Hosking v Runting and the Role of Freedom of Expression

In recent years there has been much academic and judicial debate about whether a tort of privacy does or should exist in New Zealand law.[1] In a judgment handed down in March of this year – *Hosking v Runting*[2] – the New Zealand Court of Appeal conclusively settled this debate by declaring a separate common law tort of privacy. This majority decision (and prior discussions concerning a general tort of privacy) only lightly considers the effect such a tort would have on freedom of expression. However, mentioning freedom of expression in relation to a tortious action raises the question of whether it is even relevant to consider the New Zealand Bill of Rights Act 1990 ("NZBORA") when developing a private cause of action. This case note will first examine the Court of Appeal decision and then go on to discuss the role freedom of expression has to play in the development of a tort of privacy.

The Decision

In this decision the Court of Appeal rejected an attempt by Mike Hosking, a former TV presenter, to prevent the magazine *New Idea* from publishing photos of his twin daughters. Hosking and his estranged wife, Marie, had appealed against a High Court decision allowing *New Idea* to publish photographs taken by photographer Simon Runting in a popular Auckland shopping area. The Hoskings said they feared the twins might be kidnapped if photos were published. The decision of the Court of Appeal reversed the decision of Randerson J in the High Court which, following developments in the United Kingdom, held that there was no general law of invasion of privacy, and that where the law does protect against the publication of private information it is done within the scope of breach of confidence.

Agreeing with Randerson J, the Court of Appeal ruled against Hosking on the facts: the photographs would not publicize any fact in respect of which there could be a reasonable expectation of privacy; a person of ordinary sensibilities would not find the publication of these photographs highly offensive or objectionable, even bearing in mind that young children were involved; and even on a finding that the first two elements existed, there was no evidence to suggest a serious risk to the children if publication occurred. Despite concurring with Randerson J on these points, the majority of the Court of Appeal (Gault P, Blanchard and Tipping JJ) nevertheless went beyond the requirements of the case and ruled in favour of a separate tort of privacy.

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1 See Tobin, "Invasion of Privacy" (2000) NZLJ 216.

2 (25 March 2004) unreported, Court of Appeal, CA101/03.

After a thorough discussion of the British, Australian and North American case law, Gault P and Blanchard J said that they thought there was a right of action for breach of privacy where private and personal information had been publicized.[3] They took that view, in summary, because:

- it is essentially the position reached in the United Kingdom under the breach of confidence cause of action;
- it is consistent with New Zealand's obligations under the International Covenant and the United Nations Convention on the Rights of the Child;
- it is a development recognized as open by the Law Commission;
- it is workable as demonstrated by the Broadcasting Standards Authority and similar British tribunals;
- it enables competing values to be reconciled;
- it can accommodate interests at different levels so as to take account of the position of children;
- it avoids distortion of the elements for breach of confidence;
- it enables New Zealand to draw upon extensive United States experience; and
- it will allow the law to develop with a direct focus on the legitimate protection of privacy, without the need to be related to issues of trust and confidence.

Tipping J elaborated on the first point by explaining that, in substantive terms, the recognition of a separate tort is not significantly different from the extended form of the breach of confidence cause of action as it is being developed in the United Kingdom.[4] What was at stake was really a matter of legal method rather than substantive outcome. He thought that logically it could not be held that one method is an unjustified limit on freedom of expression whereas the other is not. In his view, New Zealand courts have, to a greater or lesser extent, already espoused a separate tort to protect privacy interests and he was not persuaded that there was any good reason to confine the law to a method of analysis which did not fit the true nature or the realities of the cause of action.

The formulation of the tort of privacy proposed by the Court was heavily influenced by Dean Prosser's article entitled "Privacy".[5] In it, Prosser considered the developments in the law since Warren and Brandeis' highly influential article "The Right to Privacy",[6] and concluded that the existence of a right of privacy (in fact four separate torts) was recognized by the great majority of American jurisdictions that had considered the question.[7] For the purposes of the case before them, the Court of Appeal concerned itself with, and effectively adopted,

3 *Hosking v Runting*, supra note 2, [148].
4 Ibid [257].
5 (1960) 48 Cal L Rev 383.
6 (1890) 4 Harv L Rev 193.
7 *Hosking v Runting*, supra note 2, [67].

the third of the torts identified by Prosser, that of "Publicity Given to Private Life".[8] In relation to how the tort should be formulated in New Zealand law, the Court used Nicholson J's judgment in *P v D*[9] as the starting point and went on to state the two fundamental requirements for a successful claim for interference with privacy: the existence of facts in respect of which there is a reasonable expectation of privacy; and publicity given to those private facts that would be considered highly offensive to an objective reasonable person.[10]

The Court agreed with the statements of Prosser that public figures may have lower or diminished expectations of privacy in relation to their private lives for three reasons: by seeking publicity they have consented to a lower level of privacy; their personalities and affairs are already public facts not private ones; and there is a legitimate interest in the publication of details about public figures. This lower expectation of privacy may extend to the families of public figures. While there may be special circumstances pointing away from that conclusion, such as where there is evidence of risk to the plaintiff, this was not made out in the present case.[11] The Court did conclude, however, that the criteria for the protection of privacy provide adequate flexibility to accommodate the special vulnerability of children.[12]

However, despite the majority's clear stance in favour of the tort, Anderson J, in dissent, said that he thought the court should not lose sight of the fact that this litigation came into being to prevent the publication of photographs of people in a public street.[13] There was nothing in the least personally embarrassing or distressing about the material that might be published. Anderson J thought the declaration, by the majority, that there is a new civil liability for publishing facts about a person was created in a side wind, was amorphous, unnecessary, a disproportionate response to rare, almost hypothetical circumstances, and fell manifestly short of justifying its limitation on the right to freedom of expression affirmed by the New Zealand Bill of Rights Act 1990.

This final point, identified by Anderson and Keith JJ, is one of the concerning aspects of the majority judgment. Despite mentioning the "fundamental importance of the freedom of expression"[14] the President and Blanchard J once again demonstrate the judicial habit of giving lip-service to the New Zealand Bill of Rights Act. They provide only a cursory examination as to whether a tort of privacy would be a reasonable limit on the right that can be demonstrably justified in a free and democratic society.[15] With sparse analysis, the Justices simply conclude that "it could not be contended that limits imposed

8 Ibid [68].
9 [2000] 2 NZLR 591.
10 Hosking v Runting, supra note 2, [117].
11 Ibid [120]-[121].
12 Ibid [123]-[124].
13 Ibid [271].
14 Ibid [113].
15 NZBORA, s 5.

... cannot be justified".[16] Keith J, in his dissenting judgment, provides a more thorough discussion of the relationship between a tort of privacy and freedom of expression, concluding that a general tort of unreasonable publicizing of private information should not be recognized in law because the proposed limitation is not demonstrably justified as required by section 5 of the NZBORA. He also states that the tort would depart, without good reason, from long-established and well-considered approaches to the protection of personal information.[17]

It is axiomatic that a tort of privacy limits freedom of expression as guaranteed in section 14 of the NZBORA.[18] The real question is whether such a limitation is justifiable. This question should be carefully deliberated. Freedom of expression is essential to self-governance,[19] the facilitation of truth,[20] and the promotion of individual self-fulfilment,[21] and therefore any limitation could have serious consequences. In light of the right's three important functions it is concerning that the majority judgment in *Hosking v Runting* did not examine the extent of the limitation and its effect on the right more thoroughly. Whether such a limitation is justifiable under either the common law or section 5 of the NZBORA is outside the scope of this case note. What the next section will examine, however, is how – if at all – freedom of expression is relevant when developing a tort of privacy.

Horizontality: is Freedom of Expression Even Relevant?

When considering the interaction between a potential tort of privacy and freedom of expression, it is necessary to address whether the section 14 right has any role to play in litigation between parties or in the development of the common law. This potential role is known as "the horizontal effect".[22] Does the NZBORA simply have vertical effect and so protect the citizen against breaches of the Act by public authorities, or does it have horizontal effect and so protect private citizens against one another?

16 *Hosking v Runting*, supra note 2, [114].

17 Ibid [222].

18 How a tort of privacy would specifically impact on freedom of expression is outside the scope of this case note. In general, any tort of privacy would limit freedom of expression by imposing a tortious duty on an individual not to infringe someone's privacy when exercising their right to freedom of expression. Expressive freedom is protected only to the extent that it does not breach this tortious duty. Individuals are no longer free to undertake expressive activities, such as photography, where it would infringe privacy. The tort will most commonly affect the free expression of the media due to its role as a vehicle for expression. If the media's expressive activities are limited this also limits a citizen's right under s 14 to receive information.

19 *R v Secretary of State for the Home Department, ex parte Simms* [2000] 2 AC 115.

20 See Holmes J's dissenting opinion in *Abrams v United States* (1919) 251 US 616.

21 See *Irwin Toy Ltd v Quebec (Attorney-General)* [1989] 1 SCR 927, 976.

22 See Hunt, "The 'Horizontal Effect' of the Human Rights Act" [1998] PL 423.

While there is some support and much controversy surrounding the direct horizontal effect of bills of rights[23] (in other words a cause of action founded on a breach of a right by a private citizen), this note does not need to determine whether the right contained in the NZBORA could itself found a cause of action but rather whether the right is a relevant consideration when developing a tort of privacy.[24]

Supporters of such indirect horizontality have relied on the express words of the bill of rights document to justify the application of human rights to private disputes. Section 3 of the NZBORA refers to "acts done ... by ... the judicial branches". While the plain meaning refers to actions done by judges, such as the denial of a fair and public hearing under section 25(a), the question raised by the development of a tort of privacy, and more specifically the decision in *Hosking v Runting*, is whether the section extends to the articulation and application of the common law. If it does, are private litigants indirectly bound by the Act since they have to act consistently with a common law which must conform to it? Hunt has argued that the inclusion of courts in the definition of "public authorities" in the United Kingdom Human Rights Act 1998 imposes a duty on the courts to act compatibly with the rights contained in that Act including when presiding over purely private disputes between private parties.[25] It follows that if a right contained in the NZBORA is relevant, a court deciding a case must decide in accordance with it, no less in a case between private parties than in a case against a public authority.[26] The courts are required to develop existing causes of action in such a way as to protect an individual's rights. In the words of Professor Wade, "[a] court cannot lawfully give judgment in any case in which ... rights are in issue except in accordance with those rights".[27] This is the approach adopted by the New Zealand Court of Appeal in *Lange v Atkinson*,[28] where it said the section 14 right to freedom of expression is "to be given effect by the Court in applying the common law. That follow[s] from section 3 which refers to the actions of the judicial branch of the Government of New Zealand."[29]

A further argument in favour of the courts applying the NZBORA to private disputes is founded on the view that the court is an organ of the State. When the court speaks, the State speaks, and when the court acts, the State acts. Therefore, when a court develops the common law so as to limit freedom of expression unjustifiably and issues an injunction against publication, it places the power

23 See Wade, "The United Kingdom's Bill of Rights" *Constitutional Reform and the United Kingdom: Practice and Principles* (1998); Barak "Constitutional Human Rights and Private Law" in Friedmann and Barak-Erez, *Human Rights in Private Law* (2001) 13-42.

24 The author's preliminary view is that to directly apply freedom of expression by inventing a new cause of action based on it would defy the will of Parliament which has clearly decided, by virtue of s 3, not to make the NZBORA directly binding on everyone, including private bodies.

25 See Hunt, supra note 22.

26 See generally Wade, "Horizons of Horizontality" (2000) 116 LQR 217, 217-218.

27 Ibid 220.

28 [1998] 3 NZLR 424.

29 Ibid 431.

of the State at the disposal of the private party who is infringing another private party's right to freedom of expression. On this basis the court is violating the State's duty not to limit a citizen's right unjustifiably. Exempting the courts from this statutory duty would effectively place them above the rule of law. It would also undermine the importance placed on the NZBORA if a private party could seek a remedy from the court that would unjustifiably limit a guarantee right. The lack of coherent principle in this approach is illustrated by the fact that in a case with the same facts, but where one party is a state actor such as a government employer, the courts would be obliged to uphold freedom of expression.

It is apparent, however, that the application of the NZBORA to judicial development of the common law is not free from criticism. It is also arguable that when a court grants relief in a private dispute it acts neutrally to determine the parties' rights and obligations. If a party is entitled to privacy, and the court enforces this entitlement, it does not infringe the State's obligation to limit freedom of expression only where it is justifiable. The court is simply recognizing the non-application of the right to freedom of expression in private law.

A further criticism of applying the NZBORA to judicial development of the common law rests on the interpretation of the phrase "act done" in section 3(a). Rishworth argues that it is "conceptually inappropriate to regard the judicial process of determining a case as an 'act done' such that it must comply with the Bill of Rights".[30] This view is echoed by McIntyre J in *Dolphin Delivery*:[31]

> I cannot equate for the purposes of Charter application the order of a court with an element of governmental action....To regard a court order as an element of government intervention necessary to invoke the Charter would, it seems to me, widen the scope of Charter application to virtually all private litigation.

This statement reflects the idea that in deciding a case the judiciary is not acting as a branch of government needing restraint. The actual result of the court case is not an "act done" by the judiciary but rather an *application* of the NZBORA even if that application is wrong. The result may be challenged on appeal but to regard it as a breach of the Act by the judiciary could have the effect of "endless loops of litigation" as disappointed litigants claim fresh breaches that justify new litigation every time a decision does not go in their favour.[32] This situation cannot have been intended in the NZBORA as it "could paralyse our judicial system by removing certainty from supposedly final judgments".[33] There

30 Rishworth et al, *The New Zealand Bill of Rights* (2003) 101. Rishworth also notes here that the courts are "institutionally unsuited to making more than incremental adjustments to the common law" and therefore the large proportion of common law compliance with the NZBORA should be done by the legislature.

31 *Retail, Wholesale and Department Store Union, Local 580 v Dolphin Delivery Ltd* [1986] 2 SCR 573, 600-601 ["*Dolphin Delivery*"].

32 This is the argument of L'Heureux-Dubé J in *Dagenais v Canadian Broadcasting Corp* [1994] 3 SCR 835, 910-911 ["*Dagenais v CBC*"].

33 Ibid 911.

is a qualitative difference between 'acts done' during the course of a proceeding and the 'act' of judicial reasoning or applying the law.[34]

It is important to note here – before blindly applying any approach born out of the UK Human Rights Act to the NZBORA – that in English case law the role freedom of expression plays in cases of a horizontal nature is barely discussed. It is already implicitly accepted in England that freedom of expression, as a common law right, is applicable to horizontal situations. The first of these cases was Lord Denning's dissent in *Hubbard v Vosper*,[35] concerning a breach of confidence action, where the judge stated that "the law will not intervene to suppress freedom of speech except when it is abused".[36] In England, with the right to privacy contained in its Human Rights Act, the argument is the converse to that in New Zealand. While New Zealand lawmakers must consider the role of freedom of expression in developing a tort of privacy, with the advent of their Act, British judges and academics are considering the place of privacy within freedom of expression jurisprudence. Their horizontality debate centres around this issue. Although British discussions as to the express words of their statute are helpful when considering our section 3, more assistance can be gained from the Canadian approach where their Charter has no right to privacy and the applicability of freedom of expression to private disputes has been a contentious issue.

The situation in Canada regarding the application of the Charter to private disputes is not settled. In *Dolphin Delivery*[37] McIntyre J held that the rights set forth in the Charter are directed at the State alone. A decision that grants a remedy to a private party against another private party is not governed by standards of constitutional provisions. Moreover, the State's duty to respect the rights of private parties does not impose a similar obligation on the courts. However in *CBC v Dagenais*[38] the Supreme Court applied the Charter indirectly and viewed *Dolphin Delivery* as implicitly allowing the Court to consider Charter values in the development of the common law. Subsequently the Court decided in *Hill v Church of Scientology of Toronto*[39] that it would not apply the Charter, even indirectly, to matters that were "purely private" such as cases which involved a common law action for defamation.[40] However, it was prepared to invoke Charter values to influence the development of the common law only. This approach is similar, but not identical, to that which the United States Supreme Court took

34 See *Upton v Green (No 2)* (1996) 3 HRNZ 179. See also the Canadian case of *R v Rahey* [1987] 1 SCR 588 where the Supreme Court of Canada concluded that a trial judge's conduct in according 19 adjournments and taking 11 months to reach a decision on an application for a directed verdict contravened the Charter, specifically, the accused's right to be tried within a reasonable time.

35 [1972] 1 All ER 1023.

36 Ibid 1030. See also *Schering Chemicals v Falkman Ltd* [1981] 2 WLR 848; *Telnikoff v Matusevitch* [1992] 2 AC 343; *Rantzen v Mirror Group Newspaper Ltd* [1993] 3 WLR 954.

37 *Dolphin Delivery*, supra note 31.

38 *Dagenais v CBC*, supra note 32.

39 [1995] 2 SCR 1130 ["*Hill*"].

40 The New Zealand Court of Appeal has also said that the NZBORA does not apply to "wholly private conduct" in *R v N* [1999] 1 NZLR 713, 718.

decades earlier in *New York Times v Sullivan*[41] where it was held that common law rules regarding defamation must be adjusted to conform to the freedom of expression established in the First Amendment. In its most recent case, *RWDSU Local 558 v Pepsi-Cola Canada Beverages (West) Ltd*,[42] the Canadian Supreme Court impliedly overruled *Dolphin Delivery*. The decision removes the distinction between public and private disputes and applies the Charter to all common law private relations. The Court does not formally apply the Charter to the common law but directs that the common law must evolve in a manner consistent with the Charter. This approach is unstructured and arguably creates uncertainty in the application of the Charter to the common law.

Aversion to applying Charter rights to private disputes was articulated by Cory J in *Hill v Church of Scientology Toronto*,[43] where he stated that:[44]

> [P]rivate parties owe each other no constitutional duties and cannot found their cause of action upon a Charter right. The party challenging the common law cannot allege that the common law violates a Charter *right* because, quite simply, Charter rights do not exist in the absence of state action. The most that the private litigant can do is argue that the common law is inconsistent with Charter *values*.

This approach reflects the argument that the very reason that human rights have been given constitutional normative status is precisely because it is the legislative and executive branches that are likely to infringe them. The primary purpose of all bills of rights is to provide safeguards against the arbitrary exercise of power by government. Human rights in relations between private parties require no special constitutional status because regular legislation or common law suffices to protect an individual's rights in private situations. However, the recent litigation in both *Hosking v Runting* and *Lange v Atkinson*[45] indicates that freedom of expression is under threat not from direct government action but from private citizens.

In Rishworth's view, the common law must be consistent with the NZBORA. The starting point is that every court case must end with a result consistent with the Act, save the unavoidable cases where section 4 applies, and that is true both where the case involves a statute and where it involves the common law.[46] However, although he bases this conclusion on the application of the NZBORA to judicial acts he then goes on to describe the application of the Act to private disputes as "controversial",[47] thereby implying that the common law needs to

41 (1964) 376 US 254.
42 [2002] 31 SCR 156 ["*Pepsi Cola*"].
43 *Hill*, supra note 39. Emphasis in the original.
44 Ibid 1170.
45 [2000] 1 NZLR 257.
46 Rishworth et al, supra note 30, 98.
47 Ibid 99.

develop consistently with the Act only where the State is a party. He does proceed to say that the controversy is an overreaction because: [48]

> [The g]eneral susceptibility of the common law to Bills of Rights revision, even in private litigation, is not the same thing as saying that the common law must simply replicate the rights in the Bill of Rights by burdening private persons with the same obligations as are borne by government.

Although the rights contained in the Bill of Rights are not directly applicable to private relationships they can be viewed as an interpretative tool such that the common law must be interpreted consistently with these rights. This was the approach in *Dolphin Delivery* and *Hill* and of Elias J in *Lange v Atkinson.*[49] The assumption behind this requirement is that individuals who have contracted to be citizens in a democracy "could not reasonably acknowledge a specification of private rights that is inconsistent with the indicia of dignity to which citizens have accorded constitutional recognition".[50] Having regard to the NZBORA when interpreting and developing the common law has been termed the "weak" indirect horizontal effect.[51]

It seems intuitively wrong for the judiciary to resolve a dispute by subjecting a party to a limitation on their rights which is unreasonable in a free and democratic society. An alternative to the view that the judiciary is explicitly bound by section 3(a) to develop the common law consistently with the NZBORA, is that the common law must reflect the *values* of the Act but does not impose on citizens the same duties as those owed by the State.[52] This view rests on the orthodox proposition that where there is an inconsistency between an enactment and a common law rule the latter gives way. In this way the common law must be developed consistently with the right to freedom of expression as affirmed in the NZBORA.[53] This is the approach supported by the dissenting judgment of L'Heureux-Dubé J in *Dagenais v Canadian Broadcasting Corp*:[54]

> Charter values nonetheless remain and important consideration in judicial decision-making. Courts must strive to uphold Charter values, and preference should be given to such values in the interpretation of legislation over those which run contrary to them.

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48 Ibid.

49 [1997] 2 NZLR 22.

50 Weinrib and Weinrib, "Constitional Values in Private Law in Canada" in Friedmann and Barak-Erez (eds) *Human Rights in Private Law* (2001) 50.

51 Beale and Pittman, "The Imact of the Human Rights Act 1998 on English Tort and Contract Law" in Friedmann and Barak-Erez, supra note 50, 135; Young, "Remedial and substantive horizontality: the common law in *Douglas v Hello! Ltd*" [2002] PL 232, 235.

52 This is arguably the approach taken by Elias J in *Lange*, supra note 49, 32: "It is idle to suggest that the common law need not conform to the judgments in such legislation. They are authoritative as to where the convenience and welfare of society lies."

53 Butler, "The New Zealand Bill of Rights and Private Common Law Litigation" [1991] NZLJ 261, 262.

54 *Dagenais v CBC*, supra note 32, 911.

Furthermore, a continuation of this argument is that although judicial reasoning is not directly subject to the Bill of Rights where the principles underlying a common law rule are out of step with the values in it, the courts should scrutinize the rule closely. If it is possible to change the common law rule so as to make it consistent with these values, without upsetting the constitutional balance between judicial and legislative action, then the rule ought to be changed.[55] This proposition rests simply on the common law paradigm of incremental development of the law in light of fundamental values. If the court develops the common law in such a way as to be consistent with these values it is because it has been persuaded that this is the correct approach rather than because it is bound by the NZBORA. The Act simply forms the basis on which the court is persuaded.

As an aside, an interesting issue when examining the compatibility of a tort of privacy with the right to freedom of expression is whether an identical balancing test would be applied in the private sphere as is applied between the state and the individual. There are few cases dealing with the relevance of freedom of expression to tortious remedies and as a result there is little guidance on how freedom of expression should be weighed against private remedies. The relationship between constitutional values and private law is yet to be elucidated by the Supreme Court of Canada. In *Dolphin Delivery* the Court side-stepped having to articulate a balancing test applicable to private law limitations on Charter rights. Having affirmed that the common law should be developed in a manner consistent with Charter values, the Court gave no indication of how these values were to be elucidated in the dispute. Despite holding that the Charter did not apply to disputes between private parties, the majority of the Court held that the injunction was a reasonable limitation on Charter rights. It was as if the Court, by holding that there would be no Charter violation if the Charter applied directly, felt itself absolved from addressing what it saw as the different task of determining the relevance of constitutional values to a tort remedy that restricted freedom of expression.

This was also the case in *Hill* where, in considering a defamation action, the Court focused largely on importing the malice standard into the action rather than on specifically examining the balance between reputation and freedom of expression. In *Hill* the Court did state that as the conflict involved private litigants – and therefore was a conflict between principles – "the balancing must be more flexible than the traditional section 1 [section 5 NZBORA] analysis undertaken in cases involving government action".[56]

55 *R v Salituro* [1991] 3 SCR 654, 675 per Iacobucci J.

56 *Hill*, supra note 39, 157.

The rationale behind these different standards of justification may be linked to who is responsible for the creation of the law being invoked and who the section 1 – or section 5 – qualification is directed towards. The interpretation sections of the NZBORA[57] assume that the rights in the Act are to be protected until clearly displaced, with section 5 imposing a heavy onus on the government to demonstrably justify any limitation on those rights. This requirement reflects citizens' entitlement to respect for their rights by those who govern, and mirrors the government's responsibility to act according to the rule of law. Private litigation, by contrast, can be traced back to an important underlying value of the NZBORA – liberty. Accordingly, the Act still "protects a sphere of autonomy that includes the liberty to subscribe to values different from those of the State".[58] This sphere of autonomy is, of course, subject to reasonable limitations in order to protect community interests and the rights of others, but it is indicative of why a more flexible balancing test than that under section 5 may be applied in instances of private litigation.

Conclusion

In most cases, particularly where privacy issues are raised, the right to freedom of expression will not be susceptible to the 'purely private' distinction that the Canadian and New Zealand courts have drawn. The reason for this is that the right to freedom of expression incorporates both an individual's interest in imparting information and the societal interest in receiving that information.[59]

The fear that the NZBORA, and its accompanying right to freedom of expression, will invade the private sphere is largely an overreaction; there has never been anything stopping the enactment of legislation to regulate the private sphere. Once it is appreciated that the common law must evolve consistently in light of all persuasive values – including the rights contained in the NZBORA – any reference to section 3(a) adds nothing to the argument that freedom of expression is relevant to that evolution.

In the end, whichever is the juridical basis for the application of the NZBORA to private disputes, it is apparent from case law and academic argument that it must have a role to play when considering the development of a tort of privacy. This role arises either through the binding of the judiciary under the Act itself or through the Act being a persuasive reflection of fundamental values.

57 Sections 4-6.
58 Rishworth et al, supra note 25, 102.
59 *Dagenais v Canadian Broadcasting Corporation* (1994) 120 DLR (4th) 12, 55-7.

Having failed on the facts, *Hosking v Runting* was not an ideal case with which to develop a tort of privacy. Finding in favour of the defendant, the Court places no limitation on the specific media activity giving rise to the plaintiff's claim, and accordingly, there was little factual material with which the Court could thoroughly examine the impact such a tort would have on future expressive activity. While this decision may give some immediate relief to freedom of expression advocates, there is sparse evidence to indicate where this judgment will lead and what effect it will have in New Zealand law, particularly on the right to freedom of expression. Further case law and academic commentary are eagerly awaited.

Jane Norton BA/LLB(Hons)

Re South Pacific Shipping Limited

Introduction

On 12 February 2004, the Christchurch High Court ordered the largest award to date in a New Zealand "reckless trading" case, when it found company director Mr Klaus Löwer personally liable for $7 million of company debt and liabilities. The case was *Re South Pacific Shipping Ltd (in liq)*.[1]

There was significant media interest in the judgment, no doubt due to the high value of the award. However, leaving this award to one side, from an academic perspective William Young J provides some interesting discussion on the "reckless trading" provision (section 135) of the Companies Act 1993 ('the Act"), notwithstanding that the case was actually decided under the Companies Act 1955. William Young J has taken the opportunity in the judgment to discuss the scope of section 135 and give company directors some guidance as to what may constitute legitimate and illegitimate business practice for the purposes of the 1993 Act. Further, taking a less literal approach than the court in *Fatupaito v Bates*,[2] William Young J is of the provisional opinion that the taking of risks in business is an activity that is not, in itself, illegitimate under section 135. The judgment clearly supports the viewpoint that a literal approach to the interpretation of section 135 is onerous and impractical from a business perspective.

The Law

Previously, section 320(1)(b) of the Companies Act 1955 allowed the court to impose unlimited personal liability for the debts of a company in liquidation against any person who was, while an officer of the company, knowingly a party to the carrying on of any business of the company in a reckless manner. Case law provided further guidance as to what actions constituted recklessness. This section was replaced by section 135 of the Companies Act 1993, which was inspired by the renowned and much-cited passage of Bisson J in *Thomson v Innes*:[3]

> Was there something in the financial position of this company which would have drawn the attention of an ordinary prudent director to the real possibility not so slight as to be a negligible risk, that his continuing to carry on the business of the company would cause the kind of serious loss to creditors of the company which sec 320(1)(b) was intended to prevent?

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1 (12 February 2004) unreported, High Court, Christchurch, CIV1998-409-000069, William Young J ["*South Pacific Shipping*"].
2 [2001] 3 NZLR 386.
3 (1985) 2 NZCLC 99,463, 99,472.

Section 135 states:

> 135. 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.

Criticism of Section 135

In *South Pacific Shipping*, William Young J discusses the widespread criticism, by various commentators, of the wording of section 135.[4] He pinpoints, and largely agrees with, the key criticisms of the section (except, prudently, the last point). In sum, the criticisms are that:

- The passage of Bisson J which underpins section 135 could not have been intended by that judge to be a comprehensive test of liability.
- It is a necessary part of business to take substantial business risks, and section 135 provides no scope for business risks that are legitimate, but not necessarily successful.
- The section is poorly drafted and provides directors with no guidance as to what point a decision should be made to stop trading.
- The section is capable of being misapplied by inexperienced commercial judges bringing hindsight judgment to bear in circumstances very different from those experienced by the directors being challenged.

In an extensive discussion, William Young J canvasses the legislative history of section 135, the judicial guidance provided from earlier section 320 decisions, and academic observations on the scope of directors' duties and business risk.[5] He concludes that it is his provisional view that any liability for directors under section 320 must allow for the taking of legitimate business risks, to allow for the sensible application of the section.[6] In other words, a distinction is made between "illegitimate" business risks, which will attract liability for reckless trading, and "legitimate" business risks, which will not.[7] William Young J further states that "it is clear that liability under section 135 must be at least as broad as liability under section 320(1)(b)".[8] Thus, we may usefully consider *South Pacific*

4 *South Pacific Shipping*, supra note 1, [128].
5 Ibid [113]-[130].
6 Ibid [123].
7 Ibid [123]-[124].
8 Ibid [130].

Shipping to ascertain what behaviour might constitute illegitimate business risk taking under the 1993 Act, particularly in circumstances where a company is at risk of liquidation (although always noting that the matter of the scope of the section is still to be finalized by an appellate court).

The Facts

South Pacific Shipping Limited ("SPS") was formed in January 1992 and placed in liquidation in February 1998. William Young J described the company as "hopelessly insolvent" at the point of liquidation. The defendant, Mr Löwer, was a director of the company, and, for all intents and purposes, the dominant shareholder. The principal business of SPS was to provide scheduled trans-Tasman shipping services between fixed ports in Australia and New Zealand. Mr Löwer was to obtain over the course of the existence of the company an ownership interest in eight of the eleven vessels that were bare-boat chartered by SPS. The company had links to German interests.

The company operated in an era of market change in relation to international shipping. Anti-price-fixing provisions do not apply to international shipping, and in the early 1990s all trans-Tasman shipping companies operated under an "accord" arranged between Australasian Maritime Unions, intended to preserve the trans-Tasman trade for trans-Tasman crews. Effectively, international vessels with empty space could not transport trans-Tasman cargo. This agreement broke down, and was virtually ineffective by 1996. As a result cargo capacity increased, further exacerbated by SPS entering the market. During this period, trade volumes were lower than the cargo capacity. Freight prices dropped, fundamentally as a result of the increased competition, but also as a result of improved port efficiencies and reduced stevedoring costs. These factors had a tremendous impact on dedicated trans-Tasman shipping companies.

Within this daunting context, the affairs of SPS were being conducted in an imprudent manner. The directors of the company resided in Australia, Germany and New Zealand, although this in itself was not a problem. Formal directors' meetings were rarely held, in person or by teleconference. Records or minutes of the meetings were limited. The records that did exist failed to show comparisons between actual and projected performance of the company. The company was chronically short of capital and faced regular working capital crises.

By mid-1992, after a few teething problems and a financially inauspicious start, SPS was running a fleet of five vessels (of which four were deployed on the trans-Tasman trade, and a fifth operating the New Zealand coastal trade), but with little success. For the year ending June 1993, the company made a net loss of $5,455,890 (an increase of approximately $3.5 million on the net loss to June 1992). During this financial year, only one board meeting was held, and no minutes of that could be produced to the Court. No budget which could be directly compared or analyzed against the financial statements was produced, and

financial projections made were clearly "well adrift" of actual performance. The share capital of the company was increased from $1 million to $6.25 million, of which Mr Löwer took up directly or indirectly the majority of the shares. The capital was used to pay charter-related debt.

By mid-1993, six vessels were running the trans-Tasman route, constituting approximately 19 per cent of the total trans-Tasman trade capacity. It is of interest that a consortium of trans-Tasman shippers were concerned with the impact SPS would have on freight charges, and commissioned a (reasonably accurate) model to predict the profitability of SPS. Armed with the information that SPS was (and would continue to) trade at a loss, the consortium later visited Mr Löwer in Germany with the intention of warning him off the course. Mr Löwer responded that he would sue if the financial evaluations were released to a third party and indicated (untruthfully) that in any event, the ship owners were merely concerned with the tax benefits of New Zealand shipping.

The annual report for the year ended 30 June 1992 was signed off on 2 February 1994. The report was qualified by the auditor with a "going concern" assumption, which stated:[9]

> [T]he financial statements have been prepared on a going concern basis, the validity of which is dependant on the continued financial support of the major shareholders. Should continued support not be provided, the going concern basis may be invalid and additional provisions may be required for possible loss on realisations of the company's assets.

In the year ending June 1994, the loss rose to $6,000,407. Various financial projections were produced, which inaccurately but hopefully estimated a profit. On 18 April and 15 June of that year, significant board meetings were held. At the April meeting, notwithstanding the company's increasing losses, the board decided to charter three additional vessels; one for the trans-Tasman route, and the remaining two as feeder vessels in the Caribbean and along the European coast. In June, decisions were made to withdraw one vessel from service, purchase a related company, and to lend that company $1 million (presumably to repay debtors). In the minutes for those meetings, reference was made to industry-wide rumours that trans-Tasman shipping restrictions were likely to be removed.

For the year ending June 1995, the company loss again grew, to $6,595,959. For this year, a more detailed statement was attached to the audit report, somewhat graciously stating:[10]

> [S]ince balance date the major shareholder has provided support to the company by replacing outstanding shareholder and related party liabilities by a $5,139,000 subordinated loan. However no formal confirmation of ongoing support has been provided to the company.

9 Ibid [55].
10 Ibid [99].

> Without the ongoing support of the major shareholder the company would be dependant upon its ability to generate sufficient funds to be able to pay its debts as they fall due. We have been provided with the forecast information. Since anticipated events frequently do not occur as expected, actual results are likely to be different from forecasts and the variation may be significant.

On the recommendation of the auditors, the directors of SPS sought the first of a number of opinions regarding their potential liability for reckless trading, should SPS go into liquidation. This first opinion was not alarming, but noted that the frequency of directors' meetings was inadequate, the need to compare performance against budgets, and that a third party should examine the reasonableness of the assumptions upon which forecasts and budgets were prepared. It also suggested that serious consideration should be given to obtaining substantial commitment from Mr Löwer that he would back up the company in the event that it was unable to meet its obligations to creditors. Further, it recommended the injection of further capital into SPS.

Independent projections for 1995 were obtained. However, increased meetings were not held and the budgets were again clearly optimistic. A further opinion on directors' liability was obtained, and was much more pessimistic in tone. The previous points were reiterated strongly, and it indicated that the directors would probably be sued by the liquidator in the event of liquidation. Trading at a loss continued and there was no noticeable improvement in the management of the company, although a small increase in capital was made. The three additional vessels were added to the fleet. By the time Mr Löwer resigned as a director on 18 February 1998, the company had total liabilities of $41 million. The company went into liquidation on 19 February 1998.

The liquidators brought a case against Mr Löwer alleging that by April 1994, he had acted recklessly in breach of section 320(1)(b) of the 1955 Act, and thus was personally responsible for company debts and liabilities.

Relevant Factors

William Young J provided a number of factors to be considered in determining whether a business risk is legitimate or otherwise for the purpose of establishing liability for reckless trading:[11]

- Was the risk fully understood by those whose funds were in peril? It would be contrary to the principles of limited liability to make directors liable to creditors who were wholly aware of the risk to be undertaken.

11 Ibid [125].

- Where a company is insolvent, it is the creditors and not the shareholders who are primarily concerned with the company's financial dealings. In insolvency, the directors have an obligation to have regard to the interests of the creditors.[12]
- It is recognized that a company is not required to cease trading the moment it becomes insolvent (in a balance sheet sense), as this may inflict loss on creditors and might unnecessarily limit the possibility of salvage. However, it has been established that there are limits on the extent to which a company can trade while it is insolvent in the hope that matters will improve. William Young J highlights the fact that the time limit has been a matter of months in most cases.
- Was the conduct of the director in accordance with orthodox commercial practice? The reasonable director should put in place arrangements to ensure the company is able to trade its way back to profitability.[13] It is implicit that directors are more likely to be found liable for reckless trading where they have acted contrary to orthodox commercial practice.
- The final test is one of recklessness: it is necessary that the behaviour in question comes squarely within this ambit, and is not merely negligent.

The Decision

After considering the facts in light of the above, William Young J determined that Mr Löwer "can be fairly regarded as having forfeited the protection of limited liability".[14] William Young J unequivocally stated further:[15]

> Given [Mr Löwer's] wish to permit SPS to continue to trade despite insolvency, the hostile business environment, his unwillingness or inability to implement orthodox governance practices, and the proven unreliability of management reporting, he ought to have been prepared to put his own money up by capitalising the company to an extent that was appropriate given the risks he was taking with creditors' money. His behaviour departed so markedly from orthodox business practice and involved such extensive and unusual risks to the creditors that it can be fairly stigmatized as reckless.

Particularly significant factors were:[16]

- The fact that Mr Löwer was obtaining a number of collateral benefits in the form of fees and the like from overseas, which no doubt motivated him to continue trading.

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12 See *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242.
13 See *Re Bennett, Keane & White Ltd (in liq) (No 2)* (1988) 4 NZCLC 64, 317.
14 *South Pacific Shipping*, supra note 1, [151].
15 Ibid.
16 Ibid [150]

- The ongoing risk to creditors by continuing to trade at a loss for a number of years.
- The fact that trade creditors were not aware of the risks they faced, due to a failure to file company accounts prior to 1994, and a change in account formatting which treated related party debt as a form of quasi-equity.
- The hostile business environment for trans-Tasman shipping;
- The lamentable governance style adopted by the directors, including insufficient meetings, poor minutes, a lack of financial paper-work, poor budgeting processes.
- A failure to put in place well thought out strategies when faced with insolvency, in particular, deciding to expand operations when it was clearly inappropriate to do so.

A full discussion on quantum followed, which concluded that a reasonable, albeit conservative, figure for liability on a remedial (not punitive) basis was $7 million.[17]

Conclusion

This decision clearly turns on its own set of quite exceptional facts. However, directors can draw guidance from the above comments as to what factors may be considered by the court when determining whether certain activities are legitimate (and thus not reckless) when a company is faced with liquidation. The judgment supports those who argue that section 135 of the 1993 Act should be read in a liberal manner, thus allowing legitimate business risks to be undertaken in the course of business without liability attaching. The need to adopt orthodox business practices such as suitably documenting directors meetings and acceptable accounting practices is trite. Continuing to trade for several years while operating at a loss, without disclosing the same to creditors, would not be considered acceptable, even within a liberal reading of the section. William Young J has lent his well-considered support to a commercially sensible interpretation of section 135 of the Act. However, the true extent of a director's liability for reckless trading will remain open until the Court of Appeal or Supreme Court has the opportunity to determine the scope of the provision.

17 Ibid [154]-[173].

Endnote

A further reckless trading matter has come before the Nelson High Court, following the *South Pacific Shipping* judgment. In the case of *Walker v Allen*[18] France J noted the earlier decision of William Young J and repeated with apparent approval the conclusion that only illegitimate business practices attract liability under section 135. His Honour then applied the factors proposed in *South Pacific Shipping* to ascertain whether a business practice is in fact illegitimate, although decided (somewhat unhelpfully) that the case at hand was capable of resolution without determining the exact scope of section 135. Nevertheless, the *Walker* judgment provides implicit support for the *South Pacific Shipping* test and viewpoint.

Liz Gellert BA/LLB(Hons)

18 (18 March 2004) unreported, High Court, Nelson, CP 13/00, France J.