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Case Alert

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New Zealand High Court decision could test dishonesty exclusions

Mainzeal Property v. Yan & Ors

AT A GLANCE

This week, the New Zealand High Court awarded $36m in damages against directors of Mainzeal, once one of New Zealand's leading property and construction companies, including former Prime Minister Dame Jenny Shipley. The damages are the highest awarded for reckless trading in New Zealand's history.

The case raises a number of insurance issues, including the extent to which insurance cover might be relevant to the assessment of damages for breaches of the Companies Act, whether liability could be treated as one insured event, whether the limits of the cover will be sufficient for the directors to meet the judgment and whether the facts of the case – combined with an express finding that that the directors did not know Mainzeal's failure would occur – will test dishonesty exclusions.

The case was funded by Auckland litigation funder LPF Group, suggesting D&O matters will remain attractive for litigation funders.

Mainzeal Property and Construction Ltd was once one of New Zealand's leading property and construction companies. It was placed into liquidation on 28 February 2013, owing creditors about $117 million.

The company, which was part of the Richina Pacific Group, had lent money to other companies in the Group to buy assets in China. One of the Mainzeal directors, Mr Yan, had informed the Board that the parent company would provide financial support when needed. However, Richina Pacific's assurances were unclear, conditional, not binding, unreliable, and limited by Chinese law – and ultimately not realised.

The liquidators, BDO, pursued Mainzeal's directors alleging breaches of various statutory and fiduciary duties. They claimed the directors engaged in reckless trading when Mainzeal was rendered balance-sheet insolvent and knew the failure would occur, or would likely occur, immediately. The balance of the claim concerned restructuring in the year before Mainzeal's failure, which allegedly increased the extent of loss to creditors.

The decision

On 26 February 2019, The New Zealand High Court found that Mainzeal was trading while insolvent and that the directors engaged in conduct exposing creditors to a substantial risk of serious loss. Justice Francis Cooke found that once the loan value was excluded from the balance sheet, it meant that "Mainzeal was insolvent, and was continuously so from 2005 through to its failure in 2013".

Importantly, as late as 2010:

- Mainzeal's intercompany debt was not recoverable in reality;
- Mainzeal relied on contract payments in advance of having to pay sub-contractors to keep trading;
- there was no assurance on which the directors could reasonably rely if adverse circumstances arose; and
- Mainzeal was in a continuous vulnerable financial state. Its historical financial performance was generally poor and prone to significant one-off losses. At the time, and despite the serious risk, Mainzeal sought to change its business plan, which exposed it to greater risk of significant one-off losses.

Despite those circumstances, the directors continued to operate Mainzeal until 2013. They also failed to take any legal advice.

Four of the company's directors were found liable for breaches of s135 Companies Act and ordered to pay damages of $36m. Of that amount, $18m is to be paid by Mr Yan and $6m is to be paid by former Prime Minister Dame Jenny Shipley (Chair of Mainzeal in 2013), Peter Gomm and Clive Tilby. Paul Collins, who joined the board shortly before the company's collapse, was not ordered to pay any damages.

The claims under s136 were dismissed as the Court did not find that it was apparent to the directors that Mainzeal's failure would occur or would likely occur immediately.

The Court considered it had broad discretion under the Act to assess quantum for breaches of s135, with reference to first principles, comparison with principles of contributory negligence and loss of chance.

As part of that assessment, Justice Cooke suggested that the extent of insurance cover might be relevant to the assessment of damages. Mainzeal's D&O insurance may not cover the $36m in damages. His Honour records there is a $20m limit in the aggregate for any one transaction giving rise to liability, and suggests that any benefit of cover might be pro-rated amongst the directors. However, Justice Cooke queried whether the liability would constitute one insured event. The extent of cover might be relevant, as a person's inability to pay is a discretionary consideration in assessing an award under the Companies Act. However, His Honour did determine the point, as there was an absence of evidence of an inability to pay without insurance cover.

This High Court decision won't be the end of the Mainzeal saga.

A public statement was quickly issued by the lawyers for Shipley, Gomm and Tilby stating the directors are considering their options. It is reasonable to expect an appeal, and probably cross-appeals.

There is also a significant insurance issue potentially brewing regarding dishonesty exclusions and the required test. It will be interesting to see whether factual findings regarding conduct and knowledge will engage exclusions and to what extent the express finding that the directors did not know Mainzeal's failure would occur will impact coverage. If there is cover, there may be questions on Justice Cooke's observations that there may be more than one insured event and that cover might need to be distributed pro-rata.

The case was funded by Auckland litigation funder LPF Group. With their high-profile success in this matter, litigation funders are likely to increasingly look for opportunity in the D&O space. Given Justice Cooke's comments, other plaintiffs may also be encouraged to seek disclosure of insurance cover and challenge the extent of that cover.

While there are still a number of unknowns with this case, one thing is very clear: D&O insurers will be watching the next chapter of the Mainzeal saga with interest.

Need to know more?

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