IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2015-404-3176
[2017] NZHC 3280

BETWEEN	D4 CASH INVESTORS LIMITED Plaintiff
AND	ADVANCED CREATIVE TECHNOLOGIES LIMITED Defendant

Hearing:	12-14 June 2017 & 16 June 2017
Counsel:	M Corlett QC & H Ford for Plaintiff A M Swan for Defendant
Judgment:	21 December 2017

JUDGMENT OF DUFFY J

This judgment was delivered by me on 21 December 2017 at 11 am pursuant to Rule 11.5 of the High Court Rules.

Registrar/ Deputy Registrar

Solicitors/Counsel:
Cook Morris Quinn, Auckland
Websterlaw, Auckland
Marc Corlett QC, Auckland

Andrew M Swan, Auckland

[1] The plaintiff, D4 Cash Investors Ltd, sues to enforce a debt which is allegedly owed to it by the defendant (ACTL). At the time this proceeding was commenced the principal sum plus interest came to $3,216,562.31. The plaintiff also seeks additional interest at the agreed contractual rate on this sum from the date of filing the proceedings.

[2] The alleged debt arises from a loan agreement dated 17 August 2005 between ACTL as borrower and D4 Compression Ltd as lender (D4 Compression). When D4 Compression later went into liquidation the liquidator assigned this debt to the plaintiff.

[3] ACTL disputes it owes the debt on the grounds: (a) the loan agreement is a sham because the parties never intended that D4 Compression would advance funds to ACTL or that ACTL would repay the loan; instead the loan agreement was only intended to give D4 Compression priority over any dividends that were paid; (b) the loan is unenforceable because funds were never advanced to ACTL under the loan agreement and so there is no consideration to support it; and (c) the parties agreed that the loan would not take effect until ACTL had received royalty payments, which never eventuated.

Background

[4] ACTL owns the intellectual property in computer software known as the "Matariki Codex", which has been in an ongoing state of development since the early 2000s. Its potential uses or functions include "DNA data sequencing" and "compression data". Over the years ACTL has made much of the wonderful capabilities and potential financial returns from the Matariki Codex, which have often been said to be on the point of realisation. However, as at the date of trial nothing like this had eventuated. So far the Matariki Codex has proved a loss-making venture for investors.

[5] In 2005 ACTL required further funding to progress the development of the Matariki Codex. Existing shareholders were seemingly reluctant to advance further funding. It was then thought that one aspect, the "data compression capability", was readily able to be commercialised. Accordingly, ACTL approached Michael Ridgway,

who has a background in software development, to assist with commercialising this capability.

[6] On 25 May 2005 Mr Ridgway and ACTL entered into a Heads of Agreement under which Mr Ridgway undertook to arrange for an initial investment of $300,000 either by the new investors acquiring shares in ACTL or in a new company, with the possibility of those investors providing a further $300,000 sometime in the future. In return Mr Ridgway was to receive a shareholding in the investment vehicle.

[7] ACTL and Mr Ridgway decided to incorporate D4 Compression as a special purpose entity to raise and expend investment funds for the purpose of commercialising the data compression capability of the Matariki Codex. Arrangements for this fund raising and use of proceeds were set out in the "Capital Raising Term Sheet" dated 27 May 2005, which provided for ACTL to hold 70 per cent of the shares, Michael Ridgway or his nominee to hold 10 per cent of the shares, and the investors (who would provide the funding for the new company) were to hold 20 per cent of the shares. In return D4 Compression was to receive an exclusive licence to market the data compression features of the Matariki Codex in a defined territory of the Asia Pacific region.

[8] Mr Ridgway found 10 investors (the D4 investors). Sometime between June and July 2005 they paid somewhere between $290,000 and $300,000 into the trust account of Martelli McKegg for the benefit of D4 Compression. On 10 August 2005 Martelli McKegg transferred $290,000 to D4 Compression.

[9] When D4 Compression was incorporated on 28 July 2005, ACTL was a 90 per cent shareholder and Mr Ridgway held the remaining 10 percent of shares. Although they had provided much needed funds in 2005, the D4 investors were not registered as holding 20 per cent off the shares in D4 Compression until 24 October 2006.

[10] The initial directors of D4 Compression were Mr Ridgway and three persons who were also shareholders and directors of ACTL (Wolfgang Wright, Scott Wilson and Michael Lust).

[11] In early 2006 the development of the Matariki Codex, including commercialisation of the data compression capability, was still in progress. D4 Compression had by then paid out approximately $260,000 of the funds it had received from the D4 investors. More funds were required to complete the project. For reasons that I shall address separately, Mr Ridgway suggested that a loan arrangement be substituted for the original funding and use of proceeds arrangements in the Capital Raising Term Sheet. The other directors of D4 Compression and the directors of ACTL agreed. Scott Wilson as a director of ACTL and Michael Lust as a director of D4 Compression executed a loan agreement, which was backdated 17 August 2005 (the Loan Agreement). This agreement provides the basis for the enforcement of the debt.

[12] The Loan Agreement records the sum lent as $210,000, with an interest rate of 20 per cent. It is common ground that no interest payments were made by ACTL. Initially, D4 Compression issued invoices for interest payments. However, later, either in 2006 or early 2007, Mr Ridgway realised that invoicing for interest created taxable income for D4 Compression, which was a cost it could not afford. From then on, the company did not invoice for interest. Instead, interest was accrued each year by ACTL increasing the principal sum due in its accounts. The loan was recorded as an asset in D4 Compression's financial accounts.

[13] No further progress was made either in relation to commercialising the data compression capability or other aspects of the Matariki Codex. This meant D4 Compression never received any income from its Licence Agreement. ACTL made no payments under the Loan Agreement. On 19 December 2007, in response to pressure from the D4 investors, two of them (Scott Newman and Timothy Manning) were appointed directors of D4 Compression. However, by late 2009 the D4 investors became completely disenchanted with how things were going. They were frustrated, and they disbelieved assurances from ACTL that progress was being made. They decided to bring an end to matters by pushing for ACTL to repay the loan. However, ACTL as the majority shareholder in D4 Compression refused to do so. There were negotiations between ACTL and D4 Compression over how to resolve the impasse. No solution eventuated. Accordingly, in 2013 the D4 investors applied to this Court

to wind up and liquidate D4 Compression. On 30 May 2014 Peters J granted the application and liquidators were appointed.[1]

[14] The liquidators were unsuccessful in pursuing payment of the loan. So the D4 investors incorporated the plaintiff on 20 November 2015, and the same day the plaintiff purchased this debt from the liquidators of D4 Compression. In return for payment of $5,000, the liquidators assigned all their rights in the principal sum and interest due under the Loan Agreement along with all interest which may accrue after that date. ACTL was notified in writing of what had eventuated and the plaintiff's solicitors made demand on the debt on 9 December 2015. The demand was not and continues not to be met.

The Capital Raising Term Sheet

[15] The Capital Raising Term Sheet, which was prepared by Martelli McKegg solicitors and dated 27 May 2005, set out the original legal basis on which the D4 investors in D4 Compression became involved with ACTL and the Matariki Codex. It is clear from the descriptions contained therein that the "data compression capability" was but one aspect of the Matariki Codex.

[16] The Capital Raising Term Sheet described the Matariki Codex as "a mathematical and scientific discovery." The "data compression capability" was identified as something that was "derived from the Matariki Codex" and was "achieved through the configuration of a series of algorithms, representing aspects of that discovery, in certain ways to provide a new and unique method of data compression" that achieved "loss-less concatenable compression and de-compression of random data." This process was described in the Capital Raising Term Sheet as "a world first capability."

[17] D4 Compression was to be incorporated with 1,000 shares, each with a capital value of $1,500. Two hundred of the shares were to be sold as part of a capital-raising process with a view to raising $300,000.

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1 *Newman v Lust* [2014] NZHC 1220.

[18] Regarding use of the capital proceeds, the Capital Raising Term Sheet provided that "all funds raised through this capital raising will be used to fund D4 Compression's operating activities including final commercialization of the data compression application, legal fees associated with the preparation of licensing agreements, marketing expenses and remuneration of staff and general office expenses as required." It was anticipated that the raised funds would last the operation a minimum of six months which, at the time, was seen to be sufficient to sustain the company until income was generated. Surplus funds were to be distributed to the shareholders by way of dividend. If either ACTL or D4 Compression required additional funds, the "current round investors" were to have the first right of refusal in any further capital-raising process.

[19] In return for providing the raised capital funding, D4 Compression was to receive a licence to market "the compression features of ACTL's technology" in the Asia Pacific region. The licence was for an indefinite term but subject to a buy-back option set out in the Capital Raising Term Sheet. The licence was at no cost to D4 Compression and for the first four months no royalties were payable for any licenses D4 Compression sold. Thereafter there was a maximum royalty of 30 per cent of revenue payable by D4 Compression after funds were received from licensees, but before dividends were paid to shareholders. As part of the granting of the license, D4 Compression was required to acknowledge that all the intellectual property associated with the Matariki Codex together with all improvements or modifications, including the data compression technology and its implementation, remained the property of ACTL. Accordingly, ACTL retained exclusive ownership rights of the Matariki Codex and the rights to market it in all other regions.

[20] Under the buy-back option ACTL was entitled to offer the Matariki Codex technology in its entirety or any of its applications, including data compression, for sale, either through a sale of the company or a licensing arrangement. In the event such sale was effected, this triggered a buy-back option on all shares held by the independent investors at a pre-determined price based on the timing of that transaction.

Licence agreement

[21] In accordance with the terms of the Capital Raising Term Sheet, on 30 August 2005 ACTL and D4 Compression executed a licence agreement giving D4 Compression an exclusive licence to use the "technology" as defined in the licence agreement for the purposes of commercialising the data compression capability of the technology within the defined "territory" (the Licence Agreement). In return for the licence, D4 Compression agreed to pay royalties to ACTL with no fees being payable for the first twelve months of the term. The terms of the Licence Agreement are consistent with the terms of the Capital Raising Term Sheet. The "technology" defined in the Licence Agreement is consistent with descriptions of the Matariki Codex. The "application" defined in the Licence Agreement means the data compression capability of the "technology." The Licence Agreement makes it clear that the data compression capability is but one facet of the "technology".

Use of D4 Compression's funds

[22] The use that was made of D4 Compression's funds in the period between 2005 and 2006 is in dispute. This is a relevant issue because the plaintiff's account of how the funds were used provides the factual explanation for why the Loan Agreement was executed, and the legal basis for it being legally enforceable.

[23] Mr Ridgway, who gave evidence for the plaintiff, said that he was responsible for payment of D4 Compression's accounts and he controlled the cheque payments by D4 Compression. Mr Wright, who gave evidence for ACTL, accepted under cross-examination that Mr Ridgway had managed the accounts of D4 Compression up until late 2007. It is some years since the relevant payments were made. Cheque butts and other financial documents that would have provided helpful evidence to follow where the funds went are seemingly no longer available.

[24] However, Mr Ridgway had access to a spreadsheet of payments by D4 Compression in the years 2005–2006. Mr Ridgway said that between 18 August 2005 and 18 May 2016, $260,105.85 was paid out by D4 Compression for ACTL's benefit. By March 2007 only $10,050.60 remained in D4 Compression's cheque account from the original $290,000 which the D4 investors had transferred to D4 Compression.

[25] Mr Ridgway initially thought he had made all payments to ACTL. However, ACTL has shown Mr Ridgway to be wrong in this respect. Only one payment of $63,562.50 was made directly to ACTL. Mr Wright who gave evidence for ACTL says that he took over responsibility for the payments. The material he has managed to obtain shows payments made directly to third parties. Mr Ridgway now accepts that his initial account of where the payments went to was incorrect.

[26] Mr Ridgway says that by far the biggest recipient of D4 Compression's funds was a company called GBR Research Ltd. This company employed Graemme Brown, a physicist, who was the person primarily responsible for developing the Matariki Codex.

[27] Mr Ridgway says that between $180,000 to $200,000 of D4 Compression's funds went to pay GBR Research Ltd. Mr Ridgway further says that this expenditure covered work by GBR Research on aspects of the development of the Matariki Codex that went beyond the terms of D4 Compression's engagement under the Capital Raising Term Sheet. If this did occur, it would mean that D4 Compression's funds were used for unauthorised purposes.

[28] Mr Ridgway was the only witness the plaintiff called whose evidence was directly relevant and material to the disputed events. The other witnesses for the plaintiff were persons who formed part of the group of D4 investors. At the relevant times these persons had no knowledge of the disputed events and they did not participate in them. Their evidence was focused on later events and for this reason I have found no need to refer to it.

[29] ACTL called two witnesses: Wolfgang Wright, the remaining sole director of ACTL, and Scott Wilson, a former director of ACTL. They denied there was any unauthorised use of D4 Compression's funds. Mr Wright insisted that Graemme Brown of GBR Research only began working on developing another aspect of the Matariki Codex, DNA capability, after D4 Compression had exhausted its funds. Accordingly, he contended it was wrong to say GBR Research had received payments from D4 Compression for services unrelated to data compression capability.

[30] Mr Wright and Mr Wilson referred to what they describe as a joint venture between ACTL and D4 Compression to develop and market technology known as the Matariki Codex. Their use of the term "joint venture" is not to suggest D4 Compression and ACTL were in a legally recognisable joint venture of the type that can give rise to fiduciary obligations. ACTL's pleadings do not include such a claim and their counsel acknowledged at the hearing that ACTL relied on no such claim. Further their description of the scope of the "joint venture" is less precise than the description provided in the Capital Raising Term Sheet, which is the legal document that sets out the terms on which D4 Compression first became involved with the Matariki Codex and ACTL. However, the less precise description, which they adopt, is not meant to suggest the scope was broader than that defined in the Capital Raising Term Sheet.

[31] Mr Wright and Mr Wilson both said in evidence that the funds of D4 Compression were only used to fund the "joint venture". They did not accept that there was any irregular and unauthorised use of D4 Compression's funds which required correction.

The Loan Agreement

Terms of the Loan Agreement

[32] The Loan Agreement was written as if it was executed on 17 August 2005, which is before ACTL received any form of advance from D4 Compression. D4 Compression was recorded as lender and ACTL as borrower. However, sometime in mid-2006 is when it was actually signed by the parties. Seemingly no record was made of this event. The agreement is unhelpful because all it records is the date to which it was backdated, and given the passage of time no-one who gave evidence could give a clearer indication of when it was executed. In its statement of defence ACTL adopts mid-2006 as the period when the agreement was executed. ACTL's witness Wolfgang Wright says that it was executed "probably around July 2006". D4 Compression's witness Michael Ridgway said it was executed in August 2006.

[33] The introductory statement recorded that the loan was advanced on the terms and conditions contained in the agreement. "Agreement" was defined to mean "this

agreement, as amended from time to time." The "commencement date" meant the day on which the lender first provided the loan or part of the loan to the borrower pursuant to the agreement. The interest rate was 20 per cent per annum with a default interest rate that was 10 per cent above the interest rate.

[34] "Loan" was defined to mean:

> The loan to be provided by the Lender to the Borrower pursuant to this Agreement having a maximum principal amount of $210,000 including GST or, as the context may require, the outstanding balance from time to time of such loan or such other amount as may be agreed upon by the Parties. *The Loan will include all expenses charged to D4 Compression Ltd that the Parties agree are for the services of any person and expenses that are directly attributable to the commercialisation of the Matariki Codex for the Borrower during the Loan period.*
>
> (emphasis added)

[35] Under cl 2.1 the lender agreed to make the loan to the borrower on the terms and subject to the conditions of the agreement. Under cl 2.2 the borrower acknowledged receipt of the loan for the amount specified in the agreement. Clause 2.3 provided that the borrower would draw down the loan on an as required basis up to the maximum principal amount.

[36] The terms for repayment were provided in cl 2.4 which required the borrower to pay to the lender defined "following amounts" "on or before the day that is 365 days from the date of execution of this Agreement" (the repayment date). Provision was made to extend the repayment date.

[37] The "following amounts" referred to in cl 2.4 were: (a) the aggregate principal of the loan; (b) interest thereon at the interest rate subject to the outlined conditions; and (c) if the borrower sold or disposed of the Matariki Codex, the loan then became fully due and payable.

[38] Clause 2.7 permitted the lender on terms to extend the amount of the loan by the amount agreed upon by the parties and to extend the repayment date up to a maximum of 365 days beyond the first repayment date.

[39] Under cl 3.1 the lender agreed that provided no event or default had occurred, it would not enforce or exercise any of its rights available to it until the repayment date.

[40] Clause 4.2 excluded D4 Compression from claiming intellectual property rights by stipulating:

> The Lender represents and warrants to the Borrower that, in any dispute that may arise regarding a breach or event of default of this agreement, *the Lender will not make any claim as to title, in part or in full, for ownership of the ACTL IP in any form beyond that agreed to in the license agreement between D4 and ACTL, as a security or payment against any monies owed to D4 by ACTL.*
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> (emphasis added)

[41] Clause 5 set out "events of default". These were: (a) if the borrower failed to pay any amount or sum due under the agreement on its due date within a stipulated time; or (b) the borrower committed any breach or omitted to observe or perform any of its obligations or undertakings under the agreement on the due date.

[42] The Loan Agreement was recorded as an asset in D4 Compression's financial accounts. In its balance sheet ACTL recorded the Loan Agreement as a liability and capitalised the interest payable under it.

Parties' respective positions on the Loan Agreement

[43] At trial the parties disputed various aspects of the Loan Agreement.

[44] The plaintiff pleads the Loan Agreement as a valid actionable contract for the loan of moneys that are now due and payable to it by virtue of the assignment from D4 Compression. It pleads the principal sum, which stood at $281,966.13 at the date of repayment (being 17 August 2006) together with interest that had accrued under the loan *until* the date of repayment (being interest at 20 per cent) and penalty interest that has accrued on the outstanding amount *from* the date of repayment (being interest at 30 per cent). It then pleads breach of the loan contract and loss through ACTL's failure to pay the outstanding sum (comprising principal and accrued interest) of $3,216,562.31 as at 9 December 2015 plus interest accruing from 10 December 2015.

[45] In evidence Mr Ridgway said the purpose of the loan was to correct how funds of D4 Compression had been used from the outset to fund aspects of the development of the Matariki Codex that went beyond the terms of D4 Compression's funding arrangement under the Capital Raising Term Sheet (the original funding arrangement). He identified various occasions when those funds were applied for other extraneous purposes.

[46] Mr Ridgway also said that at the time the Loan Agreement was actually executed, there was general consensus that the use of D4 Compression funds to date would be converted into a loan, which would be backdated to 17 August 2005. I take this consensus to be between the directors of ACTL and D4 Compression because at the time the D4 investors had no knowledge of the Loan Agreement, and, contrary to the provisions of the Capital Raising Term Sheet, they were not yet shareholders of D4 Compression. He said this step was taken with the intention of regularising what had hitherto been an irregular use by ACTL of funds received from D4 Compression.

[47] It is common ground that after the Loan Agreement was executed no further advances from D4 Compression to ACTL were made.

[48] In its statement of defence, ACTL admits it "entered into" the Loan Agreement on the terms stated therein. It also admits the lender's interest in the Loan Agreement was assigned to the plaintiff. However, it denies that any money was ever advanced to it under the Loan Agreement. Accordingly, it also denies it owes the sums of money for which the plaintiff seeks recovery.

[49] By way of affirmative defences ACTL contends the Loan Agreement is a sham and is therefore unenforceable. Here ACTL contends the true situation was that D4 Compression was formed as a joint venture vehicle to develop and market ACTL's Matariki Codex with a view to ACTL and D4 Compression earning royalties from the sale of this product. Under the joint venture ACTL received 70 per cent of the shares in D4 Compression with the D4 investors receiving 30 per cent of the shares in D4 Compression. Everyone would work together to develop the Matariki Codex to the point where royalties generated by sales would then ultimately flow back to them. Accordingly, the Loan Agreement is a sham because it does not "evidence" the true

common intention of the parties. Acting in accordance with this intention, D4 Compression never advanced any funds to ACTL. Thus, the D4 investors never received a return because D4 Compression has never received any royalties, and not because ACTL refused to pay the "loan".

[50] By way of a second affirmative defence ACTL contends the Loan Agreement is unenforceable for lack of consideration because no funds were ever advanced to ACTL under the Loan Agreement either before or after its execution.

[51] By way of a third affirmative defence ACTL contends that around the time or shortly before the Loan Agreement was executed, the directors of both companies agreed that the Loan Agreement would not take effect unless and until D4 Compression received royalties pursuant to the Licence Agreement. This agreement was either an oral term of the written Loan Agreement or a collateral oral agreement. Alternatively, it constitutes a representation that was relied upon by ACTL, thereby creating an estoppel that is sufficient to preclude the plaintiff from suing on the Loan Agreement.

[52] ACTL accepts parts of Mr Ridgway's evidence. In this regard, ACTL accepts that in early to mid-2006 Mr Ridgway met with Messrs Lust, Wright and Wilson, who were all directors of D4 Compression, and suggested the original funding arrangement be converted into a loan. ACTL contends that some of D4 Compression's directors queried the need for the Loan Agreement, but ultimately they agreed to it and it was executed by D4 Compression and ACTL.

[53] ACTL's evidence on the Loan Agreement differs from that of Mr Ridgway in the following respects: (a) Messrs Wright and Wilson contend that it was agreed between D4 Compression and ACTL the loan would not be called up until such time as ACTL had received dividends from royalties received by D4 Compression or what they referred to as a monetising event; (b) they said Mr Ridgway assured them there was no danger of the loan being called up before either of those two events because as directors of D4 Compression, they had control over the company's actions and further to call up a loan before ACTL had funds to repay it made no sense; and (c) the purpose

of the loan was to do no more than to give the investors priority over dividends paid by D4 Compression once the "monetising event" had occurred.

Assignment of debt

[54] The assignment of the loan by the liquidators of D4 Compression to the plaintiff was effected by an agreement for sale and purchase of a receivable dated 20 November 2015.

[55] ACTL admits the Loan Agreement was assigned by D4 Compression to the plaintiff but otherwise denies there is money owing to the plaintiff by reason of the assignment.

Discussion

Assignment of Loan Agreement

[56] I am satisfied the Loan Agreement was properly assigned to the plaintiff, which is now the party entitled to sue upon that agreement

Was the loan agreement a sham?

[57] ACTL argues the Loan Agreement is a sham because no funds were advanced after the parties signed it. I accept that no funds were ever advanced under the Loan Agreement after it was executed. However, that alone is insufficient to warrant finding the Loan Agreement is a sham.

[58] ACTL further argues that at the time the Loan Agreement was signed there was never an intention to advance funds under the Loan Agreement, which also makes it a sham. In this regard Mr Ridgway's evidence was that at the time the directors signed the Loan Agreement, the directors of both companies realised additional funding was required to bring the project to a stage where its commercial prospects could be realised. This aspect of his evidence was not disputed by ACTL, and Mr Wright accepted in cross-examination that such additional funding was required. Accordingly, I accept this aspect of Mr Ridgway's evidence.

[59] Mr Ridgway also said that the directors of ACTL and D4 Compression saw the existence of the Loan Agreement as something that would keep the D4 investors happy, and which might encourage them to further invest in D4 Compression, thus enabling D4 Compression to provide the necessary additional funding to complete the project. This aspect of Mr Ridgway's evidence was not fully accepted by Mr Wright and Mr Wilson. Each agreed that Mr Ridgway had promoted the Loan Agreement as something that would keep the D4 investors happy, but each denied the proposition that the D4 investors were also seen as a potential source of further funding. They each said that the additional funding could have been obtained from new investors.

[60] I am satisfied that at the time of its execution, one of the purposes of the Loan Agreement was to provide a vehicle for D4 Compression to provide additional funding to ACTL. First, that is consistent with the language of the Loan Agreement, which expressly provides in clause 2.7 for an extension of the amount of the loan and the time for repayment.

[61] Secondly, I find it implausible that at the time the Loan Agreement was executed D4 Compression was not seen to be a source of further funding via the D4 investors. At that time, completion of the data compression capability to the point it was ready for sale was seen to be imminent. ACTL needed funds. Thus, completing the data compression capability would have been ACTL and D4 Compression's priority. In such circumstances D4 Compression would be the logical choice for further funding to be raised from the D4 investors. Moreover, Mr Wright and Mr Wilson have acknowledged that Mr Ridgway promoted the Loan Agreement as something that would appease the D4 investors. That directors of ACTL and D4 Compression were prepared to execute the Loan Agreement with this knowledge is consistent with them then being hopeful of obtaining further funding from D4 Compression through the D4 investors. At the time the Loan Agreement was executed, D4 Compression had exhausted its funds. The D4 investors could not unravel their circumstances. The only practical reason for keeping them happy would be because they were seen to be a potential source of much needed further funding, which is consistent with the Loan Agreement being intended to provide for further funding.

[62] Thirdly, if ACTL had tried to raise further funding from elsewhere this would either require a loan from a third party, which may have been hard to obtain given the slow performance to date in completing the project, or equity investment, which may not have been successful and which is likely to have diluted the existing interests that ACTL and D4 Compression held in the data compression capability. Whilst ACTL may have found new equity investment/lending from elsewhere for other facets of the Matariki Codex, it could not then be used to complete the data compression capability.

[63] In short, in terms of raising additional funding the sensible thing was to focus on completing the part of the project that was then recognised to be closest to ready for commercialisation, which was the data compression capability. D4 Compression through the D4 investors was realistically the best source of any further funding to achieve this outcome.

[64] Accordingly, I find that at the time of execution there was a genuine common intention that funds would be advanced under the Loan Agreement. Whilst there were no advances following the date of execution, what happened after that date cannot serve to extinguish this intention. It follows that this ground for the Loan Agreement being a sham must fail.[2]

[65] ACTL also argues that the Loan Agreement is a sham because there was never an intention ACTL would repay the loan. This argument is inconsistent with the language of the Loan Agreement, which makes it clear the loan was to be repaid. At the time of its execution, directors of ACTL and of D4 Compression signed the document in circumstances where they accepted under cross-examination they were fully aware of what they were doing and that as directors of their respective companies they were acting in the best interests of those companies. Such conduct is inconsistent with them executing a sham agreement, because that is hardly likely to be in the company's best interests.

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[2] For a contract to be a sham the parties must have intended not to have created the legal rights and obligations contained in the contract: see *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [33].

[66] I have already outlined one of the benefits of the Loan Agreement (provision for future advances) which is consistent with it having a real commercial purpose, and therefore not being a sham. There is another such purpose: namely, to regularise or fix irregular use of D4 Compression's funds.

[67] The evidence of Mr Ridgway is that funds from D4 Compression were used to fund aspects of the Matariki Codex other than data compression capability. The Loan Agreement was said to be the vehicle to fix this irregularity. If that is so it strongly suggests that there was a genuine intention on the part of ACTL to repay those funds. This is dealt with in more detail below when I address ACTL's arguments on the enforceability of the loan.

[68] The accounting treatment of the Loan Agreement both by ACTL and D4 Compression is at odds with ACTL's assertion the loan was never intended to be paid and it was a sham. If that was how ACTL and D4 Compression viewed the loan at the time it is hard to see why it would feature as an asset in D4 Compression's balance sheet and a liability in ACTL's balance sheet.

[69] Finally, I note ACTL's pleading regarding where the true intention of the parties' arrangements lay. What ACTL outlines as a joint venture based upon D4 Compression providing funds for developing the data compression capability for sale and in return receiving royalty payments from the sales of this capability in the licensed area is in effect the original funding arrangement provided by the Capital Raising Term Sheet and the Licence Agreement. If this were the case it would render the Loan Agreement meaningless. The findings I have already made necessarily entail rejection of this aspect of ACTL's defence.

Is the Loan Agreement supported by consideration?

[70] ACTL argues the Loan Agreement is unenforceable because there is no consideration to support it; and the parties agreed that the loan would not take effect until ACTL had received certain funds, which is something that never eventuated.

[71] No funds were advanced under the Loan Agreement after its execution, and the advances made beforehand cannot constitute consideration.[3] Some other consideration is required if the loan is to be enforceable.

[72] I have already referred to Mr Ridgway's evidence that after the formation of D4 Compression and before the execution of the Loan Agreement, moneys from D4 Compression were used to fund aspects of the Matariki Codex other than data compression capability. This included paying for ACTL's legal fees and paying invoices from GBR Research, which were generated by Mr Brown working on the other aspects of the Matariki Codex.

[73] Mr Ridgway accepted he erred when he stated in his brief of evidence that D4 Compression had paid money direct to ACTL. He now accepts that apart from one such payment, other payments by D4 Compression were made to third parties. ACTL relies on this to argue that ACTL never received irregular advances from D4 Compression. However, the fact much of D4 Compression's funds never went directly to ACTL is not the end of the matter. If those payments were not for goods or services relating to work on the data compression capability, but were instead for other goods and services relating to other aspects of the Matariki Codex (in which D4 Compression had no legal interest), this would still be misuse of D4 Compression's funds. Such payments could support D4 Compression acquiring a proprietary interest in the intellectual property in the Matariki Codex by "backward tracing".[4] Further, such payments could legally result through subrogation in D4 Compression acquiring rights which the third parties receiving its funds would have otherwise enjoyed against ACTL.[5] In 2005 and 2006 the same persons were directors of D4 Compression and ACTL, which could result in their knowledge that D4 Compression was paying

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3 See *Eastwood v Kenyon* (1840) 11 Ad & EI 438, which remains applicable today.

4 See *Shannon Agricultural Consulting Ltd (in liq) v Shannon* [2015] NZHC 1133 at [29]; *Taj Construction Ltd (in liq) v Singh* [2016] NZHC 584, (2016) 4 NZTR ¶26-015 at [27]; *Torbay Holdings Ltd v Napier* [2015] NZHC 2477, [2015] NZAR 1839; and *Federal Republic of Brazil v Durant International Corp* [2015] UKPC 35, [2016] AC 297 where backward tracing was applied. In *Fish Man (in liq) v Hadfield* [2016] NZHC 1750, [2016] NZAR 1198 and *Intext Coatings Ltd (in liq) v Deo* [2016] NZHC 2754, [2017] NZAR 47 the courts refused to apply backward tracing. However because there is case law where backward tracing has been applied I consider the principle is reasonably arguable. Accordingly, the relinquishment of rights based upon this principle is capable of providing consideration to support the extinguishment of any asserted claim by D4 Compression.

5 See *Intext Coatings Ltd (in liq) v Deo*, above n 5, where subrogation was granted as an alternative to backward tracing.

creditors of ACTL being attributed to ACTL. Insofar as those directors were breaching their fiduciary duties to D4 Compression by allowing its funds to be used irregularly, ACTL could be viewed as a dishonest recipient of benefits derived from those breaches, and therefore liable to account for them.[6]

[74] Arguably, therefore, the financial assistance which ACTL enjoyed through use of D4 Compression's funds for the development of aspects of the Matariki Codex beyond data compression capability may in turn have led to D4 Compression acquiring a proprietorial interest in the intellectual property of those other aspects, via backward tracing; a right to claim reimbursement of the payments via subrogation from ACTL; and a right to claim an account or equitable compensation from ACTL insofar as the company benefitted as a dishonest recipient of funds following what was arguably a breach by directors of D4 Compression of their fiduciary duty to the company. Accordingly, whether the payments went to third parties or directly to ACTL is not determinative of whether there was a need to regularise the way in which D4 Compression's funds had been applied.

[75] I am satisfied that if D4 Compression's funds were used in an unauthorised way that benefitted ACTL and was of no benefit to D4 Compression, the latter would arguably have legal remedies against ACTL. Remediation of this situation by converting the funds that were irregularly applied into a loan from D4 Compression to ACTL would put any such argument at an end. Removal of potential risk while such argument remained alive could constitute consideration. In return for D4 Compression's disavowal of interest in ACTL's intellectual property in the Matariki Codex, ACTL promised to pay the sum stipulated in the Loan Agreement. This way both ACTL and D4 Compression benefitted from the Loan Agreement. ACTL then knew its intellectual property in all aspects of the Matariki Codex was beyond attack. D4 Compression would know that through repayment of the loan it would be reimbursed for the use of all its funds to date.[7]

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6 See *Victoria Apartments Ltd (in liq) v Sharma* HC Auckland CIV-2009-404-8377, 14 October 2011.

7 In essence, D4 Compression promised not to complain about the irregular use of its funds and to forego any claim such use might have given on an interest in ACTL's intellectual property.

[76] I see no reason to doubt the reliability and credibility of Mr Ridgway's evidence that the Loan Agreement was executed to regularise misuse of the original funding from D4 Compression insofar as that funding was applied for purposes relevant to the Matariki Codex but beyond data compression capability. I find his evidence on this topic convincing and persuasive.

[77] Mr Ridgway was not one of the ACTL group of directors. He was engaged by ACTL to assist the company with fund raising as it had exhausted all its funds. The introduction came through a firm of accountants. Mr Ridgway had a lengthy involvement in the computer technology sector and he had experience in commercially developing this technology. He was the one who found and invited the D4 investors to invest in D4 Compression. He was the person to whom the D4 investors expressed their concerns when the investment did not come to fruition as early as had first been anticipated. At all material times, he was not a director of ACTL. Having found investors for the project, after hearing of their growing disappointment with the investment, and as a director of D4 Compression it is understandable that as at 2006 he would want to see any unauthorised use of D4 Compression's funds (all of which came from the D4 investors) regularised.

[78] Mr Ridgway only became a director of ACTL in 2012 when the ACTL directors attempted to rescue what was by then a foundering project by offering the D4 investors and Mr Ridgway shares in ACTL. It was only then that Mr Ridgway accepted shares in ACTL. The same offer was made to the D4 investors, but they chose not to accept it. Ultimately, Mr Ridgway became disillusioned with the progress of the Matariki Codex venture and so he moved on. He has no current interest in D4 Compression or the plaintiff. His account of events is plausible. At the relevant time the same persons were directors of ACTL and D4 Compression. It is difficult then to see why the directors of those companies would enter into the Loan Agreement if there was no benefit for either company.

[79] The account Mr Ridgway has given provides a plausible explanation for the Loan Agreement.

[80] Further, Mr Ridgway's evidence is consistent with other evidence. First, his evidence is consistent with the Loan Agreement, which defines "loan" to include:[8]

> *all expenses charged to D4 Compression* … that the Parties agree are for the services of any person and expenses that are *directly attributed to the commercialisation of the Matariki Codex for the Borrower [ACTL] during the loan period*.
>
> (emphasis added)

[81] I accept the plaintiff's submission that the plain wording of "loan" in the above clause means it applied to advances relating to more of the Matariki Codex than just data compression capability. Mr Wright accepted as much under cross-examination. He also accepted that as a director of ACTL, he was content for the company to execute the Loan Agreement on the terms expressed therein. Mr Wright was not one of the signatories to the Loan Agreement, but he is recorded as witnessing the two signatures on the agreement. This means Mr Wright was there at the time, and so would have had a copy of the Loan Agreement available to him. Mr Wright and the two signatories to the Loan Agreement were all directors of ACTL at the time. If they had concerns about the definition of "loan" being wider than intended, they could have acted to do something about it. But they did not.

[82] Secondly, Mr Ridgway's evidence is consistent with a communication he sent on 28 August 2006 to the D4 investors. Amongst other things this communication stated that:

> Firstly, *the funds used by D4 in preparing the Matariki codex applications for sale*, meeting with potential customers, and preparation of contract materials *are to be fully reimbursed to D4 by ACTL. This has been formalized by way of a loan agreement between the two companies …*
>
> Secondly, as you are aware the Matariki Codex has application in a number of other "sciences" which are progressing *in parallel with the compression, most notably at this stage being a DNA data storage, and processing capability … While these other applications are exciting they have until now, provided no opportunity for the D4 investors to mitigate their risk as they are outside the license agreement between D4 and ACTL.*
>
> (emphasis added)

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8 Clause 1.1.

[83] D4 Compression relies on this communication as confirmation that funds from D4 Compression went to fund more than just the data compression capability. On the other hand, Mr Wright disputed this. His evidence was that because of the loose usage others made of the term "Matariki Codex" they might use this term when they really meant a specific part of it, for instance data compression capability, which could give rise to a mistaken impression that funds were used for something other than data compression capability. However, I have seen no other evidence that supports Mr Wright's evidence on this point. What evidence there is (such as the above email) appears to me to show data compression capability being distinguished from other aspects of the Matariki Codex.

[84] Thirdly, whilst ACTL disputes there was any misuse of D4 Compression's funds, Mr Wright had no ready explanation for the evidence which showed D4 Compression had paid ACTL's legal bills, which is not something that fell within D4 Compression's responsibilities under the Capital Raising Term Sheet.

[85] Fourthly, Mr Ridgway said Mr Wright wanted a clause included in the Loan Agreement to protect ACTL's intellectual property in the Matariki Codex, which is consistent with the Loan Agreement providing a benefit for ACTL. Mr Wright accepted under cross-examination that he was responsible for the inclusion in the Loan Agreement of a specific term in which D4 Compression expressly warranted that it would not make:[9]

> any claim as to title, in part or in full, or ownership of the ACTL IP in any form beyond that agreed to in the license agreement between D4 and ACTL, as a security or payment against any monies owed to D4 by ACTL.

[86] Although he rejected the proposition the above clause was included to protect ACTL's intellectual property in the Matariki Codex, Mr Wilson accepted under cross-examination that sometimes funding or contributing to a piece of work can give rise to a claim of an interest in that work product. He also accepted in response to a question from the Court that a clause like the above put ACTL's ownership of the intellectual property beyond doubt. These acknowledgments suggest that at the time

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9 Clause 4.2.

he signed the loan agreement Mr Wilson would have been alive to the risk of D4 Compression making a claim on ACTL's intellectual property.

[87] I consider it more probable than not that the clause protecting ACTL's intellectual property rights was included for a beneficial purpose. Because there had been an earlier reservation of those rights to ACTL under the Licence Agreement, the only need to reiterate that reservation would be if something had subsequently occurred which made this worthwhile. One such thing would be if the use of D4 Compression's funds exposed ACTL to a proprietary claim to intellectual property in the Matariki Codex by D4 Compression. Any potential risk of this occurrence would be removed by the clause in the Loan Agreement reserving all intellectual property to ACTL. There is no other apparent reason for this clause.

[88] Whilst Mr Wright and Mr Wilson dispute Mr Ridgway's explanation, they offer nothing else by way of explanation for its existence. On their evidence the directors executed a loan agreement for no real reason. It is hard to see why that would be.

[89] Further there are no unequivocal contemporaneous documents to support ACTL's evidence the loan was only ever to be repaid once a "monetising event occurred". I acknowledge that there is a much later email from Mr Ridgway dated 7 September 2010 in which he refers to the loan being paid once commercial sales occur. However, this communication is capable of being read as no more than a recognition of the realities of the situation rather than proof of the existence of a collateral contract that the loan would not become due until a "monetising event" had occurred. Accordingly, it does not contradict Mr Ridgway's evidence about the Loan Agreement.

[90] I find that Mr Ridgway has provided a plausible account of how the Loan Agreement came into existence. His account is bolstered by circumstantial evidence. Given his present distance from ACTL and D4 Compression I see no reason for him to lie about what occurred. Accordingly, I am satisfied on the balance of probabilities that his account is correct and truthful.

[91] On the other hand, there is much about the evidence of ACTL that I find to be unsatisfactory, and some of it implausible, if not untrue. Insofar as Mr Wright remains

a director of ACTL and still has faith in commercialising the Matariki Codex, he has a real interest in maintaining the existence of that company. Accordingly, he has every reason to obstruct the plaintiff from obtaining judgment against ACTL, because if that company could not pay the judgment debt (which is likely) it could lead to liquidation, which would mean the end of the Matariki Codex for Mr Wright. Thus, he has good reason to present the Loan Agreement and reason for it in a way that is favourable to ACTL.

[92] There is no dispute that the Loan Agreement was drafted and executed without any input from the D4 investors. At the time of its execution they were unaware of the move to convert their equity investment, through them acquiring shares in D4 Compression, into a loan. Thus, they were not the drivers for this agreement. Mr Wright asserts that Mr Ridgway was the driving force behind the Loan Agreement. However, Mr Wright offers no explanation for why Mr Ridgway would have been driving this agreement, when on Mr Wright's evidence there was no reason for the Loan Agreement, which would also mean it was simply a meaningless wasted effort on the part of Mr Ridgway. Moreover, by executing the Loan Agreement ACTL went along with it, in circumstances where, on its evidence, there was no compulsion for it to do so. I find all this implausible. I consider the better view is that at the time ACTL was a willing signatory to the Loan Agreement, and regarded it as benefitting ACTL.

[93] I consider the only plausible benefits were: (a) the Loan Agreement offered a better incentive to the D4 investors to provide additional funds to D4 Compression for it to lend to ACTL; (b) the Loan Agreement provided a means of regularising the expenditure of funds from D4 Compression that had been applied to meet costs outside of data compression capability; and (c) the Loan Agreement removed any risk for ACTL of D4 Compression claiming an interest in ACTL's intellectual property in the Matariki Codex. I am also satisfied that those benefits were present at the time the Loan Agreement was executed. Accordingly, they provide sufficient consideration to support the Loan Agreement.

[94] It follows that I reject ACTL's other argument that the consideration on which D4 Compression relies is illusory.

Collateral contract/estoppel

[95] The terms of the Loan Agreement were something the directors of ACTL and D4 Compression seemingly reached agreement upon amongst themselves. There was a general assumption amongst all the witnesses who gave evidence that Martelli McKegg had prepared the Loan Agreement. However, none of them identified who was responsible for instructing those solicitors and there is nothing on the Loan Agreement to suggest it was prepared by solicitors. The Loan Agreement records a firm of accountants as the address for service for ACTL, which may suggest that firm prepared the document, but on the other hand this reference may be no more than a statement of ACTL's address for service. At this stage, given the age of the Loan Agreement it is not possible to determine who prepared it. However, the known circumstances make it clear that insofar as ACTL now asserts the existence of conditions that were not recorded in the Loan Agreement and which are at odds with the written form of the Loan Agreement, there was nothing at the time to prevent those conditions being included in the Loan Agreement.

[96] Regarding ACTL's contention the parties concluded a collateral oral contract that the Loan Agreement would not take effect until ACTL had the funds to repay the loan, I am satisfied that this was something ACTL could readily have included as a term of the written agreement. There was nothing or no-one to obstruct the inclusion of such a term.

[97] Further, if the parties' intention was to make liability to repay the loan conditional upon ACTL having the funds to do so, I would expect this to have been written into the Loan Agreement. Such a provision would be the mainstay of the agreement. This is not something that can be explained as an oversight. ACTL's evidence is essentially that a fundamental precept of the agreement was not included in the written contract, which gave it a significantly different effect from ACTL's asserted intention. I find this implausible. Accordingly, I find it more probable than not that no such term was included in the written agreement because it does not reflect the intention of the parties to the Loan Agreement. I also find it more probable than not that no collateral contract was agreed.

[98] Moreover, if the loan really was only to be repaid once a "monetising event" occurred, one would expect the loan to be recorded as a contingent debt in D4 Compression's financial accounts. But there is nothing about the accounting treatment of this loan which suggests it was being treated as a contingent debt. I find the accounting evidence is inconsistent with Mr Wright and Mr Wilson's evidence.

[99] At the time the Loan Agreement was executed, ACTL directors were also directors of D4 Compression. Those directors were hardly likely to call up a loan between the two companies if there were no funds to pay the loan. They may also have believed that once the "monetising event" occurred the loan could readily be repaid. In such circumstances, I can accept that each company simply assumed no demand for repayment would be made until ACTL could make such payment, and for this reason the inclusion of a clause deferring payment obligations until a "monetising event" was unnecessary. However, such assumption and conduct cannot constitute an enforceable oral collateral contract capable of obstructing the plaintiff's demand for payment. Nor can it amount to an enforceable representation by way of estoppel. There is no factual basis for either of these defences.

General observations on status of Loan Agreement

[100] At no time in the communications between D4 Compression and ACTL in the years between 2006 and 2012 did ACTL act in a way that suggested it disputed the loan was legally valid. Indeed, in 2010 ACTL wrote to D4 Compression proposing that the loan to ACTL, which it recognised to be comprised of the original money investment in D4 Compression, be written off and in return the D4 investors would receive shares in ACTL. This conduct is not consistent with how ACTL's witnesses have now sought to portray the Loan Agreement. Then in August 2010 ACTL's solicitors write to D4 Compression stating that ACTL did not believe it appropriate for D4 Compression to call in the advance it made to ACTL. Nothing was then said about the loan being a sham or unenforceable. Nor was anything said about the existence of a collateral oral contract being a barrier to repayment or representations that might form an estoppel against enforcement of payment.

[101] ACTL argued that I should draw an adverse inference from the plaintiff's failure to call Mr Brown as a witness. This I take to be a reference to the rule in *Jones v Dunkel* that failure to call evidence can support an inference the evidence was not called because it would have been unfavourable to that party.[10] However, that rule is usually only applicable if there is evidence that otherwise provides a basis from which the unfavourable inference can be drawn, which is not the case here.[11] In the present case there is ample evidence to support the assertion that GBR Research received payment from D4 Compression for services related to the Matariki Codex that went beyond data compression capability. Further in this case it would have been just as easy for ACTL to call Mr Brown as it would have been for the plaintiff, which is another factor that tells against the application of the rule. If the absent witness is independent of both sides and equally available to them, no inference adverse to either party because of that absence should be drawn.[12]

[102] The conclusions I have reached also mean that I reject ACTL's argument the Loan Agreement was only intended to give D4 Compression priority when it came to enjoying the financial return from the expected commercial benefits of the data compression capability. The same applies to ACTL's argument that the interest on the loan was only due to be paid on the occurrence of a monetising event. This is not consistent with the treatment of the loan in the financial accounts of either company.

[103] Finally, there are the contradictory explanations which ACTL gives for the Loan Agreement. They say it is a sham because there was never an intention the loan be repaid, but they also say repayment was only to occur once a "monetising event" had happened and in addition they say the loan was only intended to give D4 Compression priority when the funds from commercial sales occurred. Here ACTL's legal arguments rest on contradictory facts, proof of which rests on inconsistent evidential bases. This is a further reason why I find ACTL's evidence unsatisfactory.

[104] The outcome of this case has turned on the facts as found proved. The findings I have reached satisfy me there is a legally enforceable loan, which because of accrued

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10 *Jones v Dunkel* [1959] HCA 8, (1959) 101 CLR 298.
11 See *Mamo v Surace* [2014] NSWCA 58, (2014) 86 NSWLR 275 at [65]–[67].
12 *Claremont Petroleum NL v Cummings* (1992) 110 ALR 239 (FCA) at 259.

interest payments was as at the date of filing the proceeding for the sum of $3,216,562.31.

[105] The plaintiff relies on the Loan Agreement for interest (at the contract rate) to be calculated on $3,216,562.31 to the time of delivery of judgment. Clause 2.4(b) of the Loan Agreement provides for how default interest is to be calculated when there has been failure to repay the loan in accordance with the terms. ACTL did not address the application of the interest provisions should the loan be found to be enforceable. I am satisfied the Loan Agreement makes proper provision for payment of default interest. Leave is reserved to the plaintiff to file submissions setting out this calculation.

[106] The plaintiff has been successful in its claim and I see no reason why costs should not follow the event in the usual way. As to quantum, leave is reserved to the parties to file memoranda on costs.

Result

[107] ACTL owes and is directed to pay the plaintiff the sum of $3,216,562.31. Leave is reserved to the plaintiff to file submissions on recovery of interest between the date of filing its claim for $3,216,562.31 and the date of judgment.

[108] Leave is reserved to the parties to file memoranda on the quantum of costs.

Duffy J