IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2010-404-004444
[2012] NZHC 2358

UNDER	Section 301 Companies Act 1993
BETWEEN	JAKOV NIKOLA DELEGAT (AS TRUSTEE OF THE JIM DELEGAT BUSINESS TRUST) First Plaintiff
AND	BOAT 93 HOLDINGS LIMITED (IN LIQUIDATION) Second Plaintiff
AND	CHRISTOPHER JOHN NORMAN Defendant
AND	JULIE ANNE SALTHOUSE Third Party

Hearing: 16, 17, 18, 19, 20, 23, 24, 25 and 27 July 2012

Counsel: C T Patterson and E J Grove for the Plaintiffs
G P Blanchard and J P Nolen for the Defendant
D G Collecutt for the Third Party

Judgment: 4 December 2012

JUDGMENT OF WOOLFORD J

This judgment was delivered by me on Tuesday, 4 December at 3:00 pm pursuant to r 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Solicitors/Counsel:
Jones Young, Auckland.
Lowndes Associates (J P Nolen) Auckland.
Simpson Dowsett Mackie (W A Meggitt) Auckland.
C T Patterson, Auckland.
G P Blanchard, Auckland
Grant Collecutt, Auckland.

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Introduction

[1] This case arises out of the failure of a luxury yacht builder, Salthouse Marine Limited (SML), which was placed into receivership on 4 February 2010 and then into liquidation on 19 May 2010. At the time of its receivership, SML had a Salthouse 68 yacht in the early stages of construction for the first plaintiff, the Jim Delegat Business Trust (the Trust). In accordance with its normal practice, SML had incorporated a wholly owned subsidiary, Boat 93 Holdings Limited (Boat 93), for the specific purpose of contracting with the Trust to build the yacht for it.

[2] The Trust signed a contract to build the yacht with Boat 93 on 12 November 2009. In terms of the contract, the Trust paid Boat 93 $615,000 on 13 November 2009 and a further $615,000 on 8 January 2010, a total of $1.23 million. Boat 93 ceased trading on 4 February 2010 when a receiver was appointed to SML. It was unable to complete construction of the yacht and was therefore in breach of its contract with the Trust. SML had guaranteed the contract. SML was in breach of its guarantee as it too was unable to complete construction of the yacht.

[3] The Trust was left with an incomplete hull and a claim against the insolvent Boat 93 and SML. The plaintiffs say the incomplete hull was worth approximately $150,000 (if that) but a marine surveyor's report obtained by the Trust found the costs to build the hull to 4 February 2010 were $455,461 excluding GST. Whatever figure is used, the Trust suffered a substantial loss when SML failed.

[4] The Trust took possession of the incomplete hull pursuant to a security interest under its contract with Boat 93 and incorporated a company, Benson Marine Limited (BML), for the purpose of completing construction of the yacht. BML employed a number of SML employees, including the third party, Ms Julie Salthouse, who had been SML's Managing Director. BML leased premises and completed construction of the yacht over the next year or so.

[5] Having suffered a substantial loss the Trust has, not unnaturally, sought to recover that loss. Boat 93 was liquidated on the Trust's application and

Mr Grant Reynolds was appointed as liquidator, again on the Trust's application. The Trust subsequently filed a proof of debt with the liquidator but no recovery has been possible from either Boat 93 or SML.

[6] Ms Salthouse was the sole director of Boat 93. She was also one of two directors of SML. The other director was the sole defendant, Mr Christopher Norman. He was a director of SML from 23 December 2008 until he resigned on 3 February 2010, the day before SML was placed into receivership. The Trust and Boat 93 have issued proceedings just against Mr Norman, who is a distinguished naval architect resident in Perth and one of the founding directors of the Australian shipbuilder, Austal Limited, which is listed on the Australian Stock Exchange. The plaintiffs did not join Ms Salthouse as a defendant notwithstanding that SML's receiver identified potential breaches of the Companies Act 1993 by her.

[7] After being served with the proceedings, Mr Norman sought and obtained the Court's leave to issue a third party notice against Ms Salthouse on the basis that, if he was found liable to the plaintiffs, he was entitled to a contribution or indemnity from her.

[8] The Trust has not pursued claims in contract against Boat 93 and SML because of their insolvency. Instead, the Trust has funded proceedings on its own behalf and on behalf of Boat 93 against Mr Norman under s 301 of the Companies Act, which enables a creditor of a company in liquidation or a liquidator to apply to the Court for an inquiry into the conduct of a director of the company. After due inquiry, the Court may order the director to contribute such sum to the assets of the company by way of compensation as the Court thinks just if the director has been guilty of a breach of duty to the company. Although Mr Norman was never appointed a director of Boat 93, the plaintiffs allege he was a shadow or de facto director of Boat 93 in addition to being a de jure director of SML.

[9] The plaintiffs allege that Mr Norman breached ss 131, 135, 136 and 137 of the Companies Act. It is said that Mr Norman failed to act in good faith and the best interests of Boat 93 and SML, that he allowed Boat 93 and SML to trade recklessly, that he allowed Boat 93 and SML to incur obligations without reasonable belief

those obligations could be performed, and that he failed to exercise the degree of care, diligence and skill that a reasonable director would exercise. Finally, it is alleged that Mr Norman engaged in misleading and deceptive conduct in breach of s 9 of the Fair Trading Act 1986.

[10] The plaintiffs seek orders under the Companies Act that Mr Norman compensate Boat 93 and SML so that all creditors' claims can be satisfied and the liquidators paid in full. The Trust also seeks an award of damages in the amount of $1.08 million under the Fair Trading Act arising out of a misrepresentation Mr Delegat says was made to him by Mr Norman. He says the Trust would not have entered into the contract with Boat 93 had Mr Norman advised him of the true position of SML, that it was and had been balance sheet insolvent during his directorship and was completely dependent on him continuing to finance its extensive trading losses.

Factual background

[11] Ms Salthouse had been the General Manager or Managing Director of SML or its predecessor company since 1999. She came to know Mr Norman through the purchase of a Salthouse 65 yacht by Mr Norman's company, Yachts West Pty Ltd (Yachts West), in 2005. Yachts West became a sales agent for SML in Western Australia shortly thereafter.

[12] During this time, SML was reliant on finance company lending to facilitate the growth of its business. In particular, it owed approximately $6.1 million to Capital and Merchant Finance Limited (CMF). After CMF was placed into receivership in November 2007, its receiver looked for interested parties to purchase the SML debt.

[13] In June 2008, after discussions with another potential investor had fallen through, Ms Salthouse approached Mr Norman and provided him with a written proposal. She initially advised Mr Norman that SML was looking for an investment of $2 million.

[14] Between June and December 2008, Staples Rodway, a firm of chartered accountants, undertook due diligence of SML for Mr Norman. Staples Rodway were provided with balance sheets and monthly financial reporting spreadsheets for SML and its subsidiaries.

[15] Mr Norman decided to invest in SML notwithstanding its level of indebtedness because he thought SML's designs were outstanding and sales could be improved through better representation in Australia. He established two trusts for the purposes of his investment – the Capital Trust and the Merchant Trust.

[16] In August 2008, the Capital Trust purchased the SML debt for $699,500 from CMF's receiver. Mr Norman agreed not to charge interest on the CMF loan which resulted in an immediate saving to SML of approximately $1 million per annum in interest costs.

[17] In December 2008, the Merchant Trust also agreed to provide SML with a working capital facility of $1.3 million. The financing was secured by a general security agreement over SML's assets.

[18] The Merchant Trust acquired a 50 per cent shareholding in SML for the nominal sum of $1, with the remaining 50 per cent held by a trust associated with Ms Salthouse. Mr Norman became a non-executive director of SML and remained resident in Perth, while Ms Salthouse became SML's Managing Director, having previously been SML's General Manager as well as a director and shareholder.

[19] The Merchant Trust advanced initial working capital to SML of $1.3 million between December 2008 and April 2009. SML did not receive the full benefit of the $1.3 million because the legal and accounting costs of the restructuring came out of that amount as did the sum of $349,985, which was used to acquire the assets of an associated company, SML Upholstery Limited. However, between April and September 2009 Mr Norman's interests made a number of further short term advances totalling AU$868,333 (approximately $1.09 million) to SML. These advances were then repaid out of the sale of a trade-in yacht in early September 2009. Thereafter, the Merchant Trust provided further working capital to SML

between September and December 2009 totalling AU$1.54 million (approximately $1.93 million).

[20] SML's lease on its existing premises was up for renewal in December 2009. The directors determined to find a more suitable location for the business closer to the water where yachts could more easily be launched and to remove some inefficiencies in its existing location. In November 2009, the Merchant Trust settled the purchase of new premises into which SML moved in December 2009. Mr Norman agreed to charge SML the same rent which had been charged to the previous tenant by the vendor of the premises. This was slightly less than SML's existing rent. It was also less than the market rent for the new premises.

[21] In late January 2010, SML's Business Improvement Manager, Ms Emma Tallentire, asked Mr Norman for a further $730,000 to cover SML's costs for the month of February 2010. This request caused Mr Norman to take stock of his investment as no sales other than the contract with the Trust had eventuated. He contacted Staples Rodway and asked them to inspect SML's accounts and report to him. Various options were discussed. Staples Rodway's advice was to appoint a liquidator. At Ms Salthouse's request, Mr Norman agreed to appoint a receiver rather than a liquidator and Mr John Price of HBL Partners was appointed receiver of SML on 4 February 2010.

Issues for determination

[22] The plaintiffs called evidence and made submissions about various aspects of SML's operations over the 13 month period Mr Norman was a director. The following issues appear to me to be relevant to an assessment whether Mr Norman has breached any of his duties under ss 131, 135, 136 and 137 of the Companies Act:

(a) Whether Mr Norman was a shadow or de facto director of Boat 93 and/or any of the other boat building subsidiaries of SML.

(b) The practice of using funds received by boat building subsidiaries, such as Boat 93, to meet the cash requirements of SML or other boat building subsidiaries.

(c) The use of the proceeds of sale of a trade-in yacht accepted by SML as part payment for a yacht (the Summersalt) being built by Boat 89 Holdings Limited (Boat 89) for a customer resident in Perth;

(d) The agreement between SML and Yachts West for a yacht (the Luana) to be built by Boat 90 Holdings Limited (Boat 90) for Mr Norman;

(e) The financial position of SML at what the plaintiffs describe as four watershed moments;

(i) 23 December 2008 – when Mr Norman became a director of SML;

(ii) 24 April 2009 – when the Merchant Trust made its last payment under the $1.3 million working capital facility;

(iii) 31 August 2009 – when Yachts West sold the trade-in for Boat 89; and

(iv) 12 November 2009 – when the Trust signed the contract with Boat 93 to construct a yacht for it.

[23] A final and separate issue is whether Mr Norman made a misleading and deceptive representation to Mr Delegat that if the Trust did agree to purchase a yacht, it would be completed to his satisfaction.

Shadow or de facto director

[24] The plaintiffs allege that Mr Norman was a shadow or de facto director of Boat 93 and the other active boat building subsidiaries, Boat 89, Boat 90 and Boat 92

Holdings Limited (Boat 92). The plaintiffs allege that he made or participated in governance decisions, including:

(a) Locating and negotiating with customers of Boat 89, Boat 90 and Boat 93;

(b) Incorporating Boat 93;

(c) Specifying the commercial purpose of Boat 90, Boat 92 and Boat 93;

(d) Entering into build contracts with Boat 90 and Boat 93;

(e) Determining where Boat 90, Boat 92 and Boat 93's customer's yachts would be constructed;

(f) Transferring the Boat 89 trade-in vessel to Yachts West;

(g) Employing or continuing to employ Ms Salthouse as the General Manager of Boat 89, Boat 90, Boat 92 and Boat 93; and

(h) Delegating authority to Ms Salthouse, in her capacity as General Manager, to make operational decisions on behalf of Boat 89, Boat 90, Boat 92 and Boat 93.

[25] The Companies Act contains a definition of the director of a company. Section 126(1) provides:

> **126 Meaning of "director"**
>
> (1) In this Act, director, in relation to a company, includes—
>
> (a) A person occupying the position of director of the company by whatever name called; and
>
> (b) For the purposes of sections 131 to 141, 145 to 149, 298, 299, 301, 383, 385, 386A to 386F, and clause 3(4)(b) of Schedule 7—
>
> (i) A person in accordance with whose directions or instructions a person referred to in paragraph (a) of

this subsection may be required or is accustomed to act; and

(ii) A person in accordance with whose directions or instructions the board of the company may be required or is accustomed to act; and

(iii) A person who exercises or who is entitled to exercise or who controls or who is entitled to control the exercise of powers which, apart from the constitution of the company, would fall to be exercised by the board; and

(c) For the purposes of sections 131 to 149, 298, 299, 301, 383, 385, 386A to 386F, and clause 3(4)(b) of Schedule 7, a person to whom a power or duty of the board has been directly delegated by the board with that person's consent or acquiescence, or who exercises the power or duty with the consent or acquiescence of the board; and

(d) For the purposes of sections 145 to 149, and clause 3(4)(b) of Schedule 7 of this Act, a person in accordance with whose directions or instructions a person referred to in paragraphs (a) to (c) of this subsection may be required or is accustomed to act in respect of his or her duties and powers as a director.

(1A) In this Act, director, in relation to a company, does not include a receiver.

[26] Section 126 distinguishes shadow directors from de facto directors. Sections 126(1)(b)(i) and (ii) describe a shadow director who directs or instructs or has the power to direct or instruct the actions of an appointed director or the board of directors. A shadow director does not claim or purport to act as a director. Section 126(1)(a) describes a de facto director who occupies the position of director notwithstanding that he or she has not been validly appointed as such. A de facto director is one who is held out by the company and purports to act as a director.

[27] As part of the restructuring of the business in December 2008, a shareholders' agreement gave both Mr Norman and Ms Salthouse the right to appoint up to two directors to the board of SML. The initial directors appointed were Mr Norman and Ms Salthouse. Mr Norman was also the initial chairman of the board, with a casting vote in the event of a tied vote. The shareholders agreement also provided that, while Ms Salthouse would initially be the sole director of the boat building subsidiaries, Mr Norman had the right to equal representation on the board of each

subsidiary. However, Mr Norman never took up the right to appoint himself or anyone else to the board of the boat building subsidiaries.

[28] Mr Norman can be found to be a shadow director of each boat building subsidiary only if Ms Salthouse may have been required to act or was accustomed to act in accordance with Mr Norman's directions or instructions. Ms Salthouse was, however, not required to act in accordance with Mr Norman's directions or instructions. Directors are not ordinarily obliged to follow the directions of shareholders, even those who have the power to appoint and remove them.[1] The words "accustomed to act" in s 126(1)(b) suggests some sort of on-going control or influence in a company's affairs. As stated by Millett J in *Re Hydrodam (Corby) Limited*:[2]

> [w]hat is needed is ... a pattern of behaviour in which the board did not exercise any discretion or judgment of its own but acted in accordance with the direction of others.

[29] The plaintiffs have not specifically pleaded that Ms Salthouse was accustomed to act in accordance with Mr Norman's directions or instructions. Paragraph 7 of the third amended statement of claim pleads that Mr Norman was part of the governance structure of each member of the SML group as specified in the SML shareholders' agreement and that he either made or participated in the governance decisions listed in [24] above.

[30] There was however no evidence of Mr Norman giving Ms Salthouse directions or instructions in relation to the operation of the boat building subsidiaries. Both Mr Norman and Ms Salthouse gave evidence that Mr Norman had no involvement at all in relation to the boat building subsidiaries. That evidence was not disturbed in cross-examination. In cross-examination, counsel suggested that Ms Salthouse was controlled by Mr Norman because of his status as SML's only funder and because of his casting vote as chairman. However, both Mr Norman and Ms Salthouse gave evidence that they made decisions in relation to SML jointly and with little conflict. Mr Norman never used his casting vote. As Ms Salthouse herself said "He needed me as much I needed him in the business". Even if the argument

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[1] *Black White and Grey Cabs Ltd v Fox* [1969] NZLR 824 (CA) at 831.
[2] *Re Hydrodam (Corby) Limited* (1994) 2 BCLC 180 (Ch).

could be made that Mr Norman dominated SML at board level, which was clearly not the case, it would not follow that Ms Salthouse was accustomed to follow his directions or instructions in relation to the boat building subsidiaries. There is simply no evidence of that being the case.

[31] As to the allegation that Mr Norman was a de facto director of the boat building subsidiaries, the central question is whether Mr Norman had assumed the status and functions of a director even though he was not actually appointed as such. The concept of de facto director is confined to those who willingly or voluntarily take upon themselves the role, either by usurping the office or by continuing to act once their formal role has ceased. It does not extend to a person who does not willingly adopt the role of director.

[32] I accept the submissions of counsel for Mr Norman that in order to establish that a person is a de facto director of a company, it is necessary to plead and prove that he or she undertook functions in relation to the company that could properly be discharged only by a director. There needs to be clear evidence that the person was either the sole person directing the affairs of the company or if there were others who were true directors that he or she was acting on an equal footing with the others in directing the affairs of the company. If it is unclear whether the acts of the person are referable to an assumed directorship or to some other capacity, such as shareholder or consultant, the person must be entitled to the benefit of the doubt.

[33] It is clear on the evidence that Mr Norman did not assume the status and functions of a director of the boat building subsidiaries. He certainly did not willingly or voluntarily take on that role. He did not take on any functions at all in relation to the boat building subsidiaries, let alone the functions of a director. His involvement with the boat building subsidiaries was as a director and funder of SML and, through Yachts West, as an agent for SML, as a short term funder of SML and as a customer of SML and Boat 90. In relation to the specific matters listed in [7] of the third amended statement of claim:

(a) Yachts West was a sales agent for SML and it was Yachts West, through Mr Norman, which located and negotiated with customers of Boat 89, Boat 90 and Boat 93.

(b) Ms Salthouse incorporated Boat 93 without any involvement from Mr Norman.

(c) The commercial purpose of the boat building subsidiaries was determined well before Mr Norman became involved with SML and did not change during his directorship of SML. Boat 89 and Boat 90 had actually been incorporated and commenced trading before Mr Norman became a director of SML. Only Boat 93 was set up during Mr Norman's time as a director.

(d) Mr Norman's only involvement with the decision to enter into build contracts was as a director of SML because SML was the guarantor of the build contracts and was entitled to receive the gross profit on the contracts as a contribution to overheads and by way of net profit. In the case of Boat 90, Mr Norman also had involvement through Yachts West as the purchaser.

(e) Where the boats were to be constructed was already determined because they could only be constructed at the premises leased by SML.

(f) Mr Norman's role in transferring the Boat 89 trade-in vessel to Yachts West was only as a director of SML and Yachts West. Boat 89 was represented in the transaction by its sole director, Ms Salthouse.

(g) The boat building subsidiaries had no employees and Ms Salthouse was employed by SML.

(h) Ms Salthouse was the sole director of the boat building subsidiaries so that she did not need delegation from Mr Norman or anyone else to act on their behalf.

[34] If there is any doubt about the capacities in which Mr Norman was acting (that is, whether he was carrying out functions on behalf of SML, Yachts West or one of the boat building subsidiaries) the benefit of that doubt must go to Mr Norman. Mr Norman was not held out as a director of the boat building subsidiaries and he did not use the title of director of any of those companies.

[35] I therefore conclude that Mr Norman was not a shadow or de facto director of Boat 93 or any of the other boat building subsidiaries.

Use of funds received by boat building subsidiaries

[36] An analysis of how the funds received by Boat 93 from the Trust were utilised illustrates how SML operated a centralised treasury with funds being transferred between the boat building subsidiaries themselves or between the boat building subsidiaries and SML. Cash was used by SML wherever it was required.

[37] The following is an extract of the relevant cash book entries for Boat 93:

Boat 93 Holdings Limited

Cash Book

		Creditor	Income	[Balance]	SML	Boat 89	Boat 90	Boat 92
13 Nov	J Delegat		615,000.00	615,000.00				
18 Nov	Loan to SML	30,000.00		585,000.00	30,000.00			
20 Nov	Loan to SML	120,000.00		465,000.00	120,000.00			
20 Nov	Loan to Boat 89	143,000.00		322,000.00		143,000.00		
20 Nov	Loan to Boat 90	150,000.00		172,000.00			150,000.00	
20 Nov	Loan to Boat 92	29,000.00		143,000.00				29,000.00
27 Nov	Transfer to SML	70,000.00		73,000.00	70,000.00			
30 Nov	Bank fees	1.00		72,999.00				
1 Dec	Loan to SML	70,000.00		2,999.00	70,000.00			
21 Dec	Loan from SML		104,294.02	107,293.02	-104,294.02			
21 Dec	Creditors	105,293.02		2,000.00				
31 Dec	Bank fees	4.75		1,995.25				
8 Jan	J Delegat		615,000.00	616,995.25				
8 Jan	Loan to SML	75,000.00		541,995.25	75,000.00			
15 Jan	Loan to SML	50,000.00		491,995.25	50,000.00			
15 Jan	Loan to Boat 90	1,000.00		490,995.25			1,000.00	
15 Jan	GST	39,023.94		451,971.31				
19 Jan	Loan to SML	100,000.00		351,971.31	100,000.00			
21 Jan	Loan to SML	60,000.00		291,971.31	60,000.00			
22 Jan	Loan to SML	100,000.00		191,971.31	100,000.00			
22 Jan	Loan to Boat 89	53,000.00		138,971.31		53,000.00		
22 Jan	Loan to Boat 90	133,500.00		5,471.31			133,500.00	
22 Jan	Creditors	3,314.23		2,157.08				
29 Jan	Bank fees	1.75		2,155.33				
29 Jan	Loan to SML	2,000.00		155.33	2,000.00			
16 Feb	GST refund Dec		16,530.19	16,685.52				
16 Feb	GST refund Jan		7,109.91	23,795.43				
29 Feb	Bank fees	4.50		23,790.93				
9 Mar	Creditors	14,577.22		9,213.71				
11 Mar	Creditors	8,692.67		521.04				
12 Mar	Bank fees	2.50		518.54				
					572,705.98	196,000.00	284.500.00	29,000.00

[38] Substantial funds totalling $677,000 were transferred from Boat 93 to SML but $104,294.02 was returned from SML to Boat 93 on 21 December 2009 to make the monthly payments to Boat 93's creditors. The outstanding loans from Boat 93 to SML, Boat 89, Boat 90 and Boat 92 total approximately $1.08 million, which reflects the amount of the proof of debt lodged by the Trust in Boat 93's liquidation and the award of damages sought by the Trust for a misrepresentation Mr Delegat says was made to him by Mr Norman.

[39] Two matters should be noted about the cash book set out above. First, the payments to creditors on 21 December 2009 were to trade creditors only. Boat 93 did not have its own premises, equipment or employees and it used SML's premises, equipment and employees as well as SML's intellectual property in the yacht's construction. SML would also supply generic consumables, such as resin, balsa and common fittings and fixtures. SML therefore paid the staff that were working on the yacht being constructed by Boat 93 and supplied the generic consumables in its construction. It also paid some creditors directly. Secondly, SML had built a margin of $989,129 into the contract price for the yacht. This was a budgeted surplus which, in accordance with established practice, would have been drawn out of Boat 93 in the form of an overhead charge on a regular basis throughout the yacht's construction.

[40] These two factors led a professional marine surveyor retained by the Trust, Mr Neil Hayter, to estimate that the total cost of labour and materials (including a pro rata overhead charge) to build the yacht to the date of receivership on 4 February 2010 was $455,461 excluding GST.

[41] The contract between the Trust and Boat 93 did not limit the use that could be made of the funds paid by the Trust. In comments on the draft contract, the Trust's solicitor advised the Trust to obtain a general security agreement over the assets of Boat 93 which would cover the making of payments to related parties such as SML to ensure that only agreed charges were paid and no profit was taken prior to the expiry of the maintenance period. This advice was not followed. Contractually, Boat 93 and SML were therefore able to use the funds paid by the Trust as they saw fit.

[42] In opening his case for the plaintiffs, counsel described SML as operating in a manner similar to a Ponzi scheme whereby new customers were funding the repayment of SML's prior borrowings from older boat building subsidiaries as well as SML's continuing losses. He also noted that SML's financial position and business model was never disclosed to SML's customers. Rather, Mr Patterson says that customers were given a false sense of security by entering into construction contracts with a particular boat building subsidiary, which purported to have the sole purpose of constructing the customer's yacht. He submitted that the customers were given the impression that their payments would be directed exclusively towards the construction of their particular yacht. He says no other logical reason existed for using a sole purpose boat building subsidiary as far as a customer would be concerned.

[43] Mr Grant Graham, an expert accountant who was called by the plaintiffs, was more circumspect and described SML's operations not as a Ponzi scheme but as a centralised treasury, meaning that all of the various companies' funds were effectively being pooled. Mr Graham noted that as a boat building subsidiary's build progressed, it would need an increasing amount of its loans repaid in order to continue construction of its yacht. Those repayments tended to come increasingly by way of loans from boat building subsidiaries whose yacht builds were less advanced. The newer boat building subsidiaries consequently tended at any point in time to be bearing more of the burden of the debt owed by SML.

[44] Although counsel for the plaintiffs was critical of the use of the funds received by the boat building subsidiaries from customers, the contracts entered into by the customers provided for the front loading of payments with the effect that customers paid in advance of costs being incurred on their yacht. This payment structure created temporary surplus funds at the beginning of a yacht's construction. Mr Norman's evidence is that while he was aware of loans made by the boat building subsidiaries to SML, he always understood that they represented SML's draw down of its gross profit from each yacht's construction. To the extent that the surplus funds represented gross profit, I am of the view that it was open to SML to draw down its profit entitlement in whatever manner it determined subject to the requirement to repay the boat building subsidiaries to meet any cost overruns.

[45] In any event, the loans from the boat building subsidiaries to SML decreased substantially in the 13 month period of Mr Norman's directorship. As at December 2008, SML owed the boat building subsidiaries a total of $3,653,351. Mr Murray Lazelle, an expert accountant who was called by Mr Norman, gave evidence that of the $3,653,351 loaned to SML, only $1,846,000 would be required to be repaid to the boat building subsidiaries in order to complete the yachts then under construction. That was, according to Mr Lazelle, the sum that was required to pay existing creditors and meet the future costs of completing the yachts after taking account of the sums expected to be received in the future from the customers in terms of the contracts with the boat building subsidiaries. In effect, Mr Lazelle says that approximately half of the boat building subsidiary loans as at December 2008 appeared to have been funds that SML was entitled to as gross profit. Mr Lazelle acknowledges that while SML may not have had to repay all of the loans from the boat building subsidiaries, the funding of SML's overheads would still be an issue because in his calculations he assumed that all of the customers' future payments would be directed at construction costs, meaning that SML would be required to fund its overheads from sources other than the boat building subsidiaries. Mr Lazelle acknowledges that payment of those overheads would have been likely to have been met either through the Merchant Trust working capital facility or from new contracts.

[46] Mr Lazelle undertook an equivalent calculation as at December 2009. As at that date, the loans from boat building subsidiaries to SML totalled $1,558,000, of which SML would be required to repay $535,000 in order to complete the yachts then under construction. Mr Lazelle therefore estimates that in the period when Mr Norman was a director the funding shortfall in respect of the yachts then under construction reduced from $1.8 million to $0.5 million. Mr Lazelle is of the opinion that this reduction must be attributable to funds provided through the Merchant Trust working capital facility.

[47] I am therefore of the view that, overall, the position of the boat building subsidiaries was significantly improved by the continued trading. Mr Graham described the position of the boat building subsidiaries if receivership had occurred in December 2008 as "carnage" and agreed that their position in December 2009 was

"substantially better". Mr Graham also agreed with the proposition that, rather than one angry boat owner, there would have been several if SML had gone into receivership as at December 2008. Finally, Mr Graham acknowledged that this significant improvement in the debt position of the group was a result of the payments totalling $3.2 million made by Mr Norman during the year or so that he was a director.

Use of proceeds of sale of Boat 89 trade-in

[48] In terms of the agency agreement between SML and Yachts West, Yachts West was entitled to a commission of 5 per cent of the net sale price of any yacht sold during the term of the agreement. The commission was payable progressively as each instalment of the purchase price was paid to SML. When SML received payment, it was to notify Yachts West which was then to forward an invoice to SML for the commission due.

[49] On 13 March 2009, SML's Business Improvement Manager, Ms Tallentire, emailed Mr Norman:

> Here is a list of the commissions you are owed at present (all figures are AU$ excl GST):
>
> Boat 86 $14,919.62
>
> Boat 91 $161,647.00
>
> Boat 89 $116,303.97
>
> A remaining $33,831.04 is due for Boat 89 once we have received payment for the trade-in on Boat 89.

[50] Following receipt of the email, Mr Norman forwarded tax invoices to SML for these sums. On receipt of the invoices, Ms Tallentire suggested to Mr Norman that she pay the invoices out of funds from the sale of a yacht traded in as part payment for a yacht being built by Boat 89. The advantages for SML, according to Ms Tallentire, was that SML would not lose out on exchange rates from changing money from New Zealand dollars to Australian dollars and, moreover, it put a definite time on when SML would pay the invoices.

[51] Yachts West had earlier sold a Salthouse 68 yacht to a customer resident in Perth. Boat 89 was then incorporated for the purpose of building the yacht for the customer. SML did not normally accept trade-ins but prior to committing to purchase a yacht from SML, the customer had also been negotiating with a dealer for a rival boat building company who had offered to trade in his existing yacht, a Riviera 51, (the trade-in) for AU$1.3 million. SML had to match the offer if it wanted the deal and so agreed to the trade-in. The trade-in was duly delivered to Yachts West for sale on behalf of SML.

[52] The sale of the Boat 89 trade-in took longer than anticipated. On 2 April 2009, Ms Tallentire emailed Mr Norman. She stated that she was reviewing SML's cash flow for April and was wondering if he had any news on the trade-in. Ms Tallentire advised Mr Norman that SML would need to look at an alternative source of funds if the trade-in had not been sold. On 21 April 2009, Mr Norman arranged a further advance of $350,000 from the Merchant Trust to SML. The working capital facility provided by the Merchant Trust reached its limit of $1.3 million with this advance.

[53] Following further discussions with Ms Salthouse and Ms Tallentire, Mr Norman agreed that, if SML continued to have cash flow shortages, Yachts West would make short term advances to SML to be repaid when the trade-in was sold.

[54] A number of short term advances were made therefore over the next few months by Yachts West to SML, which were recorded by email exchange. An example is the email from Mr Norman to Ms Tallentire of 6 May 2009:

> As discussed I am sending an additional working capital loan amount of AU$220,000 to your AUD account today. As agreed with you and Julie, this amount will be repaid from the proceeds of the sale of the Riviera 51 trade-in vessel, together with interest at the previously agreed rate.
>
> Please would you acknowledge this.

Ms Tallentire responded saying that SML was "fine with that".

[55] Yachts West made further advances of AU$265,000 on 26 May 2010 and AU$300,000 on 19 June 2009. On 23 July 2009, a further payment of NZ$170,000

was made. By mistake it was paid into Boat 90's bank account, rather than made in Australian dollars to SML as intended. It was subsequently agreed that this sum would be retained by Boat 90 to cover variations to the build contract between Boat 90 and Yachts West for Mr Norman's new yacht, the Luana. On 1 September 2009, Mr Norman arranged for a further short term advance of NZ$100,000. This time the funds came from the C J Norman Investment Trust which paid them to SML on behalf of Yachts West.

[56] On 31 August 2009, Yachts West was able to broker the sale of the Boat 89 trade-in vessel with settlement on 4 September 2009. The purchase price agreed was AU$1.275 million, which was made up of AU$825,000 cash plus the purchaser's own trade-in vessel (a Riviera 43), which was valued at AU$450,000. At the time of settlement, Yachts West was owed AU$785,000 in advances against the Boat 89 trade-in, plus interest on those advances at 8 per cent, plus commissions of AU$322,157.64 (incl. GST) and AU$37,214.14 (incl. GST) on earlier sales in addition to commission on the sale of the trade-in yacht of AU$27,500 (incl. GST). Mr Norman accordingly advised Ms Tallentire that all the free cash realised from the trade-in needed to be repaid to Yachts West as agreed.

[57] Mr Norman was however committed to continuing to fund SML. In the same email in which he advised Ms Tallentire that there was no free cash in the trade-in, he advised Ms Tallentire that whatever was required for the 20th of the month creditors would need to be by way of an additional advance and asked her to advise him what amount was required. This confirmed Mr Norman's intention that the Merchant Trust would advance more working capital over the previously agreed limit of $1.3 million. To further assist with SML's cash flow, Yachts West also agreed to take the trade-in on the trade-in, the Riviera 43 (worth around AU$450,000), in part payment of what was owed to it by SML together with the cash sum.

[58] The purchase price agreed for the Boat 89 trade-in was AU$1.275 million. Yachts West was due almost exactly the same amount, AU$1,271,675.10, made up as follows:

(a) Commission of AU$322,157.64 (incl. GST) due for Boats 86, 91 and 89;

(b) Commission of AU$37,214.14 (incl. GST) for the balance of commission on Boat 89;

(c) Advances to SML of AU$785,000;

(d) Interest on advances at 8% of AU$16,470.14;

(e) Commission on the Boat 89 trade-in of AU$27,500 (incl. GST); and

(f) Further advance by the C J Norman Investment Trust on 1 September 2009 of AU$83,333.33 (NZ$100,000).

[59] The plaintiffs allege that Mr Norman breached his duties as a director of SML in a number of ways in relation to the use of the proceeds of sale of the Boat 89 trade-in. Counsel for the plaintiffs submitted that Mr Norman had obviously decided that "he was not going to throw more money into SML" unless his advances could be secured and that Mr Norman was, at that time, holding the only asset within the SML group that was likely to produce some cash. Counsel also submitted that the arrangement had the added advantage that Mr Norman would be able to use the proceeds of sale of the Boat 89 trade-in to prefer himself (or his interests) as a creditor by "extracting" both the interest and the outstanding commissions that Yachts West was owed. Finally, counsel submitted that Boat 89, in real terms, lost approximately AU$1.25 million from the transaction. Boat 89 is said to have been reliant on receiving the sale proceeds of the trade-in so that it could complete the building of the Summersalt.

[60] Aside from the short-term advances paid by Yachts West to SML while awaiting a sale of the Boat 89 trade-in, Mr Norman contributed various sums of money to enable SML to continue trading. Through his various entities, he bought the CMF loan for $699,500 and provided an initial working capital facility of $1.3 million in addition to later funding of AU$1.54 million. All of these payments were

secured as well, so there was nothing unusual in advancing money on the strength of a security. Mr Norman was indeed holding the Boat 89 trade-in but this was at the specific request of SML, which did not normally accept trade-ins and did not act as a broker for the sale of used boats. On the other hand, Yachts West was an established yacht broker and sales agent for SML on the west coast of Australia. The Boat 89 purchaser was a Perth resident and the trade-in sailed in west coast waters. It would not have made sense for the trade-in to be brought back to Auckland for sale because of the cost and delays involved. It was also more likely to be sold in Australia rather than New Zealand.

[61] As to preferring himself as a creditor, Mr Norman's funding enabled SML to pay all its debts as they fell due for payment throughout 2009. Although SML was insolvent in a balance sheet sense throughout this period, it paid all its normal creditors. Yachts West was also a creditor of SML in respect of both the short-term advances and the commissions it was owed for the sale of yachts it had brokered. In fact, the commissions owed were substantial and well overdue for payment. SML acknowledged owing AU$322,157.64 (incl. GST) in commissions to Yachts West in March 2009. The commissions were, however, only treated as having been paid five and a half months later, in September 2009, in the form of a trade-in on a trade-in, which Yachts West still had to sell in order to receive cash. An ordinary creditor of SML throughout 2009 would have been paid much sooner and in cash. I am therefore of the view that Mr Norman was not preferring himself as a creditor.

[62] As to the plaintiffs' claim that Mr Norman was improperly "extracting" interest from SML, Yachts West was indeed paid interest of AU$16,470.14 in respect of the short-term advances of AU$785,000 and NZ$100,000. However, when the Capital Trust bought the CMF loan, Mr Norman agreed not to charge interest on the debt, a saving of approximately $1 million per annum to SML. Furthermore, although the Merchant Trust was entitled to interest on the $1.3 million working capital facility and on the further sums totalling AU$1.45 million advanced between September and December 2009, Mr Norman only ever received two further interest payments of $20,676.23 on 21 May 2009 and $15,322 on 5 June 2009. I am therefore of the view that Mr Norman was not improperly "extracting" interest from SML in respect of the money owed to Yachts West.

[63] Finally, as to the assertion that Boat 89 lost approximately AU$1.25 million from the transaction, as at April 2009, SML owed $775,985 to Boat 89. In other words, various sums totalling $775,985, which had been received from the customer, had been transferred from Boat 89 to meet cash commitments elsewhere. As at April 2009, the customer had paid sums totalling $2,468,646, whereas the work in progress amounted to $1,871,312.

[64] By the end of August 2009, the payments recorded as having been received from the customer had only slightly increased to $2,612,679 because the trade-in delivered to Yachts West had not yet been sold but the work in progress was now $3,244,515, an increase of $1,373,203. The loan from Boat 89 to SML had also decreased from $775,985 to $41,674. I infer from these figures that the short-term advances from Yachts West to SML between April and September 2009 had, in fact, been utilised, at least in part, to substantially complete construction of the Summersalt, which was launched in November 2009.

[65] By December 2009, the customer is recorded as having paid at total of $4,201,100 (which takes into account the credit given for the trade-in, the sale of which was settled in September 2009) and the work in progress is recorded as $4,098,910. In all the circumstances I am not persuaded that Boat 89 lost approximately AU$1.25 million from the transaction. A large proportion of the advances made by Yachts West to SML can be seen as having been expended by or on behalf of Boat 89 on the building of the Summersalt.

The Luana

[66] Mr Norman commenced negotiations with Ms Salthouse at some stage in 2008, before he became a director of SML, about the construction of a new yacht for himself. An agreement was reached between them at the end of August 2008 that SML would build a new Salthouse 68 yacht for Yachts West at cost plus overheads, plus 10 per cent.

[67] Mr Norman says he agreed to the purchase after he had committed to investing in SML because he admired the quality of SML's designs and in part

because it would provide much needed work for SML which would enable SML to retain staff while it sought new sales. It was agreed that Mr Norman would not pay full retail price while SML had surplus capacity. Mr Norman says he would not have expected a discount if the build took priority over another build at full margin. As it was, the budgeted gross margin on Mr Norman's yacht was $779,478. Boat 90 was incorporated to build the yacht for Mr Norman. The yacht was later named the Luana.

[68] Although Mr Norman gave the go ahead for construction at the end of September 2008, a written contract was only executed in June 2009. The contract price was $3,220,201 plus agreed variations. The price did not include the cost of the engines, electronics or tender, which Mr Norman sourced independently. Additional items (mainly instruments) totalling $166,783 were included during the build. The agreed variations were also later calculated by Ms Tallentire to be $99,112. The total price payable by Yachts West was therefore $3,486,096. Between October 2008 and December 2009, Mr Norman paid a total of $3,505,375 to Boat 90 (ie an overpayment of $19,279).

[69] At the time of the receivership of SML, although the Luana had been launched, it had not been completed. The receiver satisfied himself that Mr Norman had paid the full contract price for the yacht but that, given the receivership, SML could not fulfil its obligations as guarantor under the agreement to complete construction of the yacht. He considered that Mr Norman was contractually entitled to possession of the Luana. Accordingly, on 11 March 2010, the receiver delivered the yacht to Mr Norman free of any encumbrance. Mr Norman paid an additional $175,948 to complete work on the Luana, recognising that neither Boat 90 nor SML was in a position to pay to complete the yacht.

[70] The plaintiffs allege that Mr Norman breached his duties as a director of SML in a number of ways in relation to the construction of the Luana. Firstly, counsel for the plaintiffs submitted that the Luana was never going to make any significant contribution towards the turning around of SML because its contract price included a large discount. Secondly, counsel submitted that by the end of August 2009 it was clear that Mr Norman only intended to fund SML until the Luana had been

completed. The plaintiffs allege that, at that point, Mr Norman knew there was only three months more to go before Boat 89 would hand over the Summersalt and before his own yacht would be in the water. Mr Patterson submitted that Mr Norman knew that if SML ceased trading at that stage he would have to complete his own yacht, resolve any claim brought against him by the owner of the Summersalt and resolve any claim brought against him by the liquidator of Boat 89 in respect to the proceeds of the sale of the Boat 89 trade-in.

[71] Thirdly, counsel submitted that Mr Norman instructed SML employees to work on completing the Luana over their scheduled Christmas holidays because of the parlous financial position of SML and Mr Norman's decision not to advance any further funds after the payment of AU$420,000 on 18 December 2009. When the Luana was launched on 11 January 2010, counsel submitted that Mr Norman had effectively maximised the mitigation of his losses. The fact that Mr Norman appointed a receiver to SML not long afterwards is said, by the plaintiffs, to be confirmation that it was always Mr Norman's intention to appoint a receiver to SML once he had his own yacht in the water.

[72] As to whether the Luana was going to make a significant contribution towards the turning around of SML, I am of the view that its construction gave some breathing space to SML while it sought to reduce overheads in an attempt to return to profitability and to garner new sales in the aftermath of the global financial crisis. While it was agreed that Mr Norman would receive some discount as a director, shareholder and funder of SML, the budgeted gross margin on the construction of the Luana was still considerable at $779,478. This can be favourably compared with a budgeted gross margin for the two other Salthouse 68's in construction at the time - $908,782 for Boat 89 and $970,141 for Boat 91. It is also significant that SML was not required to pay any commission on the sale of the Luana as it might well have been required to had it been sold through an agent (such as Yachts West).

[73] The fact that the construction of the Luana gave breathing space to SML is evident from emails in April and July 2009. On 6 April 2009, Mr Norman was asked when he would be paying the next instalment on the Luana in order to plan SML's cashflow for the month. Similarly, on 20 July 2009, Mr Norman was advised that

while the next payment due for the Luana would cover outgoings at the start of August 2009, more funds would be needed to meet payments due to creditors on 20 August 2009. A week later, he was advised that it would be helpful to SML's liquidity if Yachts West could make its scheduled payment to Boat 90 "sooner rather than later".

[74] I also do not accept that it was ever Mr Norman's intention to place SML in receivership once the Luana was substantially complete. In my view, Mr Norman was fully committed to continuing to fund SML when he advanced AUD$420,000 to SML on 18 December 2009. At that stage the Luana was nearing completion. I accept Mr Lazelle's evidence that it would have made more financial sense for Mr Norman to have placed SML in receivership before the payment of AU$420,000 and taken his yacht elsewhere to be completed rather than continue to fund SML's losses while awaiting the completion of the Luana.

[75] Between September and December 2009, the Merchant Trust had in fact advanced a total of AU$1.54 million to SML. In addition Yachts West had, in the same time period, paid a further $829,950 to Boat 90 for the ongoing construction of the Luana. It is my view that this confirms Mr Norman's commitment to the continued funding of SML. There is no evidence to support the plaintiffs' contentions to the contrary.

[76] Overall Mr Norman paid the full contract price for the Luana and received a yacht that still required considerable expenditure to complete it.

Financial position of SML

[77] Adopting an approach set out in case law[3] on the application of ss 135 and 136 of the Companies Act, counsel for the plaintiffs submitted that there were four "watershed moments" when Mr Norman was obliged to give particular consideration to whether continued trading was in the best interests of all of the SML's creditors. In essence, counsel submitted that on each of the four occasions SML should have

[3] *Fatupaito v Bates* [2001] 3 NZLR 386 (HC); and *Mason v Lewis* [2006] 3 NZLR 225 (CA).

ceased trading and that Mr Norman was, in effect, reckless in allowing SML to continue to trade.

[78] The four watershed moments were:

(a) 23 December 2008 – when Mr Norman became a director of SML;

(b) 24 April 2009 – when the Merchant Trust made its last payment to SML under the $1.3 million working capital facility;

(c) 31 August 2009 – when Yachts West sold the trade-in for Boat 89; and

(d) 13 November 2009 – when the Trust signed the contract with Boat 93 to build a yacht for it.

December 2008

[79] Counsel for the plaintiffs submitted that as at 23 December 2008, SML was "highly insolvent" and that Mr Norman should not have invested in SML because any continuation in trading was not in the best interests of SML's current and prospective creditors. In other words, SML should have ceased trading in December 2008, notwithstanding that all unsecured creditors would, at that stage, have suffered total losses.

[80] Counsel noted that of the working capital facility of $1.3 million that the Merchant Trust had agreed to put in place for SML, $349,000 was used to purchase the shares of an associated company, SMG Upholstery Limited. Legal and accounting fees were also paid out of the facility while it was intended that a further $349,000 would be used to purchase the assets of another associated company, SMG Design Limited. Counsel submitted that the facility would not even have been enough to cover more than a few months overheads for the business let alone make an impact on its historic liabilities or pre-existing debt or assuage the risk that continued trading would pose to any new creditors.

[81] When discussing a possible investment in SML in mid-2008, Mr Norman was advised by Ms Salthouse that she was hoping to receive working capital of about $2 million. Ms Tallentire also advised Mr Norman that around $2 million was needed to pay all creditors other than CMF. In a subsequent email dated 24 July 2008, Ms Tallentire estimated the "hole" at between $2.15 million and $2.9 million. In my view, Mr Norman was therefore well aware that it was likely he would have to advance more than the initial working capital facility of $1.3 million he was proposing to make available. He said he set the initial figure at $1.3 million because he did not want Ms Salthouse and Ms Tallentire to think that there was an endless supply of money available. He wanted them to focus on reducing overheads and running the business as tightly as possible.

[82] There was no challenge to Mr Norman's evidence that he had the personal wealth to fund the losses over a number of years, if necessary, provided SML's strategy to turn its fortunes around was being implemented and achieved. In the end, Mr Norman advanced approximately $3.2 million to SML – a figure above the high end estimate of the "hole" made by Ms Tallentire in July 2008 of $2.9 million. This is in addition to the $700,000 he invested through the Capital Trust purchase of the CMF debt.

[83] The risks that Mr Norman was taking on when he decided to invest in SML were considerable but it is my view that such risks were legitimate business risks given the level of funding to which Mr Norman was committed. Mr Norman was, therefore, not reckless. SML had been balance sheet insolvent for a considerable period of time prior to Mr Norman's involvement. Mr Graham described Mr Norman as acting like a white knight in coming to the rescue of a financially distressed business and as creating a path forward for the business. I am therefore of the view that Mr Norman was entitled to invest in SML and that the initial working capital facility was not inadequate for SML to continue trading and paying its debts as and when they fell due.

April 2009

[84] Counsel for the plaintiffs submitted that if for whatever reason Mr Norman did not appreciate as at 23 December 2008 that allowing SML to continue trading and allowing the continuation of inter-company lending without further committed finance in place was putting creditors at risk, he had ample opportunity between January to April 2009 to realise what was going on and bring a halt to SML's operations. The Merchant Trust made its last advance under the $1.3 million working capital facility on 24 April 2009. SML had no more committed funding available to it and no certainty it could fund any losses caused to creditors by continued trading. Mr Patterson therefore submitted that SML should have ceased trading in April 2009. Counsel suggested that it should have been clear to Mr Norman that if sales did not eventuate and further funds were not introduced the overwhelming likelihood of any further trading would be further losses for unsecured creditors.

[85] I accept that sales did not eventuate but, in fact, substantial further funds were introduced in the form of short-term advances from Yachts West on the security of the Boat 89 trade-in. The sum of AU$220,000 was advanced on 6 May 2009, AU$265,000 on 26 May 2009, AU$300,000 on 19 June 2009 and $100,000 on 1 September 2009.

[86] There is also the fact that in February 2009, Ms Tallentire had provided Ms Salthouse and Mr Norman with two year financial projections for SML based on six different scenarios. In scenario four, the Merchant Trust loan would need to increase to $2.37 million by December 2009 and $3.7 million by March 2011. In the least favourable scenario, scenario five, the Merchant Trust loan would need to increase to $2.85 million by December 2009 and $4.135 million by March 2011. Mr Norman was aware of these projections. I accept that he appreciated that the Merchant Trust may have been required to provide funding to these levels if the assumptions in the various scenarios eventuated. Mr Graham agreed that using financial projections based on scenarios like those calculated by Ms Tallentire to determine the level of funding required was all that directors could reasonably do. I

am therefore of the view that Mr Norman was entitled to continue with the directors' strategy to turn the business around while supporting it by advancing further funds.

August 2009

[87] Counsel for the plaintiffs acknowledged that SML was advanced sufficient funds from Yachts West to continue trading from the end of April 2009 through to the end of August 2009. Counsel submitted that it was, however, difficult to determine what the net effect of the continued trading in that period was on the total balance of SML's borrowings from the boat building subsidiaries. Overall, the level of the boat building subsidiary loans appears to have decreased by approximately $749,380 as a result of the continued trading. However, that improvement is said to be more than offset by the increase in SML's unpaid trade creditors which increased from $2,378,961 at the end of April 2009 to $3,336,166 at the end of August 2009, an increase of $984,205.00.

[88] Mr Patterson, for the plaintiffs, submitted that SML should have ceased trading at this point because there were no further funds available from the purchaser of the Summersalt and Mr Norman was not committed to providing SML with sufficient finance. Counsel submitted that Mr Norman chose a third option, providing funding on an "at-will" basis, so that if and when he chose, he could cease the funding to SML. The result was that Mr Norman was not bound to underwrite the cost of continued trading. The advantage for Mr Norman was said to be that if another customer, such as Mr Delegat, did materialise that customer could, through further inter-company loans, effectively subsidise the costs necessary to get the Mr Norman's yacht completed. In short, counsel submitted that Mr Norman chose the option that provided uncertain protection for SML's current and prospective creditors (or those of the boat building subsidiaries) but minimised the possibility that he would ultimately have to personally fund the full cost of having the Luana completed.

[89] However, it is my view that Mr Norman's continued commitment is very clearly demonstrated by the advances from the Merchant Trust to SML in the period September to December 2009 totalling AU$1.54 million. In addition, Mr Norman

paid a further $829,950 to Boat 90 for the ongoing construction of the Luana between September and December 2009. As noted above, Mr Norman paid the full contract price and a significant extra amount to have it completed. I am therefore of the view that Mr Norman was not obliged to cease funding SML and close the business down at the end of August 2009 when the Boat 89 trade-in was sold.

November 2009

[90] In respect of the last watershed moment, Mr Patterson submitted that at the time the Trust entered into the construction contract with Boat 93 in November 2009, Mr Norman should have recognised that the risks to the Trust were patently clear and clearly unreasonable. SML had been running at a loss throughout 2009 and it had no committed funding in place. SML had made no other sales in 2009 and such sale prospects that existed were uncertain at best. Counsel submitted that in those circumstances Mr Norman simply could not, in good faith, and in the best interests of SML or Boat 93, agree to the companies entering into the contract with the Trust to build a new yacht for Mr Delegat. In fact, counsel went further and submitted that at the time he agreed to SML and Boat 93 entering into the contract with the Trust, Mr Norman fully intended to withdraw his support of SML as soon as the Summersalt and Luana were practically completed. Furthermore, counsel submitted that Mr Norman never intended that Boat 93 would fulfil its obligations under the contract but rather, that the contract was simply a means to procure the payment of funds by the Trust to Boat 93, which would then be "borrowed" by other members of the SML group to reduce the final cost to Mr Norman of having the Summersalt and Luana completed.

[91] Although SML had been running at a loss throughout 2009 and the $1.3 million working capital facility had been exhausted, Mr Norman continued to fund SML's losses through the Merchant Trust. I accept Mr Norman's evidence that, at the time the contract was entered into with the Trust in November 2009, he was committed to continuing to fund SML. As noted above, his evidence that he had the financial means to do so for a significant period of time was not challenged. In the four months prior to SML's receivership, Mr Norman advanced a total of AU$1.54 million (approximately $1.93 million) to SML.

[92] There was also extensive evidence at trial about further sale prospects. Mr Norman gave evidence that it was not a particular surprise that there were no sales in the first half of 2009 as the global financial crisis had only just occurred and after the summer months, sales are generally slow. Two customers had, however, paid slot deposits, which provided them with a first right of refusal over a certain delivery position. It meant that if another customer came along ready to commit to a purchase, the slot deposit holder would have five working days to commit to the purchase or lose the right to have the next yacht build. It did not mean a sale was guaranteed but it gave a very strong indication of a future sale. Another customer was also committed to the purchase of a yacht once the sale of his caravan park settled which was scheduled to occur on 1 February 2010.

[93] Mr Norman and Ms Salthouse were, in fact, so confident of further sales that they authorised the commencement of construction of the hull for a Salthouse 57 yacht in September 2009 without having a sales contract in place. Construction would then be underway when a sales contract was signed with a new purchaser. As to the number of new sales required, both Mr Norman and Ms Salthouse were of the opinion at the time of the sale to the Trust in November 2009 that two to three more sales over the next few months were needed to break even. Crucially, however, further sales did not eventuate. Nonetheless, I am of the view that there is some basis for the opinion held by Mr Norman and Ms Salthouse that future sales were likely. Their opinion cannot be dismissed as unreasonable.

[94] In that regard, I accept Mr Norman's evidence that if the customer who was waiting on the settlement of his caravan park had been ready to proceed with the purchase of a yacht on 1 February 2010 he would have carried on funding SML. However, settlement of the sale of the customer's caravan park was delayed and so the customer did not proceed on 1 February 2010. No other sales materialised either. It was against that background that Mr Norman sought advice from Staples Rodway when Ms Tallentire requested further funds from him in late January 2010.

[95] I am of the view that Mr Norman was acting in good faith when SML and Boat 93 agreed to enter into the construction contract with the Trust in November 2009 and that the catalyst for the action taken by Mr Norman to appoint a receiver to

SML only arose three months later in early 2010 when a further sale did not eventuate.

Analysis

[96] Counsel for the plaintiffs submitted that when a company is insolvent (as SML was in a balance sheet sense at all material times) acting in the company's best interests means acting in the company's creditors' best interests. He also submitted that acting in good faith towards the company means acting in good faith towards the company's creditors. On the other hand, counsel for Mr Norman submitted that directors' duties are owed to the company not to its shareholders or creditors and insolvency does not change this position. He submitted that, in particular, insolvency does not result in the directors owing duties directly to the creditors. Nonetheless, in my view, it is constructive to look at the movement in SML's total current liabilities over the period during which Mr Norman was a director and in particular at the four watershed moments.

[97] The table below sets out SML's total current liabilities at the four watershed moments as well as December 2009, the last month for which accounts are available.

	Creditors	**Other creditors/accruals**	**Loans from BBS**	**CMF loan**	**Merchant Trust**	**Total current liabilities**
	$	**$**	**$**	**$**	**$**	**$**
Dec 2008	406,879	101,636	3,654.753	6,698,808	-	10,862,076
Apr 2009	780,259	398,654	2,643,479	6,698,808	1,320,545	11,841,745
Aug 2009	1,899,932*	485,785	1,426,083	6,690,374	1,333,008	11,835,182
Nov 2009	1,876,898*	351,789	1,589,418	6,690,374	1,359,744	11,868,223
Dec 2009	363,588	474,613	1,551,192	6,690,374	3,397,022*	12,476,789

* The short-term advances made by Yachts West secured by the Boat 89 trade-in and the additional advances of AU$1.54 million between 9 September 2009 and 18 December 2009 were categorised as creditors until December 2009 when $2,028,049.00 (approximately AU$1.641 million @ .798) was transferred to the Merchant Trust facility.

[98] From December 2008 to December 2009, SML's total current liabilities increased from $10,862,076 to $12,476,789, an increase of approximately $1.61

million. However, the amount owing to creditors (which included the loans from the boat building subsidiaries) decreased from $4,163,268 to $2,389,393, a decrease of approximately $1.77 million. The increase in liabilities added to the decrease in creditors matches the funds initially contributed by the Merchant Trust under the working capital facility and the later funds advanced between September and December 2009. The position of the creditors therefore improved significantly while Mr Norman was a director of SML.

[99] As to the actual losses incurred by the failure of SML, the receiver, in his first report on the receivership of SML dated 25 April 2010, noted claims for unpaid wages of $80,629, holiday pay of $150,446, PAYE of $58,492 and from various unsecured creditors for goods and services totalling $278,910. It was the receiver's view that there would be insufficient funds available for distribution to those designated as preferential creditors or for those ranked as unsecured creditors. The receiver's second report dated 8 March 2011 noted realisations of $285,911.15 and payments of $284,923.77, leaving a bank balance of $987.38.

[100] The Official Assignee was appointed liquidator of SML on 19 May 2010. The Official Assignee's report dated 12 July 2010 noted one proof of debt had been received from Greenstone Energy Limited for $1,302.73. Mr Delegat had also notified the Official Assignee of a claim for $5,556,404.25. It is unclear how Mr Delegat has calculated this figure. There were no other proofs of debt lodged.

[101] The biggest loser in SML's failure was, in fact, Mr Norman. He, or entities associated with him, advanced approximately $3.3 million to SML. He also bought the CMF debt for $699,500. He has lost his total investment. As to the position of Mr Delegat, he paid $1.23 million in terms of his contract with Boat 90 and at the time of SML's failure was left with an incomplete hull valued (by a marine surveyor retained by him) at $455,461 (excluding GST). I have not considered the question whether or not Mr Delegat was able to mitigate his losses by completing the yacht himself.

Overall assessment of duties under Companies Act 1993

[102] The plaintiffs allege breaches of ss 131, 135, 136 and 137 of the Companies Act. Section 131(1) imposes a general duty on a director to act in good faith and in the best interests of the company. It provides:

> **131 Duty of directors to act in good faith and in best interests of company**
>
> (1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.
>
> ...

[103] Brooker's Companies and Securities Law explains the scope of s 131. The learned authors state:[4]

> Section 131 restates the basic obligation the common law imposes on directors to act in good faith and in what the director believes to be the interests of the company ... "Good faith" requires that the directors act honestly and with a proper motive. The Law Commission's proposal that the required "belief" must be on reasonable grounds was rejected (although s 137 does impose an objective standard of care on a director's exercise of a power or performance of a duty). The subjective nature of the duty reflects the reluctance of the Courts to "second-guess" directors' commercial decisions. The Courts will generally presume that acts have been done in good faith unless the action was one which no director with any understanding of fiduciary duties could have taken.

[104] Sections 135 and 136 are similar, in that they are both intended to address the same sort of conduct, namely, reckless trading which causes serious losses to creditors. Sections 135 and 136 provide:

> **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.

[4] *Brooker's Company and Securities Law* (online looseleaf ed, Brooker's) at [CA 131.02].

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.

[105] The cases determined under s 135 differentiate between the taking of legitimate and illegitimate business risks. As stated by William Young J in *Re South Pacific Shipping Ltd (in liquidation)*:[5]

> No-one suggests that a company must cease trading the moment it becomes insolvent (in a balance sheet sense). The cases, however, make it clear that there are limits to the extent to which directors can keep a company trading while they are insolvent, in the hope that things will improve.

[106] In contrast to s 131, the Courts take an objective approach in determining whether the conduct of a director breaches s 135. Conduct of a director will only breach s 135 if it is reckless, in the sense of being well outside orthodox business practice.

[107] Section 136 is breached if a director agrees to the company incurring an obligation at a time when he did not believe (a subjective test) on reasonable grounds (an objective test) that the company would be able to perform that obligation when required to do so. The section therefore blends both subjective and objective approaches.

[108] As to the distinction between s 135 and s 136, it has been suggested s 135 may be more appropriate when challenging a course of conduct over an extended period of time, whereas s 136 may be more appropriate when the challenged conduct relates to the incurring of specific liabilities.[6]

[109] Section 137 requires a director to exercise the care, diligence and skill of a reasonable director. It provides:

137 Director's duty of care

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[5] *Re South Pacific Shipping Ltd (in liquidation)* (2004) 9 NZCLC 263,570 (HC) at [125].
[6] *Goatlands Ltd (in liquidation) v Borrell* HC Hamilton CIV-2005-419-1643, 14 Dec 2006.

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

[110] Section 137 imposes an objective standard of a reasonable director. The particular knowledge and experience of a director is not relevant. However, an element of subjectivity is introduced by the reference to the position of the director and the nature of the responsibilities undertaken by him or her. This seems to allow a differentiation between executive and non-executive directors.

[111] Bearing in mind the requirements for ss 131, 135, 136 and 137 of the Companies Act, I have no doubt that Mr Norman acted in good faith and in what he believed to be the best interests of SML. He was motivated by his admiration for the yachts built by SML and by genuine belief that SML could be turned around. He is obviously passionate about boats, with a considerable reputation as a distinguished naval architect. He also attempted to improve SML's prospect of success in other ways, such as charging SML less than the market rent for its new premises and fostering links with Yachts West and the wider Australian market.

[112] Because of SML's accumulated debt, Mr Norman might have been better advised to have bought its assets rather than a shareholding in the company to protect himself from its liabilities. If Mr Norman had proceeded with an asset purchase, there almost certainly would have been a total loss to unsecured creditors and substantial losses to the purchasers of the yachts under construction at the time. However, he chose to take on those liabilities which were estimated by Ms Tallentire in July 2008 to be between $2.15 million and $2.9 million.

[113] As to whether or not the business of SML was carried on by Mr Norman in a manner likely to create a substantial risk of serious loss to the company's creditors, I accept that SML's total liabilities increased by $1.61 million between December

2008 and December 2009. However, that increase was borne by Mr Norman or entities associated with him. Unsecured creditors were, in fact, better off in the same period. The amount owing to creditors had decreased by $1.77 million. In particular, the amount owing by SML to the boat building subsidiaries had decreased markedly and even though one customer, Mr Delegat, suffered a substantial loss, a number of customers would have suffered substantial losses if SML had ceased trading in December 2008.

[114] Throughout 2009, SML paid its creditors as and when debts fell due. Mr Graham agreed that most, if not all, of the unsecured liabilities that SML had as at February 2010 appear to have been incurred since December 2009. Mr Lazelle was not aware of any statutory demand being issued by any creditor in the period. He also gave evidence that, typically, insolvent companies collapse with significant liabilities to the IRD for PAYE, GST and income tax which had not been paid to the IRD but retained as funding for the business. That did not appear to have occurred here.

[115] Looking at the overall circumstances, I am of the view that there was already a risk of loss to SML's creditors as at December 2008. That risk remained but the magnitude of the potential loss decreased between December 2008 and December 2009. The decrease in the magnitude of the potential loss was entirely due to the funding provided by Mr Norman or his associated entities. I agree with counsel for Mr Norman that his willingness to fund SML is of considerable importance when judging his conduct. I am therefore of the view that Mr Norman took a legitimate business risk in investing in SML. That business risk did not, however, pay off and Mr Norman is the biggest loser in SML's failure.

[116] As to whether or not Mr Norman believed on reasonable grounds that SML would be able to guarantee the completion of Mr Delegat's yacht at the time Boat 90 entered into the contract with the Trust in early November 2009, there is no doubt that Mr Norman believed that SML would be able to guarantee the completion of the yacht. The question is whether that was a reasonable belief. In my view, it was. I accept that Mr Norman would have continued to fund SML if the customer, who was waiting on settlement of his caravan park on 1 February 2010, had proceeded with

the purchase of the yacht. I infer that Mr Norman would also have continued to fund SML if anyone else had purchased a yacht over the 2009-2010 summer period.

[117] Mr Norman called Mr Steven Bates, SML's sales director, to give evidence about the period when Boat 90 entered the contract with the Trust. He said that there were very positive signs leading up to Christmas 2009. Everyone was confident people were going to start buying boats after the worst of the global financial crisis. Mr Bates' evidence was put to Mr Graham who said that unfortunately he was someone "who spends his days dealing with directors of companies that have failed but were just about always to crack it". He asked to be excused for having a jaundiced view because it was a story he always heard. He did acknowledge, however, that he was not qualified to talk about the prospects of success or otherwise.

[118] Mr Norman was in the business of selling yachts. I accept his belief regarding further sales as a reasonable one. The plaintiffs have not led any evidence to the contrary. In giving evidence, Mr Norman impressed me as a reputable businessman who would not have permitted SML to enter into the contract with the Trust as guarantor without believing, on reasonable grounds, that SML would be able to guarantee the completion of the yacht. In that regard, I reject absolutely any suggestion that Mr Norman had an ulterior motive in taking Mr Delegat's money, namely, to complete his own yacht. Such an allegation is completely without foundation. Mr Norman has not been shown to have had any knowledge of how Mr Delegat's money was applied in the course of SML's business. It is not alleged that Mr Norman had any involvement in the calculation and timing of charges for the materials, overheads and labour by SML, nor any loans made by the boat building subsidiaries to SML.

[119] Finally, as to the requirements of s 137 that Mr Norman exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances, I note that Mr Norman was a non-executive director resident in Perth. He was sent regular financial reports covering SML's financial performance throughout 2008 and 2009 and was involved in corporate governance to the extent of

being involved in both sales strategies and cost-cutting strategies, as well as reviewing budget forecasts for SML.

[120] Counsel for the plaintiffs submitted that no reasonable director exercising due care, diligence and skill would have allowed SML to continue to trade at each of the four watershed moments. It is said that the choices Mr Norman made were always likely to cause loss to SML's creditors and did cause loss to SML's creditors. However, looking at the broader circumstances, Mr Norman made a decision to provide funding or continue to provide funding at each of the four watershed moments to enable SML to continue to pay its debts as they fell due. In the end, creditors were better off than before Mr Norman made his initial investment in December 2008.

[121] While one can have sympathy for Mr Delegat, it is my view that Mr Norman did not breach any of his duties under ss 131, 135, 136 and 137 of the Companies Act.

Fair Trading Act claim

[122] The Trust's fifth cause of action against Mr Norman alleges that he engaged in misleading and deceptive conduct in breach of s 9 of the Fair Trading Act. The Trust alleges that when Mr Norman met Mr Delegat on 22 October 2009 in Perth, Mr Norman told Mr Delegat that he would not regret the purchase of the yacht or words to that effect. Both Mr Delegat and his companion that day, Mr Ivicevich, gave evidence of the conversation. Mr Norman does not remember telling Mr Delegat that he would not regret the purchase of the yacht and says it is not a phrase he would normally use.

[123] The Trust alleges that the statement that he would not regret the purchase of the yacht carried with it an implicit representation that Mr Norman believed that SML or Boat 93 would be able to complete the construction of the yacht. It is alleged that the completion representation was misleading and/or deceptive because:

(a) Unless further funding was found, SML was inevitably going to collapse and neither SML nor any subsidiary incorporated for the purpose, such as Boat 93, would be able to complete the construction of the yacht; and

(b) At all times Mr Norman knew that and/or intended that any monies paid by the Trust would substantially be used for purposes other than to construct the yacht.

[124] I find as a matter of fact on the balance of probabilities that Mr Norman did indeed tell Mr Delegat that he would not regret the purchase of the yacht or words to that effect. Not only do Mr Delegat and Mr Ivicevich recall the statement having been made but it is consistent with Mr Norman's view of the superior design and sea faring abilities of the Salthouse yachts. Mr Norman knew that Mr Delegat was also looking at the purchase of a Riviera 61, which was manufactured by a rival company, and in those circumstances Mr Norman probably did make the statement alleged.

[125] However, it is my view that the statement does not contain a completion representation. The purpose of Mr Delegat's trip to Perth was to have a detailed look at a Salthouse 68 yacht. He and Mr Ivicevich spent a number of hours poring over every nook and cranny of the Salthouse 68 yacht which they inspected. They were all also taken for a sea trial by Mr Norman himself in his Salthouse 65 yacht, the Aronui. The discussion obviously ranged far and wide about a large number of aspects of the design, performance, comfort and suitability of the Salthouse design when compared with the yachts manufactured by rival companies, such as Riviera or Maritimo.

[126] The statement was not made by Mr Norman in the context of contract negotiations. Mr Delegat and Mr Ivicevich were in fact stopping off in Sydney on the way back to Auckland from Perth to inspect a Riviera 61 yacht. Mr Delegat was therefore someway off entering into negotiations for the purchase of the yacht. In those circumstances, it is my view that the statement made by Mr Norman could only relate to the suitability of the vessel for Mr Delegat and did not carry any

implicit representation that SML or a SML subsidiary incorporated for the purpose would be able to complete the construction of the yacht.

[127] The fifth cause of action fails.

Result

[128] The plaintiffs' claim is not proven. Judgment is given for the defendant. Costs should follow the event. If counsel are unable to agree, I will receive memoranda.

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Woolford J