

**IN THE HIGH COURT OF THE COOK ISLANDS
HELD AT RAROTONGA
(CIVIL DIVISION)**

PLAINT NO. 17/2001

BETWEEN A

Plaintiff

AND E and B

First Defendants

**AND C together with D in their capacity as
Trustee(s) THE TRUST**

Second Defendants

**Counsel: J R F Fardell QC and C Morris for Plaintiff
A F Grant and P Collins for First Defendants**

Hearing: 7 September 2002

Judgment: 10 October 2002

**INTERLOCUTORY JUDGMENT
CONCERNING FIRST DEFENDANTS' CLAIM OF PRIVILEGE
IN RESPECT OF DISCOVERABLE DOCUMENTS**

EDITED VERSION UNDER SECTION 23 INTERNATIONAL TRUSTS ACT 1984

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The Nature of the Proceedings

[1] The Plaintiff is a bank. The First Defendant E is a settlor and together with her husband First Defendant B and their children is a beneficiary of the Trust. B also transferred property to the Trust. The Trust is a registered international trust pursuant to the International Trusts Act 1984. C is a trustee company licensed pursuant to the Trustee Companies Act 1981-82 and carries on the business of the creation, establishment, maintenance and administration of international trusts.

[2] The Trust was purportedly established pursuant to a trust settlement dated 12 July 2000 made between the First Defendants and the Second Defendants as Trustees.

[3] The First Defendants are also the sole shareholders of P Inc, which was indebted to the Plaintiff under a US\$17 million promissory note dated 31 May 1999. They unconditionally guaranteed full payment to the Plaintiff of all indebtedness owed under the note. P operated a chain of four stores in Maryland, USA.

[4] It was alleged that the First Defendants were in breach of their obligations as guarantors and arbitration proceedings were commenced by the Plaintiff against the First Defendants claiming in excess of US\$17 million in July 2000. It is contended by the Plaintiff that while the arbitration proceedings were pending the First Defendants transferred assets to the Second Defendants in their capacities as Trustees of the Trust for no consideration.

[5] On 31 October the First Defendants consented to two arbitration awards against them and in favour of the Plaintiff for the amounts due under the guarantee. On 28 December 2000 the Circuit Court, State of Maryland, United States entered a judgment on the first arbitration award against the First Defendants.

[6] These proceedings are brought pursuant to section 13B(1) of the International Trusts Act which is set out in Appendix 1. The central allegation against the Defendants in these proceedings is as follows (Statement of Claim, paragraph 56):

“That the transfer of the Residence, Furnishings and Liquid Assets to the Second Defendants as trustees of the Trust were made with the intention and effort to hinder, delay, deprive or defraud the Plaintiff and has left the First Defendants without property sufficient to satisfy the First Defendants indebtedness to the Plaintiff or in respect of the Guaranty evidenced by the judgment entered in the Circuit Court, State of Maryland entered on 28 December 2000 in favour of the Plaintiff in the amount of United States Dollars Sixteen Million Eight Hundred Forty One Thousand One Hundred and Twenty Dollars Twenty Nine Cents (USD\$16,841,120.29) together with pre-judgment interest in the amount of United States Dollars Six Hundred Thirty Five

Thousand Forty Dollars and Sixty Cents (USD\$635,040.60) plus post-judgment interest and costs pursuant to the First Defendants consenting to an arbitration award dated 31 October 2000 against them in favour of the Plaintiff for amounts due under the Guaranty.”

[7] It is important to note that under section 13B(1) the Plaintiff must establish its case beyond reasonable doubt.

[8] Subsequently leave was sought and obtained to file an Amended Statement of Claim incorporating a new cause of action. This is based on certain terms of the Trust Deed which require the Trustees to pay any person determined to be a creditor of the settlors of the Trust in certain circumstances. It is not necessary to set out the details of this cause of action for the purposes of this decision.

Application by the Plaintiff in Respect of the First Defendants’ Claim for Privilege

[9] By application dated 29 August 2002 the Plaintiff applied for orders against the First Defendants as follows:

- “1. An Order that the Court inspect the documentation for which privilege has been claimed as highlighted on the attached list of documents marked “A” to this application; and/or
2. An Order allowing the plaintiffs to inspect such documentation as in this Court’s opinion privilege has been invalidly claimed by the First Defendants.
3. Costs on a solicitor/client basis.”

[10] As to the grounds for the application, these were listed as follows:

- “(a) the list of documents provided by the first defendants claims legal professional privilege and/or litigation privilege for categories of documents where advice was sought or given to allow the first defendants to commit a fraud; and
- (b) prima facie evidence of fraud with sufficient foundation in fact exists to deny the claim for legal professional privilege and/or litigation privilege; and
- (c) an inspection by the Court of the documents in Schedule “A” is warranted in all the circumstances to determine whether a prima facie case of fraud is established justifying the overturning the claimed privilege..
- (d) the documents highlighted include documents that are inadequately identified, as follows:
 - (i) by date; and/or
 - (ii) described as ‘non responsive’; and/or
 - (iii) described as discoverable.”

[11] With respect to what is referred to under (d)(ii) and (iii), at the commencement of the hearing on 7 September 2002 Mr Grant for the First Defendants explained that the annotation “non-responsive” meant that the document was no longer considered discoverable and that the annotation “discoverable” meant that the documents had already been provided to the Plaintiff. On the basis of these explanations Mr Fardell for the Plaintiff agreed to withdraw those grounds with leave reserved to reapply. They were therefore struck from the application.

[12] The application then proceeded to provide the particulars of the evidence of fraud alleged to be sufficient to justify inspection by the Court as follows:

- “1. The dishonest acts and intentions of the first defendants as assisted and promoted by lawyers and/or advisers as can be proved and/or inferred from the following uncontested acts carried out by the first defendants or by agents/advisers/lawyers on their behalf to the sole benefit of the first defendants and to the calculated loss and harm to the plaintiff.
 - (i) the establishment and creation of the Trust; and
 - (ii) the transfers of assets to the Trust; and
 - (iii) at a time when an arbitration case was pending against the first defendants; and
 - (iv) a silence from the first defendants regarding what lawful purpose was served by establishing the Trust; and
 - (v) the transfers were made without any consideration to a Trust located 7,000 miles from E and B’s domicile; and
 - (vi) the creation of the Trust within three weeks of the plaintiff’s demand for arbitration; and
 - (vii) the effect of the transfers was to leave E and B unable to meet their obligations to the plaintiff.
2. Such dishonest acts and intentions of the first defendants have been the subject of depositions and judgments in the United States.

2.1 A ruling by Judge W where the Court said:

- (i) *the Court also concludes that there is a substantial likelihood that the Bank will be able to prove E and B intended to hinder, delay or defraud their creditors when they made the various transfers described above;*
- (ii) *the timing of the creation of the Trust and the transfers of assets to it, while an arbitration case was pending against E and B, under circumstances where it was simply a matter of time before a substantial award would be made in favour of the Bank, coupled with the unmistakable silence from E and B regarding what lawful purpose was served by establishing the Trust, clearly points to a circumstance where the only*

possible purpose to creating the Trust was to prevent the Bank from collecting its judgement'

2.2 Judge Y in April 2002 said at page 12:

'I think it's important that a number of these factual findings be read into the record so that there is no doubt that there has been a proper showing of the commission of fraud in this case by these debtors'.

2.3 Privilege has been invoked and not waived by the first defendants as can be seen by the depositions.

2.4 The deposition of M is evidence that the agents (namely the attorneys for E and B) were aware the actions described above amounted to fraud."

[13] Additional grounds advanced in support of the application were said to be contained in the affidavits of F and G. In the course of the hearing reference was also made to the affidavit of H filed in support of the Plaintiff's earlier application in these proceedings for a Mareva Injunction.

[14] The First Defendants filed a Notice of Opposition dated 5 September 2002 opposing the making of the orders sought on the following bases:

“(a) Concerning Orders 1 and 2:

- (i) The documents listed in the plaintiff's schedule "A" are properly the subject of the privileges which have been claimed for them.
- (ii) There is no, or no sufficient evidence of any facts or factors which would justify dispensing with the privilege and allow the plaintiff to inspect the documents.
- (iii) The litigation in which Judge W's decision was delivered was based upon the Statute of Elizabeth (1571), a statute which is expressly excluded from the operation and effect of the International Trusts Act by virtue of s.13B(13) of that Act.
- (iv) Further, to the extent that the plaintiff relies upon the decision of Judge W, the proceedings before him were materially different in form to those which are the subject of the plaintiff's claim in this proceeding. In particular, information relating to the assets which the first defendants reasonably believed themselves to possess at the time of the establishment of the trust, and at the time of dispositions to it, was clearly regarded by the Judge as having little relevance.
- (v) To the extent that the plaintiff relies on the decision of Judge Y, the legal framework of the proceedings in which his decision was given was materially different to the framework in this proceeding. He was not provided with evidence by the first defendants concerning the extent of their assets and their solvency as at the date of creation of the trust or the dispositions to it, since these were not material to the application which he heard on 30 April 2002.
- (vi) The orders would, if made, conflict with the statutory guarantee of privacy concerning the establishment, constitution, business undertaking or affairs of an international trust, in terms of s.23(1) of the International Trusts Act, and

would generally be in conflict with the intended effect and operation of that statute.

- (vii) The plaintiff relies upon inadmissible evidence in support of its application, namely the depositions taken in Maryland, USA, which have been annexed to the plaintiff's affidavits filed in support of the application.
- (viii) The first defendants reasonably believed at the time of the creation of the trust and at the time of the dispositions to it that they had sufficient assets to pay any liability which they had to the plaintiff.
- (ix) If (which is denied) grounds exist for allowing the inspection by the plaintiff of the first defendants' privileged documents, the range of documents sought to be inspected by the plaintiff is far greater than would otherwise be permissible by law."

[15] The First Defendants also filed substantial affidavits from O, J, K, L and B.

Legal Framework

[16] There was no serious dispute about the applicable rules of discovery. Cook Islands and New Zealand law are in all material respects the same. The Code of Civil Procedure of the High Court of the Cook Islands 1981 has the same general scheme for discovery as the New Zealand High Court Rules. In relation to privilege, Rule 143 of the Cook Islands Code provides that "[w]here, on an application for an order for inspection, privilege is claimed for any document, the Court may inspect the document for the purpose of deciding whether the claim of privilege is valid". Rule 143 is identical to Rule 311 of the New Zealand High Court Rules. The central issue for determination is the scope and application of the so-called fraud exception to the rules about withholding documents on discovery on the grounds that they are privileged from production.

[17] Counsel for the Plaintiff relied upon the leading New Zealand Court of Appeal authorities on the operation of the fraud exception, namely: *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650; *Seamar Holdings Ltd v Kupe Group Ltd* [1995] 2 NZLR 274; and *Gemini Personnel Ltd v Morgan & Banks Ltd* [2001] 1 NZLR 672.

[18] Counsel for the First Defendants did not seek to challenge the principles set out in these cases or their applicability in the context of Cook Islands' trust law. However, the topic deserves a more detailed analysis for several reasons.

[19] Firstly, this appears to be the first case to consider the exception in the context of a claim by a creditor under section 13B(1) of the International Trusts Act. The question of whether privilege attaches to communications between the defendants and their legal advisers

regarding the establishment and funding of the trust could be an important or even a crucial one in some instances.

[20] Secondly, the parties (most of whom are resident in foreign jurisdictions) should know and understand the precise legal basis for my ruling, especially since claims to legal professional privilege may be approached differently in U.S. jurisdictions.

[21] Thirdly, the law in this area is not free from debate, particularly in relation to the scope of the fraud exception and the standard of proof required before disclosure is ordered.

Rationale of the Fraud Exception

[22] As to the nature of the privilege and the rationale behind the fraud exception, the privilege exists to encourage a client to confide fully and candidly in his or her legal adviser: *Waugh v British Railways Board* [1980] AC 521 at 531 per Lord Wilberforce. As the Australian Judges Mason and Wilson JJ put it in *Waterford v Commonwealth* (1987) 61 ALJR 350 at 353, “[t]he wisdom of the centuries is that the existence of the privilege encourages resort to those skilled in the law and that this makes for a better legal system”.

[23] The Courts in all jurisdictions have been loath to derogate from the cloak of confidentiality that covers client/legal adviser communications despite the conflict with the interest of the community as a whole in seeing justice fairly done. McMullin J said in *R v Uljee* [1982] 1 NZLR 561 at 576 that “[w]hether the [privilege] operates as a bar to the emergence of the truth and to the overall public detriment is not now a legal consideration”.

[24] More recently, in *Auckland District Law Society v B* (2001) 15 PRNZ 687 Elias CJ said at 689 – 690:

“Legal professional privilege protects from disclosure confidential communications between a client and his legal adviser for the purpose of legal advice. Such protection is essential if advice is to be candidly informed and given. Where the advice is sought in connection with litigation, the privilege is an important part of the fundamental right of unimpeded access to the Courts. Even where litigation is not immediately in prospect, the privilege recognises the public benefit in legal professional assistance if members of the community are to avoid disputes and order their affairs lawfully. As such, it supports the principle of legality upon which our society is organised. Legal professional privilege is subject to exceptions. It does not protect advice for purposes of fraud or illegality. And it may be limited by legislation. In the absence of express statutory language, such an important protection could be displaced only by statutory implication which, as a matter of interpretation of the statute, is clearly necessary.”

[25] However, at least since the decision in *R v Cox and Railton* (1884) 14 QBD 153, the law has recognised an exception where communications are made with intent on the client’s

part to facilitate crime or fraud because if the privilege protected such communications from disclosure it would pervert the underlying rationale for the privilege – to promote the interests and administration of justice. In *R v Cox and Railton*, Stephen J explained (page 167):

“The reason on which the rule is said to rest cannot include the case of communications, criminal in themselves, or intended to further any criminal purpose, for the protection of such communications cannot possibly be otherwise than injurious to the interests of justice, and to those of the administration of justice. Nor do such communications fall within the terms of the rule. A communication in furtherance of a criminal purpose does not ‘come into the ordinary scope of professional employment’”.

[26] Thus the privilege is not lifted from communications in furtherance of either crime or fraud. Privilege never attaches to them at all as the nature of the communications made destroys the sanctity of the relationship between lawyer and client.

[27] It is the intent of the client in seeking the advice that is overriding. Whether the legal adviser is cognisant of the client’s criminal or fraudulent purpose is not relevant. If a lawyer participates (innocently or otherwise) in the criminal purpose he or she ceases to act as a lawyer. The relationship which gives rise to the privilege does not exist in such circumstances. The exception does not apply to advice sought in aid of a legitimate defence by the client against a charge of past crimes or past misconduct, even if he is guilty. Those consultations are privileged. As Stephen J said in *R v Cox and Railton* at 175:

“... in each particular case the Court must determine upon the facts actually given in evidence or proposed to be given in evidence, whether it seems probable that the accused person may have consulted his legal adviser, **not after the commission of the crime for the legitimate purpose of being defended, but before the commission of the crime for the purpose of being guided or helped in committing it.**” (Emphasis added).

[28] Admissions made to a legal adviser after the commission of an offence in order to instruct the legal adviser in preparation of a defence must be privileged otherwise the legal adviser could be subpoenaed to give evidence against his own client as to admissions made to him or her by the client. This would fly in the face of the right of every person to a proper and adequate defence.

The Fraud Exception in New Zealand Case Law

[29] In the absence of Cook Islands authority it is convenient to begin with a brief review of the New Zealand Court of Appeal decisions. *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650 involved an appeal from a judgment of the High Court declining an application that a ruling on the production of allegedly privileged documents be

dealt with by a judge other than the trial judge. The Court of Appeal at page 653 cited with approval the leading English case *O'Rourke v Darbishire* [1920] AC 581 and set out part of the leading speech by Viscount Finlay (page 604):

“This is clear law, and, if such guilty purpose was in the client’s mind when he sought the solicitor’s advice, professional privilege is out of the question. But it is not enough to allege fraud. If the communications to the solicitor was for the purpose of obtaining professional advice, there must be, in order to get rid of privilege, not merely an allegation that they were made for the purpose of getting advice for the Commission of a fraud, but there must be something to give colour to the charge. The statement must be made in clear and definite terms, and there must further be some prima facie evidence that it has some foundation in fact. It is with reference to cases of this kind that it can be correctly said that the Court has discretion as to ordering inspection of documents. It is obvious that it would be absurd to say that the privilege could be got rid of merely by making a charge of fraud. The Court will exercise its discretion, not merely as to the terms of which the allegation is made, but also as to the surrounding circumstances, for the purpose of seeing whether the charge was made honestly and with sufficient probability of its truth to make it right to disallow the privilege of professional communication. In the present case it seems to be clear that the appellant has not shown such a prima facie case as would make it right to treat the claim if professional privilege is unfounded”.

[30] The Court of Appeal then commented (pages 653 - 654):

“The important point is that, however the test should be expressed precisely (if indeed complete precision is possible), no more than a prima facie threshold has to be crossed. The judge is of course not called upon to express any concluded opinion as to whether or not there has been a fraud. He or she is deciding only that there is or is not a sufficient indication of fraud as alleged to justify overriding the privilege in the paramount interests of justice and truth, so allowing a full examination of the allegation at the trial on all the relevant evidence.”

Scope of the Fraud Exception

[31] In general, Commonwealth Courts are very protective of the sanctity of communications between clients and their legal advisers. They are not easily persuaded that the veil of privilege should be lifted. It is not surprising that the exception was first articulated in a criminal case – *R v Cox and Railton* (1884) 14 QBD 153. The traditional approach was to confine the exception to communications in furtherance of criminal purposes or fraudulent purposes, fraud being either criminal or at least the tort of deceit. However, since *R v Cox and Railton*, the approach of the English Courts and, more recently and particularly, the Australian Courts, has been a more liberal one.

[32] The English cases are conveniently summarised in the judgment of Vinelott J in *Derby & Co Ltd v Weldon (No. 7)* [1990] 3 All ER 161 at 171 to 177. Vinelott J observed that the scope of the exclusion from legal professional privilege in civil litigation (what is meant in this context by “fraud”) was very widely defined by Kekewich J in *Williams v*

Quebrada Railway, Land and Cooper Co [1895] 2 Ch 751. In the *Williams* case the client, who was seeking to assert the privilege, argued that the alleged fraud was “of a very mild character” and fell short of the cases in which it had been held that a charge of fraud prevents privilege attaching to the communication. Kekewich J rejected that argument, holding that (page 755):

“... where there is anything of an underhand nature or approaching to fraud, especially in commercial matters, where there should be the veriest good faith, the whole transaction should be ripped up and disclosed in all its nakedness to the light of the Court. ... Then it is alleged that the company was insolvent, and that they found it useless for them to continue to carry on business and they had to stop, but that in order to prevent for a time this inevitable result they gave a charge in favour of their agents, and, as the plaintiff alleges, they did it in such a way as to defeat the holders of first debentures. That is what I understand the plaintiff’s case to be, and it is said that is not a charge of fraud. It is difficult to say it is not commercial dishonesty. It is, in my opinion, commercial dishonesty of the very worst type; and that is fraud.”

[33] Vinelott J also referred to two decisions of Goff J (as he then was) – *Crescent Farm (Sidcup) Sports Ltd v Sterling Offices Ltd* [1971] 3 All ER 1192; and *Gamlen Chemical Co (UK) Ltd v Rochem Ltd (No. 2)* (1979) 124 SJ 276. In the *Crescent Farm* case the plaintiff sought to extend the fraud exception to include the purpose of obtaining advice to further an alleged conspiracy to induce a breach of contract. Goff J held (at page 1200):

“... I think the wide submission of the plaintiffs would endanger the whole basis of legal professional privilege. It is clear that parties must be at liberty to take advice as to the ambit of their contractual obligations and liabilities in tort and what liability they will incur whether in contract or tort by a proposed course of action without thereby in every case losing professional privilege. **I agree that fraud in this connection is not limited to the tort of deceit and includes all forms of fraud and dishonesty such as fraudulent breach of trust, fraudulent conspiracy, trickery and sham contrivances**, but I cannot feel that the tort of inducing a breach of contract or the narrow form of conspiracy pleaded in this case come within that ambit.” (Emphasis added.)

[34] In the *Rochem* case, Goff LJ approved the finding of Goulding J in the Court below, where Goulding J said:

“For servants during their employment and in breach of their contractual duty of fidelity to their master to engage in a scheme, secretly using the master’s time and money, to take the master’s customers and employees and make profit from them in a competing business built up to receive themselves on leaving the master’s service, I would have thought that commercial men and lawyers alike would say that that is fraud.”

[35] Goff LJ referred to the *Williams* case and then added:

“Where you draw the line in the infinite gradation of good and evil between *Williams’s* case (Kekewich J) and the *Crescent Farm Sports* case ... I do not attempt to say, but I have no doubt the present case is on the same side as *Williams’s* case and that discovery ought to be given ... I wish only to add two further observations. First the

court must in every case, of course, be satisfied that what is prima facie proved really is dishonest, and not merely disreputable or a failure to maintain good ethical standards and must bear in mind that legal professional privilege is a very necessary thing and is not lightly to be overthrown, but on the other hand the interests of victims of fraud must not be overlooked. Each case depends on its own facts.”

[36] Also in the *Rochem* case, Templeman LJ put the exercise of the discretion as follows:

“In the light of the existing evidence, and without knowing if, at the trial, that evidence will be disproved, we must, adopting the words of Stephen J, determine whether it seems probable that the defendants may have consulted their legal advisers before the commission of fraud and for the purpose of being guided and helped wittingly or unwittingly in committing the fraud. A fortiori, if the defendants embarked on a fraudulent activity, communications between the defendants and the solicitors made in the course of that activity cannot be entitled to privilege and must be disclosed so that, in the words of Kekewich J, quoted by Goff LJ, “the whole transaction shall be ripped up and disclosed in all its nakedness to the light of the Court”.”

[37] Thus it is not necessary to suspect any conspiracy between the client and his legal advisers in furtherance of fraud for the exception to operate. The legal advisers may be completely unaware of the client’s fraudulent purpose.

[38] The High Court of Australia has decided that the exception includes communications made to further a deliberate abuse of statutory power: see *Attorney-General (NT) v Kearney* (1985) 61 ALR 55. It has also accepted the contentious proposition that “where there is a higher public interest than that which supports the privilege, the privilege is displaced”: *Re Bell, ex parte Lees* (1980) 146 CLR 141 at 155. In *Re Bell* the Court determined that legal professional privilege does not apply to protect a solicitor from disclosing confidential information relating to the whereabouts of a child who is the subject of a custody order. The Court decided that the public interest in the welfare of the child outweighed the public interest in the confidentiality of solicitor/client communications.

[39] It may be that the principle espoused in *Re Bell* is confined to cases where the welfare of a child is at stake, although the High Court of Australia did not expressly limit its decision in this way. The authors of *McNicol on Evidence* (1992) argue that to extend the exception to any case where a higher public interest prevails over the public interest which the privilege is designed to secure would tend to destroy the certainty required for the effective operation of legal professional privilege. To subject the circumstances of every case to a balancing exercise between public interests would leave every solicitor and client on shifting sands as to whether privilege would attach to their discussions and communications. There is much force in these observations.

[40] The Australian Law Reform Commission in its 1987 Report on Evidence (Report No. 38) expressed concern that *Kearney's* case had the potential to create the untenable situation where a lawyer and client could have no certainty about whether their communications were protected or not. The New South Wales Evidence Bill 1991 and the Australian Law Reform Commission Bill (clauses 111 and 107 respectively) restrict the exception to cases of crime or fraud or abuse of statutory power. The New Zealand Law Commission, in its 1999 Evidence Code (Report No. 55, clause 71) set the limits of the exception at “**a strong prima facie case** that the communication was made or received or the information was compiled or prepared for a **dishonest purpose** or to enable or aid anyone to commit or plan to commit what the person claiming the privilege knew, or reasonably should have known, to be an offence”. (Emphasis added.)

[41] The theme of the cases and the various suggested codifications is one of dishonest purpose. The scope of the fraud exception goes beyond deceit or fraud simpliciter and catches any commercial practice or business dealing that would readily be described as dishonest to the point of fraud by a reasonable businessman. Beyond this, further generalities are probably not helpful.

[42] It remains to consider under this subheading whether the limits of the exception should be more restricted in the context of the statutory asset protection regime in the Cook Islands. There is an argument that the limits of the exception should be restricted to communications in furtherance of crime or fraud simpliciter given the asset protection purposes of Cook Islands statutes such as the International Trusts Act and the fact that there is a requirement of proof beyond reasonable doubt under that Act if a creditor such as the Plaintiff is to recover under section 13B(1). This argument was alluded to in submissions by Mr Grant for the First Defendants. Subject to what is said later on the related topic of the burden of proof, however, I do not see any reason for a more restrictive approach. There is no express statutory provision that excludes or limits the operation of the exception. Nor does the Cook Islands' asset protection legislation seek to exclude creditors entirely in their efforts to recover from settlors and beneficiaries of international trusts. It simply limits the opportunity of creditors to retrieve trust assets. Within those limitations, however, there is no reason to interpret established evidential rules in a way more adverse to the creditors of international trusts than to other parties. I am fortified in this view by the decision of the Cook Islands Court of Appeal in *515 South Orange Grove Owners Association v Orange Grove Partners & Ors* (Court of Appeal, Cook Islands, CA 1/95, 6 November 1995, Sir

Duncan McMullin, Hillyer and McHugh JJ). In that case, the Court of Appeal rejected an argument that the purpose of the Cook Islands trust legislation was purely and unashamedly the soliciting of funds and giving of protection against creditors exercising their rights (page 24):

“We return to the purposes for which the legislation was passed. We find some difficulty in pursuing a purposive approach to the International Trusts Act. There is no long title in the Act from which its overall intention may be derived. On one view, the purpose of the Act may be said to be to provide a haven which protects funds deposited with trust companies to the exclusion of the rights of creditors. On another view, the purpose of the Act may be said to protect funds against actions by creditors but only after giving those creditors a chance of recovery within certain time limits.

In the end we think the Court should strive to give a common sense approach to a piece of legislation which is at once very sophisticated but also ineptly drafted in parts. We think that the better view is that Parliament, in attempting to balance the interest of settlers, trustees and creditors, has prescribed certain specific limitation periods; that the right to sue on either a cause of action or a judgment is abridged but not eliminated, and that a common sense interpretation should allow for intention to be given to those two concepts. It should not be lightly assumed that Parliament intended to defeat the claims of creditors by allowing international trusts to be used to perpetrate a fraud against a creditor.”

[43] Later, at page 27, the Court of Appeal said:

“... we would be loathe to interpret the International Trusts Act as a statute which was intended to give succour to cheats and fraudsters by totally excluding the legitimate claims of overseas creditors.

To modify the aphorism of Scrutton LJ in *Czarnikow v Roth, Schmitt & Co* [1922] 2 KB 478 at 488, we cannot think that Parliament ever intended that by passing of the International Trusts Act the Cook Islands should become an Alsatia in the South Pacific from which the commercial comity of nations was completely ousted.”

Communications in Furtherance of Fraud and those in Furtherance of Defence to Allegations of Fraud

[44] A client seeking advice on how to defend past conduct (even if guilty) must be able to appraise his legal advisers of the situation and formulate a strategy without any fear that those communications will be disclosed without the client’s consent. If it were otherwise, every defendant who faced a prima facie case of fraud would be obliged to disclose his or her litigation strategy and brief to opposing parties. Counsel for the First Defendants referred me to a comment by Vinelott J in *Derby & Co Ltd v Weldon (No. 7)* [1990] 3 All ER 161 at 178 to this effect:

“The plaintiffs are not entitled to disclosure of any documents which fall under a different head of privilege: legal advice obtained and documents coming into existence for the dominant purpose of being used in pending or contemplated proceedings”.

[45] This distinction may be of relevance in this case given that the First Defendants may have been contemporaneously transferring assets to the trust and seeking advice as to potential recovery proceedings by the Bank in the Cook Islands.

Standard of Proof of Fraud Required for Disclosure

[46] The test has been variously described. It is clear that a mere allegation of fraud is insufficient. There must be “something to give colour to the charge” (Viscount Finlay in *O’Rourke* at page 604). How much colour is required must in the end be a question of discretion on the facts of each particular case. Viscount Finlay said (page 604):

“[T]here must further be **some** prima facie evidence that [the allegation of fraud] has **some** foundation in fact.” (Emphasis added.)

On a literal reading, this appears to be a liberal test. In contrast, Lord Denning MR said in *Buttes Gas and Oil Co v Hammer (No. 3)* [1980] 3 All ER 475 at 486:

“No privilege can be invoked so as to cover up fraud or iniquity. But this principle must not be carried too far. No person faced with an allegation of fraud could safely ask for legal advice. To do away with the privilege at the discovery stage there must be strong evidence of fraud such that the court can say: ‘This is such an obvious fraud that he should not be allowed to shelter behind the cloak of privilege’.” (Emphasis added.)

In the same case, Donaldson LJ said (page 490):

“[I] find it unnecessary to express any view on how strong a prima facie case of fraud is necessary to defeat a claim for disclosure based on legal professional privilege, but something exceptional is called for.” (Emphasis added.)

[47] However, some judges have taken a more relaxed view of the test. Vinelott J suggested in *Derby & Co Ltd v Weldon (No. 7)* [1990] 2 All ER 161 at 177 that these differing formulae may be:

“... a continuous spectrum and it is impossible to, as it were, calibrate or express in any simple formula the strength of the case that the plaintiff must show in each of these categories.”

Additionally, in *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650 at 653 the New Zealand Court of Appeal doubted whether complete precision is possible and concluded that (page 654):

“No more than a prima facie threshold has to be crossed. ...[the judge] is deciding only that there is or is not a sufficient indication of fraud as alleged to justify overriding the privilege in the paramount interests of justice and truth, so allowing a full examination of the allegation at the trial on all the relevant evidence.”

[48] A prima facie case involves such evidence as is sufficient to establish the group or chain of facts constituting the party's claim and which if not rebutted or contradicted will remain sufficient to sustain judgment for the Claimant. To establish a case of fraud under section 13B, the fraud must be proved beyond reasonable doubt. For this reason the Cook Islands' asset protection legislation requires in my view a possible "raising of the bar" in terms of the standard of proof of fraud required before disclosure will be ordered, at least compared to the less stringent test espoused by Viscount Finlay in *O'Rourke v Darbishire* [1920] AC 581. The standard should be that proposed by the New Zealand Law Commission and referred to in paragraph 40 above, namely a strong prima facie case of fraud or dishonest purpose, or as Lord Wrenbury put it in *O'Rourke* (as cited below in paragraph 52) "a strong probability that there was fraud".

Standard of Proof of Fraud Required Before a Judge will Exercise Power of Inspection

[49] Counsel for the Plaintiff relied upon the following passages from the New Zealand Court of Appeal's judgment in *Seamar Holdings Ltd v Kupe Group Ltd* [1995] 2 NZLR 274 at 278 – 279:

“Accordingly there seems to be no authority directly on the point of whether a Judge must be satisfied (and if so to what degree) that there is or may be fraud before he might exercise the right to inspect documents to determine whether they should be open to inspection by the other parties.

If it were correct that the Judge must find sufficient evidence the fraud entirely outside of the documents before overruling the claim for privilege it would be pointless inspecting the documents at all. But we were referred to no authority requiring a threshold finding of prima facie fraud entirely outside the document. *R v Governor of Pentonville Prison, ex parte Osman* is to the contrary and is treated as authoritative on the point: see Phipson on Evidence (148 ed 1990) para 20-26. In these days when greater openness in litigation is required and where Rule 311 gives an unfettered right to inspect, good reason would be needed to justify any such rigid threshold. No such reason was advanced. In our view it would be artificial in ruling on a disputed claim to privilege to seek draw a distinction between evidence of fraud and documents made in furtherance of it so as to permit judicial inspection of the documents for one purpose but not the other ...”.

“A judge will not automatically inspect but as a matter of judgment will no doubt satisfy himself or herself that the circumstances warrant exercising the power of inspection and that it is likely to be of assistance. We see no reason to impose anything more.”

[50] Since Rule 311 of the High Court Rules is identical to Rule 143 of the Cook Islands Code of Civil Procedure, judicial inspection is a matter entirely within the judge's discretion should it be necessary to determine the issue of disclosure one way or the other.

The Facts – Introduction

[51] There are a number of preliminary matters which must be addressed before taking stock of the material that is legitimately before the Court and reaching a decision on whether the Plaintiff has established a strong prima facie case of fraud in the sense of dishonest purpose. In particular, the following issues arise:

- (a) what weight, if any, can be placed on the decisions of Judge W and Judge Y (together “the Maryland Decisions”);
- (b) should any weight be placed on the deposition of M;
- (c) should account be taken of the evidence filed for the Plaintiff in support of its Mareva Injunction application and does the grant of the Mareva Injunction itself support the Plaintiff’s allegation of a prima facie case of fraud; and
- (d) whether the nature of the Defendants’ claim to privilege on some documents is in itself corroborative of the Defendants’ alleged knowledge that their actions were fraudulent.

[52] In considering these matters it is to be remembered that this stage in the action is only an interlocutory one and the materials must be weighed, such as they are, without the benefit of a formal trial process. The approach of Lord Wrenbury in *O’Rourke v Darbishire* [1920] AC 581 at 633:

“If I may venture to express this in my own words I should say that to obtain discovery on the ground of fraud the plaintiff must show to the satisfaction of the Court good ground for saying that prima facie a state of things exists which, if not displaced at the trial, will support a charge of fraud. This may be done in various ways – admissions on the pleadings of facts which go to show fraud – affidavits in some interlocutory proceedings which go to show fraud – possibly even without admission or affidavit allegations of facts which, if not disputed or met by other facts, would lead a reasonable person to see, at any rate, a strong probability that there was fraud, may be taken by the Court to be sufficient. Every case must be decided on its merits.”

Relevance of the Maryland Decisions

[53] The Plaintiff put forward the rulings of Judge W (of the Circuit Court) and Judge Y (of the United States Bankruptcy Court) that the establishment and endowment of the Trust by the First Defendants constituted a fraudulent act. The specific statements within those judgments on which the Plaintiff relies are set out in the Plaintiff’s current application and are set out in paragraph 12 of this Judgment.

[54] Whether rulings of this kind can be recognised and taken into account at common law is conveniently discussed in Hill, *International Commercial Disputes* (2nd Ed, 1998) at 12.3 and following. It is not proposed to take Judge W's and Judge Y's rulings into account for two reasons, neither of which involve a reflection on the quality of the judgments. The first is that while this Court is asked to give a decision involving the same parties (at least insofar as the Bank and E and B are concerned), the present application involves different issues and different standards of proof and falls to be determined on the basis of a different governing law from that addressed by Judge W and Judge Y. The common law requires identity of causes of action or issues: see Hill at 12.3.21.

[55] The affidavit of J, the lead litigation counsel for E and B in the United States who has appeared on their behalf before both Judge W and Judge Y, sets out some of the parameters and circumstances within which the Judges evaluated the rights of the Plaintiff and E and B. It appears from J's affidavit and the judgments themselves that their Honours' task differed from that of this Court in the following respects.

[56] Firstly, it does not appear that the extent of the evidence before either Judge W or Judge Y was the same as the evidence before this Court. For example, Judge W referred to "unmistakable silence from E and B regarding what lawful purpose was served by establishing the Trust...". In contrast, this Court has the benefit of an explanation in paragraph 11 of B's affidavit dated 4 September 2002.

[57] Secondly, both Judges were dealing with statutes whose genesis was the Statute of Elizabeth 1571. The International Trusts Act, specifically section 13B(13), excludes the application of the Statute of Elizabeth to trusts registered after 1991.

[58] Thirdly, whether the settling, establishment or any disposition to a trust is a fraudulent act under the International Trusts Act depends in part on whether the Settlor intended to defraud creditors. Intention to defraud was not a relevant factor in terms of the determinations of Judges W and Y. What may be termed fraudulent in the United States does not necessarily amount to fraud under Cook Islands law.

[59] Fourthly, it appears that Judge W's decision was of an interlocutory nature and therefore any finding of fraud was not a final decision but merely one that there was a sufficient case to justify an interim injunction.

[60] Lastly, section 13D of the International Trusts Act 1984 provides inter alia that:

“... no proceedings for or in relation to the ... recognition of a judgment obtained in a jurisdiction other than the Cook Islands against any interested party shall be in any way entertained, recognised or enforced by any Court of the Cook Islands to the extent that the judgment –

(a) is based upon the application of any law inconsistent with the provisions of this Act ...”. (Emphasis added.)

[61] The wording of this provision is sufficiently wide to cover the use of the U.S. decision which the plaintiff proposes in this interlocutory matter.

[62] For these reasons, the decisions of Judge W and Judge Y do not assist me in determining pursuant to Cook Islands law whether there is a prima facie case of fraud sufficient to displace the privilege to which the Defendants would otherwise be entitled in this case.

The Deposition of M

[63] The deposition of M is not entitled to any weight in the present application. M is a former employee of the Colorado law firm engaged by the First Defendants to establish the Trust. In a deposition given in the U.S. proceedings M claimed that certain partners at his former firm had expressed concern about the legitimacy or propriety of the establishment and funding of the Trust. The Plaintiff points to M’s allegations as supporting the likelihood that the Trust was set up for fraudulent purposes. The First Defendants have filed affidavits from the partners concerned, a K and L, who both deny any concern about the propriety of the Trust and deny making any statements to the contrary to M.

[64] Quite apart from the inherent nature of a “deposition” in American civil procedure – a procedure alien to New Zealand or Cook Islands law – it was open to the Plaintiff to file an affidavit from M if it wished his evidence to be taken into account. In the absence of such an affidavit, all the Court has before it are the sworn denials from K and L. Those are accepted for the purpose of this decision.

[65] Further, the Defendants have filed affidavits from B (paragraph 13) and O (E and B’s commercial attorney in Maryland – paragraph 15) asserting that neither they nor any other attorney in O’s firm spoke with M. Anything M has to say about E and B’s intention in setting up the Trust is plainly hearsay.

[66] Finally, K and L also set out various details surrounding M's departure from the firm. It is not necessary to go into the details, but without any sworn version of events from M, the matters raised by K and L are sufficient to give me concern about the reliability of M's account as disclosed in his deposition.

Affidavits in Support of and the Granting of Mareva Injunction

[67] The Plaintiff filed an ex parte application for a Mareva Injunction on 28 June 2001. Affidavits of F dated 28 June 2001 and N were filed in support of the application. The significant affidavit for present purposes is that of F.

[68] I am prepared to look at these affidavits and take them into account for the purposes of this decision. They were sworn and filed well over a year ago. Where the First Defendants have not contested any matter to which F deposes, I have taken it to be reliable evidence of the particular fact for the purpose of deciding this interlocutory application.

[69] However, the fact that a Mareva Injunction was granted has little or no bearing on the merits of the present application. This is for the obvious reason that the application was, as usual, made and granted on an ex parte basis. This Court now has before it considerable additional material, being in large part the affidavits filed on behalf of the First Defendants. This material was not before Greig CJ. In addition, factors such as those that go to the balance of convenience and to a lesser extent some factors that go to the overall justice of the case when dealing with an application for a Mareva Injunction are not matters that I need to weigh in order to reach a conclusion about the present application.

Whether the Defendants' Claim of Litigation Privilege Corroborates the Allegation of Fraudulent Knowledge

[70] For the Plaintiff, Mr Fardell submitted:

“...the nature of the privilege claimed is in itself corroborative of the defendants' knowledge of their action. In the main the documents claim a privilege marked “C”. Class “C” falls within the litigation privilege claim as defined on page 23 of the list of documents. Accordingly E and B are asserting that they were contemplating this litigation at the time of setting up the Trust (refer doc 289-291 being dated 22 May 2000). In other words the defendants contemplated being sued for fraudulent conveyances seven months [sic] before the plaintiffs were ever aware of a cause of action.”

[71] The document to which the Plaintiff refers is listed as “O Notes re: birthdates and family Trusts 22 May 2000”. The First Defendants and the second-named Second

Defendant, D, claim three separate heads of privilege in respect of documents contained in their list of documents. The categories of privilege are described as follows:

“1. Legal Professional Privilege

a) The documents marked “A” consist of:

- (i) communications or records of communications between the 1st defendants and the 2nd named 2nd defendant and their legal advisers to provide instructions to, and receive instructions from, their legal advisers; and
- (ii) communications or records of communications between legal advisers relating to the provision of legal advice.

2. Litigation Privilege

The documents classified under “litigation privilege” were made after this proceeding was in contemplation and for the purpose of enabling the legal advisers to advise the 1st defendants and 2nd named 2nd defendant and conduct their defence.

a) The documents marked “B” consist of:

- (i) communications or records of communications between the 1st defendants, 2nd named 2nd defendant and their various legal advisers; or
- (ii) communications or records of communications between agents for the 1st defendants or 2nd named 2nd defendant and the 1st defendants’ and 2nd named 2nd defendant’s legal advisers.

b) The documents marked “C” consist of the 1st defendants’ and 2nd named 2nd defendant’s legal advisers’ briefs, file notes and internal memoranda.”

[72] The First Defendants’ categorisation of heads of privilege in general and the categorisation of the specific document referred to by the Plaintiff are somewhat odd. In relation to the specific document mentioned, neither the date nor the description of the document appears to support any claim for privilege on the basis that it was “made after this proceeding was in contemplation and for the purpose of enabling the legal advisers to advise the First Defendants and second named 2nd Defendant and conduct their defence”. Further, from my perusal of the First Defendants’ list of privileged documents, it appears that privilege has been claimed for the same reasons (for the purpose of defence to proceedings in contemplation) for a number of documents the descriptions of which appear to be nothing to do with the proceedings but rather to do with the establishment and funding of the Trust. For example, there are numerous entries where the category “C” privilege is claimed for documents described as “O Notes re: Trust” or “O Notes re: Transfers to Trust” or, in the extreme, “O Notes re: Art Appraisal”. There are numerous other examples. It is hard to see

how an art appraisal can be a document made in contemplation of the present proceedings and for the purpose of conducting the Defendants' defence.

[73] The confusion probably lies in the First Defendants' categorisation of privilege. The point is that all of the different types of documents referred to in the First Defendants' categorisation in fact come under the heading "Legal Professional Privilege". In New Zealand and Cook Islands law, "litigation privilege" is a useful (at times) subheading of legal professional privilege that is properly used to refer to privilege claimed in relation to communications between a client and/or the client's legal advisers and **third parties**. Such communications will be privileged if they are made for the dominant purpose of pending or contemplated litigation.

[74] In contrast, communications between a client and his or her legal advisers are always privileged (subject to the exception discussed in this judgment), regardless of whether any litigation is pending or in contemplation so long as the client intended the communication to be a confidential one and for the purpose of obtaining legal advice. If in fact litigation happens to be anticipated at the time the communication between a client and legal adviser is made, that simply goes to the question of whether the communication was intended to be confidential. So long as it was so intended, the communication is privileged (again subject to the exception discussed herein). Lord Denning put it succinctly in *Buttes Gas and Oil Co v Hammer (No. 3)* [1980] 3 All ER 475 at 484:

"The first [category of privilege] is legal professional privilege properly so called. It extends to all communications between the client and his legal adviser for the purpose of obtaining advice. It exists whether litigation is anticipated or not."

See also *Cross on Evidence* (5th NZ Ed, 1996) at 10.20.

[75] Accordingly there is no need for the First Defendants to divide client/legal adviser communications into those relating to instructions to and advice from their legal advisers (categorisation "A") and those where the client/legal adviser communications occurred and were recorded once litigation was contemplated and for the purpose of defending that litigation (categorisations "B" and "C"). However, what is important in this context is not the niceties of delineation between different heads of privilege. What is relevant is the scope of the fraud exception to all documents that come under the heading of legal professional privilege. It is to be noted, however, that in relation to the particular document identified by the Plaintiff, it is not appropriate to take much from it at this point. The explanation for the

privilege classification for the document may lie in confusion relating to categories of privilege or differences in the law of privilege between the United States and the Cook Islands. As will be seen, nothing turns on the significance of this particular point in any event.

[76] What is important is the line to be drawn between documents subject to legal professional privilege that are in furtherance of a dishonest purpose as opposed to communications for the purpose of a defence after the alleged fraudulent or dishonest purpose has been attempted or achieved. This distinction does have an effect on the outcome of this application.

[77] Finally, I do not overlook that Vinelott J referred to “legal advice obtained and documents coming into existence for the dominant purpose of being used in pending or contemplated proceedings” as falling under a “different head of privilege” in *Derby & Co Ltd v Weldon (No. 7)* [1990] 3 All ER 161 at 178. With respect, in the context of *Derby & Co Ltd v Weldon* the Judge was referring to the limits of the exception to the privilege rather than attempting to delineate between particular heads of privilege within legal professional privilege. In my view, the better formulation of the limits of the exception is that espoused by Stephen J in *R v Cox and Railton* (1884) 14 QBD 153 set out in paragraph 27 above.

A Chronology Derived from the Affidavit Evidence

[78] I am left with the matters deposed to in the affidavits of F Jr dated 28 June 2001 (filed in support of the Plaintiff’s application for a Mareva Injunction) and the affidavits filed for the First Defendants in opposition to the present application from B and O. The other affidavits filed for the First Defendants dealt with matters to which I have already referred.

[79] From these affidavits one may establish a chronology of what I consider (at this interim stage and for the purposes of this decision) to be the important events, none of which can be seriously disputed.

April 1995 – Sept 1999 E and B’s company, P Inc., opened four stores” [E affidavit, paragraph 2].

24 March 1988 The Plaintiff made a line of credit available to P in total and not to exceed US\$17 million. [F affidavit, paragraph 5].

31 May 1999	The line of credit matured but was renewed pursuant to the terms of a promissory note dated 31 May 1999 executed by P to the order of the Plaintiff [affidavit, paragraph 5].
31 May 1999	E and B guaranteed payment to the Plaintiff of all indebtedness under the promissory note absolutely and unconditionally. [F affidavit, paragraph 6].
31 May 2000	The promissory note matured. As a result, all indebtedness to the Bank under the promissory note and the guarantee signed by E and B became immediately due and payable by P and E and B. The amount owing to the Bank under the promissory note at this point was approximately US\$16.2 million [F affidavit, paragraph 7; O affidavit, paragraph 10].
5 June 2000	The Plaintiff demanded payment from P and E and B of the money owed under the promissory note before 5pm on 12 June 2000. The demand was not met [F affidavit, paragraph 8].
Circa April to June 2000	In the (Northern Hemisphere) late spring/early summer of 2000 E and B decided to sell the stores and instructed O to assist [O affidavit, paragraph 4].
Circa June 2000	Efforts to sell the stores commenced. The initial asking price was US\$15 million [E affidavit, paragraph 6].
June 2000 – circa Dec 2000	Efforts to sell the stores continued. Initial interest was shown by retail chain stores Q and R. Negotiations began with R [E affidavit, paragraphs 7 and 8; O affidavit, paragraphs 5 to 7].
23 June 2000	E and B were served with a notice of claim and demand for arbitration notifying them that the Plaintiff claimed that E and B were indebted to the Bank and demanded arbitration of E and B's liability to the Bank under the guarantee. [F affidavit, paragraph 9].

12 July 2000	A notice was issued by S (the arbitration forum agreed by the parties under the guarantee) officially notifying the parties that arbitration proceedings had been initiated [F affidavit, paragraph 12].
12 July 2000	E and B formed the Trust [F affidavit, paragraph 13; E affidavit, paragraph 10].
18 July 2000	The Bank served its Complaint in the arbitration proceedings [F affidavit, paragraph 19].
26 July 2000	E and B served their Answer to the Bank's Complaint [F affidavit, paragraph 20].
1 August – circa Oct 2000	E and B transferred assets to the Trust for minimal consideration. The transferred assets include E and B's residence in Maryland, a second property in Georgia, the furnishings and artwork contained in the Maryland residence and cash, shares and interests in partnerships worth over US\$16 million. Mr F's affidavit states at paragraph 43 that the last transfer occurred on 28 November 2000. However the transfers detailed at paragraphs 23 to 34 of his affidavit indicate that the final transfer took place in October 2000. However, little if anything turns on the particular date of the final transfer. All the particular assets mentioned above appear, on the evidence before me, to have been transferred prior to the end of October 2000 [F affidavit, paragraphs 21 to 36].
7 August 2000	A PricewaterhouseCoopers valuation report on P was issued (although the copy annexed to O's affidavit is stamped "Draft"). The report valued P at US\$12.7 million [O affidavit, paragraph 6 and exhibit 2]. (Whether this was fair market value at the time will no doubt be a contested issue at trial.)

31 October 2000	E and B consented to two arbitration awards against them in favour of the Bank totalling over US\$17 million [F affidavit, paragraph 38].
28 December 2000	The Circuit Court entered judgment against E and B for an amount over US\$17 million including interest and costs [F affidavit, paragraph 39].
End of 2000	R indicated that it was not in a position to proceed with the purchase of the stores [O affidavit, paragraph 7].
Late December 2000	Approximately US\$14 million in cash and US\$729,000 in stocks and other investments were transferred by the Trust to a Swiss bank, U [F affidavit, paragraph 47]. There was no explanation in the First Defendants' affidavits as to the purpose of this transfer.
Circa 2001	P filed for bankruptcy protection [O affidavit, paragraph 9].
January 2001	The Plaintiff Bank learned of the existence of the Trust [F affidavit, paragraph 46].
Circa March-May 2001	In (Northern Hemisphere) Spring 2001, R filed for bankruptcy protection [O affidavit, paragraph 7].

[80] I also note the following matters. Firstly, E and B and their children have continued to live in the residence in Maryland and enjoy the furnishings and artwork without (on the evidence before me) payment of any rent for these items to the Trust.

[81] Secondly, it appears from F's affidavit that most of E and B's assets that remain in the United States (apart from their shares in P) cannot be reached by creditors. These assets comprise interests in partnerships controlled by E's father, D, who is named as one of the Second Defendants in this proceeding (as trustee of the Trust). In F's assessment, these partnerships are unlikely to distribute any proceeds to E until she has resolved her dispute with the Plaintiff. Whether or not this is so, there is no evidence before me to suggest that E has made any efforts to release any value in any of her assets remaining in the United States to facilitate payment of the First Defendants' debt to the Bank.

[82] Thirdly, the Bank has recovered approximately US\$3.4 million from the sale of P's assets, the stores' stock and fixtures.

[83] Fourthly, O points out in his affidavit (paragraph 8) that in connection with the Plaintiff's loan to P, the Bank had a lien against all of P's assets. Accordingly, after the loan became due on 1 June 2000, the stores were operating at the Bank's sufferance because it could have closed down the operations at any time by executing the lien.

[84] Finally, B has provided the following explanation for the creation of the Trust and the transfers of assets to it at paragraph 11 of his affidavit:

“The Trust was established and funded upon the advice of O and another principal in his firm, V, who concentrates in the field of estates and trusts. As part of our estate planning, we decided to preserve the value of assets by placing them in the Trust for the benefit of our children. By having a trustee with responsibility for administering and safeguarding the assets, they would be protected from potentially ill-advised business ventures or expenditures of other kinds which we and, eventually, our children might otherwise undertake. The assets also would be protected from future creditors of ours and/or our children. As described in paragraph 10 of this Affidavit, we felt confident that we could satisfy our then creditors from assets not placed in the Trust, such as P, and the Partnerships.”

Decision

[85] The Plaintiff contends in essence that the timing of the establishment of the Trust and the transfers to it, occurring immediately after demand for payment by the Bank and commencement of arbitration proceedings to recover the debt, gives rise to a strong inference that actions were undertaken to defraud E and B's creditors. The First Defendants, on the other hand, say that the Trust was established and funded for the legitimate purpose of future asset protection for themselves and their children. They say that they believed that the assets they had left after funding the Trust would be sufficient to satisfy their outstanding creditors. In my view the Plaintiff has satisfied the strong prima facie test by reference to the establishment of the Trust in the shadow of an impending arbitration and judgment (eventually by consent) for a very substantial sum. Although E and B profess legitimate reasons for the establishment of the Trust, a careful reading of B's explanation reveals no persuasive reason for its timing or the rapid transfer of assets to it thereafter. If, in fact, E and B were establishing a trust for legitimate reasons, it is perhaps odd that they had not done so before. They are clearly wealthy and sophisticated business people who had been taking business risks involving substantial borrowings since the establishment of the first store in

1995. Full evidence at trial may lead to the prima facie case falling away and the Plaintiff failing to satisfy the beyond reasonable doubt test contained in section 13B but as matters stand a strong prima facie case has been established, especially since the requirement under section 13B(1) is to demonstrate that the “principal intent”, not the sole intent, was to defraud.

[86] To the extent that E and B claim to have left sufficient assets in the United States to satisfy the Bank, this of course was dependent largely on the successful sale of the stores at a good price. This was by no mean guaranteed at the time the Trust was set up on 12 July 2000. It was early days in the sale process. Obviously adverse events might take place – and indeed they did. As at 12 July 2000 there was no agreement for sale and purchase or even a heads of agreement. The asking price of US\$15 million had been set by E and B and O. The PricewaterhouseCoopers valuation did not arrive until 7 August 2000, by which time transfers to the Trust had already begun.

[87] All this is not to say that the Plaintiff will succeed at a full hearing on the matter. This decision is made on the basis of the strong prima facie threshold, which is to be contrasted with the much higher threshold that the Plaintiff will have to reach at trial (beyond reasonable doubt) due to the terms of section 13B(1) of the International Trusts Act. There will be further evidence and cross-examination if the matter proceeds to a full hearing. Accordingly this decision in no way prejudices the ultimate issue or outcome. As was said in *Matua Finance Ltd v Equiticorp Industries Group Ltd* [1993] 3 NZLR 650 at 654:

“The Judge is of course not called upon to express any concluded opinion as to whether or not there has been fraud. He or she is deciding only that there is or is not a sufficient indication of fraud as alleged to justify overriding the privilege in the paramount interests of justice and truth, so allowing a full examination of the allegation at the trial on all the relevant evidence. Judges are well accustomed to giving rulings as to the existence or otherwise of a prima facie case, without in any way compromising their ultimate findings. They are also well accustomed to excluding from their minds in deciding an issue or directing a jury upon it evidence which they have seen or hears (as on a voir dire hearing) but have ruled inadmissible (compare *Hardy v Booth* [1992] 1 NZLR 356).”

Documents which May Fall Outside the Exception

[88] I do have a concern about the line to be drawn between documents created that may record or may be communications in furtherance of a fraudulent purpose and those created for the legitimate purpose of advising on and preparing for the defence to the allegations in the statement of claim.

[89] In my view there is a distinction to be drawn between documents which are or record communications for the purpose of establishing and funding the Trust and the intentions behind doing so on the one hand and those documents that are or record communications for the legitimate purpose of defending proceedings against E and B or the Trust and trustees. By “defending the proceedings” I do not include evidence of arrangements made as part of the litigation strategy to evade enforcement of any judgment (be it the arbitration judgment or any possible judgment against the Defendants in this proceeding). Otherwise, fraudulent arrangements could be made to frustrate the enforcement of any judgment while proceedings were on foot and those discussions would be protected by the inviolable privilege that protects client/solicitor communications (and communications with third parties in some circumstances) for the purpose of defending civil or criminal litigation.

[90] In this case, I stress that any communications relating to the establishment and funding of the Trust, the intention behind doing so and the subsequent movement of funds in and out of the Trust are, prima facie, communications in furtherance of a fraudulent purpose. Such communications, where recorded in documents sought by the Plaintiff in the highlighted segments of the Defendants’ list of documents (attached to the Plaintiff’s application), must be disclosed.

[91] If, however, any of those documents contain in whole or in part records of communications that have the legitimate purpose of defending subsequent allegations of fraud levelled after the commission of the alleged fraudulent acts – i.e. after the establishment of the Trust, the transfers to it and the movement of funds in and out of the Trust – then those communications retain privilege and are not to be disclosed.

[92] It is difficult to be exact about which of the documents that the Plaintiff seeks fall in which category on the limited information contained in the Defendants’ list of documents. This is particularly so because many of the documents listed do not include a date. From the limited information that I have to go on in the list of documents, it appears to me that all the documents sought by the Plaintiff should be disclosed. However, I will reserve leave for any of the Defendants to apply to exclude any specific document or class of documents which they consider to fall outside the scope of the type of documents that I have ordered to be disclosed. On any such application I will most likely inspect any such document or class of documents and make a specific ruling in relation to them in line with the principles that I have outlined in this judgment.

Result

[93] The First Defendants are to disclose to the Plaintiff all of the documents highlighted on the list of documents annexed to the Plaintiff's present application within two weeks of the date of this interlocutory judgment. Disclosure is subject only to leave for the Defendants to apply to this Court within that same two weeks for a determination in relation to any specific document that would otherwise be required to be disclosed as to whether the document may be in furtherance of a fraudulent purpose or for the legitimate purpose of advising on and preparing for the defence to the allegations in this proceeding.

Costs

[94] Counsel are to submit memoranda on costs within 21 days.

Addendum: Publication and Reporting of Proceedings and this Judgment – Section 23, International Trusts Act 1984

[95] This judgment is now delivered to the parties for their own private information. The parties should not publish this decision lest they commit a breach of section 23(2). The Court has an obligation under section 23(3) to publish or report this judgment for the purposes of affording a record of these proceedings. However, editing must first be undertaken and no decision may be reported or published until the Court has ascertained the views of the parties as to the adequacy of the editing. Thereafter, the Court must certify to the Registrar that the decision as edited may be released for publication or reporting. An edited version of this judgment will be supplied shortly. If any parties have any views as to the nature of the editing please provide such comments in writing within 14 days of receipt of the edited version. If a party has no comments or suggestions, would that party please send a letter indicating its assent to the proposed editing.

David Williams J