DIRECTOR AND SHAREHOLDER LIABILITY AT PIKE RIVER COAL

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Abstract

More than five years on from the tragedy that occurred at Pike River mine, no individual has been held to account for the many failures at the mine that have been exposed subsequently. This article explores the events leading to the tragedy and considers whether directors and shareholders of the company are liable under New Zealand company law for the losses sustained by the miners and their families.

The result of the analysis in this article is the finding that shareholders will not be liable merely in their capacity as shareholders. The ability to pierce the corporate veil in New Zealand in the absence of fraud or evasion is remote at best.

There may, however, be grounds for liability to arise upon directors as they have failed in their duty of care to the company (s 137 of the Companies Act 1993). This liability may extend to New Zealand Oil and Gas Limited in their capacity as a shadow director up until 2007.

As the miners and their families remain creditors of the company, they may pursue an action against the directors under the remedies available under s 271 or s 301 of the Companies Act 1993.

I. Introduction

Thirty-one men went to work in a mine deep in the Paparoa Ranges on the West Coast of the South Island of New Zealand on 19 November 2010. A methane gas explosion burst through the mine at 3.45pm that afternoon. Two men, Daniel Rockhouse and Russell Smith, walked out of the mine later that afternoon. Five years on, the other 29 men remain underground.

During the early days following the explosion, hopes remained that the men would be rescued, the New Zealand public holding on to fresh memories of the dramatic rescue of 33 Chilean gold mine workers after 69 days trapped

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underground. Five days later, another explosion at Pike River wiped out all hope of rescue. It had become clear the conditions were far too dangerous for any attempted rescue to take place and the chances of survival were slim. The public became aware that coal mining carried a different set of risks to gold mining.

Days and weeks passed as the families waited for the bodies of the men to be returned. Hopes were raised and then dashed time and time again. In November 2014 the current owners of the mine, Solid Energy Ltd, decided that the mine would not be re-entered due to safety reasons. Families have been forced to accept that this is the tomb in which their beloved family member will remain. For many, especially those families who live in Australia, South Africa and the United Kingdom, having their loved ones so far from home is heart-wrenching.

A Royal Commission Inquiry report leaves little doubt that the tragedy that occurred at Pike River Mine in November 2010 was a result of poor safety standards that were allowed to continue for a combination of reasons. One of those reasons, the focus of this article, was the low priority the company gave to the safety of its employees.

The article focuses on corporate law liability - in particular, the law around liability of the shareholders and directors of Pike River Coal Ltd ("Pike River Coal ") for the failure of the company to provide a safe work environment at the mine. The article is clearly speculative in its nature. If there were obvious remedies and causes of action, these paths would have been followed already.

Part II will explore the issues surrounding the tragedy at the mine and the factors that contributed to the event.

Part III looks at whether shareholders could be accountable to the families of the dead men and the two survivors, who now stand as unsecured creditors of Pike River Coal following a judgment against the company under the Health and Safety in Employment Act 1992. Is it possible, in circumstances such as those surrounding Pike River Coal, to "pierce the corporate veil" and reach the deeper pockets of shareholders, in order to satisfy the liabilities owing to the families and survivors? The conclusion reached in this part is that the law, as it stands today, will not allow a court to pierce the veil and hold shareholders accountable for the company's debts solely due to their position as shareholders.

Part IV looks at the potential liability of the directors of Pike River Coal. This part considers the directors' statutory duties, in particular s 137 of the Companies Act 1993, which imposes upon directors a "duty of care". Who are the directors who share these duties? What is meant by the "best interests of the company"? What is the "duty of care"? These issues are examined and the conclusion is reached that the directors of Pike River Coal may be accountable for failing in their duty of care to the company. Amongst the pool of directors failing in this duty may be New Zealand Oil and Gas Limited ("NZOG") in their capacity as a shadow director, a controller and also as the major shareholder of Pike River Coal - the shareholder with "deep pockets" and ironically the biggest creditor of the company.

II. Pike River Coal Ltd

A. The Royal Commission Report

Almost two years on from the initial explosion, the Royal Commission on the Pike River Coal Ltd Mine Tragedy reported to the Governor General on the questions of what happened in the Paparoa Ranges and what can be done to prevent such a tragedy occurring again.

The Royal Commission concluded that the immediate cause of the tragedy was a large methane explosion. Methane gas is emitted from the coalface and, when mixed with air, creates a highly flammable combination. It is still not clear exactly what caused the methane explosion but several potential ignition sources were identified by the Commission, including: [1]

> ... arcing in the mine electrical system, a diesel engine overheating, contraband taken into the mine, electric motors in the non-restricted part of the mine and frictional sparking caused by work activities.

The Royal Commission found that, while the direct and immediate cause of the deaths was methane gas explosion, the more probing question was determining the underlying factors that contributed to that immediate cause. They state: [2]

> ... any system relying on error-free human performance is fundamentally flawed. In any event, accidents are rarely the result of a single action, failure or factor, but rather a combination of personal, task-related, environmental and organisational factors, some longstanding.

In investigating the underlying causes of the tragedy, the following issues were identified by the Commission:[3]

- This was a process safety accident, being an unintended escape of methane followed by an explosion in the mine. It occurred during a drive to achieve coal production in a mine with leadership, operational systems and cultural problems.
- Such problems coincided with inadequate oversight of the mine by a health and safety regulator that lacked focus, resourcing and inspection capacity.
- The legal framework for health and safety in underground mining is deficient.

1 Hon Graham Panckhurst, Stewart Bell and David Henry *Royal Commission on the Pike River Coal Mine Tragedy - Volume 1* (October 2012) at 15.

2 Hon Graham Panckhurst, Stewart Bell and David Henry *Royal Commission on the Pike River Coal Mine Tragedy - Volume 2* (October 2012) at 28.

3 Royal Commission Report Vol 1, above n 1, at 15.

- Those involved in the search and rescue were very committed, but the operation suffered from an absence of advance planning for a coalmine emergency, and from a failure to properly implement the principles of the New Zealand Co-ordinated Incident Management System (CIMS).
- The families of the 29 men would have benefited from better communications during the search, rescue and recovery phases.

This article focuses on the first of the underlying causes identified by the Royal Commission - the leadership, operational systems and cultural problems that existed at the mine.

The Royal Commission found that at the executive manager level "there was a culture of production before safety at Pike River".[4] On 5 July 2010, all employees at the mine had been offered substantial bonus payments, dependent upon reaching performance targets by a specified date.[5] Financial pressures were increasing and the company had failed to meet promised production targets - in fact, it had barely produced any coal at all.[6] The company had also been forced to go out to the market on a number of occasions seeking further funding.[7] The pressure to reach production targets permeated the whole organisation, and health and safety issues had to wait.

The Royal Commission findings in the Report place blame on the shoulders of the directors and senior management of the company. Management's preoccupation with production placed significant safety concerns at a low priority. The board "did not provide effective health and safety leadership ... It was distracted by the financial and production pressures that confronted the company".[8]

B. Department of Labour v Pike River Coal Ltd

Alongside the Royal Commission Inquiry, charges were brought against Pike River Coal, by the Department of Labour.[9] Nine charges were laid under the Health and Safety in Employment Act 1992. The charges were against the company itself and not against any one individual, or group of individuals. The case was heard in the Greymouth District Court before Judge Farish. The company was found to be in breach of all of the charges. The company was not represented at the trial. As the company was now in a position where no

4 At 19.
5 Rebecca Macfie *Tragedy at Pike River Mine* (Awa Press, Wellington, 2013) at 140.
6 The initial public offering prospectus in 2007 stated production would be 1 million tonnes per year from 2009. By November 2010, only 42,000 tonnes of coal had been produced and shipped.
7 Pike River Coal Ltd had been out to the market four times seeking equity investment. It was just about to seek an additional $70 million in equity investment from the market.
8 Royal Commission Report Vol 1, above n 1, at 18.
9 *Department of Labour v Pike River Coal Limited* [2013] DCR 523.

assets would remain to pay out any further unsecured creditors, the company representatives saw little point in attending.

Sentencing took place on 5 July 2013.[10] Judge Farish ordered Pike River Coal to pay reparation of $3,410,000 and fines of $760,000. The reparation amounts to $110,000 paid to each family of the dead men and $110,000 paid to each of the two survivors (hereinafter referred to collectively as "the Pike River victims").

Within the month after the explosion, the company had been put into receivership by NZOG as the biggest creditor. The Pike River victims would stand at the back of the queue of creditors. Judge Farish was well aware of the financial situation of the company by July 2013. Nevertheless, she made her views clear in her notes on sentencing as to where the reparation should come from:[11]

> I have a discretion not to order reparation if I am satisfied that there is no ability of the company to pay. However, I am not of that view. Here I am satisfied that there is the means for this reparation order to be paid, either by the existing shareholders or by a combination of shareholders and/or directors.

Judge Farish then noted that NZOG, the largest shareholder, continued to put further funding into Pike River Coal after the company went into receivership in order to "control its own indebtedness".[12]

It is clear Judge Farish believed NZOG and other shareholders and directors should be responsible for paying the reparation ordered by the Court. But is there any legal basis for that belief? That question is explored in Part IV below.

C. Health and safety concerns at the mine

The Royal Commission of Inquiry found significant health and safety flaws in the mine. One was the decision to have only one main ventilation fan and to locate this underground. The original plan was to have two main ventilation fans, both above ground, which was the more conventional approach. Locating the main ventilation fan underground meant that, in the event of an explosion, the fan might not work - this was what happened on 19 November 2010. The mine was operating with minimal ventilation capacity and the decision to put the main fan underground in a gassy mine was a risky one.

Another significant safety issue identified by the Royal Commission was the inadequate methane management system in the mine.[13] The mine had high methane levels and, while it did contain methane sensors, these were

10 *Department of Labour v Pike River Coal Limited* [2014] DCR 32.
11 At [20].
12 At [20].
13 Royal Commission Report Vol 1, above n 1, at 20.

not adequately maintained. The purpose of methane sensors is twofold. One purpose is to notify staff that methane levels are high. The second is to automatically shut off all electronic equipment in the area, to reduce the risk of explosion. At the time of the explosion, of the four sensors that reported to the control room above ground, only one was functioning, and it was unable to read methane levels above 2.96 per cent. This extent of methane monitoring was woefully inadequate, given methane levels were known to spike higher than 3 per cent, and an explosive concentration would be around 5 per cent. In the mine, the methane levels were continually reaching high levels, which led to mine workers bypassing the mine sensors altogether to stop them interfering with the bigger priority, production.

Doug White, the mine's manager, was requested to report to the Board on safety matters just four days before the explosion. This was the first time he had been asked to report on safety. White described the methane problems in the mine as "more of a nuisance" than a barrier to operations.[14] Pike River Coal appeared to hold the view that methane sensors were a necessary hindrance, rather than protection for mine workers in hazardous conditions.

The Royal Commission found further problems with inadequate electrical safety in respect of processes, staffing and the "unconventional" arrangements adopted.[15] Concerns also existed over the choice of hydro-mining over more traditional techniques. The hydro-mining technique increased the risk of rock falls, which releases methane from the coal seam, potentially causing an explosion. The Commission found that hydro-mining was used in the mine with inadequate risk assessment and insufficient knowledge of the technique.[16]

The Royal Commission found that, while the mine had employed a health and safety manager and the company had health and safety documentation in place, the management of the company failed to put the company policies and procedures into daily practice.[17]

D. Issues in the mine's development

Alongside the significant weaknesses in the mine's safety systems and culture were some fundamental issues surrounding the mine development itself. These weaknesses in the mine's development are important to identify because they go some way toward explaining the company's focus on expediency of production above other factors.

In the planning stage leading up to the mine's development, the mine promoter's understanding of what lay underground was inadequate, according to some experts.[18] One of those experts, Murray Cave, was contracted to advise

14 Macfie, above n 5, at 174.
15 Royal Commission Report Vol 2, above n 2, at 154.
16 At 169.
17 At 79.
18 Macfie, above n 5, at 51 and 55 cites geologists Jane Newman and Murray Cave expressing concern at the lack of information or understanding of the geology of the area.

the Department of Conservation ("DOC") on the mining application made by Pike River Coal. Cave had several concerns about the application. Based on his significant experience in the coal mining industry in New Zealand, he knew the application lacked detail on what lay beneath the ground. In his view, the applicants "hadn't drilled enough exploration boreholes, didn't have enough accurate gas data, lacked geotechnical and structural information, and didn't know enough about potential surface subsidence caused by mining".[19] In particular, Cave was concerned about the economic viability of the project, as the lack of information indicated to him the company was already under financial pressure, cutting corners in order to step closer toward production without doing the groundwork necessary to determine whether the mine was viable at all.[20]

The feasibility study written to support the application to DOC was undertaken by mining consulting company Minarco. In exchange for their work, Minarco received a shareholding in Pike River Coal. As a shareholder, Minarco shared NZOG's interest in getting Pike River Coal extracting coal and generating cash. This arrangement also lends weight to Cave's concern that the project was already under financial pressure at this early stage of the mine's establishment.

Another fundamental weakness in the mine's establishment was the development of the ventilation shaft. Several methods were considered in order to construct the shaft. The method chosen was, once again, based on expediency. Unfortunately, during its construction, the shaft suffered a massive collapse, filling the bottom of the shaft with rubble and rendering it completely inoperable. The solution was to create a new dog-leg shaft from the bottom to meet up with the clear area of the existing shaft, called an Alimak raise. The less prudent decision to choose the most expedient method to construct the shaft had backfired, resulting in significant further costs and delays.[21]

E. Funding the mine

Pike River Coal was privately owned up until 2007, when it offered shares to the public. However, both prior to and after the initial public offering, the largest shareholding was held by the New Zealand Oil and Gas ("NZOG") group, followed by two Indian companies, Gujarat NRE Limited ("Gujarat") and Saurashtra World Holdings PTE Limited ("Saurashtra"). The two Indian companies invested in the mine intending to become customers, being keen to purchase the highly-valued coking coal that lay beneath the land in the coal seams of the Paparoa Ranges.

19 At 55.
20 At 55.
21 At 75-82.

The last set of published financial statements as at 30 June 2010, show a company with assets exceeding liabilities, funded predominantly by equity but with some debt funding. On 19 November 2010, the company had over 414 million ordinary shares issued. Almost a third of these shares were held by NZOG Services Limited ("NZOGS") along with more than 17 million options to purchase shares at a later date, should the share price become favourable enough. NZOGS is a fully owned subsidiary of NZOG. Other shareholders held significantly smaller parcels, with the next largest shareholders being Gujarat with 7.1 per cent of shares and Saurashtra holding 5.5 per cent.

Pike River Coal was also funded through borrowings. The Bank of New Zealand had lent Pike River Coal $22.9 million via two flexible debt facilities, both secured with first ranking charges over the company's assets. Both these facilities were fully drawn down. The other significant borrowing was from NZOG itself. This was USD 28.9 million of convertible bonds, issued on 28 May 2010 to replace debt repaid to lender Liberty Harbor, a division of Goldman Sachs. The Liberty Harbor debt was subject to performance conditions such as meeting targeted levels of production. As Pike River Coal never came anywhere near meeting those targets, Liberty Harbor was unwilling to roll over the bonds and they were required to be repaid.

On 13 December 2010, Pike River Coal was put into receivership by NZOG under the conditions of their general security arrangement. NZOG appointed John Fisk, David Bridgman and Malcolm Hollis, all from PricewaterhouseCoopers, as receivers under the Receiverships Act 1993. Receivers are appointed to manage the assets of a company,[22] often leading up to liquidation. They are required to exercise their powers in the "best interests" of those who appoint them[23] - in this case, NZOG. These receivers remain in place now. They control the assets of the company and act solely for NZOG.

In the receivers' first report,[24] they listed the following creditors:

Preferential creditors (per schedule 7 Companies Act 1993): employees, NZ customs, IRD (employee deductions)	$3,122,039
Secured creditors	
NZOG	$51,335,941
BNZ	$22,412,525
Solid Energy Limited	$1,217,619
PMSI creditors	
Various finance companies and lessors	$399,451

22 Receiverships Act 1993, s 14.
23 S 18(2).
24 Required under s 23 of the Receiverships Act 1993.

Unsecured creditors	
NZOG	$13,210,817
IRD – FBT	$4,400
Employees' claims	$2,958,765
ACC levies	$334,410
Trade creditors	$15,426,458
Total creditors' claims	$110,422,424

Of the total claims of $110.4 million, the largest creditor is NZOG who claim $64.5 million of debt owed by Pike River Coal. Over the intervening years between 13 December 2010 and now, the receivers have been selling assets, selling coal, collecting insurance monies and paying back creditors as the cash rolls in. Meanwhile, some creditors' claims have increased as interest and other costs accumulated. As at the last receivers' report for the six months to 13 December 2015, the amounts still outstanding are:

Preferential creditors (per schedule 7 Companies Act 1993): employees, NZ customs, IRD (employee deductions)	nil
Secured creditors	
NZOG	$28,728,964
BNZ	nil
Solid Energy Limited	nil
PMSI creditors	
Various finance companies and lessors	$99,789
Unsecured creditors	
NZOG	$24,905,183
IRD – FBT	$7,218
Employees' claims	$1,441,359
ACC levies	$445,848
Trade creditors	$13,091,268
Total creditors' claims	$68,719,628

Much of the $13 million owed to trade creditors, which will never be repaid, is owed to mining contractors who provided men to Pike River Coal to work in and around the mine. Those contractors received $10,000 each, regardless of the total debt owed to them. That decision was made by the receivers upon instruction from NZOG, as a gesture of goodwill.

NZOG has been left with a substantial amount of unpaid debt on top of their equity investment. Their debt continues to increase over the period

of the receivership as they are accumulating interest. In fact, NZOG have received payments of around $45 m toward their original outstanding debts of $64.5 m.

None of the shareholders have received any of their original investment back.

On the face of it NZOG appear to have been generous in giving other debt holders priority over its own debts. The BNZ were fully repaid early on. Some unsecured creditors such as the contractors were granted a $10,000 payment each by the receivers, approved by NZOG as their appointer. The receivers granted $500,000 to "The Pike River Miners Relief Fund". As a debt holder, NZOG has perhaps sacrificed some of its own potential debt repayment in favour of others.

However, when Judge Farish gave the judgment against Pike River Coal for $3.4 m to be paid to the families, NZOG chose not to contribute to the reparation costs.[25]

F. NZOG's role in Pike River Coal Ltd

At the time of the explosions, NZOG (through NZOGS) was a shareholder with a 29 per cent stake in the shares of Pike River Coal. NZOG was also a major lender to Pike River Coal, holding $42 million in convertible bonds. NZOG shared two directors with Pike River Coal: Tony Radford and Ray Meyer. The origins of Pike River Coal stem directly from NZOG and, in particular, from Tony Radford.

The licence to mine for coal in the Paparoa Ranges had been held by various entities under Tony Radford's control from the late 1970s. It was in the late 1990s that the opportunity to use the licence was seized by a senior manager of NZOG, Gordon Ward. Gordon Ward was an accountant and could see an opportunity to make some money for NZOG. The intention was to find partners with experience in the coal mining industry to provide the technical expertise. When none were forthcoming, NZOG decided to go it alone. Along the way, additional shareholders were incorporated into the investment through provision for services in exchange for shares deals like the Minarco arrangement. By 2007, NZOG owned 54 per cent of the total shares of the company, plus a significant number of share options. Gujarat owned over 17 per cent of the shares while Saurashtra held 14.78 per cent. These three shareholders had the largest shareholdings just prior to the initial public offering that took place in mid-2007.

During 2007 Pike River Coal needed further investment to develop the mine, so it went out to the public to raise $85,000,000. This public issue resulted in further dispersal and dilution of the shareholding. NZOG continued to hold the largest shareholding of 31 per cent of the total.

25 Note that the reparation was eventually paid by Peter Whittall's insurers in a deal struck with the Department of Labour to drop the charges against the former Director of Pike River Coal.

Pike River Coal sought funding from the public three more times after the IPO and was in the process of seeking a fifth issue on 19 November 2010. The second time Pike River Coal went to the capital markets to raise further equity of $60 million was only eight months after the IPO. The third request for another $45 million of investment from the public was in 2009, shortly after the ventilation shaft disaster, which placed further financial pressure on the company. The fourth issue was in May 2010, when a further $40 million was raised. On top of these public issues, further institutional issues were also made. Pike River Coal was constantly in need of fresh cash to top up working capital requirements while the mine was being established.

The company had seriously underestimated the quantity of cash it would require to establish the mine and was frequently having to go back to NZOG and other investors for more. By 19 November 2010, Pike River Coal had absorbed significant cash from shareholders and creditors with only a single asset - the mine - to show for it, and with that asset having no real value other than production value.

Moreover, on top of grossly underestimating the investment requirements, there seems to be evidence that the amount of coal expected to be extracted from the mine had been estimated on an optimistic basis. In 1992, a Japanese company experienced in mining, Mitsui, looked at a potential partnership with NZOG at Pike River Coal. Mitsui drilled some boreholes in 1993 and concluded that while the mine might produce five to six million tonnes of coal, the nature of the environment would render the operation too difficult and expensive to mine commercially. The 2007 prospectus issued by Pike River Coal to prospective shareholders predicted total production of 17.6 million tonnes. This rosy view of potential production appeared to be based on information that was too scant to be reliable.[26]

Up until 2006, Tony Radford had chaired the board of Pike River Coal. In preparation for the IPO, it was decided he would step down as chair and an independent director would be sought. Dennis Wood took on the role of chair and James Ogden was also appointed to the board. They sat on the board alongside Tony Radford (from NZOG), Ray Meyer (from NZOG), Graeme Duncan (from Minarco), Dipak Agarwalla (from Saurashtra) and Gordon Ward (executive director from August 2006).

On December 8, 2006, Dennis Wood, James Ogden and Graeme Duncan resigned - all for "personal reasons". In 2007, these directors were replaced with John Dow and Stuart Nattrass - both independent of the shareholders. Dow took the chair role and remained in this position until well after the company entered receivership. Revelations since the tragedy at Pike River show that Wood and Duncan resigned as they felt NZOG was acting in the role of the board and not allowing the directors to make independant

26 Macfie, above n 5, at 60. Newman, Cave and Bell all expressed concerns about the inadequacy of the information Pike River Coal based its proposal upon.

governance decisions.[27] In addition to that, Wood expressed dissatisfaction at the inadequate funding of the company.[28]

To summarise the corporate situation at Pike River Coal, the following points can be made:

- Pike River Coal was established by NZOG and remained under its control at least until the IPO in 2007.
- Three directors of Pike River Coal, Wood, Ogden and Duncan, all resigned on the same day, prior to the IPO, apparently due to feeling disempowered by NZOG and unable to perform their role as directors.
- Pike River Coal was substantially undercapitalised and had to return to shareholders and the wider market time and time again for more cash.
- Pike River Coal had ambitious expectations for production that were based on sparse information.
- Pike River Coal suffered various setbacks, such as the collapse of the ventilation shaft, at least partially due to making decisions based on production demands instead of prudence.
- Pike River Coal put production demands well ahead of safety.
- NZOG funded Pike River Coal inadequately, based on optimistic projections that created the production pressure.

III. Shareholders' liability

A. Statutory limited liability for companies in New Zealand

Pike River Coal is a company registered in New Zealand under the Companies Act 1993. Section 97(1) of the Companies Act 1993 states that:

> … except where the constitution of a company provides that the liability of the shareholders of the company is unlimited, a shareholder is not liable for an obligation of the company by reason only of being a shareholder.

Liability is generally limited to any amount unpaid on a share held by the shareholder. However, it is possible for shareholders to incur further liabilities arising under ss 131 to 137, the directors' duties provisions, by virtue of s 126 (2), the deemed director provision.[29] This will be explored in Part IV of this article.

27 At 61–62.
28 At 62.
29 Companies Act 1993, s 97(2).

Limited liability has existed for shareholders of New Zealand companies since the first Act permitting incorporation by registration, the Joint Stock Companies Act 1860. With limited liability, creditors of the company are only able to access the resources of the company, not that of its shareholders. Equally, creditors of the shareholders cannot claim on assets of the company.

B. Weaknesses of limited liability

One of the features of limited liability is that it involves the externalisation of risk. By granting shareholders a limitation on their liability, the effect is that shareholders will not always bear the full losses that the firm incurs. Losses may instead be suffered by creditors who are unable to claim assets beyond those held by the company. Companies can make risky decisions, but shareholders' losses are limited to that of their original investment. On the other hand, profits are always enjoyed by shareholders, after any costs have been expended. So, arguably, limited liability encourages risky behaviour.

Commentators Easterbrook and Fischel consider that externalisation of risk poses no problem for voluntary creditors - that is, creditors who contract with the company on a voluntary basis. These creditors are able to factor the risks of default by the company into their investment decision and the price of their lending.[30] They are also able to monitor the on-going performance of the company during the period of the lending relationship. Stephen Bainbridge makes the argument that limited liability is even desirable for contractual creditors, as it means they don't need to continually monitor the creditworthiness of the shareholders, only the creditworthiness of the entity itself.[31]

Conversely, Millon considers limited liability from the perspective of a *subsidy* for shareholders. He believes contractual creditors subsidise shareholders of a company through limited liability. He states:[32]

> … the notion of limited liability as a benefit or subsidy conferred by corporate law upon shareholders disregards the possibility that creditors will factor the risk imposed by limited liability ... into the interest rates they charge to corporate debtors.

Millon also explores the effect of the *status quo bias* upon shareholders. The status quo bias is established in behavioural economics and reflects findings that shareholders value limited liability more highly than contracting creditors and that this is reflected in the price arranged for debt between the

30 Frank H Easterbrook and Daniel R Fischel "Limited Liability and the Corporation" (1985) 52(1) U Chi L Rev 89 at 105–106.

31 Stephen M Bainbridge "Abolishing Veil Piercing" (2001) 26 J Corp L 479 at 492–493.

32 David Millon "Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability" (2007) 56 Emory LJ 1305 at 1318.

parties. Millon concludes that there is evidence to show a shareholder subsidy does exist within a limited liability system, as a result of the status quo bias.[33]

C. Involuntary creditors

More challenging for all commentators is the effect of limited liability upon involuntary creditors. The Pike River men were employees and so were voluntary "contractual" creditors. But it is a fallacy to think that employees can adequately calculate and assess the safety risk to themselves, or are in the position to bargain effectively for the risk of the company failing to be included in the price paid for their labour. For that reason it is better to consider the Pike River victims as involuntary creditors.

Involuntary creditors are that group of creditors who have not entered into contractual relationships with the entity. Liability to involuntary creditors often arises due to a tort committed by the entity for which a judgment is made against it. Involuntary creditors are distinguished from voluntary creditors, as the debt has not arisen through contract. This means they have not had the opportunity to negotiate the terms of their relationship with the entity. These creditors may be victims of an industrial accident such as the Pike River victims, families and communities around Bhopal in India or those residents in the Gulf of Mexico after the Deep Water Horizon oil spill. More often they are victims of faulty or dangerous products such as asbestos in building materials, the Dalkon Shield, cigarettes or thalidomide.

Easterbrook and Fischel describe involuntary creditors as the "real cost of limited liability", although the magnitude of this cost is reduced by a firm's incentive to insure.[34] The problem with limiting the liability of shareholders is that there is reduced incentive for an entity to act in a way that minimises the chance of harm being caused to third parties. Arguably, limited liability encourages firms to work toward their goals with no or little regard for potential harm to third parties. In the case of Pike River Coal, the inquiry found the company was focused entirely on production and did not give health and safety concerns any consideration in the boardroom.[35] In New Zealand, where the Accident Compensation Corporation ("ACC") provides no fault compensation for accidents, the incentives for companies to prioritise health and safety are reduced further. There are some weak deterrents, such as fines under current health and safety legislation,[36] the courts' ability to award exemplary damages,[37] and experience rating systems for some organisations.[38]

33 At 1319-1324.

34 Easterbrook and Fischel, above n 30, at 107.

35 Royal Commission Report Vol 2, above n 2, at 56.

36 Health and Safety in Employment Act 1992. That legislation is being replaced by the Health and Safety at Work Act 2015, which will come into force on 4 April 2016.

37 See *Couch v Attorney-General* [2015] NZSC 27, although perversely exemplary damages are not recoverable by an estate where the victim has died: see Law Reform Act 1936, s3(2)(a).

38 Annual experience ratings set by regulation, for example the Accident Compensation (Experience Rating) Regulations 2015.

But these weak deterrents may not counter the lack of incentives to take care: New Zealand has a higher rate of workplace fatalities than other comparable jurisdictions.[39]

Bainbridge also acknowledges "those pesky externalities"[40] which may result from limiting liability of shareholders. However, he justifies limited liability even in relation to tort creditors as "it increases the size of the pie out of which tort creditors' claims may be satisfied, by encouraging equity investment in corporations".[41]

While commentators such as Easterbrook, Fischel and Bainbridge have been able to rationalise the application of limited liability in the case of involuntary creditors by the company's ability to insure, this deals only with financial outcomes and therefore could be viewed as missing the point. Involuntary creditors are often victims of illness or accident due to the tort committed by a company. The costs of these torts cannot be quantified into financial loss. The torts result in costs that, for the victims, may be catastrophic. For that reason, other commentators find these costs more difficult to dismiss as "pesky externalities".

Leebron notes with regard to other commentators:[42]

> Indeed almost every commentator has paused to note that limited liability cannot be satisfactorily justified for tort victims.... and then moved on as though there is nothing to do about this unfortunate wrinkle in the economic perfection of the law.

Millon makes the following comments in respect of the "moral hazard" of limited liability and corporate torts:[43]

> Involuntary, or tort, creditors are in quite a different situation. The pedestrian hit by a taxicab or the victim of a toxic waste spill has not agreed to assume the risk of corporate solvency and shareholders' limited liability. He or she has not received *ex ante* compensation for doing so or had the opportunity to bargain for contractual safeguards. The owners of a limited liability entity therefore are in a position to shift some of the social costs of their business activity on to members of the public who have not agreed to bear those costs. As long as an activity holds some promise of increasing shareholder wealth, limited liability encourages shareholders (or their representatives) to undertake it without regard for the magnitude of possible social costs, which may

39 These points will be explored further in a future article by one of the authors.
40 Bainbridge, above n 31, at 496.
41 At 497.
42 David W Leebron "Limited liability, tort victims, and creditors" (1991) 91 Colum L Rev 1565 at 1601.
43 Millon, above n 32, at 1316–1317.

> be far greater than the benefits to the owners themselves. In this respect, limited liability for tort claims creates a moral hazard problem and results in inefficient resource allocation decisions.

More generally, limited liability in respect of involuntary creditors as a result of torts committed by the entity is "pesky". It is so "pesky" that some commentators have suggested limited liability should not exist at all. Henry Hansmann and Reinier Kraakman advance the view that limited liability does not serve the public interest at all and should be replaced with unlimited liability for corporate torts - largely based upon avoiding externalisation of risk.[44]

D. Application of limited liability to Pike River Coal

The case taken by the Department of Labour against Pike River Coal resulted in the Pike River victims becoming creditors of the company. Judge Farish made it clear that in the case of these particular creditors, the shareholders and/or directors of the company should come forward to satisfy those liabilities. Judge Farish makes particular reference to the deep pockets of NZOG, which continued to supply fresh funds to the company, even after it went into receivership, in order to ensure the company continued in receivership rather than being put into liquidation.

In our view, Judge Farish's comments were based upon a personal belief that because the reparation that was ordered by her court resulted from multiple failures of the company, a moral obligation should fall on the shareholders and directors. Whether she believed there are legal grounds for making these other parties liable is not explored in her judgment.

Further, there is shared public opinion that NZOG, as the most significant shareholder and creditor, should have acknowledged the part they have played in the explosion by paying the reparation costs to the families, regardless of the legal position.[45]

The shareholders did not voluntarily come forward to satisfy the Pike River victims' claims.

What grounds, if any, may exist to hold the shareholders liable for the failings of Pike River Coal within the current legal framework? In particular, is it possible to attribute liability to the shareholders by piercing the corporate veil, or by pursuing the shareholders as shadow directors, as discussed in Part IV?

44 Henry Hansmann and Reinier Kraakman "Toward Unlimited Shareholder Liability for Corporate Torts" (1991) 100 Yale LJ 1879.

45 Fran O'Sullivan "NZOG needs to fork out for Pike River" *The New Zealand Herald* (Auckland, 10 July 2013); Brian Gaynor "Pike River - why mine owners must pay the money" *The New Zealand Herald* (Auckland, 13 July 2013).

E. Piercing the corporate veil

The term "piercing" or "lifting the corporate veil" was described in *Attorney General v Equiticorp Industries Group* as:[46]

> … a description of the process by which in certain situations the Courts can look behind the corporate facade and identify the real nature of a transaction and the reality of the relationships created. It is not a principle. It describes the process, but provides no guidance as to when it can be used.

Piercing the corporate veil is the process by which a court will look through the entity as a separate legal person and seek retribution or compensation from persons beyond the entity. Piercing the corporate veil is hailed by some commentators as the safety net for victims of corporate torts.[47]

The veil piercing doctrine has been applied most frequently in the United States. However, as Easterbrook and Fischel describe it, "'Piercing' seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled."[48] Commentators consistently observe that there appears to be little guidance on when veil piercing may strike. Bainbridge states:[49]

> The doctrine's vague standards, such as "sanction fraud or promote injustice," give judges little guidance but wide discretion … The present state of veil piercing doctrine allows judges to impose their own brand of rough justice without being overly concerned with precedent or appellate review.

Millon also describes the current array of veil piercing cases as unpredictable and incoherent.[50] But, he also suggests that the doctrine "can play an important role in ensuring that corporate shareholders do not use limited liability in ways that are inconsistent with sound public policy."[51]

Despite the seemingly inconsistent methodologies for applying veil piercing in US cases, Robert B Thompson's empirical study attempts to organise and categorise the litigation. One area of Thompson's research is the analysis of veil piercing cases based on the identity of shareholders.[52]

The most notable result of Thompson's findings from the perspective of Pike River Coal Ltd's involuntary creditors is that, of the 1,423 cases included in the study, only nine were cases against companies with public shareholders,

46 *Attorney General v Equiticorp Industries Group Ltd (In Statutory Management)* [1996] 1 NZLR 528 (CA) at 541.

47 See Easterbrook and Fischel, above n 30 at 117: "To reduce this social cost of limited liability, courts have pierced the corporate veil in situations where the incentive to engage in excessively risky activities is the greatest."

48 At 89.

49 Bainbridge, above n 31, at 514–515.

50 Millon, above n 32, at 1339–1340.

51 At 1339.

52 Robert B Thompson "Piercing the corporate veil: an empirical study" (1991) 76 Cornell L Rev 1036 at 1055.

and the veil was not pierced in any of those nine cases. So, despite the large volume of veil piercing cases in the United States courts, public shareholders have never been held liable for the debts of the company.

Shareholders of publicly held companies seem to have been exempt from liability by veil piercing to date because of the requirement that, to be liable, a shareholder must exert some sort of control over the functions of the company. Shareholders of publicly listed companies are less likely to be able to exert control over the company and its board. In an earlier article by one of the authors, it is argued that the corporate veil is lifted or pierced when a company has not been permitted to operate as a separate legal entity from its controller. In such a situation the legal capacity of the controller (shareholder, director, creditor) becomes irrelevant.[53]

With regard to the United States, Bainbridge also unites the veil piercing cases with the feature of control:[54]

> Control is the common (if sometimes implicit) feature of all concepts used to describe cases in which veil piercing is appropriate. Minority shareholders who do not actively participate in the corporation's business or management are rarely held liable on a veil piercing theory. Hence, it seems clear that control is an essential prerequisite for holding a shareholder liable.

Millon also recognises that "a finding of control should be a necessary condition for shareholder liability based on veil piercing".[55]

On the other side of the Atlantic Ocean and closer to home in a juridical sense, the House of Lords have analysed the current position on veil piercing in the UK in a recent family court case, *Prest v Petrodel Resources Limited*.[56] This case involved an appeal by Mrs Prest to have the assets of Petrodel Resources Ltd transferred to her. Petrodel Resources Ltd is one of the companies in Mr Prest's portfolio of entities. This company held the family home in London and several investment properties. The Court of first instance had awarded the family home and properties to Mrs Prest. The Court found that the properties were held by the company in trust and for the benefit of Mr Prest and therefore were part of the pool of assets available for matrimonial claims. The House of Lords unanimously supported this view and found that Petrodel Resources Ltd held the assets in trust for Mr Prest and they must be distributed to Mrs Prest as ordered by the judge in the court of first instance. The case is most interesting for corporate lawyers because of its extensive and authoritative discussion on veil piercing in the United Kingdom. Essentially,

53 Susan Watson "Who Hides Behind the Corporate Veil: Finding a Way Out of "The Legal Quagmire" (2002) 2014 C&SLJ 198.

54 Bainbridge, above n 31, at 37.

55 Millon, above n 32, at 24.

56 *Prest v Petrodel Resources Ltd* [2013] UKSC 34; [2013] 2 AC 415

the House of Lords all but eliminated the doctrine entirely other than a small window of application where: [57]

> … a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control.

Lord Sumption refers to the doctrine of veil piercing being available where there has been an abuse of the company form and elaborates on this by stating:

> … it is not an abuse to cause a legal liability to be incurred by the company in the first place. It is not an abuse to rely upon the fact (if it is a fact) that a liability is not the controller's because it is the company's."

The *Prest* case clarifies the position in the UK that veil piercing applies only in very limited circumstances where a controller interposes a company to evade an already existing liability.

The position in New Zealand on veil piercing is unclear due to a lack of authority. Involuntary creditors of Pike River Coal Ltd will struggle for precedents in New Zealand case law upon which to base any case for piercing the corporate veil. Veil piercing in the purest sense has taken place on few occasions in New Zealand courts and in much the same circumstances as those cases in other jurisdictions - that is, where misrepresentation and fraud take place in ownership structures involving shareholders with control.[58]

While there have been a number of tax cases where the corporate veil has been pierced in favour of the Commissioner of Inland Revenue, the authors of this article do not believe these cases have shifted the generic doctrine of veil piercing at all. In recent years, *Ben Nevis v Commissioner of Inland Revenue*[59] and *Alesco v Commissioner of Inland Revenue*[60] have been the leading cases finding in favour of the Commissioner by ignoring the legal form of transactions corporate entities have undertaken. However, tax cases are different. For a start, there is legislative permission for a Court to lift the veil in favour of the Commissioner in cases where taxpaying entities have entered arrangements designed to thwart tax obligations.[61] Secondly, these cases do not unravel the transactions or treat them as sham transactions; they simply void the transactions as against the Commissioner, meaning the transactions or arrangements stand, but the tax that has been avoided is still due and payable. These cases place the Commissioner in a special position as revenue collector for the Crown. They are therefore unlikely to widen the scope for other veil piercing applications to be successful.

57 At para 35.
58 Official Assignee v 15 Insoll Ave Ltd [2001] 2 NZLR 492 (HC).
59 Ben Nevis v Commissioner of Inland Revenue [2008] NZSC 115.
60 Alesco v Commissioner of Inland Revenue [2013] NZSC 66.
61 See Income Tax Act 2007, s BG 1.

The current approach to veil piercing means the victims of the Pike River Mine tragedy do not have any identifiable grounds for applying to the courts to pierce the corporate veil in order to make claims against the shareholders of the company simply by virtue of their role as shareholders. Both the United Kingdom and New Zealand jurisdictions have accepted the doctrine as existing within the legal framework to override the separate legal personality of a company in limited and extreme situations. Both jurisdictions use terms such as "facade" and "evasion" to indicate a deliberate and wilful act of a shareholder to establish a corporate entity for the specific purpose of avoiding a liability that would otherwise exist. This limited scope for piercing the corporate veil and making shareholders directly accountable for the liabilities of the company is not wide enough for the Pike River victims to access the deeper pockets of the Pike River Coal shareholders.

As Lord Sumption said in the *Prest* case, veil piercing is unlikely to be used frequently because, upon analysis of a set of facts, a legal relationship is likely to exist between the company and its controller already. This means that there will often be grounds to claim from a shareholder on a basis other than veil piercing. This obiter comment is also reflected in New Zealand statute, where s 97 of the Companies Act 1993 states that shareholders are not liable for obligations of the company by reason only of being a shareholder; however:[62]

> Nothing in this section affects the liability of a shareholder to a company under a contract ... or for any tort, or breach of a fiduciary duty, or actionable wrong committed by the shareholder.

This possibility is explored in the next section.

IV. Directors' liability

While it is highly unlikely the Pike River victims will be able to pursue a claim against the shareholders of Pike River Coal under the veil piercing doctrine, they may consider the liability of others for the victims' losses. In particular, the potential liability of directors must be examined.

Directors are responsible for directing and managing (or supervising the management of) the company.[63] The Companies Act 1993 grants directors the powers they require to undertake those responsibilities. However, the Act also imposes duties upon directors. This part considers the duties of the Pike River Coal directors and whether these duties required the directors to consider the interests of the Pike River victims.

62 Companies Act 1993, s 97(3).
63 Companies Act 1993, s 128

The Pike River victims have at least two relationships with Pike River Coal. First, they were the employees and contractors of the company during the period up until the explosion (and necessarily as creditors as part of the employment or contractual relationship). Second, they are creditors of the company since the judgment in the Greymouth District Court.[64] Possibly there is a third relationship, prior to the judgment of the Greymouth District Court, as potential or contingent creditors of the company. The Pike River victims could have been contingent creditors as far back as the period before the accident when the company was approaching insolvency.[65]

So the question to consider in this part of this article is whether the directors owed a duty to the Pike River victims in any of their capacities, and whether any failure of the duty or duties led to the losses. However, first we will address the question of why a claim against the directors may be considered at all.

A. What is the purpose of pursuing the directors of Pike River Coal?

The families have received $110,000 each from Peter Whittall's insurers as a result of a deal made with MBIE (as discussed further below) and will have received or be receiving payments from ACC. Given the families have received the amounts due by the company (although not from the company), why pursue the directors further for these liabilities?

At least some families feel the need to hold those people responsible for the tragedy accountable.[66]

The Royal Commission of Inquiry, when considering whether the current health and safety legislation was fit for purpose, made the following comments[67]:

> The second area of legislation requiring early attention is that of governance by the board of directors. Directors should see health and safety risks as their concern and should give them the same careful attention they apply to other risks facing the company. Current health and safety legislation places general duties on employers, managers and others but not on directors. The statutory responsibilities of directors for health and safety in the workplace should reflect their responsibilities for good governance.

64 Above n 10.

65 Pike River Coal Ltd had retained earnings of ($52,225,000) as at 30 June 2010. The only way the company could continue to meet its debt obligations was to issue more shares. Arguably, Pike River Coal Ltd was approaching insolvency at this point.

66 In Adam Bennett "Pike River: Labour accuse Govt of dodgy deal" *New Zealand Herald* (Auckland, 27 February 2014), Anna Osborne, wife of deceased miner Milton Osborne is quoted as saying "and we still don't have accountability".

67 Above n 1 at 33.

> Regardless of legislative change, it is essential that directors and those in equivalent positions rigorously review and monitor their organisation's compliance with health and safety law and best practice.

The outcome of the recommendations made by the Commission resulted in the new Health and Safety at Work Act 2015 that has recently come into force. This legislation places duties upon governance boards to maintain a healthy and safe work environment. It also provides for the subsequent liabilities of governance boards that fail to do this.

The enactment of this new legislation is a direct result of the Commission's finding that directors should be accountable for providing a healthy and safe work culture and the directors at Pike River Coal failed to do this.

The Commission felt there should be accountability, the families feel there should be accountability and many members of the public feel there should be accountability.

B. Who are the directors of Pike River Coal?

1. Appointed directors

On 19 November 2010, the appointed directors on the board of Pike River Coal Ltd were:

- John Dow (Chair)
- Stuart Nattrass
- Peter Whittall (CEO)
- Ray Meyer
- Tony Radford
- Dipak Agarwalla
- Aran Jagatramka

John Dow and Stuart Nattrass were appointed as independent directors for the purposes of the NZX listing rules as at 30 June 2010.[68] The listing rules require that at least two directors do not hold an executive position with the company or represent a substantial security holder. While these two directors fulfil the requirements for an independent director within the NZX rules, both also held substantial share parcels and share options, so they had a personal interest in the financial performance of the company.

68 The NZX listing rules can be found at <www.nzx.com>.

The two independent directors do not represent a substantial security holder, but the majority of the board positions did represent shareholders with significant holdings.

2. Previous directors

Over the years Pike River Coal was in operation, a number of directors passed through the boardroom. Until October 2010, Gordon Ward was a member of the board of directors and had been on the board for four years. As mentioned above, Gordon Ward was instrumental in the establishment of Pike River Coal and the mine it built. So, although he was not a director on 19 November 2010, his role as a director in former times cannot be overlooked as having made a contribution to the culture of production over safety at the mine.

Also notable was the short-lived presence of Wood, Ogden and Duncan who all resigned on December 8, 2006. Initially the public explanation was they had resigned for "personal reasons" but later, evidence shows Duncan and Wood were frustrated by the power exerted by NZOG and their inability to operate effectively as directors. So the influence of NZOG should also be examined.

3. Shadow directors

The definition of a director in the Companies Act 1993 is far more wide-reaching than those persons specifically appointed as directors ("de jure directors"). Persons who exercise control over individual directors or the board of directors are themselves deemed to be directors. In the vernacular these deemed directors are usually described as "shadow directors". United Kingdom courts and commentators are divided on whether fiduciary obligations can and should be imposed on shadow directors.[69] Given the impact of our ACC regime to prohibit an action in tort for personal injury or death, whether a shadow director could be liable for tortious actions becomes irrelevant here. However, in New Zealand, the statute makes it clear that the statutory duties imposed upon directors in ss 131 and 137 apply equally to persons occupying the position of a shadow director.[70]

Under s 126(1)(b)(ii) of the Companies Act 1993, a shadow director includes a person "in accordance with whose directions or instructions the board of the company may be required or is accustomed to act". Millett J discusses the meaning and criteria for shadow directorship in *Re Hydrodam (Corby) Ltd:*[71]

69 The first case where fiduciary duties were imposed on shadow directors was *Yukong Lines Ltd of Korea v Rendsburg Investments Corp of Liberia* [1998] 2 BCLC 485 (QB).

70 Companies Act 1993, s 126 (1)(b).

71 *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180 (Ch) at 183.

> A de facto director, I repeat, is one who claims to act and purports to act as a director, although not validly appointed as such. A shadow director, by contrast, does not claim or purport to act as a director. On the contrary, he claims not to be a director. He lurks in the shadows, sheltering behind others who, he claims, are the only directors of the company to the exclusion of himself. He is not held out as a director by the company. To establish that a defendant is a shadow director of a company it is necessary to allege and prove: (1) who are the directors of the company, whether de facto or de jure; (2) that the defendant directed those directors how to act in relation to the company or that he was one of the persons who did so; (3) that those directors acted in accordance with such directions; and (4) that they were accustomed so to act. What is needed is, first, a board of directors claiming and purporting to act as such; and, secondly, a pattern of behaviour in which the board did not exercise any discretion or judgment of its own, but acted in accordance with the directions of others.

These criteria have been confirmed as identical to the test in s 126 in the New Zealand courts.[72] Whether or not a board is "accustomed to act" on the directions or instructions of another is a question of fact.[73] It must be shown that a board (or a director) has deferred to the direction of the shadow director and acted "in accordance" with those directions. There also needs to be evidence that the board (or director) has established a pattern of behaving in this way if it is to be shown that they are "accustomed" so to act.

The inclusion of the words "required to act" in the New Zealand statutory definition have not been tested in court, but a commentator has expressed the view that this may broaden the definition of shadow director to include those persons in a position of control over the board or a board member, without having to establish an ongoing pattern of exercising that control.[74] Lynne Taylor suggests:[75]

> … it is then conceivable that a company might have a shadow director right from its very beginning, a possibility that seems difficult to achieve if it must be shown the board is "accustomed to act" on the directions or instructions of the shadow director.

72 *Vance v Lamb* (2010) 10 NZCLC 264,498 (HC) at [44].

73 *Dairy Containers v NZI Bank* [1995] 2 NZLR 30 (HC).

74 Lynne Taylor "Expanding the pool of defendant directors in a corporate insolvency: the de facto directors, shadow directors and other categories of deemed directors" (2010) 16(2) NZBLQ 203 at 214.

75 At 214.

The fact that at least two directors resigned due to the power being exerted by NZOG in 2006 indicates NZOG may have been a shadow director. Discussions with Rebecca Macfie, author of *Tragedy at Pike River Mine,*[76] indicate that NZOG was controlling the board at the time the company was preparing to issue shares to the public. The two directors resigned due to frustration at not being able to exercise their own judgment and discretion over decisions at Pike River Coal. It is likely that, during the period up to the public offering, NZOG was acting as a shadow director.

As NZOG's shareholding was diluted by further public offerings, so was their control and influence over the board. Macfie's investigations reveal that, in later times, and certainly around the time of the explosion, NZOG's influence and control over the board of Pike River Coal was significantly reduced. NZOG remained very involved with Pike River Coal as its largest creditor, and had weekly meetings with its representatives. However, NZOG's influence and control in board decision-making was probably not significant enough for it to be considered a shadow director after the 2007 IPO. Although NZOG still shared two directors with Pike River Coal (Radford and Meyer), Macfie's investigations reveal these two directors fed little information back to NZOG's board.[77]

So it is highly likely that up to 2007, NZOG were shadow directors of Pike River Coal. This means if the losses suffered subsequent to that resulted from actions taken by NZOG in their capacity as director, liability may attach. We will explore this further below.

First, we need to consider the scope of the duties owed by directors and to whom they are owed.

C. Directors' duties

Section 131 of the Companies Act 1993 mandates that directors must act in good faith and what they believe to be the best interests of the company. Section 137 imposes a duty of care upon directors. Section 169 specifically states that the duties in ss 131 and 137 are owed to "the company", and this is distinguished from other statutory duties of directors that are owed to and therefore may be pursued by an individual shareholder.[78] Some authority exists that, in the period approaching insolvency, acting in the best interests of the company requires directors to take account of the interests of creditors and, perhaps, contingent creditors.[79] However, in terms of the Companies

76 Macfie, above n 5.
77 Macfie, above n 5, at 118.
78 Companies Act 1993, s 169(3).
79 *Sojourner v Robb* [2006] 3 NZLR 808 at [102]: "If a director believes that the duty to act in the best interests of the company is a duty always to act in the best interests of shareholders, and never in the interests of creditors, in a situation of doubt as to the solvency of the company, the director cannot be said to be acting in good faith. Creditors are persons to whom the company has ongoing obligations. The best interests of the company include the obligation to discharge those obligations before rewarding the shareholders."

Act 1993, there is no *direct* duty owed by the directors of Pike River Coal to the Pike River victims. Any recovery from the directors for breach of any statutory directors' duty by the victims would therefore need to be through the company.

1. Section 131: Duty to act in good faith and in the best interests of the company

Directors have a duty under s 131 of the Companies Act 1993 to "act in good faith and in the best interests of the company". A director complies with the duty in s 131 if his or her primary motivation is to act in a manner that he or she genuinely believes to be in the best interests of the company. Negligence, even gross negligence, is not the same as disloyalty, and is therefore unlikely to be considered a breach of s 131.[80]

More contentious is whether it is legitimate or even, in some situations, mandatory for directors when acting in the best interests of the company to consider the interests of other "stakeholders" in the company, such as employees or creditors.[81] Shareholder primacy theory of the company has predominated North American law and economics scholarship.[82] A variant, director primacy, treats the board as a type of platonic guardian serving the nexus of all the contracts making up the corporation, with an obligation to maximise the value of the shareholders' residual claim.[83] By way of contrast, stakeholder theorists argue that it is legitimate for directors to take into account wider concerns. In team production theory, for example, the board is regarded as a mediating hierarchy between all the "teams" in the company, such as employees, creditors, shareholders and managers.[84] Opponents of stakeholder theory argue that if directors are obliged or required to take into account these wider concerns, the risk is that they will become accountable to

80 See *Motorworld Ltd (in liq) v Turners Auctions Ltd* [2010] NZCCLR 30 (HC) and the discussion of the case in Peter Watts "Gross negligence and the director's duty of loyalty two recent cases" [2010] CSLB 99.

81 See F Dawson "Acting in the best interests of the company: For whom are directors 'trustees'?" (1984) 11 NZULR 68, where it is argued there is danger in extending the range of interests that directors must consider because there is then risk that all control will be lost over the propriety of decisions made by directors.

82 See, as a sample of the literature, R H Coase " The Nature of the Firm" (1937) 4 Economica 386; E F Fama and M C Jensen "Separation of Ownership and Control" (1983) 26 JLE 301; E F Fama and M C Jensen "Agency Problems and Residual Claims" (1983) 26 JLE 327; M Jensen and W Meckling "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 JFE 305; F H Easterbrook and D R Fischel "Shareholder Voting Rights and the Exercise of Efficiency of Shareholder Oversight" (1988) 20 JFE 237.

83 See S M Bainbridge "Director Primacy: The Means and Ends of Corporate Governance" (2003) 97 Nw U L Rev 547.

84 See M Blair and L Stout "A Team Production Theory of Corporate Law" (1999) 85 Va L Rev 247. Professor Austin, Judge of the Supreme Court of New South Wales, in an address to the Legal Research Foundation's Seminar "Corporate Governance at the Crossroads", argued that the mediating hierarchy model is a more accurate reflection of the corporate law of industrialised countries than the contractual theory: R P Austin "What is Corporate Governance? Precepts and Legal Principles" [2005] 3 NZ Law Review 335 at 339.

no one. These opponents assert that it is the shareholders, as residual claimants to the funds of the company, who are best equipped to monitor management.

The debate is a long-standing one in company law, perhaps epitomized by the series of articles on corporate accountability which took place between A A Berle and E M Dodd in the 1930s. It was Berle's view that corporate powers were powers in trust exercisable for the benefit of all the shareholders.[85] Berle's views may form the foundation of shareholder primacy theory. Berle's arguments also fit neatly with a conception of English company law where the board is regarded as the agent of the shareholders, and shareholders as the source of its powers. On the other hand, Dodd saw corporations as economic institutions that had responsibilities not only to shareholders but to employees, customers and the public.[86] Dodd's arguments form the foundation of stakeholder theory.[87]

Within New Zealand, and with the exception of employees in the specific situation set out in s 132, no express statutory obligation on directors to consider any interests beyond those of the company exists. However, statutory directors' duties, which support an assertion that "the company" includes other groups, have been included in the Companies Act 1993. Although in s 169(3) the duties set out in s 135 (the reckless trading provision) and s 136 (the obligation on directors not to allow the company to enter into obligations it will not be able to perform) are stated to be owed to the company, it is suggested that these duties can only have been included to protect the interests of creditors of the company.[88] The common law equivalent of the obligation in s 131 acts as a defence for directors against existing shareholders of the company if directors do, in fact, consider the interests of creditors. There can be little doubt that the statutory provision would operate in a similar way if existing shareholders brought an action on the basis that the directors of the company considered the interests of creditors ahead of their own, at least when the company was insolvent or nearing insolvency.

One rationale for considering the interests of creditors when a company is insolvent or nearing insolvency is that in insolvency the creditors become the residual claimants, just as in a solvent company the shareholders are the

85 A A Berle "Corporate Powers as Powers in Trust" (1931) 44 Harv L Rev 1049.

86 E M Dodd "For Whom are Corporate Managers Trustees?" (1932) 45 Harv L Rev 1145.

87 See the discussion in D Attenborough "The Company Law Reform Bill: an Analysis of Directors' Duties and the Objective of the Company" (2006) 27 The Company Lawyer 162.

88 The Law Commission discussed these duties. The argument that the company is a legal entity distinct from its shareholders, and that the interests of creditors must be considered when there is a substantial risk to creditors, is given support by Miller J in *Kings Wharf Coldstore Ltd (in rec & liq) v Wilson* (2005) 2 NZCCLR 1042 (HC).

residual claimants.[89] This rationale was set out in the judgment of Fogarty J in *Sojourner v Robb*,[90] where Fogarty J somewhat acerbically commented that: [91]

> Directors of a company who are also the only shareholders of the company do not naturally believe that the best interests of the creditors of the company are the best interests of the company.

Fogarty J also took the opportunity to discuss the statutory duty set out in s 131(1), indicating that a belief that an action is in the best interests of the company may not be enough to satisfy the obligation set out in that section:[92]

> In this context, the standard in s 131 is an amalgam of objective standards as to how people of business might be expected to act, coupled with a subjective criterion as to whether the directors have done what they honestly believe to be right. The standard does not allow a director to discharge the duty by acting with a belief that what he is doing is in the best interest of the company, if that belief rests on a wholly inappropriate appreciation as to the interests of the company. If a director believes that the duty to act in the best interests of the company is a duty always to act in the best interests of the shareholders, and never in the interests of the creditors, in a situation of doubt as to the solvency of the company, the director cannot be said to be acting in good faith. Creditors are persons to whom the company has ongoing obligations. The best interests of the company include the obligation to discharge those obligations before rewarding the shareholders.

When affirming the High Court decision, the Court of Appeal rationalised the basis of the obligation owed to creditors by directors in a slightly different way, quoting from a judgment of Gummow J:[93]

89 See *West Mercia Safetywear Ltd (in liq) v Dodd* [1988] BCLC 250 (CA), and the discussion in P L Davies *Gower and Davies' Principles of Modern Company Law* (3rd ed, Sweet & Maxwell, London, 2003) at 372–374.

90 Above n 79.

91 At [98]. See also the discussion of Clifford J in *Jordan v O'Sullivan* HC Wellington CIV-2004-485-2611, 13 May 2008 at [69].

92 At [102]. The decision of Fogarty J was upheld by the Court of Appeal in *Robb v Sojourner* [2007] NZCA 493; [2008] 1 NZLR 751.

93 *Re New World Alliance Pty Ltd* (1994) 51 FCR 425 (FCA) at 444–445, quoted in *Robb v Sojourner* (CA), above n79, at [25]. The Court of Appeal also referred to the views expressed by Cumming, Bruce and Templeman LJJ in *Re Horsely & Weight Ltd* [1982] Ch 442 (CA) at 454–455, adopted by Cooke J in *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (CA) at 250 and expressed to the same effect by the New South Wales Court of Appeal in *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722 (NSWCA) at 730, followed and applied by the English Court of Appeal in *West Mercia Safetywear Ltd (in liq) v Dodd* [1988] BCLC 250 (CA) at 252.

> It is clear that the duty to take into account the interests of creditors is merely a restriction on the right of shareholders to ratify breaches of the duty owed to the company. The restriction is similar to that found in cases involving fraud on the minority. Where a company is insolvent or nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overridden by the shareholders. This restriction does not, in the absence of any conferral of such a right by statute, confer upon creditors any general law right against former directors of the company to recover losses suffered by those creditors … the result is that there is a duty of imperfect obligation owed to creditors, one which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator.

Sojourner v Robb[94] tells us that the best interests of the company encompass wider interests than the interests of the shareholders alone, in limited circumstances where a duty to consider the interests of another group may arise. It could be argued that a duty had arisen to consider the interests of employees, as a group of contingent creditors of a company nearing insolvency. Alternatively, it could be argued that when weighing up health and safety concerns with profitability, a duty to consider the health and safety interests of the workers in the mine had arisen. Appealing though such an argument may be, it may not be considered tenable in a jurisdiction where, rightly or wrongly, shareholder primacy conceptions of the company predominate.

2. Section 137: the duty of care

The duty of care for directors was initially developed in equity before the modern tort of negligence.[95] It required no more of a director than an absence of gross negligence. The position changed with the New South Wales Court of Appeal decision of *Daniels v Anderson Ltd* (the "*AWA case*").[96] The majority of the Court said old cases, with their notions of subjective tests and gross negligence, were outdated. The idea that the shareholders were ultimately responsible for the unwise appointments of directors "led to the duty of care, skill and diligence which a director owed to a company being characterised as remarkably low".[97] The court continued:[98]

> In our opinion, the responsibilities of directors require that they take reasonable steps to place themselves in a position

94 Above n 79.
95 John Farrar and Susan Watson (eds) *Companies and Securities Law in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2013) at 416.
96 *Daniels v Anderson Ltd* (1995) 16 ACSR 607 (NSWCA).
97 At 658.
98 At 664.

> to guide and monitor the management of the company … The Courts have recognised that directors must be allowed to make business judgments and business decisions in a spirit of enterprise … Any entrepreneur will rely upon a variety of talents in deciding whether to invest in a business venture. These may include legitimate, but ephemeral, political insights, a feel for future economic trends, trust in the capacity of other human beings. Great risks may be taken in the hope of commensurate rewards. If such ventures fail, how is the undertaking of it to be judged against the allegation of negligence by the entrepreneur? *In our opinion the concept of negligence which depends ultimately "upon a general public sentiment of moral wrongdoing for which the offender must pay" (Donoghue v Stevenson [1932] AC 562 at 580) can adapt to measure appropriately in the given case whether the acts or omission of an entrepreneur are negligent.* (emphasis added)

Section 137 of the Companies Act 1993 states that a director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances, taking into account, but without limitation, the nature of the company, the nature of the decision and the position of the director and the nature of the responsibilities undertaken by him or her. When exercising powers or performing duties, therefore, directors are charged with exercising the care, diligence and skill that a reasonable director would exercise in the same circumstances.[99]

Although essentially similar, the Companies Act 1993 appears to depart from the common law by setting an objective standard of care for directors. This has been criticised by directors of listed companies and others for imposing a duty of care that, it is argued, inhibits the exercise of normal business judgment. Critics say that by establishing an objective standard of care, the legislature is asking the courts to make business judgments - something that in the past the courts have been notoriously reluctant to do.[100] This criticism is perhaps overstated because the test is also partly subjective, as the section requires that the courts look at the environment in which a decision was made. In establishing whether the standard of care was reached, factors the courts must consider include the nature of the company, the nature of the decision and the position of the director and nature of the responsibilities undertaken. The long title to the 1993 Act talks of "allowing directors a wide

99 Companies Act 1993, s 137.

100 See *Mountfort v Tasman Pacific Airlines Ltd* [2006] 1 NZLR 104, [27] "[C]ompliance with accepted professional standards will be a defence unless those standards are shown to be wholly unreasonable."

discretion in matters of business judgment". It is likely that the courts will adopt a similar approach to that taken in the *AWA case*.

In the case of Pike River Coal, coal mining carries a set of risks that are quite specific to that industry. There are significant financial risks as coal mines are very costly to develop and there are time delays between the financial outlays and the production of income. There is significant uncertainty as to the terrain that is being mined until the miners actually enter. There are inherent safety risks with working underground and working amongst flammable gasses. This is an industry that requires care and prudence.

The Royal Commission found that the board of directors of Pike River Coal and the company's senior management put production before safety. In the company's final annual report, approved on 22 September 2010, just two months before the explosion, the Corporate Governance Policies state that the board has a committee specifically set up for matters of health, safety and the environment. The report states:[101]

> The purpose of the Health, Safety and Environment Committee is to ensure that Pike River is providing a safe work place for its staff and contractors, to monitor compliance with environmental consents, permits and agreements and to review projects. The Health, Safety and Environment Committee meets as required, usually twice a year, and the current members are John Dow (Chairman) and Ray Meyer.

The Commission found that the Health, Safety and Environment Committee had not met for 13 months prior to the explosion and had no future meetings scheduled. They also found that "Mr Dow's general attitude was that things were under control, unless told otherwise."[102]

Equally, Judge Farish in *Department of Labour v Pike River Coal Limited*[103] found the company guilty of nine charges of breaching health and safety standards. As she said in her sentencing notes[104]:

> There was, in my view, a total lack of risk assessment and reassessment and a complete failure to implement and audit its own procedures and performances … The hazards were well-known. They were predictable and preventable. However, the health and safety issues were not given priority by the company.

Both the judge hearing the charges against Pike River Coal and the Royal Commission of Inquiry into the disaster found the company had failed in its health and safety obligations due to the pressure of production.

101 Pike River Coal Ltd "Financial Review 2010" (3 November 2010) at 34 <www.companies.govt.nz>.
102 Royal Commission Report Vol 2, above n 2, at 56.
103 Department of Labour v Pike River Coal Limited [2013] DCR 523.
104 Department of Labour v Pike River Coal Limited [2014] DCR 32 at [4] and [5].

In this respect, the directors have breached their duty of care to the company.

In the balancing of risk against reward, neglecting health and safety concerns and processes could not be regarded as appropriate, particularly in an industry like mining. In the view of the authors, the directors of Pike River Coal failed in their duty of care to the company by neglecting to attend to the safety concerns at the mine adequately. They have not looked after the long-term interests of the company, but have instead taken unnecessarily high risks in an attempt to expedite the production of the company.

3. Independent Duty of Care to Pike River victims

Most directors' duties are owed to the company. In the Companies Act 1993, however, some duties are owed to individual shareholders. Section 169 states:

> 169(1) [Power to bring action] A shareholder or former shareholder may bring an action against a director for a breach of a duty owed to him or her as a shareholder.

The rationale for these duties being owed to individual shareholders is that it is shareholders as individuals who will suffer harm if the duties are breached. The duty on a director to ensure fair value is paid or received when the director buys or sells shares, found in s 149 of the Companies Act 1993, has its common law equivalent in *Coleman v Myers,*[105] where the New Zealand Court of Appeal held that, in special circumstances, directors may be held to owe a fiduciary duty to individual shareholders.[106] The Court found a fiduciary obligation existed because of the special circumstances of the case.

To the best of the authors' knowledge, there has never been a case where the courts have held that directors owe a fiduciary duty to employees. That does not mean that fiduciary or equitable obligations relating to a duty of care could not arise to a particular group of employees if the appropriate set of circumstances existed. The threshold standard of care for directors in the old equitable duty of care cases, which required gross negligence for a duty to be found to exist, was held to be too low in modern director care cases such as *Daniels v Anderson*, discussed above, and in New Zealand in *Dairy Containers Ltd.*[107] Fiduciary obligations, but not a fiduciary relationship, can arise if someone in a position of trust provides advice or undertakes an obligation to someone who places them in a position of trust. Recently in *Holmes v Kiriwai Consultants,*[108] the Court of Appeal followed *Coleman v Myers* in deciding that a fiduciary relationship existed between a director and

105 *Coleman v Myers* [1977] 2 NZLR 225 (CA).

106 The default postion is that directors do not owe a duty to individual shareholders: *Percival v Wright* [1902] 2 Ch 401.

107 Dairy Containers Ltd v NZI Bank [1995] 2 NZLR 30 (HC).

108 Holmes v Kiriwai Consultants Ltd [2015] NZCA 149.

minority shareholder. In explaining when a fiduciary duty could arise because of special factual circumstances, following *Chirnside v Fay*,[109] French J said:[110]

> The sort of circumstances which will generate a fiduciary duty are not capable of precise definition but the hallmarks of a fiduciary relationship are said to be that it is a relationship in which there are elements of reliance, confidence or trust between the parties often arising out of an imbalance of power or vulnerability in relation to the exercise of rights, powers or the use of information affecting their respective interests. One party has a legitimate expectation or is entitled to rely on the other not to act in a way that is contrary to the other's interest.

In the Pike River situation, evidence exists that the directors breached the statutory duty of care. In addition, directors are not immune from liability in tort if all of the elements of a tort are present.[111] Indeed, if the rationale stated above by French J is followed, it is easy to see how a fiduciary obligation may arise by the directors of Pike River Coal to the employees and contractors working at the mine. The employees and contractors *place reliance, confidence and trust* in the directors to ensure they operate in a safe environment. There is a natural power imbalance between directors and employees and contractors. Directors ultimately control the mine activities and employees and contractors must rely on the Directors to protect them through adequate processes and monitoring of safety. This did not happen.

It may be possible to argue that in the particular circumstances that existed at the Pike River Mine, an equitable duty of care arose between the directors, or some of the directors involved in health and safety and in the day to day operation of the mine, and the workers in the mine. As the High Court of Australia said in *Gould v The Mount Oxide Mines*:[112]

> No rule of universal application can be formulated as to a director's obligation in all circumstances. The extent of his duty must depend on the particular function he is performing, the circumstances of the specific case, and the terms on which he has undertaken to act as director.

However, even if all the elements necessary to establish breach of a tortious duty of care are present, actions in negligence for personal injury including death are not possible in New Zealand because of the ACC regime.[113] However, the ACC regime largely prevents tortious claims for damages arising out of

109 *Chirnside v Fay* [2006] NZSC 68; [2007] NZLR 433.
110 At [54].
111 Standard Chartered Bank v Pakistan National Shipping Corp [2003] 1 AC 959 (HL).
112 *Gould v The Mount Oxide Mines Ltd (in liq)* 22 CLR 490 (HCA) at 531, cited in Farrar and Watson, above n 95, at 416.
113 Accident Compensation Act 2001, s 317.

physical injury. There may be scope here for the two men who survived the explosions to make a claim from directors for mental injury and this will be discussed further below.

4. Summary of potential directors' liabilities

To summarise the discussion in Part IV of this paper so far, the areas where director liability may exist in the circumstances at Pike River Coal, are in the statutory duties owed by the directors to the company (in particular ss 131 and 137 of the Companies Act 1993) and a potential duty of care to employees and contractors in tort. The authors believe the directors of Pike River Coal may have breached their statutory duty of care found in s 137 that is owed to "the company". The authors conclude it may be difficult to argue that the Directors have breached their duty to act in good faith and in the best interests of the company (s 131) in a world where shareholder primacy is the accepted paradigm. While there may have been a breach of a tortious duty of care owed directly to employees and contractors, the ACC regime in New Zealand prevents an action being taken for any loss suffered as a result of any personal injury including death.

D. Loss resulting from breach of duties

1. Loss as a result of NZOG's breach of duties

Arguably the evidence points to the entire establishment of the mine having a predisposition toward putting production ahead of safety. Consistently, compromises were made in order to reduce delays. Decisions were made on the basis of expediting production rather than ensuring the safety of those men working in the mine.

In addition to the decisions on the mine's setup and fit-out, the entire project appeared to be based upon overly optimistic, "best case" scenarios undertaken by people with a financial interest in seeing the mine productive. The need for the company to return to the market several times for further funding indicates a series of board members who failed to understand the capital requirements of the mine. NZOG had no experience in the coalmining sector, but ploughed ahead on the basis of optimistic projections. This is summarised by Dr Elder, CEO of Solid Energy during the hearings of the Royal Commission of Inquiry into the Pike River Mine Tragedy:[114]

> Unique factors influence the credibility and commercial viability in developing an underground mine in the difficult conditions of the West Coast. These had specific implications

114 Transcript of phase 1 hearing commencing on 11 July 2011 at Greymouth @1405, Royal Commission Inquiry into the Pike River Mine Tragedy, retrieved from <pikeriver.royalcommission.govt.nz>.

> for the planned Pike River Mine. By comparison with Solid Energy's requirements Pike River was from early planning stages over optimistic, had done insufficient coal seam and geological investigation work and had insufficient information to proceed with mine design and development at a level of risk consistent with what Solid Energy would consider good industry practice. From 2000 onwards I and my Solid Energy colleagues increasingly held the view that the Pike River Mine would experience significant development and production issues, was unlikely to achieve most of its production and financial targets and that this would result in major financial issues. We believe the commercial risk associated with the Pike River development was very high.

As already stated, NZOG appeared to step away from overt and direct control of the board of Pike River Coal in 2007 when the IPO took place. However, NZOG played a part in creating the prospectus that enticed investors to part with their cash on the basis of optimistic time frames and production levels. Evidence from Dr Elder and Jane Newman during the Royal Commission of Inquiry points to NZOG playing a significant role in the management of the company during the early to mid 2000s.[115]

The question of liability for breach of a director's duty requires proof of a causal connection between the directions or instructions and the loss to the company resulting from the breach.

If we accept NZOG was acting as a shadow director of Pike River Coal up until the date of the IPO, did its directions or instructions contribute to the eventual losses of the company? Did NZOG, in its capacity as shadow director, have an obligation to establish the mine on the basis of prudent, careful and safe standards, given the significant impact that failure to perform these duties adequately would have on the long-term interests of the company itself?

Many of the decisions surrounding the mine's safety that drew criticism from the Royal Commission took place after the IPO in 2007. These include the establishment of the egress, installing and maintaining gas sensors and providing an adequate ventilation system. However, the feasibility study and the optimistic expectations upon which subsequent boards relied were established prior to 2007. If a link can be drawn between the directions or instructions of NZOG and the losses suffered by the company in 2010, there is potentially a failure by NZOG to exercise its duty of care while acting as a shadow director. This will be a question of fact for a Court to consider.

115 Above, n 114, at 1045, Peter Whittall states that in 2005, he became an employee of Pike River Coal Limited and yet he was "employed by NZOG". At 1625, Jane Newman describes how, in 2001, all the geological work she and her team undertook at Pike River mine was sent directly to NZOG.

It would be speculative to guess whether a Court would find the actions of NZOG contributed to losses later suffered by the Pike River victims. However, the Royal Commission found the mine was developed upon "optimism and confidence"[116] and this contributed to the pressure later to expedite production. Judge Farish also found the company suffered "an accumulation of errors and omissions which transpired over a number of years."[117]

2. Loss as a result of de jure directors' breach of duties

The question of whether the de jure directors of Pike River Coal (and Gordon Ward) are liable for a breach of duty to the company requires a causal link between the decisions the board has made and the loss suffered by "the company".

The losses that result from the explosion in the mine are two-fold. First, there is the loss of life and all the consequences that flow from that to the families of the men. There is also the losses suffered by the two men who survived in terms of the emotional damage and impact on their ability to work that is discussed in the Department of Labour's case against Pike River Coal.[118] Both of these losses are difficult to pursue due to the limitations of the ACC regime. Finally, there is, of course, the financial loss to investors and creditors (including employees and contractors) as a result of the loss of the mine.

The directors of Pike River Coal have been found to put production before safety by the Royal Commission of Inquiry. A board of directors of a high-risk business such as coal mining should be ensuring the mine is operated safely in order to ensure the mine's future. The only substantial asset of the company was the mine itself. Pike River Coal did not own the land. The mine has no intrinsic value - its value is derived from its production capacity. From a financial perspective alone, the director's actions or inaction, have put the main asset of the company in jeopardy. Without the mine, there is no value in the company.

A board of directors that is not preserving the value of the main asset of a company cannot be acting in accordance with a duty of care towards the company (including its shareholders and creditors). In the opinion of the authors, the board's disregard for the safety of the company has not lived up to the standard required from a board operating in a high-risk environment, and the result of their failure in their duty is the losses suffered by the shareholders, creditors, employees and their families at Pike River Mine.

The authors conclude the breach of the directors' duty of care contributed to the loss of the mine. This in turn resulted in the unpaid liabilities to its creditors and shareholders.

116 Royal Commission Report Vol 2, above n 2, at 36.
117 Department of Labour v Pike River Coal Limited [2013] DCR 523, [introduction].
118 Department of Labour v Pike River Coal Limited, above n 117.

E. Potential remedies for Pike River victims

If directors and shadow directors are found to be in breach of their duties to the company under the Companies Act 1993, what remedy might be available to the Pike River victims?

1. Section 301 of the Companies Act 1993

Watson and Noonan set out potential consequences of being a shadow director (or any director, for that matter) as:[119]

> Shadow directors may also be made liable on liquidation for transactions for inadequate or excessive consideration, securities and charges granted in favour of directors, and orders under s 301 for repayment of money or return of property.

The remedy in s 301 of the Companies Act 1993 is available to creditors and shareholders in the event of a company's liquidation. A court can require persons to repay money or return property. As stated above, the Pike River victims now stand in the position of creditors, since the judgment against the company in the Greymouth District Court. Therefore, if a breach of duty were found to be made by the directors of Pike River Coal, a claim for recovery of losses may be made against the directors using the mechanism found in s 301 of the Companies Act 1993.

Currently Pike River Coal is in receivership, with the receivers having been installed by NZOG. The company had hoped to receive further income from the sale of the mine to Solid Energy Ltd, dependent upon the performance of the mine in future years. With the subsequent demise of Solid Energy and a tanking commodity price for coal, any further receipts are unlikely. However, a creditor such as the Pike River victims may apply to the court to commence liquidation of the company,[120] and then the provisions of s 301 could be activated at any time.

The court in *Mitchell v Hesketh*[121] interpreted s 301 as applying to require a director to restore monies lost *directly* to the applicant creditor *only* where the director has been found to have misapplied, retained or become liable for money or property of the company. In other circumstances, the directors are to contribute the appropriate amount, as directed under s 301, to the company itself. Where the company is the recipient of the restored monies, the liquidator must distribute this to creditors according to the ordering rules of the Companies Act 1993.

If the Pike River victims could establish that the directors and NZOG (as shadow director) have breached their duty of care to the company, s 301

119 Watson S and Noonan C "Defining Directorship," (2010) Australian Journal of Corporate Law 5.

120 Under the Companies Act 1993, s 241(2)(c)(iv).

121 *Mitchell v Hesketh* (1998) 8 NZCLC 261,559 (HC).

will be the mechanism for a court to enforce payment of the outstanding amounts from directors. The amount would be determinable by the court using principles of equity. However, any amount recoverable from directors would be payable to the company itself, not directly to the applicant creditors. Ironically, the main beneficiary of the payment would be NZOG.

Although Pike River Coal has never paid the $110,000 reparation to each of the Pike River victims, nor the $760,000 fine, the Pike River victims have received this amount from another source. The Ministry of Business, Innovation and Employment ("MBIE") were pursuing Peter Whittall, ex-CEO of Pike River Coal for breaches under the Health and Safety in Employment Act 1992. Each offence under this Act carries a maximum fine of $250,000.[122] In a deal struck between Peter Whittall's lawyers and insurers and MBIE, the insurers agreed to make a voluntary payment, on behalf of the Pike River Coal board of directors, of $110,000 per family, in return for the charges against Peter Whittall being dropped. This deal drew much criticism for its "back room" nature.[123]

This "settlement" of charges under the Health and Safety in Employment Act 1992 does not prevent action being taken against any director for failure in their director's duties. The Pike River victims remain creditors of the company as there are liabilities outstanding for unpaid wages and contractors' fees.

2. Remedy for creditors using pooling orders

Section 271 of the Companies Act 1993 provides another avenue for creditors to claim unpaid sums still owing by companies that are part of a group. This section gives a court power to order a company *related* to the company in liquidation to pay on creditors' claims where they believe it is "just and equitable".

A company is *related* to another company for the purposes of the Companies Act 1993 where one has more than a 50 per cent share of the interests of the other, they are both related to another common company, or they are carried on as though the two companies are not separately identifiable.[124] Pike River Coal and NZOG were related until the time NZOG's share in Pike River Coal reduced below 50 per cent after the initial IPO in 2007. So, it is possible that NZOG could be required to pay the claims of creditors of Pike River Coal if the court believes it is "just and equitable" to make that order. The legislation provides guidance for the court to determine in what circumstances it may be just and equitable to make this order. Section 272 includes the following factors: the participation of the related party in the management of the company in liquidation; the conduct of the related party

122 Health and Safety in Employment Act 1992, s 50.

123 See Adam Bennett "Pike River: Labour accuse Govt of dodgy deal" *New Zealand Herald* (Auckland, 27 February 2014).

124 Companies Act 1993, s 2(3).

toward the creditors of the company in liquidation; the extent to which the related party may have acted in a way that contributes to the circumstances leading to liquidation of the company; and any other matter the Court thinks fit.

Mountfort v Tasman Pacific Airlines of NZ Ltd[125] is the leading case on the application of s 271. Baragwanath J reiterates the fundamental importance of s 15 of the Companies Act 1993, which gives a company separate legal personality. He states the application of s 271 "concerns how upon the facts of [the] case the pooling provisions and s 15 are to be reconciled".[126] This is aptly restated by MacKenzie J in *Lewis Holdings v Steel & Tube Holdings*:[127]

> … what is required is an application of the statutory criteria in s 272(1) to the facts of this case as I determine them to be. In applying the criteria I must balance two policy considerations inherent in the legislation which weigh on different sides of the scales. The first is that the separate corporate identity of the company in liquidation is to be respected. The second is that s 271 is directed to the mischief that an overly strict application of that separate corporate identity may cause.

This compromise means that s 271 is more likely to be read narrowly rather than widely, as its application results in statutorily lifting the corporate veil. However, the outcome in the *Lewis Holdings* case was in favour of the plaintiff and the Court did make an order under s 271(1)(a) of the Companies Act 1993. The Court made that decision based on the criteria in s 272(1)(d) - that is, in consideration of "such other matters as the Court thinks fit". The facts of the *Lewis Holdings* case were very different to those at Pike River Coal, so it is difficult to draw any conclusions or principles from the application of the pooling order provisions. The decision was largely based upon the intertwined governance of the company in liquidation - Stube Industries Ltd - and its shareholder Steel and Tube Holdings Ltd, who were the defendants in the case. The facts of the case showed a lack of distinction between the governance of the subsidiary entity, which was insolvent, and its parent company.

The basis for any claim upon which any creditor may apply for an order under s 271(1)(a) against NZOG would be for different reasons to those in *Lewis Holdings*. While NZOG may have been acting as a shadow director until at least 2007, the circumstances upon which the creditors' claims have come about are a result of breaches in safety compliance at the company, rather than a controlling shareholder choosing to walk away from a subsidiary's financial obligations.

125 Mountfort v Tasman Pacific Airlines of NZ Ltd [2006] 1 NZLR 104 (HC).
126 At [3].
127 Lewis Holdings Ltd v Steel & Tube Holdings Ltd [2014] NZHC 3311, [2015] 2 NZLR 831 at [19].

There is no precedent for a situation like Pike River Coal. However, the Pike River victims, as creditors, could use the factual evidence found by the Royal Commission to request a court to make a pooling order against NZOG. There are several factors that may count against NZOG, and a court may consider using the statutory discretion given to them, including:

- NZOG controlled Pike River Coal until 2007 and was instrumental in its foundation;
- arguably, NZOG undercapitalised the company from early on, using overly optimistic predictions;
- the IPOs were also sold on the basis of over optimistic predictions;
- despite NZOG's role in the foundation of Pike River Coal and their culpability in its failure, they have taken at least $45 million in debt repayments from Pike River Coal, while the Pike River victims have not received anything from the company; and
- the debts to NZOG continue to accumulate interest and grow rapidly while debts to the unsecured creditors including the Pike River victims remain static. Any money that comes into Pike River Coal in the future will be paid out to relieve NZOG's growing debt, making it even less likely the other creditors will ever get anything.

As with s 301, in order to invoke a request for an order under s 271, a creditor would need to apply to the Court to have Pike River Coal put into liquidation.

3. Remedy in tort for breach of statutory duty

An alternative to using the mechanism in s 301 of the Companies Act 1993 to recover the unpaid debt from the directors would be to pursue an action in tort. Any tortious claim would need to meet the following requirements:[128]

1. The plaintiff must show that there is a duty owed by the defendant (the director in this case);
2. the plaintiff must show the duty is owed to the plaintiff;
3. thirdly, the plaintiff must show they have suffered damage that the statute was designed to prevent;
4. the defendant must be in breach of the duty; and
5. finally, the plaintiff will need to prove (on the balance of probabilities) that the breach resulted in the loss.

As stated in point 2, the plaintiff must be the person to whom the duty is owed. As discussed above, there are several duties owed by directors but the statutory duty of care in s 137 of the Companies Act 1993 is owed to "the

128 Stephen Todd et al *The Law of Torts in New Zealand* (6th ed, Thomson Reuters, Wellington, 2013) at ch 8.3.

company". This means only "the company" can be the plaintiff if seeking a remedy in tort. Responsibility for management of any company lies with the directors under s 128 of the Companies Act 1993. The company now only has one sole director remaining, Surendra Sinha. Unless the director pursued the action against the former directors as representative of the company, the requirement of point 2 cannot be met. While this may be possible in theory, it is unlikely to occur in practice.

4. Remedy in tort for breach of duty owed directly to employees, contractors and their families

A remedy for the Pike River victims directly in tort is difficult to achieve given the impact of the Accident Compensation Act 2001. Even if it were possible for the Pike River victims to establish that the former directors of Pike River Coal had a duty of care to them directly, s 37(1) of the Accident Compensation Act 2001 states:

> *No person may bring proceedings independently of this Act …*
> *for damages arising directly or indirectly out of -*
>
> (a) personal injury covered by this Act …

Personal injury includes any injury or death caused by an accident in New Zealand.[129] This Act is designed to reduce and avoid litigation for accidental injury, and provide the victims of accidental injury a secure means of compensation from the statutory fund, regardless of blame or responsibility. Therefore, even if a duty of care could be established by the directors to the Pike River victims, an action would be prohibited on behalf of those who died, although family members will have received funeral grants[130] and will be receiving weekly compensation and survivors' grants.[131] The key compensation will be weekly compensation payable to the surviving spouse, if any (60 per cent of the weekly compensation for loss of earnings that the deceased would have been entitled to, that is, 80 per cent of their weekly earnings[132]) and children (20 per cent of the weekly compensation for loss of earnings that the deceased would have been entitled to[133]). The ACC payments will have been substantial for those victims who had families.

If the two survivors suffered only mental injury unaccompanied by any physical injury, they could sue the directors under this duty of care for compensatory damages, in addition to exemplary damages. The reason is that mental injury is not covered by the ACC scheme unless it is suffered because of (that is, arises out of) physical injury.[134] The survivors would have

129 Accident Compensation Act 2001, s 20(2).
130 Accident Compensation Act 2001, s 64.
131 Accident Compensation Act 2001, s.65.
132 Accident Compensation Act 2001, 1st Schedule, clause 66.
133 Accident Compensation Act 2001, 1st Schedule, clause 70.
134 Accident Compensation Act 2001, s 26(1)(b); *Queenstown Lakes v Palmer* [1999] 1 NZLR 549 (CA).

to show that they have suffered a recognisable psychiatric injury such as Post Traumatic Stress or depression[135]. Plaintiffs usually plead that they have suffered a recognisable psychiatric illness even if they have not, just to survive strike out. There is one High Court decision which suggests that for primary victims (which the two survivors are), a psychiatric illness may not have to be shown, but this is dicta; the point is not authoritatively settled.[136]

V. Conclusion

Five years after the tragedy at Pike River unfolded, families have little to compensate them for their loss. The bodies of the men remain in the mine. No one has been held accountable for the tragedy. This "accident" was not a random or unpredictable event - it could have been avoided. The explosion occurred due to a combination of factors: poor health and safety management, suboptimal decisions being taken favouring production over prudence, poor understanding of the industry and the terrain the company was mining in, to name just a few. All those factors stemmed from the culture at the top of the organisation's structure - the board of directors and perhaps even from the shareholders. Systemic problems with Pike River Mine existed from its inception.

Although the company was held responsible and accountable for failures under the Health and Safety in Employment Act 1992, the company had become a faceless, empty carcass at that point, and that is exactly how it was presented to Judge Farish in court. Contrast this with the time the company was replete with directors and management willing to draw their salaries and directors' fees in exchange for taking responsibility for managing the company toward success. Those faces were absent when it was time to be made accountable for the decisions, actions and culture that led to the tragedy.

This article has been written to consider whether those shareholders and directors who were so eager to participate in the profits of a successful mining operation should now be liable or accountable for the losses suffered by those who worked at the coalface and their families.

Piercing the corporate veil is a term we hear often, but in practice it is a rare event. Only the most extreme case of fraud or misrepresentation would see a New Zealand court willing to pierce the corporate veil and make shareholders liable for losses. In no circumstance can we envisage a shareholder being liable to creditors of the company solely due to their position as a shareholder. Control of the company is usually required by a court to pierce the corporate veil. In this case, the Pike River victims will not find that they can reach the deeper pockets of NZOG and other shareholders through actions requiring a court to pierce the corporate veil.

135 *Van Soest v RIMU* [2000] 1 NZLR 179 (CA).
136 *L v Robinson* [2000] 3 NZLR 499, p 508 per Chisholm J.

Directors have several duties under the Companies Act 1993. Section 137 of the Companies Act 1993 requires directors to exercise a duty of care toward the company. The authors of this article believe the directors of Pike River Coal have failed in their duty of care to the company by failing to give adequate attention to safety considerations at the mine. In neglecting safety at the mine, the directors have taken unnecessarily high risks at the expense of the long-term interests of the company.

The safety problems at Pike River mine were systemic and existed from the inception of the company. At that time and for a period after incorporation, clear arguments could be made that NZOG was a shadow director and therefore subject to the duties of directors, including the duty of care in s 137.

The Companies Act 1993 provides remedies for creditors and shareholders to make claims upon negligent directors to repay money to the company or directly to creditors under ss 271 (pooling orders) and 301 (court discretion to order repayment). Engaging these provisions to seek reparation from the directors will require the Pike River victims to utilise their position as creditors of the company to put the company into liquidation.

The authors of this article believe there is a case to be heard on behalf of the Pike River victims against the former directors of Pike River Coal and NZOG for failure in their statutory duty under s 137 of the Companies Act 1993.