relevant section of the second amended statement of claim refers to two emails concerning Sprint. The first was from Mr Farmer on 24 June 2013 in which he advised Mr Banks:

> Last week we completed a contract with Bulls[E]ye Telecom in the US and they already have their first customers lined up. We also got the first full version of a product supply agreement with Sprint. They too have their first customers lined up but it may take another 30-45 days to finalise the contract.

[212] The second was an email on 5 November 2013 attaching the three-page news release announcing the teaming agreement between Mako and Sprint headed "Sprint and Mako Networks to Offer Simple, Secure PCI-compliant Solution for U.S. Businesses | Sprint Newsroom".

[213] Mr Banks contends in his notice of appeal that the Judge ought to have found that the representations made in these emails amounted to misleading and deceptive conduct. In particular, he says the Judge ought to have found that Mr Farmer misled him by failing to advise that an agreement with Sprint was unlikely and that this would have a material impact on Mako's future prospects.

[214] There is no doubt that the statements of fact contained in these two emails were correct at the time they were sent. The "product supply agreement" with Sprint referred to in the 24 June 2013 email appears to be a reference to the teaming agreement that was later executed with an effective date of 23 July 2013 (signed by Mr Gamble on that date and by Sprint on 18 September 2013). The 5 November 2013 email simply attached the Sprint news release announcing this teaming agreement.

[215] In November 2013, Mako commenced discussions with Sprint about a productisation agreement, which would be a step up from the teaming agreement. On 14 January 2014, Mr Gamble provided a brief on the background and current status of Mako's relationship with Sprint that Mr Farmer passed on to KordaMentha. Mr Gamble noted that Sprint was the third of the big three carriers in the United States behind Verizon and AT&T. Sprint wished to deliver networking solutions to their many distributed enterprise customers in competition with these two main rivals and Mako offered a superior solution. Mr Gamble reported that he had been invited to pitch to senior Sprint management at its headquarters in Kansas City in December 2013. He was told that Sprint had committed internally to getting Mako "productised" by the end of March 2014 and selling 15,000 units by the end of that calendar year. On 8 January 2014, Mr Christopher Callender, the Sprint senior product manager, advised that they were likely to commit to 50,000 units over two years with

an initial order which Mr Gamble anticipated would be for 5,000 units and associated licences. Mr Callender indicated that Sprint was still on track to have the process completed before the end of March.

[216] The draft terms exchanged with Sprint provided for upfront payments of USD347 per unit of hardware and USD504 for a three-year licence. The initial payment for 5,000 was therefore expected to be USD4,255,000. The minimum two-year commitment of 50,000 would produce revenue of USD42.5 million.

[217] The first indication of a potential issue with Sprint funding the upfront payment commitment appears to have been late March or early April 2014. Mr Gamble sent an email to Mr Callender on 3 April 2014:

> Further to our discussion last week there are matters that Mako need to be sure of as we go into the contract finalization stage.
>
> As previously discussed, Mako is a hi-growth new US market entrant and as such does not have the balance sheet to fund financing of Sprint's requirements. The pricing that we have submitted reflects this and Sprint performing that obligation. Should you require us to introduce a financier we have identified a few that have indicated an interest in performing this function but they will need to be party to the negotiations as they will be financing Sprint not Mako. Can you please confirm for me which path Sprint will be pursuing so I can make any necessary arrangements.
>
> Further to this, your sharing of projections last week is really appreciated. In fact this will be an essential element of ensuring ongoing timely supply of the hardware given the management of long lead-time components. We are currently preparing to gear up for the original 5,000 unit order and the earlier we can confirm this the better we will be placed to ensure product arrives in an appropriate time frame. Given all the sales opportunities, it seems prudent to have product sooner rather than later.
>
> I'm very much looking forward to getting through the contract phase and into the exciting time that awaits.

[218] The Mako board minutes of the 9 April 2014 meeting note this issue and the expectation that the need for Sprint to obtain third party funding was likely to delay the launch until June.

[219] Mr Gamble reported to Mr Farmer and others on 12 April 2014 following his discussion with Mr Callender and the person he reported to, Mr Scott Smeltzer. Mr Smeltzer advised that Sprint's projection was 4,000 units for the current calendar

year and asked whether the upfront order of 5,000 units could be dropped to 4,000. He also asked what Sprint would have to pay if the initial order was for 4,000 units, to which Mr Gamble replied USD3.404 million. Mr Callender explained that they would need to obtain sign off from senior executives and asked for further information to assist them in their presentation to the senior executives to secure financing and with a view to obtaining response the following week. Mr Gamble concluded by reiterating the benefits of the Mako offer.

[220] On 26 April 2014, two days after Mr Banks' funds were received, Mr Gamble emailed Mr Farmer updating him on recent developments with Sprint. His email was in the form of a draft update to be sent to all board members. He advised that, contrary to indications given by Mr Callender in December 2013 and the terms that had been discussed since January 2014, Mr Callender had now told him that Sprint was either unwilling or unable to buy product in bulk upfront. Third party lenders, including Wells Fargo, were not prepared to provide the required financing to Sprint over a three-year term because of their concerns about Sprint's long-term outlook. They said they had no such concerns about financing Mako's other customers such as Chevron, or about Mako's product.

[221] There is no mention of any discussion or other communication with Mr Banks about the negotiations for a Sprint productisation agreement in appendix 1 to the Substantive judgment. Mr Banks' brief of evidence suggests the first time he heard about this agreement was when he met with Mr Farmer on 3 September 2014. It is hard to see how Mr Banks could have been misled about this transaction inducing his last advance on 24 April 2014 when he did not even know about it at that stage. Mr Farmer first heard from Mr Gamble about the inability of Sprint to fund the purchase around 26 April 2014. The other directors did not know about it until a short time later.

[222] For the reasons given above, we have concluded that the appeal in respect of the FTA claims must be dismissed. We are not persuaded the Judge was wrong to conclude that the conduct complained of was not misleading or deceptive. It is therefore not necessary to consider whether such conduct was causative of Mr Banks'

losses or whether Messrs Gamble and Massam should have been found additionally liable as accessories.

Companies Act claims

Section 135 — reckless trading

Legal principles

[223] Section 135 of the Companies Act provides:

> **135 Reckless trading**
>
> A director of a company must not—
>
> (a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

[224] The meaning of this provision must be ascertained from its text and in the light of its purpose and its context.[51] The preamble states that the purposes of the Companies Act include to reaffirm the value of the company as a means of achieving economic and social benefits through the aggregation of capital for productive purposes, the spreading of economic risk, and the taking of business risks. Another purpose is to encourage efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgment while at the same time providing protection for shareholders and creditors against the abuse of management power.

[225] The difficulties with a literal wording of s 135 are well known.[52] However, it cannot have been Parliament's intention to inhibit directors from taking legitimate business risks, including the pursuit of opportunities that may involve high risk but have the real potential for commensurately high returns.[53] Many successful companies

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51 Legislation Act 2019, s 10(1).

52 See for example *Re South Pacific Shipping Ltd (in liq)* (2004) 2 NZCCLR 8 (HC) at [128].

53 *Yan v Mainzeal Property and Construction Ltd (in liq)* [2021] NZCA 99, [2021] 3 NZLR 598 at [253] and [261].

that have created significant wealth commenced as relatively high-risk start-ups. The Supreme Court observed in *Debut Homes* that this is one of the main concerns with the wording of s 135.[54]

[226] The s 135 duty is forward-looking and focuses on the risk of loss to creditors from the manner of trading — not to allow the business to carry on in a manner likely to create a substantial risk of serious loss to the company's creditors. The duty is owed to the company rather than to any particular creditor and the test is objective.[55] The words "in a manner" are broad in scope and would capture, for example, a failure to maintain adequate accounting and other business records such that the directors are effectively "flying blind". However, directors do not themselves have a duty to provide or procure additional capital where a company becomes insolvent.[56]

[227] The Supreme Court made it clear in *Debut Homes* that where a company is insolvent and the directors know that the financial position is unsalvageable, continued trading will inevitably constitute a breach of s 135 even where the overall deficit would be reduced.[57] On the other hand, where a company is facing insolvency but the position appears to be salvageable, the directors will not be in breach of s 135 by continuing to trade if they address the reasons for the insolvency and implement appropriate strategies to restore the company's financial position.[58] The probability of salvaging the position must be weighed against the risk of serious loss to creditors that may result from an immediate cessation of trading. William Young J's observations in *Re South Pacific* are worth repeating:[59]

> No one suggests that a company must cease trading the moment it becomes insolvent (in a balance sheet sense). Such a cessation of business may inflict serious loss on creditors and, where there is a probability of salvage, such loss can fairly be regarded as unnecessary.

[228] In *Mainzeal*, this Court summarised the overall question under s 135 as being whether the business of the company is being carried on in a manner that is more likely

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54 *Madsen-Ries (as liquidators of Debut Homes Ltd (in Liq)) v Cooper* [2020] NZSC 100, [2021] 1 NZLR 43 at [69].
55 *Fatupaito v Bates* [2001] 3 NZLR 386 (HC) at [66]–[67].
56 *Sojourner v Robb* [2007] NZCA 493, [2008] 1 NZLR 751 at [24].
57 *Debut Homes*, above n 54, at [70] and [174].
58 *Re South Pacific Shipping Ltd (in liq)*, above n 52, at [150].
59 At [125].

than not to create a large or significant risk of a serious loss to the company's creditors.[60] This Court observed that where a company is insolvent or on the verge of insolvency, directors may face perverse risk-taking incentives in that the downside risk of continued trading is borne by the creditors but any upside gain will accrue to the shareholders who appoint the directors or who, particularly in small companies, may also be directors (often with exposure under personal guarantees).[61] One of the purposes of s 135 is to protect creditors from the consequences of illegitimate risk-taking by directors who yield to these types of perverse incentives.[62] Two broad types of harm that may be caused by directors continuing to trade if the company that is either insolvent or near insolvent were identified. The first is harm to existing creditors who would have received more in an earlier liquidation. The second is harm to new creditors who would not have been exposed to the company if it had been placed in liquidation earlier.[63]

[229] This Court provided guidance in *Mainzeal* on how directors should respond where a company is facing insolvency:[64]

> (a) The directors must squarely face up to that financial situation and assess the risk of a serious loss to creditors.
>
> (b) If continuing to trade in a "business as usual" manner is likely to create a significant risk of serious loss to creditors, trading on in that manner is not permitted.
>
> (c) A decision to trade on should be made only after undertaking a sober assessment of the likely consequences of doing so. Unfounded optimism is not enough.
>
> (d) A decision to trade on, rather than take immediate steps to cease trading, is likely to breach s 135 unless the manner in which the directors choose to trade on has realistic prospects of enabling the company both to service pre-existing debt and to meet the new commitments which such trading will inevitably attract. It is not enough that there is a realistic prospect that existing creditors will be paid by substituting new creditors, who in turn will face a substantial risk of serious loss. Section 135 does not condone a policy of robbing Peter to pay Paul, on condition that Peter's losses are exceeded by Paul's gains.

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60 *Mainzeal*, above n 53, at [260].
61 At [231].
62 At [261].
63 At [233].
64 At [269].

Substantive judgment

[230] The Judge found that the directors breached their duties under s 135 from late April or early May 2014 when they ought to have realised that successfully concluding the Sprint deal was unlikely.[65] Had the Sprint deal materialised, which up until then the directors reasonably believed was imminent, Mako would have had sufficient funds to meet its obligations, including to Telecom Rentals and to Mr Banks.[66]

[231] The Judge's reasons for rejecting the claim for the prior period, from December 2013 to the failure of the Sprint deal in late-April to mid-May 2014, may be summarised as follows:

(a) Mako was never balance sheet insolvent applying appropriate valuation multiples to its historical and projected revenues.[67]

(b) Mako became cashflow insolvent when Telecom Rentals withdrew its funding facility in December 2013.[68]

(c) It was nevertheless appropriate to continue to trade in the short period from then until early February 2014 while the Telecom Rentals debt was renegotiated and restructured.[69]

(d) The restructure provided Mako with $5 million in cash and a debt holiday for two years.[70]

(e) Two of Mako's principal creditors, Telecom Rentals and GPC (a product supplier to Mako in the United States), were aware of Mako's position and supported the decision to continue trading.[71]

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65 Substantive judgment, above n 2, at [439].
66 At [452].
67 At [401].
68 At [403].
69 At [408]–[418].
70 At [426].
71 At [424].

(f) Until 26 April 2014, there was a reasonable and legitimate expectation that a binding agreement with Sprint on the terms discussed (including the minimum commitment of USD42.5 million of revenue in the first two years) was imminent.[72]

(g) There were other promising opportunities being actively pursued at the time, including with BullsEye, Phoenix, and Telstra.[73]

Submissions

[232] Mr Johnson says the group had negative shareholder funds from June 2012 at the latest. He submits that at all times after 28 June 2013, when Mako guaranteed the Telecom Rentals debt, it was balance sheet insolvent, and the respondents should have caused the company to cease trading. Even taking the most favourable view, the existing facility from Telecom Rentals would be exhausted within 12 months. This funding was expensive and not fit for purpose. It was clear that alternative funding was needed quickly and the arrangement with Telecom Rentals was "a roadblock". Despite this, Mr Johnson contends that the respondents adopted a business as usual approach without confronting the "crippling" funding issue. While the June 2013 restructure with Telecom Rentals enabled Mako to continue trading, it was not appropriate to do so. Because Mr Banks was the only material creditor of Mako, its guarantee of the Telecom Rentals debt put him at substantial risk of serious loss.

[233] By November 2013, Mr Weldon had advised the respondents that the capital structure was highly risky, if that was not already obvious. The respondents were also aware by then of the extent of restatement required to the FY12 accounts and the substantial negative equity disclosed by the FY13 accounts audited by Deloitte. Mr Johnson says that at this point, Telecom Rentals had "iced" the prospect of a debt conversion, putting an IPO in serious doubt.

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72 At [429] and [435].
73 At [433].

[234] Mr Johnson submits it was even clearer by January or February 2014 that the company should have ceased to trade. Mr Frawley had resigned. The respondents knew they were at risk of breaching their obligations under the Companies Act. Mr Johnson submits that the minutes of the 18 January 2014 board meeting disclose that the respondents' decision to trade on closely matched the director's decision-making in *Debut Homes* that was found by the Supreme Court to be impermissible. Mr Johnson relies in particular on the following extract from the minutes of this meeting:

> Directors considered the prospects of the investment proposal succeeding, the outcome was highly uncertain, however, if successful the solution could potentially see the business achieve its potential targets and be in a position to eventually settle [Telecom Rentals'] debt.

[235] While the Telecom Rentals debt restructure in February 2014 allowed Mako to continue to operate, that does not mean it was appropriate to do so. Mr Johnson says the restructure did not address Mako's ability to fund future growth and did nothing more than delay the inevitable. He submits the Judge was wrong to conclude that Telecom Rentals supported the decision to continue to trade.[74] He notes that the Judge stated two paragraphs earlier:[75]

> … it should not be inferred that Telecom Rentals' decision to restructure the debt rather than wind Mako up reflected a significant degree of confidence in Mako's ability to trade out of its difficulties.

Mr Johnson notes that the 11 March 2014 Mako board minutes confirm that it was only the prospect of disruption to the SecureMe service that led Telecom to the view that receivership was not the preferred option.

[236] For these reasons, Mr Johnson submits the Judge was in error in concluding that s 135 was not breached prior to late April or early May 2014. He says the directors breached their obligations under s 135 by mid-2013 at the latest.

[237] Mr Hollyman supports the Judge's analysis. He says Mr Banks' argument that Mako ought to have ceased trading in mid-2013 is based on his contention that it was balance sheet insolvent at that time. However, Mr Hollyman submits that the Judge

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74 Substantive judgment, above n 2, at [424].
75 At [422].

was entitled to accept the evidence of Mr Shane Hussey, a forensic accountant called by the directors, which was supported by the Norcal report, that Mako was balance sheet solvent at the relevant times. Mr David Bridgman, a corporate finance expert called by Mr Banks, accepted that Mako's prospects were relevant to the company's balance sheet value. Mako had recently signed contracts with Chevron and BullsEye in addition to its existing contracts and it appeared likely to secure other significant contracts in the United States. The company was working towards listing on the NZX and had secured a $35 million funding facility with Telecom Rentals. Mr Banks himself endorsed Mr Frawley's actions throughout as being prudent and reasonable. That suggests he does not criticise the directors for allowing the company to continue to trade until Telecom Rentals formally withdrew its funding in late December 2013, leading to Mr Frawley's resignation at that time. Mr Hollyman submits that the directors would likely have been in breach of their obligations under s 131 of the Companies Act (to act in good faith and in the best interests of the company) if they had resolved to put the company into liquidation just after it had executed significant contracts in the United States and while its advisers were preparing for an IPO.

[238] Mr Hollyman submits that the position remained unchanged until about November 2013. It was only then that the directors knew there was no reasonable prospect of Telecom Rentals agreeing to equitise its debt and an IPO was therefore unlikely in the near term. When Telecom Rentals suspended further funding pending the KordaMentha review, the directors reacted appropriately in accordance with their duties, including by laying off half of its development, administrative and operational staff, obtaining legal and insolvency advice from respected advisers, and personally advancing further funds to ensure the company could survive in the short-term until negotiations could be completed with Telecom Rentals.

[239] The debt restructure resulted in Mako receiving $5 million in cash, comprising a further advance of $2 million and $3 million from the sale of the New Zealand operations. It also meant that its debt repayment obligations to Telecom Rentals were suspended for two years. The company was therefore well positioned to take advantage of the significant opportunities available to it, including the Sprint deal that was expected to be worth USD42.5 million over a two-year period. In the meantime, the Mako system was being rolled out to thousands of Chevron sites in the

United States. Mr Hollyman submits that the directors carried out a realistic assessment of Mako's prospects and made a reasonable business decision to trade on.

Analysis

[240] For the reasons that follow, we consider the Judge was correct to dismiss the claim that the directors breached their obligations under s 135 by allowing the company to continue to trade in the period until Telecom Rentals suspended funding in November/December 2013. We deal with this period first.

[241] There was no dispute between the experts, Mr Hussey for the directors and Mr John Fisk, an experienced insolvency practitioner called by Mr Banks, that Mako was cashflow solvent at least until Telecom Rentals withdrew funding support in November/December 2013.[76] Mr Hussey considered that Mako was balance sheet solvent throughout. Mr Fisk's opinion was that Mako became balance sheet insolvent when it accepted liability for the debt to Telecom Rentals on 28 June 2013. However, Mr Fisk acknowledged that he did not take account of the enterprise value in reaching this assessment and left that topic for Mr Bridgman to address. All experts agreed that the enterprise value is relevant to the question of balance sheet solvency. However, none of them carried out a valuation of Mako or the group. We see no reason to disturb the Judge's finding that Mako was balance sheet solvent during this period. It was also cashflow solvent.

[242] It seems clear that Mako had successfully developed and patented an innovative, class-leading product that had huge earning potential. There is ample evidence of this including the company's early successes with major enterprises locally and in global markets (such as Telecom, Ministry of Health, Fonterra, NetComm, Phoenix, Chevron, BullsEye and Aperia). The Norcal market assessments supported the directors' reasonable belief in the competitive advantage of the Mako offering and the scale of the market opportunity. Telecom Rentals, a sophisticated and informed market participant, was sufficiently impressed with the quality of Mako's

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[76] Mr Fisk stated in his brief of evidence that from at least December 2013 the group, and consequently Mako as a result of its contingent liability to Telecom Rentals, were cashflow insolvent. However, in the joint statement of experts, he stated that Mako became cashflow insolvent in October 2013. The difference between these dates is immaterial to the claims.

product and its commercial potential that it was prepared to assist in funding its growth by advancing over $25 million to the company.

[243] While the company consistently lacked sufficient capital to exploit the market potential of its product effectively, the directors recognised this and pursued reasonable strategies to raise the additional capital needed to continue trading and fund its growth, including by engaging appropriate professionals to assist with an IPO. Cameron Partners was initially enthusiastic about the prospects of Mako launching a successful IPO in 2013. We agree with Mr Hollyman that the directors could have been vulnerable to criticism (including from Mr Banks) had they made the decision to cease trading while those preparatory steps to raise significant capital were being taken in accordance with Cameron Partners' recommendations and in the light of Norcal's reports.

[244] The Weldon report, which followed due diligence, provided the directors with a clear-eyed expert appraisal of Mako's situation in October 2013. Far from suggesting the company was in an unsalvageable position and should cease trading immediately, Mr Weldon and Ms McGowan considered that an increase in the value of the company of between $50 million and $100 million was "likely" if the next 12 to 18 months could be navigated successfully. However, to achieve this, they considered that various weaknesses in the business, including its inadequate capital structure, would need to be addressed urgently. The authors made the obvious point that no company "can survive for an extended period" with inadequate capital as this "will eventually throttle growth, control, flexibility and profit". It seems to us that the directors were not in breach of their obligations under s 135 by allowing the company to continue trading at that stage. The company required careful ongoing stewardship, but simply giving up and inviting the appointment of receivers or resolving to go into liquidation would not appear to have been a sensible response by the directors to Mako's situation at that stage.

[245] The position changed dramatically for the worse when Telecom Rentals suddenly withdrew its ongoing funding support in November/December 2013. The directors were then faced with a difficult choice. One option was to cease trading immediately. This would inevitably cause serious loss to creditors, including

Telecom Rentals and Mr Banks, and forego the major upside potential confirmed by Mr Weldon and Ms McGowan, and others. The alternative was to hold the position for a short period at least until negotiations could be concluded with Telecom Rentals thereby enabling an assessment of future options once the position had crystalised. We agree with the Judge that the course followed by the directors was reasonable. They immediately made significant cuts to expenditure, including by laying off a large number of staff. The evidence indicates that with the possible exception of Mr Massam, the directors did not take salaries or directors' fees and personally made cash contributions to ensure the company's short-term cashflow requirements were met. These steps gave some breathing space to enable the company's sole secured and largest creditor the opportunity to assess its options in the light of KordaMentha's report and determine the company's fate. There is no evidence of a net deterioration in the company's financial position during this period.

[246] Mr Gamble was probably better placed than anyone to be able to make a realistic assessment of Mako's prospects of trading its way out of the difficulties it faced given the opportunities available at that time, particularly in the United States. Any suggestion that the directors were recklessly or unreasonably gambling with creditors' money on the threshold of insolvency needs to be considered in the context of his decision to invest his (and his wife's) entire life savings of $375,000 at that time. Messrs Farmer and Frederick also invested substantial monies at this time, despite having no obligation to do so. This does not necessarily mean that they were not in breach of their duties, but the fact these informed insiders were willing to commit their own capital demonstrates their collective confidence in the company's positive outlook and tends to suggest that their decision to allow the company to continue trading in the interim was reasonable based on the information then available.

[247] We place no weight on the fact that Mr Frawley chose to resign as a director on 29 December 2013. That was his choice, but it does not follow that the remaining directors breached their duties by deciding not to request Telecom Rentals appoint receivers at that stage or resolve to place the company in liquidation. Mr Frawley did not suggest that either of these steps should be taken. On the contrary, he stated it was crucial that the board develops a good rapport with KordaMentha as their report would likely determine the type of support, if any, the company would receive from

Telecom Rentals going forward. He said the ideal situation would be for Telecom Rentals to agree to a debt for equity swap as that would reopen the door to an IPO. He recommended that the board consider what to do if Telecom Rentals declined to support Mako and suggested the options would include a sale of some of the company's equity to a venture capital firm, a sale of whole or part of Mako's business as a going concern, or administration or liquidation in the event Telecom Rentals declined to provide any assistance. Mr Frawley did not suggest that Mako should cease trading pending KordaMentha's report and he concluded his resignation letter by saying:

> … I hold all of the Board members and in particular [Mr Farmer] in the highest regard. I also think that the company has huge potential and with the right partner(s), strategy and structures it should achieve it.

[248] We do not accept Mr Johnson's submission that the minutes of the board meeting held on 18 January 2014 show that the directors' decision to trade on closely matched the director's decision in *Debut Homes*. The director's decision to trade on in that case breached s 135 because the Supreme Court found that he knew the company's position was unsalvageable. It was not open to the director to conduct his own form of administration or liquidation.[77] The position faced by the directors of Mako at the 18 January 2014 board meeting is not comparable. They considered Mako's situation was salvageable, but this depended on whether Telecom Rentals as the secured creditor was prepared to support continued trading or decided to appoint receivers. With expenses having been trimmed, there was sufficient cash on hand to fund continued trading until 20 January 2014, pending the expected completion of negotiations with Telecom.[78]

[249] On 29 January 2014, Mr Mark Laing, general manager of corporate finance at Telecom, wrote to Messrs Frederick and Farmer confirming that Telecom was prepared to provide Mako with an emergency liquidity facility of up to $750,000 to enable continued trading in the interim. He concluded this letter by stating:

> The Mako board should have no doubt that Telecom management is committed to working with Mako to assist it in finding a solution that allows

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77 *Debut Homes*, above n 54, at [70] and [76]–[77].

78 The minutes of the board meeting held on 10 January 2014 indicate that re-worked cashflow projections were considered. These showed that trading could continue until 25 January 2014.

> Mako to continue to trade and provide services in New Zealand while it seeks new investment capital in order to develop its business and which will also allow Telecom to achieve repayment of its considerable existing debt.

[250] The investment proposal referred to in the 18 January 2014 board minutes involved the prospect of a capital injection of at least $10 million by 22 potential investors (including four arranged by Mr Tingey). The money would be advanced in cash but would convert to equity at a significant discount on a subsequent capital raising through an IPO. This would provide sufficient capital to fund the business until an IPO could be launched later that year, likely in August. It needs to be kept in mind that this was before the Telecom Rentals debt was restructured, the debt holiday agreed, and the additional cash received. The extract Mr Johnson relies on (emphasised in italics below) forms part of a wider discussion recorded in the minutes as follows:

> Mr Tingey of Bell Gully joined the meeting. Mr Farmer asked for clarification of directors responsibilities and liabilities should the investment proposal be adopted.
>
> Mr Tingey explained that when a company is in financial trouble the directors could be personally liable for the incremental liabilities incurred [if the company should have] ceased trading. Effectively incurring liabilities when there is not a valid belief they can be met or an illegitimate business risk is taken knowing the business should have ceased.
>
> The liability in question is not the total debt of the company it is the incremental liabilities incurred from the time the company should have ceased trading. …
>
> …
>
> Mr Tingey gave a brief update on investors he had approached [and] would be able to provide feedback by Tuesday.
>
> Mr Tingey left the meeting.
>
> The directors turned their minds to forming a view with knowledge of the legal ramifications outlined by Mr Tingey.
>
> The proposed actions were considered in the best interests of the creditors as immediately ceasing trading would be destructive to value and could potentially disrupt Telecoms SecureMe service (without a satisfactory plan of action).
>
> The investment proposal if successful would clearly be the best result for the company and its creditors.

> *Directors considered the prospects of the investment proposal succeeding, the outcome was highly uncertain however, if successful the solution could potentially see the business achieve its potential targets and be in a position to eventually settle* [*Telecom Rentals'*] *debt.*
>
> The Chairman tabled a resolution to proceed with the investment proposal. Directors unanimously agreed to the investment proposal outlined by Mr Farmer. It was noted Mr Monks agreed to the plan.

[251] Viewed in their proper context, these minutes do not support Mr Banks' claim that the directors were acting in breach of s 135 by allowing the business to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. In our view, it was entirely appropriate for the directors to be exploring all potentially available options to recapitalise the business while KordaMentha's report was awaited and pending the outcome of negotiations with Telecom Rentals. That the prospect of this investment proposal succeeding was thought to be highly uncertain, does not mean it was not worth pursuing. The business decision recorded in the minutes seems to us to have been reasonable in the circumstances. Importantly, success of the proposal was not critical to the decision to carry on trading until negotiations with Telecom Rentals were concluded.

[252] We have already set out the terms of the Telecom Rentals debt restructure and the sale of the SecureMe business.[79] The directors had little realistic option but to recommend acceptance of those terms. It is not suggested that the proposed transaction would not be of benefit to the company or that acceptance of it was not in its best interests. As noted, it had the effect of reducing the level of the company's indebtedness, providing a two-year payment holiday on its largest debt, and giving Mako immediate access to $5 million. The decision whether to accept the terms of the restructure rested with the shareholders because a special resolution was required. The resolution to proceed with the transaction was approved unanimously. Mr Banks supported this decision at the time. Again, we agree with the Judge that the directors did not breach their obligations under s 135 by allowing the company to continue to trade until this time (7 February 2014).

[253] The directors then had to take stock and decide how to progress from there. The New Zealand business had been sold and a large percentage of the company's

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[79] See above at [89].

staff had been let go. As Mr Farmer put it to his fellow directors at the time, the company was at a crossroads. Mako needed to focus its efforts on existing offshore opportunities, particularly in the United States, that were likely to produce maximum profits in the shortest possible time.

[254] Mr Banks claims the directors should have ceased trading at this point. He says the decision to trade on merely delayed the inevitable. However, it is important not to allow hindsight to colour the evaluation. If the directors had caused Mako to cease trading, the considerable upside prospects being actively pursued in the United States and elsewhere would have evaporated overnight. Mr Banks would have had no prospect of recouping his investments under Agreements 1 and 2. There would have been no point in entering into the Telecom Rentals debt restructure. The two-year debt holiday would be meaningless and the additional $2 million advanced by Telecom Rentals would simply be returned via the receivers or liquidators (after deduction of costs). Telecom Rentals clearly considered its best interests would be served by providing some accommodation to enable Mako to continue to trade. That was no doubt partly to support the SecureMe business, but it is reasonable to infer that Telecom Rentals considered it was more likely than not that its position would improve (and not deteriorate) by supporting Mako's continued trading. Otherwise, it could be expected to have appointed receivers at that stage. In an email sent to Messrs Frederick and Farmer on 24 January 2014, Mr Laing expressed his view that "[e]ven after [the] asset sale, it [would be] in everyone's best interest for Mako to continue to trade."

[255] Was the Judge correct to find that the directors were not in breach of their duty under s 135 to allow the company to trade in the manner it did in the period from February to late April or early May 2014? Assuming the directors had a strategy which they reasonably expected would result in a restoration of the company's financial position, the answer would have to be yes. The terms of the productisation agreement then being negotiated with Sprint would have produced revenue of at least USD42.5 million over a two-year term including an upfront payment of USD4.25 million. The evidence indicates that even if this was the only new contract secured during this period, it would have provided sufficient additional funding to enable the company to continue to trade profitably in the short term. We have already

summarised the course of the negotiations in the relevant period until the end of April or early May 2014.[80] The Judge's finding that the directors reasonably believed that the agreement would be concluded imminently on the proposed terms is well supported by the evidence of Messrs Gamble and Farmer who attended the meetings with the senior Sprint executives who had the carriage of the negotiations. We see no justification for departing from the Judge's factual findings on this issue.

Section 136 — duty in relation to obligations

[256] Mr Banks maintains that the directors also breached their duties under s 136. This section reads:

> **136 Duty in relation to obligations**
>
> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

[257] The inquiry is directed to the director's belief at the time the obligation is incurred. The director must not only believe that the company will be able to perform the obligation when required to do so, there must be reasonable grounds for that belief.[81] As stated in *Mainzeal*, "the focus will be on what the director knew or would have known if they had made the inquiries that a reasonable director would have made".[82]

Agreement 1

[258] Mr Banks has accepted throughout that the directors genuinely believed on reasonable grounds at the date of Agreement 1 (4 February 2011) that Mako would be able to perform its obligations when required to do so in respect of tranches 1 and 2. These tranches (£130,000 and £547,000 respectively) were advanced on 10 March 2011 for a minimum of two years.

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80 See above at [114]–[117] and [215]–[220].
81 *Debut Homes*, above n 54, at [91]; and *Mainzeal*, above n 53, at [284]–[286].
82 *Mainzeal*, above n 53, at [285].

[259] However, tranche 3 (£500,000) was for a minimum term of three months with a notice period of three months. Mr Banks contends there were no reasonable grounds for the directors' belief that Mako would be able to perform this obligation when required to do so.

[260] The Judge gave six reasons for rejecting this claim:[83]

(a) Mako had substantial reserves accruing from its New Zealand-based operations and had trading revenue of over $3.7 million in FY10.[84]

(b) Mako had recently become the first company in the world to achieve PCI-DSS certification.

(c) The directors expected to sell 300 licences in New Zealand based on forecast meetings held with Telecom.[85]

(d) The directors had been told by Gen-i that it would purchase 10,000 licences to deliver Mako PCI services to National Australia Bank and Commonwealth Bank of Australia.

(e) Mako was at that time conducting proof of concept trials at major trading banks in the United Kingdom, including Royal Bank of Scotland.

(f) While Mr Banks could require repayment of £500,000 after three months (subject to giving three months' notice), the balance of the loan, £677,000, could not be called up for at least two years.

[261] Mr Johnson argues that the Judge's reasoning focused almost exclusively on the respondents' subjective views of Mako's prospects, with no analysis of Mako's actual financial position at the time. He makes three related points. First, he says the expected sales referred to are the same as those relied on in the PPM to project revenue

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83 Substantive judgment, above n 2, at [473].
84 This appears to be a typographical error and should be 3.37 million, not 3.7 million.
85 This also appears to be a typographical error and should be 3,000, not 300.

of $17 million for FY11, whereas the actual revenue achieved that year was only a fraction of this. Secondly, he says that any analysis of the FY11 results raises serious doubts as to Mako's ability to repay. Mako's cash outflows exceeded its inflows, the FY11 accounts record cash on hand of $123,560 and current assets of $326,014. Mr Banks says Mako could not repay £500,000 (plus interest) as at 30 June 2011 if he had given three months' notice requiring this. Thirdly, as the Judge acknowledged, Mako's cashflow remained tight throughout 2011 and 2012.

[262] For the reasons that follow, we are not persuaded we should interfere with the Judge's conclusion that the directors did not breach their duties under s 136 in respect of tranche 3 of Agreement 1.

[263] There is no dispute that Mako had secured substantial recurring revenues by February 2011. As the first to achieve PCI-DSS certified compliance, Mako had a strong competitive advantage in a huge market. Based on industry feedback, including from existing customers, the directors reasonably expected to be able to capitalise on this opportunity to pursue exponential revenue growth. This expectation was only partly based on the matters summarised by the Judge and referred to at [260(b)–(e)] above. Contrary to Mr Johnson's submission, these matters (other than (c)) are objectively ascertainable facts, not subjective beliefs. The underlying facts are supported by evidence that was not seriously challenged. The expected number of licence sales in New Zealand (item (c)) is an opinion but the Judge was satisfied there was a reasonable factual basis to support it, being based on discussions at forecast meetings held with Telecom.

[264] The submission that the opportunities cited by the Court are the same as those used by Mako to project revenue of $17 million in FY11 is not strictly correct as can be seen by comparing those referred to by the Judge with the assumptions set out in the PPM. The assumption underpinning the revenue projection for FY11 was the sale of a 3,000 unit licence block in New Zealand, 10,000 in Australia and 20,000 in the United Kingdom. We have already discussed the basis for those projections and concluded that they had a reasonable factual foundation at the time they were prepared. We were not taken to any evidence to indicate that the basis for this expectation had changed in any material way between the date of the PPM and Agreement 1. It is not

enough to say, with the benefit of hindsight after the FY11 accounts were finalised, that these revenue projections were not achieved.

[265] Mr Banks next argues that an analysis of the actual FY11 results "raises serious doubts" as to Mako's ability to repay him. However, the question must be asked at the time the obligation is incurred (4 February 2011), not with the hindsight knowledge of the 30 June year-end financial statements.

[266] Mr Banks is undoubtedly correct when he says that Mako's cashflow was tight throughout 2011 and 2012. However, it does not necessarily follow that Mako would have been unable to repay tranche 3 if Mr Banks had demanded it on three months' notice. As Mr Hollyman observes, Mr Banks' contention assumes that the loan could only be repaid from current earnings. Given Mako's prospects and investor interest at the time, there is force in his submission that there were other ways the money could have been raised if required. Mako was balance sheet solvent at that time and the directors could have raised the money from investors or borrowed it if necessary.

[267] Mr Banks' s 136 claim in respect of tranche 3 is not supported by the expert financial witnesses. Mr Fisk expressed the opinion that the directors "could reasonably have believed that they could meet this obligation", referring to all advances made pursuant to Agreement 1. As noted, Mr Fisk considered that Mako was balance sheet solvent until it took responsibility for the liability to Telecom Rentals as part of the first restructure from 28 June 2013. In his view, the Mako group, and consequently Mako itself, became cashflow insolvent from around December 2013 when Telecom Rentals withdrew funding.

[268] Mr Hollyman also says that the s 136 claim was not pleaded in relation to Agreement 1. We do not accept this. It seems to us that the pleading is sufficiently broadly drawn to capture all advances made under each of the three agreements. However, it was not put to the respondents in cross-examination that they had no reasonable grounds to believe Mako could meet its obligations when required in respect of this tranche. Nor was their independent expert, Mr Hussey, challenged on his view that there were reasonable grounds to support the directors' belief.

Agreement 2

[269] As noted, Agreement 2 is in the form of a letter dated 30 June 2013. It records "the updated terms of unsecured debts current and to be created" between Mr Banks and Mako. The advances are then set out. These were the three tranches under Agreement 1 together calculated to be £1,268,291.05 including interest as at 31 March 2013, and two further advances being £237,722.43 on 14 May 2013 and £24,779.14 on 3 June 2013. The terms and conditions were the same as recorded in Agreement 1 except for the agreement to convert all advances and accrued interest calculated as at 30 June 2013 to equity upon completion of the expected IPO.

[270] The Judge considered there was some ambiguity as to the loan period. Agreement 2 was to be on the same terms and conditions as Agreement 1 but Agreement 1 provided for two different loan terms — two years with six months' notice for tranches 1 and 2 and three months with three months' notice for tranche 3.[86] It was also unclear whether the term would commence on the date of each advance (15 and 31 May 2013) or on the date of the agreement (30 June 2013).[87] However, the Judge concluded that the answer would be the same whatever date was chosen and that the directors had reasonable grounds for their belief that Mako could meet its obligations under Agreement 2 when required.[88] The Judge gave three reasons for reaching this conclusion:

(a) Telecom Rentals had confirmed in writing that the agreed debt ceiling in the short to medium term was $35 million. At the time the debt stood at $21 million, allowing Mako headroom of about $14 million.[89]

(b) Mako's business prospects were promising. The testing period with Chevron had successfully concluded and the imminent installation of its products at Chevron sites was likely to lead to further significant

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86 Substantive judgment, above n 2, at [486].

87 There are some inconsistencies in the documentary evidence regarding these dates. The discrepancy is immaterial, but we have adopted the dates recorded in the letter agreement, being 14 May 2013 and 3 June 2013.

88 Substantive judgment, above n 2, at [487].

89 At [488].

business opportunities being secured with other large global customers.[90]

(c) Mr Banks had agreed to convert his debt to equity on an IPO which, as at 30 June 2013, was "certainly a reasonable prospect".[91]

[271] Mr Banks contends that Telecom Rentals would not have allowed its facility to be used to repay him as an unsecured creditor. He says the only way Mako could have met its liability would have been through an IPO. However, he repeats his earlier submission that an IPO was not likely at that time. Accordingly, he says his commitment to convert all debt to equity on an IPO could not be relied on by the directors.

[272] Noting that the obligation to repay Mr Banks rested with Mako, Mr Fisk focused on its financial position at the relevant time, rather than that of the group as a whole. Mr Fisk understood that the terms of the advances made in May and June 2013 were agreed in April 2013. He noted that Mako was not at that stage liable for the debt to Telecom Rentals. Prior to taking on that obligation, Mako's assets exceeded its liabilities, including the amounts owed to Mr Banks. Accordingly, Mr Fisk considered that although the position was not as clear as with the advances under Agreement 1, on balance the directors had reasonable grounds to believe that the company would be able to perform its obligations under Agreement 2. In reaching his opinion, Mr Fisk took into account that Mr Banks had agreed to capitalise his debt in connection with the planned IPO and that real progress was being made towards this.

[273] We do not agree with Mr Johnson that the assessment should be made as at 30 June 2013. The email exchanges between Mr Banks and Mr Farmer indicate that the terms were agreed in April, even though the documentation was not completed until 30 June 2013. The mutual obligations were incurred in April 2013. Further, the advances were received on 14 May and 3 June 2013. Mako's repayment obligations were triggered at the latest by then. The common expectation was that Mako would satisfy its obligations to Mr Banks in respect of all borrowing by the issue of shares as

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90 At [489].
91 At [490].

part of the IPO. A resolution to this effect was passed unanimously at the board meeting on 28 June 2013. We have already concluded that at this time the directors reasonably believed that an IPO was likely to occur in the second half of 2013.

[274] We conclude that the Judge was correct to dismiss the s 136 claim in respect of the advances made under Agreement 2.

Agreement 3

[275] Because the final advance of $500,000 was not received by Mako until 24 April 2014, the Judge considered that was the appropriate date to assess the reasonableness of the directors' belief that the company could perform its obligations. The Judge found that although Mr Gamble was aware prior to 24 April 2014 that the negotiations with Sprint were "becoming more difficult", he still believed the deal would be successfully completed. The Judge considered that some deference to Mr Gamble's view should be allowed because he was dealing with senior Sprint executives face-to-face. The Judge found that Mr Farmer first learned of Sprint's changing position on 26 April 2014, after Mr Banks' money had been received.[92]

[276] The Judge concluded that as at 24 April 2014, the directors reasonably believed Mako would be able to meet its obligations under Agreement 3, principally because an agreement with Sprint remained likely. The Judge also took into account other significant initiatives that were being pursued at the time, particularly with Chevron and D&S Communications.[93]

[277] Mr Johnson says it is clear that Mako could not fund the Sprint deal and he says there is no documentary evidence to show that Sprint was willing to do so. He says Sprint advised Mako on 20 April 2014 that it would not pre-purchase the product. This is what Mr Farmer advised shareholders in his 25 August 2014 report. For those reasons, Mr Johnson contends the directors must have known, before Mr Banks' monies were paid, that the Sprint deal was an outside chance at best.

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92 At [500]–[501].
93 At [503]–[504].

He submits that the company's failure by this point was inevitable, as was reflected in the Judge's finding in respect of s 135.

[278] Mr Johnson notes that the minutes of the board meeting held on 9 April 2014 refer to two statutory demands having been served by GPC Electronics for equipment that had been shipped to the United States but not paid for. The minutes record that GPC had agreed not to take further action on the statutory demand in respect of the outstanding debt, but Mako would have to pay for any new product prior to shipment. Mr Farmer advised the directors at the meeting that the company's cash position was $425,000 net positive, a further $500,000 was expected from Mr Banks and $700,000 from another shareholder. The minutes of the next board meeting held on 16 May 2014 show that Mr Banks' money would be used to cover operations until mid-June 2014. Mr Johnson says this is a classic case of robbing Peter to pay Paul, to use the language adopted in *Debut Homes* and *Mainzeal*.

[279] Mr Banks' s 136 claim in respect of this advance is supported by the evidence of Mr Fisk. In his opinion, the group and Mako were insolvent on a balance sheet and cashflow basis and the directors should have known this at the time Mr Banks' money was received on 24 April 2014. The Telecom Rentals secured debt significantly exceeded the reported value of the group's assets, principally the Mako system, and the board minutes show that the directors were unsure how much longer the group would be able to continue trading. The performance of the group was such that an IPO was not a realistic option at that time. In these circumstances, Mr Fisk considered that there were no reasonable grounds to justify any belief by the directors that Mako would be able to meet its obligation to repay Mr Banks the $500,000 advance.

[280] Mr Hollyman argues that the directors had reasonable grounds to believe that Mr Banks had converted his debt to equity. He says that following the meeting between Mr Banks and Mr Farmer in early March 2014, it is clear that the parties were looking at an equity investment. Mr Farmer sent Mr Banks a shareholder agreement following which Mr Banks responded: "[t]he agreement looks good. Let's do this when you're ready." Mr Hollyman contends that Mr Banks' email of 18 March 2014, quoted at [110] above, provides further confirmation that he was, in Mr Banks' words, "happy to buy in". He suggests this was supported by later communications in which

Mr Farmer and Mr Banks refer to the loan being "reinstated". On this basis, Mr Hollyman submits that the directors "rightly believed" that Mr Banks had converted all his debt to equity and Mako had no obligation to repay this advance or any of the previous advances.

[281] In any event, Mr Hollyman submits that the Sprint deal remained "very much on the cards" on 24 April 2014. Mr Gamble was having weekly meetings with Sprint personnel, and he says that contract finalisation appeared to be imminent. He submits that there is no justification for this Court to interfere with the Judge's reasoning on this issue.

[282] We do not accept Mr Hollyman's submission that Mr Banks had converted his debt to equity. While it is clear the parties expected this would occur, any debt conversion would be for the entire debt, including the advances made under Agreements 1 and 2. Mr Banks did not sign the shareholders agreement or the deed of accession, and no shares were ever issued to him.

[283] The Judge did not address any argument that Mr Banks did in fact convert his debt to equity such that there was no repayment obligation. The Judge's approach to the claim is consistent with the pleadings. In his second amended statement of claim, Mr Banks pleaded that the terms of Agreement 3 were agreed on 4 March 2014. Although the terms were to be recorded in writing, as had been done with the earlier agreements, this did not occur. The particulars and agreed terms were said to be as follows:

> 60 The representations from Mr Farmer up until this time and promises from Mr Farmer of a discount on shares at the time of conversion, induced [Mr Banks] into making a final advance to Mako of $500,000.00 NZD on 24 April 2014 (**Agreement 3**).
>
> 61 Agreement 3 was discussed further on 4 March 2014 on the basis that a written agreement would be entered into recording that:
>
> (a) [Mr Banks] would invest a further $500,000.00, adding to the existing debt;
>
> (b) conversion of [Mr Banks'] total advances into shares would occur at a valuation of $50 million (when Mako listed on the NZX, as under Agreement 2); and

(c) future investors would invest at a valuation of at least $100 million.

62 A written version of Agreement 3 was never finalised.

63 The overall effect of Agreement 3 was that [Mr Banks'] investment amount increased.

64 [Mr Banks] performed the contract by paying the $500,000.00 advanced to Mako under Agreement 3.

[284] In his amended statement of defence, Mr Farmer denied paragraph 60 but admitted that "Mr Banks made the *further loan* to Mako".[94] He admitted the meeting on 4 March 2014 but otherwise denied paragraph 61. He pleaded there was "no specific agreement that a new written agreement would be entered into" and said that the "value at which Mr Banks debt would be converted to equity was agreed at $50 million".

[285] As can be seen, Mr Banks' pleaded claim was that the terms of the agreement were agreed on 4 March 2014 and the $500,000 was to be a further loan to Mako in the first instance with a conversion to equity on an agreed valuation of $50 million at some later stage, in the context of an IPO. This pleading has some support in the evidence (the meeting on that date is referred to at [106] above), although it may be that agreement was not finally reached until the meeting on 25 March 2014 (referred to at [111] above). The Judge made no finding as to when the agreement was reached, but it seems clear that the terms must have been agreed by 25 March 2014 at the latest. There is no recorded meeting between that date and the receipt of the money on 24 April 2014. The only correspondence in the intervening period are the emails on 2 April 2014 when Mr Farmer asks when the money will be transferred and the response from Mr Banks 10 April advising that he should receive it around 24 April.

[286] The question to be asked is when were the directors required to direct their attention to their duties under s 136 in respect of Mako's obligations to Mr Banks under this agreement? This turns on when the obligations were incurred. This was a significant one-off transaction that involved important commitments by Mako, including as to the future conversion of all of his loans to equity on agreed terms.

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94 Emphasis added.

Both parties were bound to these commitments, at the latest by 25 March 2014. Thereafter, Mako was not at liberty to withdraw unilaterally from the agreement. This is entirely consistent with Mr Banks' pleading that he "*performed* the contract by paying the $500,000".[95] We therefore prefer the view that the relevant obligations were incurred for the purposes of s 136 no later than 25 March 2014 when the agreement was reached, not on 24 April 2014 when Mr Banks performed his obligations pursuant to it. It follows that, before making these binding commitments to Mr Banks on or before 25 March 2014, the directors needed to be satisfied that Mako could perform its obligations. We therefore take 25 March 2014 as the relevant date for assessment of the directors' performance (or otherwise) of their duty under s 136.

[287] The evidence supports the Judge's finding that a productisation agreement with Sprint appeared to be imminent at that stage on terms that would have solved Mako's solvency issues by generating immediate revenue of USD4.25 million and a total of USD42.5 million over two years. This would have greatly assisted Mako to exploit other opportunities, particularly in the United States market, and paved the way for an IPO. Given the reasonable expectation on 25 March 2014 that a productisation agreement with Sprint would be concluded imminently on the terms that had been discussed, we agree with the Judge's conclusion that the directors had reasonable grounds to believe that Mako would be able to perform its obligations to Mr Banks when required. At that stage, the most likely scenario was that the obligation would be performed by the issue of shares.

[288] Mr Banks was well aware that Mako was cash constrained at this time and part of his motivation was to assist in enabling it to continue to trade until this problem could be overcome. Like the directors and others who contributed funds during this difficult period, Mr Banks must have appreciated there was risk, but he could see the opportunity for significant upside in the medium term.

[289] It was not until 20 April 2014 that Mr Callender advised Mr Gamble that Sprint was either unable or unwilling to bulk purchase Mako's product upfront.

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[95] Emphasis added.

Section 138 — reliance on information and advice

[290] Section 138 of the Companies Act entitles directors, in performing their duties, to rely on professional advice and other specified information so long as they act in good faith, make proper inquiry where the need for this is indicated by the circumstances, and subject to the director having no knowledge that such reliance is unwarranted.

[291] Mr Farmer pleaded as an affirmative defence that he was entitled to rely on reports, statements, financial data, advice, and other information obtained from accountants, auditors, legal advisors, investment bankers, financial advisors, and company employees.

[292] Mr Johnson made the submission in the High Court that the respondents ought to have called the witnesses in these categories, including Mr McGregor, Mr Frawley, Cameron Partners, Deloitte, Mr Tingey, Mr Weldon and Mr Sidorenko (of Norcal). In advancing this submission, he relied on this Court's decision in *Morgenstern v Jeffreys* for the proposition that directors seeking to rely on s 138 are expected to adduce direct evidence from the professional advisors and make them available for cross-examination.[96] Failure to do so may lead to an adverse inference being drawn that their evidence would not have assisted the defence.[97]

[293] The Judge was "not prepared to reject the defence, to the limited extent it was relied upon, nor draw any adverse inferences".[98] He considered that *Morgenstern* was clearly distinguishable.[99] In the present case, the contemporaneous documentary record was self-explanatory and was relied on by all parties and the independent experts who were called to give evidence.[100] Some of the advice, such as that obtained from Mr Tingey, was admissible on a limited basis and not as truth of its contents.[101]

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96 *Morgenstern v Jeffreys* [2014] NZCA 449, (2014) 11, NZCLC 98-024 at [76].
97 At [78] and [81(c)].
98 Substantive judgment, above n 2, at [358].
99 At [359].
100 At [360].
101 At [360].

[294] The Norcal reports authored by Mr Sidorenko were in a different category but Mr Banks' own experts, Mr Fisk and Mr Bridgman, considered the pipeline assessment to be a thorough market appraisal. The detailed methodology and reasons set out in the report enabled the experts to form a view on the reliability of the information. The Judge did not consider there was any material prejudice in these advisors not being made available for cross-examination.[102]

[295] The Judge reached the same view in respect of Mr Frawley. His views and opinions were captured in the contemporaneous documentary record, mostly emails and board minutes. The Judge said it was difficult to imagine what additional advantage there would have been for either party if he had been called as a witness. Mr Frawley was portrayed by Mr Banks' experts and counsel as reflecting the standard required by the Companies Act of a reasonable and prudent director in the circumstances. The directors responded that if that were so, they could not be faulted on Mr Banks' own case for their actions up to 29 December 2013, when Mr Frawley resigned.[103]

[296] Mr Johnson submits that the Judge was wrong to distinguish *Morgenstern* and simply rely on the documentary record as speaking for itself. He says this runs roughshod over the hearsay evidence rules and the approach does not allow the professional advisors to be tested on their instructions, qualifications, or assumptions. He says the evidence was relevant to key issues, including matters of valuation, whether revenue had been correctly claimed in the FY12 financial statements and the accuracy and relevance of the 30 June 2013 solvency paper prepared by Mr McGregor.

[297] The circumstances in *Morgenstern* were quite different. Mr Morgenstern was the sole director and shareholder of a property development company (Morning Star Enterprises Ltd) which was balance sheet insolvent and in serious financial difficulties when he decided to repay his overdrawn current account by causing the company to acquire (for $3.5 million) his shares in another property development company (Morning Star (St Lukes Garden Apartments) Ltd) of which he was also the sole director. The liquidators successfully claimed that the consideration for the share

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102 At [361].
103 At [362].

transfer was excessive. Mr Morgenstern contended that in entering into the transaction, he had relied on advice from his accountants and that the sale price was calculated by reference to a feasibility study prepared by a third party. The liquidators objected prior to the trial to Mr Morgenstern's evidence as to the advice given by the accountants as being inadmissible hearsay because the accountants were not called. The trial judge admitted the evidence with the reservation that its hearsay nature would be relevant to the weight that could be placed on it. The third party who carried out the feasibility study was neither an expert share valuer nor independent.

[298] It was in this context that this Court expressed the following uncontroversial propositions: first, a director seeking to rely on a defence under s 138 bears the onus of proof; and, secondly, the director will therefore need to adduce evidence establishing the nature and scope of the advice and the circumstances justifying the director's reliance on it.[104] This Court went on to say that a director who does not adduce direct evidence from the relevant professional advisors is "*unlikely* to be able to establish the defence *solely* on the basis of his or her own evidence".[105] An adverse inference may be drawn where a witness is in the "camp" of one party and it will be natural for that party to produce the witness.[106]

[299] We agree with the Judge that *Morgenstern* is distinguishable. The issue in that case was the adequacy of the consideration, with Mr Morgenstern bearing the onus of proving adequacy. He failed to call any witness to establish this and his own hearsay account, which was objected to prior to the trial, was insufficient to discharge the onus. By contrast, in the present case, both parties relied on the substantial contemporaneous record without objection. Expert witnesses were called on both sides to address contested issues based on this record, including the financial statements and other reports that were considered by the directors over the relevant period.

[300] As can be seen from our analysis of the claims, we have not found it necessary to address the affirmative defence pleaded in reliance on s 138. So, for example, we have reached our own view based on all the evidence as to whether the directors acted

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104 *Morgenstern v Jeffreys*, above n 96, at [75]–[76].
105 At [77] (emphasis added).
106 At [78].

reasonably in continuing to trade and in incurring the relevant obligations. In reaching these conclusions, we have not taken into account, for example, the substance of what Mr Tingey may or may not have advised at the directors' meeting or the views expressed by Mr Frawley at the time of his resignation at the end of 2013. As the Judge said, the Norcal reports set out in detail the data relied on and the methodology employed in reaching the stated conclusions. These contemporaneous reports speak for themselves, and it is unclear what would have been gained if Mr Sidorenko had been called to give evidence. The important point is that appropriate independent experts were called to address solvency and other financial issues that were central to the outcome of the various claims to which this evidence had some relevance. Indeed, there was no real contest between the parties about the vast market opportunity indicated by those reports. The real issue was whether Mako was realistically able to exploit that opportunity.

Section 301 — court's power to require repayment of money

[301] Having rejected the appeal against the Judge's findings that the directors did not breach their duties under the Companies Act at the time Mako incurred its obligations under Agreements 1, 2 and 3, it is not necessary for us to consider what remedy ought to be given under s 301. Had we found that a breach was proved, we would have considered it appropriate to make an order under this section given that Mako has been restored to the register and in the light of the position taken by the liquidators and Spark.

Securities Act claims

Relevant provisions

[302] At the relevant time, s 33 of the Securities Act imposed restrictions on offering securities to the public.[107] The core restriction is set out in s 33(1). Additional restrictions applying to debt securities and participatory securities are set out in the following subsections. For present purposes, only s 33(1) and (2) are relevant:[108]

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[107] The Securities Act 1978 was repealed as from 1 December 2014 by s 4(1)(a) of the Financial Markets (Repeals and Amendments) Act 2013.

[108] Section 33(2)(ab) was inserted as from 1 May 2011 by s 12(1) of the Securities Amendment Act 2011.

33 Restrictions on offer of securities to the public

(1) No security shall be offered to the public for subscription, by or on behalf of an issuer, unless—

(a) the offer is made in, or accompanied by, an authorised advertisement that is an investment statement that complies with this Act and regulations; or

(b) the offer is made in an authorised advertisement that is not an investment statement; or

(c) the offer is made in, or accompanied by, a registered prospectus that complies with this Act and regulations.

(2) No debt security shall be offered to the public for subscription, by or on behalf of an issuer, unless—

(a) the issuer of the security has appointed a person as a trustee in respect of the security and both the issuer and that person have signed a trust deed relating to the security; and

(b) a copy of the trust deed has been registered by the Registrar pursuant to section 46; and

(c) where the provisions of the trust deed have been amended, a copy of the instrument amending the deed has been registered by the Registrar pursuant to section 47 of the Act.

[303] Section 37 provides that no allotment of a security offered to the public for subscription shall be made unless at the time there is a registered prospectus relating to the security. Any allotment made in contravention of this section is invalid and of no effect.[109] Where subscriptions for securities are received by or on behalf of an issuer but may not be allotted by virtue of s 37, the issuer is required to ensure that the subscriptions together with interest are repaid as soon as reasonably practicable.[110] If the subscriptions are not repaid within two months, the directors are jointly and severally liable with the issuer to repay the subscriptions plus interest.[111]

[304] A security is relevantly defined to include a debt security.[112] Subject to some exceptions that do not apply, a debt security means any interest in or right to be paid

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109 Securities Act, s 37(4).
110 Section 37(5).
111 Section 37(6).
112 Section 2D(1)(b).

money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property).[113]

[305] An "offer" is broadly defined in s 2 to include an invitation, and any proposal or invitation to make an offer. The words "to offer" have a corresponding meaning. "Subscribe" is defined to include purchase and contribute to, whether by way of cash or otherwise. "Subscription" has a corresponding meaning. "Allot" includes sell, issue, assign and convey and "allotment" has a corresponding meaning.

[306] It is common ground that Mr Banks' advances constituted debt securities and there was no registered prospectus. The question is whether the debt securities were *offered to the public* in terms of the inclusive definition in s 3(1) and whether any of the exceptions in s 3(2) applied. Because of its central importance, we set out the key parts of s 3:

> **3 Construction of references to offering securities to the public**
>
> (1) Any reference in this Act to an offer of securities to the public shall be construed as including—
>
> (a) a reference to offering the securities to any section of the public, however selected; and
>
> (b) a reference to offering the securities to individual members of the public selected at random; and
>
> (c) a reference to offering the securities to a person if the person became known to the offeror as a result of any advertisement made by or on behalf of the offeror and that was intended or likely to result in the public seeking further information or advice about any investment opportunity or services,—
>
> whether or not any such offer is calculated to result in the securities becoming available for subscription by persons other than those receiving the offer.
>
> (2) None of the following offers shall constitute an offer of securities to the public:
>
> (a) an offer of securities made to any or all of the following persons only:
>
> (i) relatives or close business associates of the issuer or of a director of the issuer:

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113 Section 2 definition of "debt security".

(ii) persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money:

(iia) persons who are each required to pay a minimum subscription price of at least $500,000 for the securities before the allotment of those securities:

(iib) persons who have each previously paid a minimum subscription price of at least $500,000 for securities (the initial securities) in a single transaction before the allotment of the initial securities, provided that—

(A) the offer of the securities is made by the issuer of the initial securities; and

(B) the offer of the securities is made within 18 months of the date of the first allotment of the initial securities.

(iii) any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public:

…

(3) A person shall not be precluded from being regarded as a member of the public in regard to any offer of securities by reason only that he or she is a purchaser of goods from, or an employee or client of, or a holder of securities previously issued by, the issuer or any promoter of the securities.

(4) Any reference in this Act to an offer of securities to the public shall be construed as including a reference to distributing an advertisement, a prospectus, a registered prospectus, or an application form for the subscription of securities.

(5) Proof of an offer of securities to one person selected as a member of the public shall be prima facie evidence of an offer of securities to the public.

Substantive judgment

Agreement 1

[307] The Judge considered there was no offer by Mako because it was Ms Banks who first approached Mr Farmer to invest in Mako, having been appraised of the investment opportunity through Mr Winslade. She then combined her energies with Mr Banks' "to bring about the investment".[114] However, even if that was not correct,

[114] Substantive judgment, above n 2, at [289].

the Judge was satisfied it was not an offer to the public.[115] First, Mako never intended to engage with the public and sought to exclude the requirements of the Securities Act by making it clear in the PPM that the offer was not available to the public, only to exempt persons.[116] Secondly, even if Mr Banks and the other investors targeted (who would be exempt under s 3(2)(a)(ii) as high net worth individuals with investing experience) could be considered a section of the public, they were selected otherwise than as a member of the public in terms of s 3(2)(a)(iii).[117] Thirdly, the Judge rejected the idea that a single individual, engaged with privately in the circumstances of this case as he found them to be, could conceivably be described as a section of the public.[118] Fourthly, there was no offer of securities to individual members of the public selected at random in terms of s 3(1)(b).[119] Finally, there was no advertisement by or on behalf of Mako that was intended or likely to result in the public seeking further information about any investment opportunity in terms of s 3(1)(c).[120] The Judge concluded that there was no offer of security to the public that could be linked to Agreement 1 or the first allotment of debt security.[121]

[308] In any event, the Judge considered that the exception in s 3(2)(a)(ii) applied, finding that Mr Banks was a person whose principal business was the investment of money or who, in the course of and for the purposes of his business, habitually invested money.[122]

Agreement 2

[309] The Judge found that Agreement 2 came about through Mr Banks' existing business relationship with Mr Farmer and Mako. It was Mr Banks who suggested a further investment and there was no prior approach by Mako or Mr Farmer. The Judge's earlier findings, that neither Ms Banks nor Mr Banks were members of the public for the purposes of Agreement 1, applied equally to Agreement 2.[123]

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115 At [290].
116 At [291]–[293].
117 At [294]–[296].
118 At [297].
119 At [298].
120 At [299].
121 At [300].
122 At [301]–[311].
123 At [321].

Agreement 3

[310] The Judge concluded that Agreement 3 also came about as a result of the pre-existing relationship, not as a result of any offer to the public. If Mr Banks approached Mr Farmer, as he did prior to Agreement 2, the Judge considered no offer could have been made by Mako. On the other hand, if Mr Farmer approached Mr Banks seeking further investment, he did so because of the pre-existing relationship. Either way, the Judge reasoned the investment was not made as a result of an offer to the public.[124]

Submissions

[311] Mr Johnson submits that the word "offer" is to be construed broadly. An offer includes an invitation to make an offer. Mr Farmer's discussions with Mr Winslade, providing him with the PPM and then giving a copy of the PPM to Mr Banks, must amount to an invitation to make an offer.

[312] Mr Johnson submits that the Judge conflated the general rule relating to offers of securities to the public under s 3(1) with the exception applying to offers to persons selected otherwise than as members of the public under s 3(2)(a)(iii). This distinction is important because the burden of proving the former falls on Mr Banks as the claimant, whereas the burden of proving the latter falls on the directors.

[313] Mr Johnson contends that the Judge erred in finding there was no offer to the public for the purposes of Agreement 1. He says it was not appropriate to make the assessment only as between Messrs Farmer and Banks and ignore the wider context that Mako was seeking to raise funds at the time the agreement was being negotiated. As the Court observed, there was little evidence about other participating investors. In Mr Johnson's submission, it follows that the Judge's assessment that everyone to whom an offer was made would be otherwise excluded is unsustainable. Mako's intention to confine any offer to exempt persons is irrelevant. An intention to comply does not equate to compliance. Further, relying on this Court's decision in *Lawrence v Registrar of Companies*, he emphasised the need to take account of the

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124 At [327].

context of the prior exceptions in s 3(2), including persons having a close relationship with the issuer such that they would be able to obtain relevant information and protect themselves.[125] Mr Johnson submits that Mr Banks did not come within this category given the comparatively few meetings he had with Mr Farmer over the relevant period. He also says that there was insufficient evidence to show Mr Banks was a habitual investor, even if the CMC Markets and Vantage FX transactions were genuine investments as found by the Judge.

[314] Mr Johnson submits that these same considerations apply in respect of Agreements 2 and 3. He points out that Agreement 3 occurred in the context of a general capital raise. The minutes of the board meeting held on 27 November 2013 record that Mr Farmer was actively seeking an immediate cash injection from a range of investors, including Mr Banks.

[315] Mr Hollyman supports the Judge's analysis. As to Agreement 1, he says that no offer was made to Mr Banks because it was the Banks family who approached Mako seeking to invest. Further, the securities offered to Mr Banks were bespoke agreements unavailable to anyone else. The securities to which Mr Banks subscribed were therefore not offered to the public unless Mr Banks, standing alone, qualified as a member of the public.

[316] Mr Hollyman contends that the Judge correctly held that no offer was made to the public because:

(a) Mako never intended to engage with the public — the PPM was carefully worded to avoid classification as an offer of securities to the public.

(b) Ms Banks, like other investors, was selected otherwise than as a member of the public (s 3(2)(a)(iii)).

(c) A single individual, engaged with privately in the circumstances of this case, cannot be described as a section of the public (s 3(1)(a)).

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125 *Lawrence v Registrar of Companies* [2004] 3 NZLR 37 (CA).

(d) The investors Mako was seeking to attract were not individual members of the public selected at random (s 3(1)(b)).

(e) No advertisement was made by or on behalf of Mako that was intended or likely to result in the public seeking further information advice about any investment opportunity (s 3(1)(c)).

[317] In any case, Mr Hollyman submits that Mr Banks came within the habitual investor exception in s 3(2)(a)(ii). He was engaged in managing his family's significant wealth through the administration of the trusts controlling the investments and he lived off investment income. Mr Hollyman says the evidence establishes that Mr Banks' investment in Mako was simply another large, but otherwise unremarkable, investment in Mr Banks' business life. For example, in July 2010, he invested over $1 million in debenture stock in Marac Finance Ltd and he deposited significant funds in trading accounts with CMC Markets and Vantage FX in late 2011.

[318] Mr Hollyman submits the Judge was correct to find that Agreement 2 arose from the existing business relationship. Mr Banks suggested the further investment and there was no offer to the public. The second allotment superseded the first allotment by converting the loan to a convertible note.

[319] With respect to Agreement 3, Mr Hollyman submits that this too was not the product of an offer to the public. Additionally, he says it fell within two further statutory exceptions:

(a) No security was allotted before Mr Banks paid $500,000 to Mako (s 3(2)(a)(iia)).

(b) Mr Banks had paid in excess of $500,000 for securities less than a year earlier (s 3(2)(a)(iib)).

[320] In summary, Mr Hollyman supports the Judge's conclusion that the Securities Act did not apply to any of Mr Banks' investments in Mako.

Analysis

Agreement 1

[321] The word "offer" in this context is to be given a wide construction. We agree with Mr Johnson that the circumstances found by the Judge — including Mr Farmer's informal discussions with Mr Winslade at a social event, providing him with the PPM and later giving a copy to Mr Banks at his request — are sufficient to amount to an invitation to make an offer. Mr Farmer had let it be known that Mako was looking to raise capital and that is enough.[126]

[322] To the extent the Judge relied on this Court's decision in *Society of Lloyd's v Hyslop* in finding there was no offer, we consider this was misplaced.[127] In that case, Richardson J observed that there was no suggestion that the Securities Act would be engaged in circumstances where contact was initiated by persons seeking to become Lloyd's Names. However, there had been a departure from this usual practice when an agent contacted six or so of his long-standing friends, including Mr and Mrs Hyslop, and asked whether they might be interested in joining Lloyd's. The Securities Act was held not to apply, not because no offer had been made, but because there was no offer to the public. Those solicited were not a section of the public within s 3(1)(a), nor were they selected at random under s 3(1)(b), and, in the absence of an advertisement, s 3(1)(c) could not apply.[128] In any case, these individuals were selected otherwise than as members of the public and therefore fell within the exception in s 3(2)(a)(iii).

[323] The critical question in the present case is similarly whether the offer of securities was made to the public. By the time Mr Banks became involved, the offer set out in the PPM to raise capital by the issue of shares had closed. That offer expired on 30 November 2010 and Mr Farmer's first meeting with Mr Banks was not until December 2010. Mr Farmer gave Mr Banks a copy of the PPM at his request as it contained background information about Mako. However, Mr Banks was not

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126 *Re Dingwall v Paulger Ltd (in rec)* (1990) 5 NZCLC 66,780 (HC) at 66,790; *DFC Financial Services Ltd v Abel* [1991] 2 NZLR 619 (HC) at 626; and *Robert Jones Investments Ltd v Gardner* (1993) 6 NZCLC 68,514 (HC) at 68,530.

127 *Society of Lloyd's v Hyslop* [1993] 3 NZLR 135 (CA).

128 At 142.

interested in subscribing to shares along the lines of that earlier offer; rather, he sought a bespoke arrangement tailored to meet his personal requirements and taking the form of a debt security backed by a personal guarantee with an option to convert the debt to equity. No debt security was offered to anyone else at that time. The offer, in the sense of an invitation to make an offer, was made to Mr Banks alone. He did not come within s 3(1)(a) as "any section of the public", or s 3(1)(b) as coming within "individual members of the public selected at random". As in *Society of Lloyd's v Hyslop*, there was no advertisement in the ordinary sense of that word and s 3(1)(c) does not apply.[129]

[324] It follows that there was no offer of securities to the public within the inclusive part of the definition in s 3(1) of the Securities Act. Even if that were not the case, we consider that in all the circumstances Mr Banks can properly be regarded as having been selected otherwise than as a member of the public and therefore the exclusion in s 3(2)(a)(iii) applies. In *Lawrence v Registrar of Companies*, this Court considered the scope of the exception in s 3(2)(a)(iii) and concluded that, read in context, what was intended was a relationship analogous to those described in s 3(2)(a)(i) and (ii).[130] Such an interpretation was considered to be consistent with the policy of excluding categories of "persons able to protect themselves either by being able to require the issuer to provide them with relevant information or because of general sophistication in investment matters".[131] *Lawrence* was decided prior to the insertion of s 3(2)(2)(iia) and (iib)[132] which introduced additional indicia not concerned with the relationship between the offeree and the issuer or a director of the issuer.[133] However, consistent with the policy and purpose of the Securities Act and reading the provision in context, the residual category of excluded persons captured by s 3(2)(a)(iii) will, by analogy with the other categories of persons described in s 3(2)(a), be able to look after their own interests and have less need for the disclosure protections provided. This is consistent with what this Court said in *Lawrence*:[134]

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129 *Orr v Martin* (1991) 5 NZCLC 67,383 (HC) at 67,391.

130 *Lawrence v Registrar of Companies*, above n 125, at [33].

131 At [33].

132 Section 3(2)(a)(iia) was inserted by s 5(2) of the Securities Amendment Act 2004 with effect from 15 April 2004. Section 3(2)(a)(iib) was inserted by s 5(1) of the Securities (Disclosure) Amendment Act 2009 with effect from 28 July 2009.

133 See further Victoria Stace *Securities Law in New Zealand* (2010, LexisNexis, Wellington) at 2.4.2(d).

134 *Lawrence v Registrar of Companies*, above n 125, at [35].

> [The] question of who is in the category of persons protected because they are part of the public remains a question of fact to be determined as a matter of impression having regard to all the relevant circumstances rather than by reference to fixed criteria.

[325] Mr Banks was not responding to an offer of securities available to the public. He suggested to Mr Farmer that Mako consider issuing a debt security on terms that he proposed, and which were designed to meet his personal requirements and tax position. The offer of a debt security was made only to him. This was a bespoke private offer instigated by Mr Banks. The subscription in terms of Agreement 1 far exceeded (by more than four times) the $500,000 minimum subscription price set in terms of the exclusion in s 3(2)(a)(iia). Whether or not Mr Banks qualified as a professional or habitual investor in terms of s 3(2)(a)(ii), in all the circumstances we consider he was well able to protect his own interests in respect of this significant investment, including by taking legal and other professional advice if required. It is also relevant that a term of Agreement 1 proposed by Mr Banks was that he would provide advice to Mako regarding capital raising and other financial advice.

[326] For these reasons, we agree with the Judge that the Securities Act did not apply to Agreement 1.

[327] Although we strictly do not need to determine the issue, we briefly consider whether the Judge was right to find that Mr Banks' principal business was the investment of money or a habitual investor, engaging the further exclusion in s 3(2)(a)(ii). Mr Banks stated that he has never had, or needed to have, paid employment. The Judge found:[135]

> … Mr Banks lives off investment income. He has no other visible means of support. He described himself as self-employed. He spoke of administering the trusts from which his substantial investment funds appear to have been derived. Certainly, at the relevant periods, he was in control of significant funds.

[328] While we reach no concluded view, we doubt that Mr Banks could be classified, on the basis of these findings, as a professional or habitual investor within the intended scope of this exception. He does not appear to have been in the business

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135 Substantive judgment, above n 2, at [305].

of investing money, nor does he appear to have habitually invested money for the purposes of his business. We reach this tentative conclusion even on the basis most favourable to the respondents, namely that the Nuves emails were fabricated, and the Vantage FX and CMC Markets investments were true investments, not simulated activity undertaken for the sole purposes of a research project at the university.

Agreement 2

[329] For similar reasons, the Securities Act did not apply to Agreement 2. Mako was not at that time offering debt securities to the public. Mr Banks had other investments maturing and he contacted Mr Farmer proposing to add to his existing investment in Mako. The proposal was again tailored to meet Mr Banks' requirements. The arrangement involved a debt security on the same terms as Agreement 1 except that all debt, including the amounts paid under Agreement 1, would be converted to equity at an agreed discount in the context of the anticipated IPO. In our view, this was not an offer of securities to the public.

[330] Even if the offer could be regarded as coming within the inclusive part of the definition in s 3(1), we take the view that Mr Banks was in all the circumstances selected otherwise than as a member of the public. In addition to the factors discussed above, we consider it of some relevance that pursuant to Agreement 1 Mr Banks was entitled to receive all information available to Mako's shareholders and to regular informal updates about the business. This forms part of the context in which he was "selected" and lends weight to our conclusion that this was otherwise than as a member of the public in terms of s 3(2)(a)(iii).

Agreement 3

[331] The discussions leading to Mr Banks' final investment occurred in the context of the acute cashflow problems caused by Telecom Rentals' sudden decision to withdraw ongoing funding support under the finance facility in November 2013. Messrs Gamble, Frederick and Farmer, and Mr Farmer's family trust contributed by way of cash contributions and/or by foregoing salary and directors' fees. The minutes of the board meeting held on 27 November 2013 record that Mr Farmer was seeking an immediate cash injection of around $1 to $2 million from various investors,

including Mr Banks. The evidence shows that these other prospective investors were selected otherwise than as members of the public, being professional investors, fund managers, and relatives or close business associates of Mako or its directors.

[332] Mr Banks did not take up the offer to subscribe to the equity securities available to him and these other investors in late 2013. Mr Farmer withdrew the offer when he sent his email to Mr Banks on 24 December 2013 asking him to "hold off" transferring any funds to Mako at that time. The prospect of Mr Banks making a further investment did not resurface until February 2014. The offer Mr Banks subscribed to was not an equity security as had been offered to the other investors. Instead, he subscribed for a debt security with an option of converting the debt to equity along with his earlier advances. There is no evidence that any such security was offered to anyone else at that or any other time.

[333] We agree with the Judge that the Securities Act requirements did not apply as there was no offer of securities to the public. We consider it to be clear that Mr Banks was selected otherwise than as a member of the public.

[334] While it does not detract from this conclusion, we are not prepared to accept Mr Hollyman's invitation to find that the exclusions in s 3(2)(a)(iia) and (iib) also applied. The Judge made no such finding, and the respondents did not file any notice to support the judgment on other grounds.

[335] As to the exclusion in s 3(2)(a)(iia), the discussions between Messrs Banks and Farmer all appear to have proceeded on the basis that Mr Banks would be making an advance of $500,000. Mr Banks offered to pay that sum but there is no evidence of any requirement by Mako that he had to pay a minimum subscription price of at least $500,000.

[336] The only "transaction" that could qualify as involving an allotment of initial securities coming within the requisite 18-month period in terms of s 3(2)(a)(iib) is Agreement 2. Properly analysed, the advances set out in the letter agreement referred to as Agreement 2 comprised two earlier transactions, two subscriptions and two allotments. Neither of the advances met the $500,000 threshold, based on the

applicable conversion rates at the time. Even in combination, they just fell short. Mr Banks had therefore not previously paid a minimum subscription price of at least $500,000 for securities in a single transaction within 18 months of any offer of securities for the purposes of Agreement 3.

The Nuves emails

[337] Given our analysis of the Securities Act claims and our primary reliance on the contemporary record rather than credibility findings, the authenticity of the Nuves emails has diminished importance. The issue is now mainly relevant to the question of costs. For that reason, we do not propose to engage with all the detail of the factual contest that was reprised on appeal.

[338] This issue was the subject of intense scrutiny post-trial. The Judge considered evidence from seven witnesses, including experts, during the two-day resumed hearing convened for the sole purpose of determining the authenticity of the emails. The Judge gave numerous reasons in his Substantive judgment explaining why he was driven to the conclusion that these emails were fabricated by Mr Banks for the purpose of assisting his case.[136]

[339] While Mr Johnson was able to demonstrate that the Judge was mistaken in one respect,[137] this does not materially detract from the overall strength of the reasoning. Having reviewed the evidence on the topic, we are not at all persuaded that we should depart from the Judge's careful analysis and firm finding. Like the Judge, we consider Mr Banks' explanation for these emails is implausible on many levels. We mention only a few by way of illustration.

[340] Mr Nuves could not be found, nor was there any trace of him on the internet or elsewhere. This was surprising, if Mr Nuves truly did exist, given the numerous teaching and treasury positions he was said to have held at the Auckland University and the fact that Mr Banks claimed to have previously "vetted" him and considered him to be "a respectable person". Mr Banks' response to this difficulty was to suggest

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136 At [166]–[204].
137 At [190].

that Chris Nuves may not have been Mr Nuves' legal name, even though "Chris Nuves" was the name that appeared on all the emails.

[341] Mr Banks' explanation of the claimed research project was also implausible. He said he was approached by Mr Nuves at the University on 16 August 2011 and asked if he wanted to be part of a group which was going to "research the usability of software that related to people, money and/or online shopping". This seems an unlikely topic for a university research project.

[342] We also agree with the Judge's view that it "stretches credulity" that Mr Banks would "advance more than $500,000 to support research into the utility of software to assist a man who is virtually unknown to him".[138]

[343] The format and content of the emails was strongly suggestive of fabrication, although the experts could not categorically confirm this. The experts filed a joint statement agreeing:

(a) No email containing Mr Nuves' email address (chris1astro@zoho.com) for the 2011 to 2012 time period was located in either the hardware or Mr Banks' Gmail account.

(b) No contact record with the name Nuves, Nooves or Noovs was located for the entire Google account, nor was "chris1astro@zoho.com" attached to any contact.

(c) The Nuves emails have very little header information and are missing much of what would be expected to be standard email header data. There is no means to verify the authenticity of these emails.

[344] Mr Banks offered an explanation in his affidavit for the absence of any reference to Mr Nuves in his Gmail account but, like the Judge, we consider this is also highly implausible:

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138 At [186].

Inquiries I made since this issue was raised

25 After Mr Farmer indicated that he was planning on filing this application, on 3 September 2019 I decided to check the flash drive's functionality. I did this by moving a few files on and off the drive.

26 On 24 September 2019 I was looking through my Gmail account for anything relating to Chris and noticed and that his email address appeared in my "Frequently contacted" list. A screenshot showing this is annexed …

27 After I took this screenshot, I decided to add Chris' name to the entry (thinking that this might reveal more information about the email address).

28 When I did this, Google automatically moved the entry to the "Contacts" list. I did not want to have disturbed the original entry, so I deleted it from the "Contacts" list, thinking that [i]t would reappear on the "Frequently Contacted" list. It did not.

[345] We see no reason to differ from the Judge's conclusion that the emails were fabrications.

Costs appeal

[346] There were three primary components to the Judge's costs assessment:

(a) Indemnity costs for post-trial steps through which it was established that Mr Banks had forged the 28 Nuves emails he produced in evidence. Mr Banks did not resist this award. The Judge considered that while Mr Banks' misconduct was flagrant and designed to deceive, it was confined to particular steps in the proceedings, and it would be overly punitive to award indemnity costs for the entire proceeding as sought by the respondents.[139]

(b) Increased costs (uplift of 40 per cent on scale) for other steps to take account of the following factors:[140]

(i) The need for censure in connection with the forged emails.[141]

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139 Costs judgment, above n 28, at [28]–[31].
140 At [60].
141 At [52].

(ii) Mr Banks' evasive, defensive, and uncooperative approach to giving evidence, including giving lengthy and often circular responses to questions put in cross-examination. The Judge was satisfied Mr Banks gave evidence that, "to put it generously, bent the truth".[142]

(iii) Mr Banks' "voluminous claims", including his pleading of 53 allegedly actionable misrepresentations, added considerable time and expense to the proceeding.[143]

(iv) Mr Banks refused a settlement offer of $150,000 shortly before the commencement of the trial.[144]

(c) Rather than awarding costs to each respondent, the Judge awarded one set of costs, but he applied an uplift of 20 per cent to take account of the additional time incurred and complexity involved in running the case for multiple defendants. This resulted in the total costs being increased by approximately $50,000 to recognise the costs incurred by the second to fourth respondents. The Judge considered this was reasonable given their actual legal costs were approximately $150,000.[145]

[347] Mr Farmer appeals against the Costs judgment on two grounds. First, he argues that indemnity costs ought to have been awarded for all steps taken after 24 April 2019, being the date Mr Banks served his brief of evidence together with the forged emails. Secondly, he contends that a separate costs award should have been made in his favour.

[348] Mr Hollyman submits that the fabrication of 28 emails to be used in evidence constitutes deception on a large scale. It was an attempt to mislead the Court on a material issue and is sufficiently serious to warrant indemnity costs from the time the evidence was served on the respondents. Further, the Judge's findings about

142 At [53].
143 At [54].
144 At [55]–[57].
145 At [61]–[67].

Mr Banks' lack of veracity extended beyond these emails. Mr Hollyman submits that Mr Banks pursued his claim on bases which he knew to be false and continued it in wilful disregard of known facts within the scope of r 14.6(4)(a) of the High Court Rules 2016 and this justifies indemnity costs being awarded for the trial.

[349] We agree with Mr Johnson that there is no appealable error in the Judge's approach to the exercise of the costs discretion on this issue. The award of indemnity costs for all post-trial steps and an uplift on scale costs for other steps was a measured and appropriate response to Mr Banks' deceitful misconduct in respect of the emails and the other unsatisfactory aspects of his evidence. The deception did not go to the heart of any of the claims. We would not characterise Mr Banks' claims as being wholly without merit, as Mr Hollyman contends. Mr Banks succeeded in establishing that the directors breached their duties in continuing to trade after May 2014 and there was a proper foundation for his other claims.

[350] Mr Hollyman does not take issue with the Judge's summary of principle in considering whether more than one set of costs should be awarded. The general rule is that the court will not allow more than one set of costs if several defendants defended a proceeding separately and all or some of them could have joined in their defence.[146] There must be good reason to depart from this general rule.

[351] Mr Hollyman submits that although there was a degree of overlap in the litigation position of the respondents, Mr Banks' FTA claims were based almost entirely on Mr Farmer. The other respondents had no direct contact with Mr Banks. Mr Hollyman contends that this gave rise to an actual or potential conflict of interest justifying separate representation for Mr Farmer from the other respondents. But the other respondents were not represented at the trial and were therefore not entitled to a costs award for any steps after they ceased to have representation.

[352] The Judge's reasoning on this issue is encapsulated in the following paragraph of his Costs judgment:

> [65] The defendants in the present case were represented by the same counsel for some time. While some aspects of Mr Banks' claim were

[146] High Court Rules 2016, r 14.15.

> primarily directed at Mr Farmer, much of the case against the defendants overlapped. Mr Banks sought relief from the defendants collectively, all of whom were directors of Mako. The defendants' interest in defending the claim, to that end, was materially identical. The defendants could have, and did, rely upon the evidence and submissions of one another. Nor was there any conflict of interest between the defendants' cases, particularly because Mr Banks pleaded that the defendants were joint[ly] and severally liable for any relief. There was clearly an overlap in the litigation position of the defendants. It is therefore my view that only one set of costs should be awarded.

[353] We see no appealable error in this reasoning. Mr Banks pursued all of the respondents in respect of each of his causes of action and he sought the same relief from each of them. The same defences were advanced (Mr Farmer advanced some additional defences that were particular to him), and the respondents presented a united front. There were no cross claims. There does not appear to have been any actual or potential conflict of interest. We consider the Judge was right to award one set of costs and to allow an uplift of 20 per cent to account for the added cost and complexity of running a case for multiple defendants.

Result

[354] The application to adduce further evidence in CA531/2021 is granted in part, but only in respect of the liquidator's updating affidavit.

[355] The appeal in CA531/2021 is dismissed.

[356] The appellant in CA531/2021 must pay costs to the respondents for a complex appeal on a band A basis and usual disbursements. We certify for second counsel.

[357] The appeal in CA164/2022 is dismissed.

[358] The appellant in CA164/2022 must pay costs to the first respondent in the sum of $2,500.

Solicitors:
Wynn Williams, Auckland for Mr Banks
Lodder Law Ltd, Auckland for Mr Farmer
Maberly & Co, Auckland for Second to Fourth Respondents