IN THE COURT OF APPEAL OF NEW ZEALAND

CA563/2011
[2011] NZCA 675

BETWEEN	S H LOCK (NZ) LIMITED Appellant
AND	NEW ZEALAND BLOODSTOCK LEASING LIMITED AND NEW ZEALAND BLOODSTOCK FINANCE LIMITED AND NEW ZEALAND BLOODSTOCK PROGENY LIMITED First Respondents
AND	GLENMORGAN FARM LIMITED (IN RECEIVERSHIP AND LIQUIDATION) Second Respondents

Hearing: 21 September 2011

Court: O'Regan P, Chambers and Harrison JJ

Counsel: D A Campbell for Appellant
P J Morgan QC and R A Edwards for First Respondents
M C Black for Second Respondents

Judgment: 20 December 2011 at 2:30 PM

JUDGMENT OF THE COURT

A The appeal is allowed.

B The judgment in the High Court ordering the appellant to pay the respondents' costs and disbursements is quashed.

C If the parties are unable to agree, the High Court is to determine costs in that Court.

D The respondents must pay the appellant costs in this Court for a standard appeal on a band A basis and usual disbursements.

REASONS OF THE COURT

(Given by Harrison J)

Introduction

[1] This appeal against a costs judgment in the High Court raises one discrete but important point of principle: in what circumstances is a non-party liable for an award of costs?

[2] Glenmorgan Farm Ltd sued New Zealand Bloodstock Leasing Ltd, New Zealand Bloodstock Finance Ltd and New Zealand Bloodstock Progeny Ltd (collectively "Bloodstock") for damages of $5.988 million. Its principal claims were for conversion of a valuable stallion named Generous and for failure of consideration. Potter J dismissed Glenmorgan's claims and entered judgment for Bloodstock on its counterclaim for $2,221,796.14.[1] In a judgment delivered contemporaneously with this decision this Court dismissed Glenmorgan's appeal.[2]

[3] Potter J also awarded Bloodstock costs of $34,924 plus disbursements. Glenmorgan had paid $17,500 as security for costs. An additional $409 had accrued in interest. That money was paid to Bloodstock. However, Glenmorgan was insolvent and unable to pay the shortfall of $17,005 on the costs award.

[4] Bloodstock applied for an order that either Glenmorgan's liquidator personally or a non-party, S H Lock (NZ) Ltd, pay the costs on the ground that the latter had funded and substantially controlled the substantive proceeding for its own benefit. Bloodstock later abandoned its allegation of control. Potter J found for Bloodstock.[3] She ordered Lock to pay the costs and disbursements shortfall. Lock now appeals.

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1 *Glenmorgan Farm Ltd (in rec and in liq) v New Zealand Bloodstock Leasing Ltd* HC Auckland CIV-2008-404-1759, 27 September 2010.

2 *Glenmorgan Farm Ltd v New Zealand Bloodstock Leasing Ltd* [2011] NZCA 672.

3 *Glenmorgan Farm Ltd (in rec and in liq) v New Zealand Bloodstock Leasing Ltd* HC Auckland CIV-2008-404-1759, 11 August 2011.

High Court

[5] By way of background, both Bloodstock and Lock had provided funding facilities for Glenmorgan. Glenmorgan was in substantial default when Lock placed it in receivership in July 2005: the receivers' return filed on 5 August 2008 recited Glenmorgan's then indebtedness to Lock and Bloodstock at $1.077 million and $1.382 million respectively with a further $1.7 million owing to other creditors.

[6] Glenmorgan's failure generated a good deal of litigation, principally relating to the ownership of and security rights over Generous. Proceedings between related parties have been to this Court on three separate occasions.[4] The result of one appeal was that, as between the two financiers, Lock's security interest in Generous had priority over Glenmorgan's interest.[5]

[7] Glenmorgan commenced the proceeding against Bloodstock on 1 April 2008. However, for unexplained reasons, Bloodstock did not apply for an order for security for costs until 4 December 2008 even though Glenmorgan was in liquidation. Glenmorgan filed a notice of opposition and affidavit in reply on 19 December 2008. Its liquidator, Gerald Rea, advised that the company had no funds or assets available to pay security for costs. Significantly, Mr Rea confirmed that because of its impecuniosity Glenmorgan was not paying legal fees. Instead, by arrangement with its counsel, Mr Black, the company would pay a reasonable fee if Glenmorgan succeeded.

[8] Again, for unexplained reasons, Bloodstock's application for an order for security for costs was not determined until 13 April 2010. On that date Associate Judge Christiansen issued a minute (a copy has not been provided) ordering Lock to pay security of $17,500. We are unaware whether the order was made by consent or following a defended hearing.

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4 *Waller v New Zealand Bloodstock Ltd* [2006] 3 NZLR 629; *Jenkins v New Zealand Bloodstock Leasing Ltd* [2008] NZCA 413 and *Glenmorgan Farm Ltd v New Zealand Bloodstock Leasing Ltd* [2011] NZCA 672.

5 *Waller v New Zealand Bloodstock Ltd* [2006] 3 NZLR 629.

[9] Gerald Van Tilborg from Lock swore an affidavit in opposition to Bloodstock's application for non-party costs on 25 July 2011. He advised, among other things, that Lock was not involved in the decision to commence the proceeding; that Lock had no control at all of the conduct of the proceeding; that Lock was approached by Mr Rea after 13 April 2010 to pay the security because Glenmorgan did not have sufficient funds for that purpose; that Lock understood from Messrs Rea and Black that the amount of the security was intended to be the full amount of costs to which Glenmorgan would be exposed at trial; and that on or about 28 May 2010 Lock paid $17,500 to Mr Rea to meet the security as ordered. Mr Van Tilborg was not cross-examined on this evidence.

[10] Glenmorgan's claim went to trial before Potter J on 10 and 11 July 2010. It must have been set down for hearing while Bloodstock's application for an order for security for costs was pending but before it was determined on 13 April 2010.

[11] Potter J's reasons for ordering costs against Lock, which had already paid the security of $17,500, were as follows:

> [43] I accept that Lock did not control these proceedings. But it certainly stood to benefit from them and it stood to benefit from them in priority to, and realistically to the exclusion of, all other creditors. Lock was and still is owed approximately $1m (excluding interest, legal and other costs). Had the litigation succeeded Lock had first call after the liquidator's costs on any proceeds. Despite the plaintiff's claim that it was entitled to damages in the region of $3m to $4m, being the claimed value of Generous, the reality was that Generous was sold in June 2005 for $1,013,153. *On any realistic assessment of the situation the likely recovery would have met or substantially met the balance owing to Lock but would have left nothing over for other creditors.* Lock's priority had been established by the previous judgments of this Court and the Court of Appeal. *That priority meant that Lock was first in line to benefit from any recovery made in the proceedings and realistically it was the only party likely to benefit.*
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> [44] Lock was the only party that put up any money, which was logical because Lock was the only party that realistically stood to benefit from the litigation. Thus, while this case is not, as Lock's counsel submitted, a classic case of a non-party funding litigation and controlling the proceedings, it is a case where Lock has been the sole provider of any funding and has clearly stood to benefit from the litigation.
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> [45] I reject Lock's submission that if it is ordered to pay costs it should be liable for only those costs arising after 24 May 2010 when it paid the security for costs of $17,500. I consider it irrelevant when Lock made the payment. *The payment was the catalyst for the proceedings to be advanced.*

> Because of the arrangements made by the liquidator in respect of his fees and the fees of the plaintiff's legal representatives no payments had been required prior to the order for security for costs made on 13 April 2010. *That payment caused and enabled what had gone before and what followed in the proceedings to be put into effect.*
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> (Our emphasis.)

Competing cases

[12] Mr Campbell for Lock submits that, in exercising her discretion to award costs against a non party, Potter J erred in:

(a) Failing to take into account that the substantive proceeding was able to be commenced and proceed to trial because Glenmorgan's counsel was willing throughout to act on the basis that he would only be paid if the result was successful – in a comparative sense, of the relative values of Lock's payment of security for costs against counsel's notional but unpaid legal fees. Lock was not responsible for the case going to trial.

(b) Failing to take into account that the proceeding, if successful, would have been for the benefit both of Lock and other creditors.

(c) Concluding that Bloodstock had established a causative link between Lock's provision of the payment for security for costs and the subsequent continuation of the litigation.

[13] In opposition, Mr Morgan QC for Bloodstock submits that Potter J did not err in finding that, in particular, Lock was effectively the only beneficiary of Glenmorgan's litigation, and that Lock did in fact promote the proceeding for its own benefit.

Principles

[14] In *Dymocks Franchise Systems (NSW) Pty Ltd v Todd (No 2)* the Privy Council identified these principles relevant to exercising the Court's discretionary power to award costs against a non-party:[6]

(a) cost orders against non-parties are exceptional in the sense that they are outside the ordinary class of cases where parties pursue claims for their own benefit and at their own expense;

(b) the ultimate question in any exceptional case is whether in all the circumstances it is just to make the order, thereby requiring a fact specific inquiry;

(c) as a general rule, third party litigation funders are only liable for costs where they not only fund proceedings but substantially control it or "at any rate [are] to benefit from them" – that is because the funder is gaining access to justice for its own purposes and is in effect the real party to litigation;

(d) the most difficult cases are those where non-parties fund receivers or liquidators in litigation which is designed to advance the funders' own financial interests – in that case, again as a general rule, the funder pursuing its own interests should not be able to escape without risk to liability for costs if the proceeding fails.

[15] Two other important points emerge from *Dymocks*, both of which were emphasised by Mr Campbell in argument. First, a but for approach to causation is appropriate[7] – the question in *Dymocks* was whether, but for the funder's involvement, the plaintiff would have pursued its appeal. In finding the third party, Associated Industrial Finance Pty Ltd, liable for Dymocks' costs, the Privy Council

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6 *Dymocks Franchise Systems (NSW) Pty Ltd v Todd (No 2)* [2004] UKPC 39, [2005] 1 NZLR 145 at [25].

7 *Dymocks* at [20].

regarded as decisive that Associated "... took the all important decision to fund and thereby promote the appeal".[8]

[16] Second, the Privy Council in *Dymocks*[9] approved Fisher J's statements in *Arklow Investments Ltd v MacLean* that:[10]

> [19] The guiding principle here is that costs orders against third parties are exceptional but that they are warranted in cases where there would otherwise be a situation in which a person could fund litigation in order to pursue his or her own interests and without risk to himself or herself should the proceedings fail or be discontinued.
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> [20] [w]here a person is a major shareholder and dominant director in a company which brings proceedings, that alone will not justify a third party costs order. Something additional is normally warranted as a matter of discretion. The critical element will often be a fresh injection of capital for the known purpose of funding litigation.
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> [21] ... [T]he overall rationale [is] that it is wrong to allow someone to fund litigation in the hope of gaining a benefit without a corresponding risk that that person will share in the costs of the proceedings if they ultimately fail.

Decision

[17] In awarding costs against a non-party, Potter J was primarily influenced by two factors: that Lock stood to gain the principal benefit if the proceeding was successful; and that Lock funded the litigation in the High Court by paying the security for costs, which became the catalyst to proceed. While accepting the limitations on this Court's power to interfere against the exercise of a discretion, Mr Campbell submits that Potter J materially erred in the weight she gave to both factors. We shall address each in the same order.

(a) Lock as principal beneficiary

[18] First, we agree with Mr Campbell that the Judge erred in relying on her finding that a realistic assessment of the merits, presumably when Lock paid the security in April 2010, would have shown that even if it was successful Glenmorgan

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8 *Dymocks Franchise Systems (NSW) Pty Ltd v Todd (No 2)* [2005] 1 NZLR 145 at [30] (PC).
9 *Dymocks Franchise Systems (NSW) Pty Ltd v Todd (No 2)* [2005] 1 NZLR 145 at [26] (PC).
10 *Arklow Investments Ltd v MacLean* HC Auckland CP49/97, 19 May 2000.

would never have recovered more than its indebtedness to Lock and thus Lock was the only party which stood to benefit.

[19] With respect, that was not the issue. Glenmorgan alone initiated and ran the claim. In that capacity Glenmorgan, not Lock, was responsible for making an assessment of the merits. Its liquidator acted on legal advice that the company would recover close to $6 million. That advice was, it transpires, totally unrealistic and it does not appear that any consideration was given to Bloodstock's rights of counterclaim.

[20] Nevertheless, the liquidator who had control of the proceeding was entitled to and did accept counsel's advice in April 2008 and afterwards. Lock had no input to that exercise. It must be inferred that Mr Rea acted on the premise that he was pursuing the claim for the benefit of all creditors including Lock and Bloodstock. There is no evidence to show that it was being pursued solely or even principally for Lock. Lock's priority to any damages award is irrelevant in that context. In terms of the *Dymocks* principles, it cannot be said that Lock was the real party to the claim.

(b) Funding

[21] Lock's only financial involvement was through its payment, at Glenmorgan's request, of security for costs. Potter J found that that event was the catalyst for advancing the proceeding because it "... caused and enabled what had gone before and what followed in the proceedings to be put into effect".[11]

[22] Lock's payment of security must be examined in context. It occurred two years after Glenmorgan issued the proceeding. Lock made no financial contribution towards Glenmorgan's own legal costs. As Mr Campbell submits, the dominant factor in the litigation's progress was Mr Black's agreement not to charge legal fees unless Glenmorgan succeeded. Without that arrangement, the proceeding would never have been initiated or gone to trial.

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[11] *Glenmorgan Farm Ltd (in rec and in liq) v New Zealand Bloodstock Leasing Ltd* HC Auckland CIV-2008-404-1759, 11 August 2011 at [45].

[23] Lock's payment of security did not directly fund Glenmorgan's claim. It was of a different nature, more akin to a disbursement. It satisfied an obligation incurred by Glenmorgan to Bloodstock. In that sense, as Potter J found, the payment enabled the case to proceed further along the spectrum towards trial. And, on a literal application of the but for test, it could be said to have had a causative effect; without it the proceeding would have been stayed.

[24] However, in our judgment, it could not be said that Lock's payment rendered it the funder. At best, it was a contributing factor in the case going to trial. On a relative basis, Mr Black's agreement not to charge fees was of a much greater value and causative effect. In that sense it can properly be said that counsel, not Lock, funded the litigation.

(c) Security for costs

[25] Another factor, not discussed by Potter J, is also relevant. Bloodstock did not apply for an order for security for costs until eight months after the proceeding commenced. It allowed a further 18 months to pass before its application was determined. We do not know the reasons for this delay. But plainly Bloodstock must have concurred in all the steps which would have been undertaken in the interim to prepare for trial without obtaining an order for security. As noted, the case must have been set down for trial before security was ordered.

[26] If security had been obtained in a timely manner, say in February 2009, Bloodstock would have been entitled to apply again, before setting the proceeding down for trial, for a further order for security, on the basis that Lock paid the first order and should be responsible for paying the second. In that way, Bloodstock would have been able to counter Glenmorgan's obvious ground of opposition of impecuniosity and may have obtained security on a principled basis for all its costs before trial. In the same way, Lock would have been given the opportunity to make a principled decision on whether it was prepared to effectively indemnify Glenmorgan for its liability for Bloodstock's costs if the latter succeeded.

(d) Conclusion

[27] As the Privy Council observed in *Dymocks*:[12]

> In the light of these authorities Their Lordships would hold that, generally speaking, where a non-party promotes and funds proceedings by an insolvent company solely or substantially for his own financial benefit, he should be liable for the costs if his claim or defence or appeal fails. As explained in the cases, however, that is not to say that orders will invariably be made in such cases, particularly, say, where the non-party is himself a director or liquidator who can realistically be regarded as acting rather in the interests of the company (and more especially its shareholders and creditors) than in his own interests.

[28] Applying the *Dymocks* principles, we are not satisfied that it was just to make an order for costs against Lock. Lock did not promote or direct the litigation; nor could it be described as the real party to the claim. Its participation in the funding was of a limited and indirect nature. The proceeding was, we repeat, initiated and controlled by Glenmorgan's liquidator, acting on legal advice in the interests of the company as a whole.

[29] We are hesitant to interfere with Potter J's exercise of a discretionary power. Nevertheless, we are satisfied that the Judge erred in relying on finding that Lock was likely to be the sole beneficiary of a successful claim, was the sole provider of any funding and should thus be liable for Bloodstock's costs.

[30] We add that non party cost orders should not have the effect of deterring creditors from funding litigation bought by liquidators. There is a public interest in encouraging the pursuit of claims by liquidators where the purpose is to benefit creditors and shareholders generally by recovering property from those who have allegedly acted wrongfully.[13] There is statutory support for this proposition.[14] In our judgment an award of costs against a non party creditor in Lock's position would run counter to this public interest.

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12 *Dymocks* at [29].

13 *State Bank of New South Wales v Brown* [2001] NSWCA 223, (2001) 38 ACSR 715 at 728 per Hodgson JA (Handley JA concurring).

14 Cl (1)(e) of Schedule 7 of the Companies Act 1993 gives priority to any creditor who "protects, preserves the value of, or recovers assets of the company for the benefit of the company's creditors by the payment of money or the giving of an indemnity" equal to the amount received by the liquidator by the realisation of those assets (up to the value of that creditor's unsecured debt) and the amount of costs incurred by that creditor.

Result

[31] Lock's appeal is allowed.

[32] The order made by Potter J in the High Court that Lock pay Bloodstock's costs and disbursements is set aside.

[33] Potter J did not make an order for costs on Bloodstock's application for an order for costs. If the parties cannot agree, the High Court is to determine costs on the application for costs.

[34] Bloodstock must pay Lock costs for a standard appeal on a band A basis and usual disbursements.

Solicitors:
Kensington Swan, Auckland, for Appellant
J G Collinge, Auckland for the Respondent
Craig Griffin & Lord, Auckland for the Third Party