

**IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY**

**I TE KŌTI MATUA O AOTEAROA
TĀMAKI MAKĀURAU ROHE**

**CIV-2015-404-1274
[2019] NZHC 907**

BETWEEN TRENDS PUBLISHING
INTERNATIONAL LIMITED
Counterclaim Plaintiff

AND CALLAGHAN INNOVATION
Counterclaim Defendant

Hearing: 31 July 2018 – 3 August 2018, 6-10 August 2018, 13-17 August
2018, 23-24 August 2018

Appearances: M A Corlett QC and H Lawson for the Counterclaim Plaintiff
D H McLellan QC, S M Collier and T J Burgess for the
Counterclaim Defendant

Judgment: 30 April 2019

JUDGMENT OF POWELL J

This judgment was delivered by me on 30 April 2019 at 3.30 pm pursuant to
R 11.5 of the High Court Rules

Registrar/Deputy Registrar
Date:

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Introduction

[1] The counterclaim plaintiff, Trends Publishing International Limited (“Trends”), seeks damages in the sum of \$61 million from Callaghan Innovation (“Callaghan”). The damages are for alleged breaches of contract and statutory duties arising out of a Funding Agreement for a Growth Grant entered into by Trends and Callaghan on 2 April 2014 (“the Funding Agreement”).

[2] The Funding Agreement, which was backdated to 1 January 2014, entitled Trends to seek reimbursement from Callaghan for 20 per cent of “eligible research and development expenditure” (“Eligible R&D Expenditure”) over a three-year period, with an option to extend the Funding Agreement for a further two years.

[3] Claims for reimbursement made by Trends for the periods 1 January 2014 – 31 March 2014 (“the Q1 claim”) and 1 April 2014 – 30 June 2014 (“the Q2 claim”) were reimbursed by Callaghan in accordance with the terms of the Funding Agreement. When Trends sought reimbursement for the period 1 July 2014 – 30 September 2014 (“the Q3 claim”) Callaghan sought further information from Trends with regard to the amounts claimed. Following the provision of further information from Trends, Callaghan appointed Deloitte New Zealand Ltd (“Deloitte”) to undertake an investigation of Trends’ compliance with the Funding Agreement.

[4] Deloitte commenced the investigation on 6 November 2014. Following initial investigations which included meeting with Trends and reporting back to Callaghan, Deloitte prepared a draft report in December 2014 (“the Deloitte Draft Report”) which advised Callaghan “Trends may have intentionally set out to mislead Callaghan to obtain funds to keep its business afloat financially whilst transforming from a paper based to an online business operation”. The Deloitte Draft Report went on to identify a number of concerns including:

- (a) the labour costs claimed as a result of the number of Trends’ employees working on research and development activity;

- (b) other expenses claimed in relation to research and development activity; and
- (c) the quality of Trends' accounting records and financial management practices.

[5] Following receipt of the Deloitte Draft Report, Callaghan referred the concerns raised to the Serious Fraud Office which later, in December 2014, confirmed it had begun a formal investigation of Trends.

[6] Callaghan met with Trends on 17 December 2014 and by letter of the same date ("the Suspension Letter") gave notice of immediate suspension of the Funding Agreement. The Suspension Letter noted that Callaghan had received a copy of the Deloitte Draft Report and considered that Trends had:

- (a) in breach of cl 10.4(a) used some or all of the research and development funding provided under the Funding Agreement other than as set out in the agreement; and
- (b) in breach of cl 10.4(c) claimed funding that it was not entitled to claim, including by claiming for expenditure that was not Eligible R&D Expenditure in breach of cl 10.4(c).

[7] In addition, Callaghan advised that it considered Trends had breached its obligation to keep appropriate accounting and other records of its Eligible R&D Expenditure and its use of the funding pursuant to cl 5.1 of the Funding Agreement. Callaghan also advised that Trends had failed to provide all information that Deloitte required in the course of the investigation.

[8] At the same time as the Suspension Letter notified Trends it was suspending the Funding Agreement, Callaghan provided Trends with a copy of the executive summary of the Deloitte Draft Report. Callaghan also gave Trends a copy of a draft press release ("the Suspension Press Release") which it proceeded to issue later the same day. In addition to announcing the suspension of the Funding Agreement, the

press release also specifically stated “[t]he matter has also been referred to the Serious Fraud Office”.

[9] Trends provided an initial response to Callaghan and Deloitte in January 2015, followed by further responses in February and March 2015 after Callaghan had provided a redacted version of the Deloitte Draft Report to Trends. Despite these responses, Deloitte raised further concerns which were discussed at a meeting between Deloitte and Trends on 11 March 2015. Following this meeting, Deloitte proceeded to finalise its report to Callaghan in April 2015 (“the Deloitte Final Report”).

[10] Following receipt of the Deloitte Final Report, Callaghan met again with Trends on 21 April 2015. At the meeting, a letter of the same date was given to Trends advising that the Funding Agreement had been terminated for breach of contract (“the Termination Letter”). The grounds for termination cited by Callaghan, based on the conclusions contained in the Deloitte Final Report, were that Trends was in:

- (a) Breach of cl 5.1 of the Funding Agreement “on the basis that Trends has not kept appropriate accounting and other records of its Eligible R&D Expenditure and in its use of the Funding, nor managed its records in accordance with recognised research in accounting best practice standards, so as to enable Callaghan Innovation to carry out an audit to determine whether Trends is complying or has complied with the [Funding] Agreement”.
- (b) Breach of cl 10.4(b) of Funding Agreement “on the basis that Trends has provided Callaghan Innovation with misleading or inaccurate information”; and
- (c) Breach of cl 10.4 (c) of the Funding Agreement “on the basis that Trends has claimed for funding that it is not entitled to claim under the Funding Agreement, including claiming for expenditure that is not Eligible R&D Expenditure as described in clauses 3.1 and 3.2, by reference to NZ IAS 38 and NZ FRS 13”.

[11] At the same meeting Trends was provided a copy of a draft press release (“the Termination Press Release”) which Callaghan subsequently issued, publicly confirming the termination of the Funding Agreement.

[12] Trends contends the investigation carried out by Deloitte failed to comply with the Funding Agreement and disputes that Callaghan was entitled to either suspend or terminate the Funding Agreement. In addition, Trends argues that Callaghan further breached the contract by issuing both the suspension and termination press releases alleging that the release of that information was in breach of the terms of the Funding Agreement.

[13] Trends maintains that at all times it complied with its obligations under the Funding Agreement and contends that, as a result of Callaghan’s breaches, it lost a chance to commercialise the development work it was undertaking and, in particular following the issue of the suspension press release, lost the opportunity to attract third party investors. Trends argues that this had a catastrophic effect on Trends’ business, both in terms of its existing business model and its ability to utilise the digital platform it had been developing.

[14] The present trial was originally intended to cover all aspects of Trends’ claim against Callaghan. However, in the course of the hearing it was necessary to split Trends’ claims between liability and quantum. As a result, this judgment deals with the question of liability only and, in particular, the following issues:

Issue One - Did the Funding Agreement include an implied term and/or specific statutory obligations in addition to its written terms?

Issue Two - Did Callaghan breach the Funding Agreement by withholding payment of Trends’ Q3 claim?

Issue Three – Was the Deloitte investigation an audit or a review in terms of the Funding Agreement?

Issue Four - Did Callaghan comply with the procedural requirements of the Funding Agreement as the Deloitte investigation began?

Issue Five - Was Callaghan entitled to suspend the Funding Agreement on 17 December 2014?

Issue Six - Did Callaghan breach the Funding Agreement by issuing the Suspension Press Release?

Issue Seven - Did Callaghan comply with the procedural requirements of the Funding Agreement in providing an opportunity for Trends to respond?

Issue Eight - Did Callaghan have grounds to terminate the Funding Agreement on 21 April 2015?

Issue Nine - Did Callaghan breach the Funding Agreement by issuing the Termination Press Release?

Background to the Funding Agreement

[15] Trends is a marketing and publishing company first founded in 1982. Under the direction of its sole director, David Johnson, Trends was able to expand globally throughout the late 1990s and, by 2007, was conducting its business in the United States of America, Australia, Singapore, Malaysia, Hong Kong, Indonesia, Dubai, China, India, Canada and New Zealand.

[16] Trends developed a particular niche in the home interest market with publications that combined home design ideas with extensive supplier advertising. There is no dispute that Trends developed a reputation for innovation and, in particular, with the way it was able to template its publications in a manner that significantly reduced its production cost relative to its competitors. Such innovations were recognised when Mr Johnson won the Ernst & Young New Zealand Entrepreneur of the Year Award in 1998.

[17] Although Trends established its first website relatively early, in 1998, like other print media companies Trends experienced declining advertising revenue and the global financial crises of 2008/2009 also had an effect on Trends' business. As a result, Trends sought to further develop its digital business in order to "create revenue in new ways". Much of the responsibility for this new direction fell to David Johnson's son, Andrew Johnson. By 2012, Andrew Johnson was looking to "create an online environment that was the blending of a mini search engine combined with the socialisation of the content in order to connect people".

[18] To assist in achieving its goals, Trends sought support from the Ministry of Science and Innovation ("MSI"). It applied for a Project Grant from MSI and in the application set out what it was trying to do in the following terms:

Our Audience, Our Brand

Trends has spent nearly 30 years creating an internationally recognised media brand in the home and commercial building industry. It presents its audience with quality products, beautiful content, and factually useful information.

Since 1999 Trends has published all of its content online for users to browse. This has created both a media website and the in-house services to produce the various content - ie photography, video, animation, etc.

The Trends series of publications connects people in an engaged and enduring way in many countries around the world. As a result Trends already has a massive real world community following that far outweighs the size of the current online audience. We now want to enable these people to meet and interact more effectively on our online platform.

Our Opportunity

We can create an online environment where our audience are able to connect and exchange information and services in a brand new way. By studying and understanding the successful formulas of other online content communities such as Google, YouTube, iStock, Facebook, Trends can enable its online community to be better communicators, using our world class content to express themselves. They will also be able to plan design projects, and to share their own ideas or content in a forum associated with the Trends brand. The platform will explore the use of search results, social search and engagement techniques to provide market trends and metric data direct from our clients' perspective target audience. 'Suggestion engines' helping to run the content display will use inspiration as a sales and marketing technique by displaying information proactively to the user. This means listening and watching user behaviour to predict the kind of styles, products or services they may be looking for but don't know are out there. Additional subject matters such as travel, health, food and property will be introduced to this highly sought after demographic.

We can also provide our platform as 'software as a service' to our clients and partners to support their own communications.

Our Point of Difference

Trends has strong and direct relationships with our clients and the products and services that they represent. Only about 2% of our contact with clients is through advertising agencies, as the majority of our national and international relationships are with the CEO's of businesses.

Trends provides many additional business communication solutions outside of advertising requirements. Other media companies are becoming stronger in multimedia and multi platform, but they are still struggling to understand how to [maximise] the digital world successfully as they continue to look at a 'controlled access to content' model for revenue.

At the same time the majority of web users are still leaning towards 'free content for all'. So there is a limited number who will pay for access which ultimately leads to a reduction in platform and channel market share.

Our Solution

Trends will offer registered users free access to all our content, and will create revenue incomes by monetising the resulting actions taken by our audience when they are presented with beautiful images, words and videos full of great ideas, products and services.

Our web platform clients will invest in the successful outcomes by paying for the leads generated when users engages with them and request to learn more, enquire, visit or purchase. This is combined with the unique ability to offer selected product and services clients free print advertising and web space to give exposure and generate enquiries.

Trends also provides all the content creation services clients need to have their stories well-told and discussed or used by members of the online community. This means that the sales and marketing 'advertising' content of the web platform is seen as integrated and informative content, and not just banner advertising. The platform is designed to be accessed on devices such as desktop computers, laptops, touch devices, tablets, smart phones and smart TV's.

Our Facts

The new structure will replace the current website which contains 10,000 stories and over 40,000 images, hundreds of videos and other media promotions and competitions. It is currently number 3 in NZ for \$100k + incomes and is the number 1 home interest website in NZ. It's one of 5 main magazines in India with a magazine and website combined offering for the market.

[19] The application was successful and in July 2012 Trends received a Project Grant of \$347,506 ("the Project Grant").

[20] Technical support for the project was provided by Jason Liddiard and his company AnotherInnovation. After Andrew Johnson provided a brief to Mr Liddiard, Mr Liddiard confirmed his instructions in a briefing document entitled Project RedBull dated 2 February 2013. Mr Liddiard saw the Trends project in the following terms:

2.1 Background

With the current world-wide “trend” of an ever increasing digitally demanding audience, every traditional publishing company around world is facing the challenge of monetizing their content online and becoming “digital”.

With lower profit margins than print and easy access for new competitors to enter the market, speed of execution is essential. [Trends] is embarking on a journey to enhance their current digital offering through the rapid application development of a new digital web-based content delivery platform.

This platform will enable the business to become more “nimble” and “digitally savvy” and quickly respond to market demands for solving consumer’s problems. i.e.: “Where can I learn about different kitchen bench tops?” This will allow [Trends] to solve these problems by creating profitable information products and services.

Such a platform will become a key enabler for the next level of two-way engagement that [Trends] can monetize in the effort to create new revenue streams for the business to rebuild the declining profit margins in from printed media advertorials and subscriptions.

A careful thought-out strategy is required for [Trends] deeper transition into the online space to ensure profitable digital products are created that allow the continued funding for the expected on-going development of the web platform solution.

These products will use as much leverage as possible in terms of existing digital assets such as articles, videos, images and advertorials. Leveraging also the non-tangible assets such as client relationships, brand awareness, good will, existing traffic sources and joint venture opportunities.

2.2 Description

Project RedBull forms part of the wider digital strategic plan to implement modular components of the [Trends] web platform in a sustainable approach that ensures that each project within the Energise Program sees deliverables that can realise measurable revenue benefits immediately.

RedBull seeks approval to do this through the development and implementation of a global online vertical marketing platform. These are sophisticated localised search engines on a web platform that creates multiple directory websites focussed on highly focussed super niches. Kitchen Design, Bathroom Design, Interior Design, Landscape Design and Commercial Design could all be super niche vertical markets in which the platform can create to enable micro-targeted advertising revenue streams.

[21] Specifically, Mr Liddiard identified the objectives and deliverables of Project RedBull in the following terms:

2.4 Objectives

The Project shall:

Key Objective # 1

- Complete development of the platform within 12 weeks beginning on Monday 28th January 2013 till Friday 19th April 2013.

Key Objective #2

- Facilitate change management to implement the new business processes required to support the new revenue streams.

Key Objective # 3

- Launch multiple new verticals populated by the platforms global database under [TRENDS] 's choice of niche branded domain names.

2.5 Deliverables

RedBull will deliver the following

Vertical Marketing Platforms host clients that pay to promote their businesses products and services on. Some of the key features for the platform are listed below.

- Cloud-based Software-as-a-Service marketing platform
- Highly available and scalable platform infrastructure
- Content Delivery Network for efficient serving of media files
- Multiple domain sites populated from data-driven dynamic
- Fully automated and self-service registration
- Shopping cart for advertising packages and additional offers (up-sells)
- E-commerce enabled for credit card payments (one-off and recurring)
- Purchase Order e-commerce for invoicing large purchases (agency model)
- A Pay-per-Lead "Multi-Quote" system where suppliers pay for leads
- Modern HTML5 & CSS3 responsive layout design
- Web font face for headings, tags, credits and links
- Modern look and feel, clean, clear and simple web publishing

- Social two-way engagement through comments and sharing
- Search engine and visitor data analytics

[22] In an undated report at the conclusion of the Project Grant in July 2013, Andrew Johnson confirmed what had been achieved up to that point:

OVERVIEW:

The Trends Media Group is proud to announce the launch of our new digital platform project, stage one - The Trends Ideas Space: Search Engine.

Our new digital platform aims to change the ways we communicate about our homes.

The platform is a technology foundation that allows us to deploy diverse applications or functionality across the Internet. At its heart are the algorithms that drive heart of social technologies. And it allows us to provide users with information that they seek, or to inspire them with ideas they didn't even know about.

Our first application is a search engine of images, articles and videos that allows consumers, specifiers, and product and service suppliers to communicate with each other. By building company profiles and connecting with other people through content, the search engine provides a new meeting space for the industry.

We believe that our new platform really is the future of 'where ideas take shape'.

TECHNOLOGY OUTCOMES:

The main technology outcomes are centered around searching, saving and sharing content and the functionality to allow consumers to connect with each other and the industry. The project has also seen the development of sophisticated systems for content management loading and collating, together with user registration and social sign up. The technology is also designed to observe and learn by watching user behavior and activity, in order to create suggestion and prediction engines that will inspire the need for a product or service.

Some of the key technology areas include:

- Image Process and Gallery Display
- Video engine and Distribution Content ID Software
- Social Media Integration
- Front end Usability
- Free Access Library Online shop
- CRM
- User Personal Profile Builder Subscription
- Digital Website Subscription
- Automated Personalization engine
- Professional Directory
- Drag N Drop uploading for Client Profiles
- Multiple Photo Title & Description
- Editing Photo titles and description
- Email Login
- Tooltips for icons on the Photo and Article view
- Selection of Cover Image for Collected objects
- Attaching Partners to Master profile
- Click - through to Profile from Photo and Article view
- New Look Dashboard for Client Profiles

New Contact Us: 2-step direct enquiry process
New category menu slider for the side bar navigation
Performance enhancements with client browser caching
Stability enhancements for PC IE 9+ and Mac Safari
Video and eBook uploading
Search ranking ration controls for profiles and content
Search engine optimization of search results
New direct enquiry email template

COMMERCIAL SUCCESS

The web platform has already experienced a great commercial success. We have secured 35 major brands in New Zealand to be part of our launch phase, with an initial investment of \$20k each. They bring with them a network of 900 business partners/outlets to fill the platform with places and people that users can contact/visit to find products or services. This has been achieved in less than 6 weeks from a standing start. We have secured an extended spend from these clients within the additional business units of the media group (such as advertising and digital services). We have also extended the platform to Australia, with the same launch process having started 2 weeks ago.

The Trends Platform has been designed to work across many global territories, as well as creating the opportunity for additional industries to use the software with or without the Trends brand. The current Trends territories are being rolled out on an individual basis, with a number of distinct regional business factors shaping the pathway to market for the platform. In some cases this will be done with existing Trends Media Partners. Additional industries outside residential and commercial building have been identified and prepped to understand the benefits of the platform. After completing the initial launch phase in New Zealand, Australia, and North America (July 2013 - Sept 2013) some of these additional industries will partner to create new Trends Topics.

R & D - IMPACT AND ONGOING IMPLICATIONS

The platform has started a shift within the company. It is creating a 'vortex' effect as we redeploy staff and focus resources to look towards the platform as a central point for the company.

This has seen significant change in roles and responsibilities, plus the addition of new staff with skill sets and activities that are brand new to the company. The connections with key industry players have also effected the perception of Trends within both the home building industry and the media communications world. The platform will continue to have significant R&D requirements, as it becomes a living and breathing entity that requires constant feeding and development. It has gone from a project on the side and in secret to become the center and very public focus for the Trends brand. This is illustrated by the fact we have taken the message onto mainstream TV to showcase the project and build an awareness of the new platform.

MINISTRY OF SCIENCE AND INNOVATION - THE EXPERIENCE

Working with the Ministry of Science and Innovation has been an interesting and successful process in terms of helping our company move forward with this project.

The relationship management teams are very good in assisting us to process the required information into the system. And in our case, there have been various helpful connections made with other organizations as well.

Being able to refer to the Ministry's association by way of founding with the Ideas and Concepts behind the new Web Platform has provided added credibility to the project.

We are looking forward to a continued relationship moving forward.

[23] Following the successful completion of the Project Grant, Trends investigated obtaining a further tranche of similar funding. In the meantime, however, MSI's role in the allocation of Crown research and development funding had been replaced by Callaghan.

[24] Callaghan was established in February 2013, pursuant to the Callaghan Innovation Act 2012. The Act established Callaghan as a Crown agency in the terms of the Crown Entities Act 2004, with its main object "to support science and technology based innovation and its commercialisation by businesses in order to improve their growth and competitiveness".¹

[25] Section 15 of the Callaghan Innovation Act went on to relevantly provide:

Operating principles

- (1) In meeting its main objective, and performing its functions, Callaghan Innovation must—
 - (a) aim to ensure that any activities it undertakes are for the benefit of New Zealand; and
 - ...
- (2) In addition, in performing the function specified in section 14(1)(f) (which relates to allocating and administering RS&T funding), Callaghan Innovation must—
 - (a) act fairly and transparently; and
 - (b) implement systems and procedures to enable it to give effect to the principle set out in paragraph (a); and
 - (c) make information about those systems and procedures available on its Internet site; and

¹ Callaghan Innovation Act 2012, s 13.

- (d) include in its annual report under section 150 of the Crown Entities Act 2004 a report on its implementation of those systems and procedures.

...

[26] One of Callaghan’s primary functions is to allocate and administer research, science and technology funding.² It does this through administering a number of different grants, which in 2013 and 2014 included project grants of the type previously obtained by Trends, and a Growth Grant.

[27] The grants administered by Callaghan were established by a ministerial direction from the Minister of Science and Innovation.³ In allocating and administering the funding Callaghan was, and is required, to perform any additional function that the Minister directs pursuant to s 112 of the Crown Entities Act 2004.⁴ The relevant direction to Callaghan, setting out the criteria for assessing proposals for funding, was signed off on 23 October 2013, by the then Minister of Science and Innovation the Hon Stephen Joyce (“the Minister’s Direction”).

[28] The Minister’s Direction set out the types of funding available and the criteria for assessing proposals. The Minister directed Callaghan to “develop and implement processes for vetting and auditing businesses to ensure that claimed research and development is legitimate” and contained “clawback provisions” whereupon:

Businesses may be expected to return some or all grant funding, during or following a grant agreement, to Callaghan Innovation, if:

- The business breaches any grant agreement, misappropriates funding, provides incorrect information to Callaghan Innovation, or claims ineligible expenditure ...

[29] In addition, the Minister directed that any business that was found to be wilfully misreporting its research and development expenditure “at any point will be immediately removed from the initiative and will be ineligible to reapply for three years”.

² Section 14(1)(f).

³ Crown Entities Act 2004, s 103.

⁴ Callaghan Innovation Act 2012, s 14(1)(i).

[30] The Minister’s Direction went on to define “eligible research and development expenditure for research and development growth grants” in the following terms:

Eligible R&D expenditure is defined as those meeting the New Zealand Equivalent to International Account Standard 38 (NZ IAS 38) definition of research and development and expensed under that standard.

The NZ IAS 38 definitions of R&D are:

- **Research** is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
- **Development** is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

Clarifying Principle

If necessary, when seeking to distinguish R&D from non R&D, the further advice provided by the New Zealand Financial Reporting Standard 13 (NZ FRS 13) should be applied:

- R&D is distinguished from non-R&D by the presence or absence of an appreciable element of innovation. If the activity departs from routine and breaks new ground it is normally R&D; if it follows an established pattern it is normally not R&D.

[31] The Minister’s Direction went on to detail a wide range of general and specific exclusions for research and development otherwise within the definitions set out above.

Trends’ application for a Growth Grant

[32] On 5 December 2013, Trends applied to Callaghan for a Growth Grant. The application provided considerable detail about Trends’ current business and leadership and what was intended to be undertaken, building off what had been completed in the course of the Project Grant. Specifically, Trends confirmed the following had already been completed:

Engagement platform successfully designed and architected to provide the foundation for future application module development. Platform populated with 13,944 articles, 78,866 images and 817 business profiles, all indexed and searchable within the platforms search engine. This achieves stage ones Engagement Platform Build 1 & 2 milestones. Some key features include the

commercialisation of business profiles on the platform enabling revenue. Reference customers include, Lockwood Homes, G.J Gardner Homes, Laminex, Plumbing World, Landmark Homes, and Resene who are using their business profiles and product content on the platform to engage with consumers within a Social Media environment [sic].

Platform Social Media modules implemented include User and Business Profiles, User and Business Collections, Business Profile Owner Creation with Drag'N'Drop Content Uploading, User Public and Private Messaging, Business Profiles Reviews, User Comments, User Followers and Following, Photo, Video and Article Content Editing. An analytic engine is tracking consumer visits and behaviour on business profiles to inform customers on consumer behaviour.

Research & Development successes include HTML5 Application cache development using an MVC JavaScript framework running client-side within users browsers. Complete RestJSON API web services providing storage and search capability acheiveing [sic] both horizontal and vertical scalability with the Amazon Web Services cloud infrastructure. Success has been achieved in implementing the design into a production environment under the trendsideas.com domain.

[33] Trends identified “8 main areas that the research teams are going to focus on that offer the largest and most significant growth for the business over the next 3 years”. Those areas were identified as:

1. Lead Generation
2. Metric Data
3. Project Purchase and Sales commissions.
4. Platform and Social Software as a service.
5. Self Publishing
6. Mobile
7. Suggestion and recommendation engine
8. Project Management and time lining.

[34] Elaborating on each of those areas, Trends made it clear that much of the research planned by Trends was not technical research or development but rather research aimed at optimising the commercial use of the existing platform, including identifying what technology was available; developing subscription and pricing models; researching social media platforms; and how other e-commerce providers had successfully used social media and e-commerce. This was confirmed by the research

and development programme set out in the Growth Grant application which identified the following technical objectives and work plans:

Technical objective 1

Objective name:

Relations, Leads & Subscriptions

Work plan:

Research options for selection of a suitable Customer Relationship Management Solution to use for the Platform Lead Management module. Design to possible Use Case Diagrams and process flows for Lead Management. Research and develop a recommended business product around a subscription model for lead generation.

Technical objective 1 > Milestone 1.1

Milestone:

Relationship Management Use Cases, Business Requirements & Wireframes

Milestone work plan:

Research and document all the requirements for a suitable CRM solution.

Technical objective 1 > Milestone 1.2

Milestone:

Lead Management Use Cases, Business Requirements & Wireframes

Milestone work plan:

Researching market solutions to gain insights on how current technology providers are managing and commercialising leads.

Technical objective 1 > Milestone 1.3

Milestone:

Subscription Management Use Cases, Business Requirements & Wireframes

Milestone work plan:

Research how to implement a successful subscription and pricing model for leads.

Technical objective 2

Objective name:

Message, Notifications & Tagging

Work plan:

Research all current social platform trends and future thinking into the possible solutions designs for messaging, notifications and tagging. Documenting what is currently available on the global marketplace for organisations to enable their audience to communicate effectively. This phase of the [the] project focuses heavily on researching communication trends on social platforms and creating future-based thinking solutions to give the platform a clear and specific competitive advantage in the immediate future.

Technical objective 2 > Milestone 2.1**Milestone:**

Message Centre Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research all the worlds most popular social media platforms and create a future design, building on the existing standards, discovering enhancement for a messaging centre with competitive advantages for commercialisation.

Technical objective 2 > Milestone 2.2**Milestone:**

Notification Cases, Business Requirements and Wireframes

Milestone work plan:

Research into social media success stories such as WeChat, Weibo, Sina, Qq, FaceBook, Pinterest, Google Plus and Twitter to identify common notification features that social media platform audiences have come to expect and high engagement rates.

Technical objective 2 > Milestone 2.3**Milestone:**

Tagging Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research the phenomenon that is tagging content with links to social pages on the worlds top 10 social media platforms. Look to identify and document opportunities for new use cases.

Technical objective 3**Objective name:**

E-Commerce, Products & Services

Work plan:

Research social commerce and document how successful commerce providers that have commercial benefits at the core of their business model have implemented a social media strategy. Survey successfully on-line retailers to discover how social media is changing the way their retailers market to their target consumers.

Technical objective 3 > Milestone 3.1**Milestone:**

E-Commerce Use Cases, Business Requirements and Wireframes

Milestone work plan:

E-Commerce Use Cases for popular social commerce platforms such as ASOS and Shopify that have successfully used social commerce strategies to grow conversions while increasing brand reputation. Research the most popular features and those that are driving increased conversions. Document these features and the functionality they provide to the user.

Technical objective 3 > Milestone 3.2**Milestone:**

Product Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research popular social platforms that have implemented product search, product details and online e-commerce transactions. Examples would be amazon.com, taobao.com and ebay.com. Discover and document the social media integration implemented on these properties to facilitate social engagement around the products they list. Research their back-office features to learn how they enable a great user experience around product inventory management and stock/price control.

Technical objective 3 > Milestone 3.3**Milestone:**

Services Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research popular trends for start-up service websites that have captured large audiences overnight with their service listing features such as fiverr.com, airtasker.com and odesk.com. Document the driving factors for high audience numbers and repeat traffic.

Technical objective 4**Objective name:**

Big Data Storage, Analytics & Subscriptions

Work plan:

Research and develop plans for solution design for enabling big data activities and events created by users on the platform. Survey and question our prospective buyers and subscribers for data subs to discover what metrics are important for their business decisions. Prioritise a metrics list based on future customer needs.

Technical objective 4 > Milestone 4.1**Milestone:**

Big Data Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research how giant social media platforms such as Facebook construct their platform around being able to mine and resell user data. Discover and document what technology stacks are being deployed and infrastructure designs are popular.

Technical objective 4 > Milestone 4.2**Milestone:**

Data Analytics Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research current solutions designs and architecture used to manage data rivers and streams. Document possible solution designs for managing data analytics on demand. Survey our prospective customers to discover how they currently use social media analytics for business planning.

Technical objective 4 > Milestone 4.3**Milestone:**

Data Subscription Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research current competitors business models for data subscription services to social analytics to discover current trends within the market on which to develop. Document those trends and services currently offered also covering off any future business models that could be created from making social data available to the global market place.

Technical objective 5**Objective name:**

Multi-Lingual + Internationalisation

Work plan:

Research the current trends for providing true internationalisation across the platform.

Technical objective 5 > Milestone 5.1**Milestone:**

Multi-Lingual Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research the User interface designs and user experience when using global web platforms that have the multi-lingual functionality to store and distribute data across many common languages.

Technical objective 5 > Milestone 5.2**Milestone:**

Internationalisation Use Cases, Business Requirements and Wireframes

Milestone work plan:

Perform research and prototyping to understand how current web standards and best practise offers a true global experience to international users. Document a high-level solution for the technology implementations required to adhere to global standards for true internationalisation.

Technical objective 6**Objective name:**

Native Mobile Platform Application

Work plan:

Research the current leading native mobile operating systems and their respective users bases to determine a short-list of targets for the platforms mobile offering. Likely leaders are iOS, Apple's leading mobile operating system and the lightweight version of the Linux OS, Android. Confirm the recommended targeted operating systems and create use case diagrams for the minimum required feature set that the platforms users could benefit from. Survey current mobile application users of similar application to discover what features are most popular and gain insight into any potential market gaps from which to seize opportunities. Perform raw data analysis on the survey results and drive out the first set of business requirements and wire frames for the first released version of the platforms mobile application.

Technical objective 6 > Milestone 6.1**Milestone:**

Native Mobile Platform Use Cases, Business Requirements and Wireframes

Milestone work plan:

Research the current options with mobile development trends for providing users with a great mobile experience.

Technical objective 7**Objective name:**

Platform Solution Design & Architectural Development

Work plan:

- * Component Architecture
- * API/Integration Architecture
- * Technology Stack Architecture
- * AAA Architecture
- * Project Mandate
- * Project Investment Proposal
- * Project Plan.

Technical objective 7 > Milestone 7.1**Milestone:**

Low-Level Platform Solution Design Document

Milestone work plan:

Using all the previous research documents and knowledge acquired within the R&D programme, complete the detailed version of the Platform Solution Design documentation for all the leading edge components and features for the development team to execute.

Technical objective 8**Objective name:**

Custom Self-Publishing

Work plan:

Research and understand how current on-line custom printing solutions are functioning from both a end-users and publishers perspective. Document all leading and popular features and create a high-level solution outline on which to base the business requirements. Digest this high-level data and provide deep business analysis to produce a set of wire frames from a detailed business requirements document.

Technical objective 9

Objective name:

Recommendation Engine Design

Work plan:

Research and test drive the world's recommendation engine software services to deepen our understanding of the components and algorithms they utilise to enhance the consumers experience when they themselves are researching products and services to purchase. Pick the best technologies from the selection and use this data to drive out a high-level design for a prototype for a recommendation engine.

Technical objective 10

Objective name:

Real-Time Video + Chat Collaboration

Work plan:

Research browsers capability, consumers network connection speeds and technology advances that would enable consumers to reliably and cost-effectively perform real-time visual collaboration. Document a high-level design to enable the minimum expected baseline for a platforms functionality.

Technical objective 11

Objective name:

Contribution + Subscription OpenAPI Service

Work plan:

Research successful organisations that are hosting a series of web services that are profitably and growing to understand what makes a companies data source worth subscribing too. Also research why contributors are compelled to distribute their contributions through popular on-line providers.

[35] It appears only Technical Objective 7 suggested active “Platform Solution Design & Architectural Development”, a component due to start in July 2015 and be completed in December 2015. However, even this appeared limited to a “Low Level Platform Solution Design Document” rather than actual research and development.

[36] In assessing Trends’ application, Callaghan took a very narrow view of what it was required to assess. The majority of those considering the application concluded that Callaghan was bound to approve Trends’ application if Trends could establish that

it met the business eligibility criteria as a New Zealand business and, as outlined in the Minister's Direction:

- have had at least \$300,000 in eligible R&D expenditure ... sourced from non-government funds in each of the two most recent years;
- have had eligible R&D expenditure of at least 1.5 per cent of revenues in each of the two most recent years;
- meet financial and management due diligence requirements sufficient to justify three years of funding; and
- provide Callaghan Innovation with a R&D plan including an estimate of R&D expenditures over the next three years. Businesses must compile the R&D plan to a level of detail and clarity sufficient to assess progress in the businesses' R&D programme over time.

[37] As a result, Callaghan did not consider the nature of the research and development proposed to be undertaken by Trends but instead limited its analysis to the factors set out in [36] above. Callaghan therefore obtained auditor's reports with regard to Trends' financial position, as well as a statement from Moore Stephens Markhams confirming Trends' historical research and development expenditure. While this confirmed Trends had undertaken research and development over a two year period,⁵ it did not identify whether that historical research and development expenditure was Eligible R&D Expenditure for the purposes of the Growth Grant. Indeed, Moore Stephens Markhams confirmed:

The Research and Development expenditure disclosed above is related to expenditure on research, **particularly in areas of gaining understanding of marketing opportunities, insight into current and future users experiences on large scale global platform**, established a pathway for the current media to digital transition. Research expenditure it is recognised as expense when it is incurred.

(emphasis added)

[38] Thus while Callaghan identified some issues around Trends' financial position, it did not look at what Trends said it was intending to develop, the Project itself. It therefore made no real attempt to understand and/or provide feedback to Trends on what parts of Trends' stated research and development programme would constitute

⁵ The Moore Stephens Markhams certificate confirmed only that the salaries of four Trends' staff had been research and development expenditure in terms of the Project Grant. No other expenditure appears to have been claimed.

Eligible R&D Expenditure for the purposes of the Growth Grant. The lack of focus on what Trends was actually intending to do clearly concerned a number of the Callaghan staff tasked with assessing the application, but ultimately Callaghan concluded it could not decline the application.⁶ A funding agreement in what appears to have been standard terms was then prepared by Callaghan and sent to Trends for execution. There does not appear to have been any negotiations in the terms of the Funding Agreement before it was signed on 2 April 2014, although it was agreed it would retrospectively have effect from 1 January 2014, thereby enabling Trends to seek payment of Eligible R&D Expenditure it had incurred in the first quarter of 2014. Trends' success, along with 14 other companies in securing Growth Grant funding was subsequently the subject of a press release by Callaghan.

The Funding Agreement

[39] The Funding Agreement began by confirming:

You have applied to Callaghan Innovation for a funding grant to cover a portion of the costs of your research and development programme ("**Programme**") for a minimum of 3 years. The Programme is referred to in the schedule to this Agreement ("**Schedule**") and described in detail in your application and your research and development plan ("Application").

Your Application has been approved, and Callaghan Innovation will provide the funding specified in the Schedule to enable you to carry out the Programme ("Funding").

[40] The next section of the Funding Agreement made it clear that Callaghan's support of Trends, and its research and development programme set out in the Growth Grant application, was limited to "an amount that is 20% of your eligible R&D expenditure" up to a maximum of \$5 million in each contract year".⁷ Eligible R&D Expenditure as defined in the Funding Agreement followed closely the formulation contained in the Minister's Direction; namely research or development as those terms were defined in NZ IAS 38 and NZ FRS 13⁸ and adopted almost without exception the specific exclusions contained in the Minister's Directions. Those confirmed that

⁶ A subsequent investigation undertaken by Deloitte on behalf of Callaghan ultimately concluded that Callaghan's approach was too narrow.

⁷ The Funding Agreement, cl 1.1 and Schedule.

⁸ Clause 3.1. See [29] above.

Eligible R&D Expenditure, for the purposes of the Funding Agreement, did not include expenditure:⁹

- (a) that is capitalised as an intangible asset for the purposes of NZ IAS 38;
- ...
- (g) on routine, ongoing efforts to refine, enrich, or otherwise improve on the quality of an existing product or process, or to make cosmetic or stylistic changes to it;
- ...
- (j) on adapting an existing product or process to a particular customer's need or site;
- (k) on supporting, de-bugging, or making minor improvements to existing computer software;
- (l) on market research or surveys, market testing, market development or sales promotion, management studies, efficiency surveys, or the routine collection of information;
- ...
- (n) on interest expenses or lease payments of any kind, and any overheads that are not closely linked to research and development activities, except for finance, personnel, training, travel, administration, and library activities associated with the Programme, and reasonable costs associated with transportation, storage, cleaning, repairs, maintenance and security activities in relation to the Programme;
- ...
- (p) on research in the social sciences, arts, or humanities; ...

[41] In return Trends confirmed relevantly it would "... comply with the requirements of [the Funding] Agreement in respect of the Programme and [its] claims for Funding".¹⁰ Callaghan made it clear in cl 6 of the Funding Agreement that it relied upon Trends to report regularly and accurately on any matter that may affect the funding, noting that Callaghan needed:¹¹

... to monitor its provision of Funding for the Programme so that it can identify and report the benefits to New Zealand arising from the Programme, and take appropriate action if [Trends does] not comply with this Agreement.

⁹ Clause 3.2.

¹⁰ Clause 1.2(a).

¹¹ Clause 6.1.

[42] Nowhere in the Funding Agreement was there any kind of approval for the Technical Objectives and Milestones set out in Trends' Growth Grant application. Nor was there any acknowledgement that any of the research and/or development identified in the Growth Grant application would, if undertaken, amount to Eligible R&D Expenditure for the purposes of the Funding Agreement.

[43] Instead, the Schedule to the Funding Agreement provided that Eligible R&D Expenditure was to be invoiced by Trends on a quarterly basis, together with a report setting out details of Trends' performance in the programme and the Eligible R&D Expenditure incurred. Furthermore:¹²

Each invoice must specify the actual amount of Eligible R&D Expenditure spent by you in the quarter, and the amount of Funding you are claiming. The Funding claimed by you **must be 20% of the amount of Eligible R&D Expenditure spent by you in the quarter.**

(emphasis added)

[44] At that point Trends was advised:¹³

If your invoice is satisfactory to Callaghan Innovation **in all respects**, Callaghan Innovation will pay you the Funding, except that Callaghan Innovation:

- a. will withhold 10% of each amount claimed by you; and
- b. is not required to pay you more than the maximum Funding Amount specified in this Agreement in a Contract Year (including the 10% withheld under paragraph a).

(emphasis added)

[45] The Schedule went on to confirm that at the end of each year Trends could issue an invoice for the amounts retained by Callaghan at which point:¹⁴

If your invoice is satisfactory to Callaghan Innovation in all respects, Callaghan Innovation will pay you the Funding, including any Funding previously withheld from you, so that the total amount of Funding paid to you for the Contract Year is 20% of your Eligible R&D Expenditure, up to the maximum Funding Amount specified in this Agreement.

¹² Schedule to the Funding Agreement Quarterly Claims at 3.

¹³ At 4.

¹⁴ Schedule to the Funding Agreement End of year claims at 8.

[46] Although the recitals of the Funding Agreement confirmed that the funding was for a minimum of three years, and that after two years Trends could apply for a two-year extension to the funding which would be granted if the relevant criteria were met, there was in fact no guarantee that the Funding Agreement would in fact continue for the whole of that period. In particular, cl 10.1 of the Funding Agreement provided:

This Agreement may be terminated by either of us at any time by giving 2 months notice to the other party.

[47] Two mechanisms were provided for Callaghan to monitor Trends' performance under the Funding Agreement, an audit process under cl 5 and a review mechanism in cl 7. Clause 5 of the Funding Agreement enabled an audit to occur at any point until two years after the Funding Agreement had ended.¹⁵ Clause 5.1 required Trends to:

... keep appropriate accounting and other records of your Eligible R&D Expenditure and your use of the Funding (including payslips, invoices, and receipts) and manage your records in accordance with recognised research and accounting best practice standards, so as to enable Callaghan Innovation to carry out an audit to determine whether you are complying or have complied with this Agreement. ...

[48] Clauses 5.3 – 5.6 specified how the audit was to be conducted and will be considered in detail under the heading of **Issue Four**.¹⁶ Clause 5.7 set out what options were available in the event a breach of the Funding Agreement was identified.¹⁷ Clause 5.10 then provided:

Callaghan Innovation may suspend payment of the Funding from the date of the notice of Audit if Callaghan Innovation considers that you may have breached this Agreement. In such case:

- (a) Callaghan Innovation will give notice that specifies that payment of the Funding has been suspended; and
- (b) if the final Audit report shows that you have not breached this Agreement, Callaghan Innovation will recommence payment of the Funding, and provide an amount equivalent to the amount of Funding that would have accrued if the Funding had not been suspended. If there has been a material delay to the Programme as a result of the suspension of Funding under this clause, the matter will be deemed to be a Change Event.

¹⁵ The Funding Agreement, cl 5.2.

¹⁶ See [98] of this judgment.

¹⁷ See **Issue Eight** from [192] of this judgment.

[49] Likewise, at the conclusion of the audit cl 5.7 provided Callaghan with a range of remedies including taking no further action,¹⁸ terminating the agreement,¹⁹ and recovering all or part of the funding previously provided).²⁰

[50] The review process under cl 7 was not as detailed as the audit process. Clause 7.1 required Trends to participate in a review “as reasonably required by Callaghan”, and provided that if the review was not satisfactory to Callaghan “the matter **may** be considered and managed in accordance with the Change Event provisions of [the Funding] Agreement.”²¹ The “Change Event” procedures were in turn set out in cl 9, with a Change Event being defined as including:

- (a) an event that prevents, or is likely to prevent, either of us from being able to meet our obligations under this Agreement;
- (b) an event, including an actual or likely change in your ownership or sale of any of your assets, which materially affects, or is likely to materially affect the anticipated benefits for New Zealand of the Programme, including planned research and development activity in New Zealand, and the timing of those benefits; or
- (c) Callaghan Innovation determines, at any time, that your actual Eligible R&D Expenditure is or is likely to be significantly different from the amount of Eligible R&D Expenditure that you anticipated investing in the Programme that is specified in your Application.

[51] Importantly, while the procedures to be followed in the event of a Change Event being identified included a range of responses, cl 9.6 provided:

Nothing in this clause prevents either of us from exercising our powers under clause 10.

[52] Clause 10 in turn provided for “termination and reduction or suspension of funding”. As noted, cl 10.1 provided the parties were entitled to terminate on two months’ notice. In addition cl 10.3 provided that either party could terminate immediately for breach of the Funding Agreement, with cl 10.4 specifically providing that Callaghan was able to terminate immediately if Trends was to:

¹⁸ The Funding Agreement, cl 5.7(a).

¹⁹ Clause 5.7(e).

²⁰ Clause 5.7(f).

²¹ Clause 7.2 (emphasis added).

- (a) use some or all of the Funding other than as set out in this Agreement, including that there is, in Callaghan Innovation's reasonable opinion, misappropriation or fraud in relation to the Funding;
- (b) give (or have given) any information, representation, or statement to Callaghan Innovation that is misleading or inaccurate in any material respect;
- (c) claim Funding that you are not entitled to claim under this Agreement, including claiming for expenditure that is not Eligible R&D Expenditure;
- (d) enter into a contract or an arrangement that, in the reasonable opinion of Callaghan Innovation, materially reduces the benefit to New Zealand anticipated from the Programme without the prior written approval of Callaghan Innovation; or
- (e) become, or are presumed to be, bankrupt or insolvent, are wound up, have a receiver, manager or administrator appointed, or go into liquidation or receivership.

Issue One - Did the Funding Agreement include an implied term and statutory obligations in addition to its written terms?

[53] There is no dispute that the terms of the Funding Agreement include those clauses within the written document signed on 22 April 2014, but Trends also initially contended the following further terms apply:

- (a) A statutory obligation arising out of sections 14 and 15 of the Callaghan Innovation Act that in allocating and administering research science and technology funding²² it was required to fairly allocate growth grants and implement systems and procedures so as to give effect to principles of fairness and transparency;²³ and
- (b) An implied term:²⁴

When Callaghan held discretionary rights under the Funding Agreement relating to a draft audit report and a final audit report it would exercise those rights fairly, transparently, in good faith, consider all options available to it and select appropriate and proportionate options where there was a choice of options.

²² Callaghan Innovation Act 2012, s 14(1)(f).

²³ Section 15(2)(a) and (b).

²⁴ Trends had originally presented no less than four implied terms but confirmed that this had reduced to one by the time the case went to trial.

[54] Both the statutory duty and implied term were pleaded in terms of providing Trends a separate basis for damage, but such an approach was not reflected in Trends' position in closing submissions. Instead, Mr Corlett submitted on behalf of Trends that the Funding Agreement must be "tempered" by both Callaghan's statutory duties under ss 15(2)(a) and (b) of the Callaghan Innovation Act, and the implied term.

[55] Ultimately, there did not appear to be much difference in practice between the statutory duty as ultimately conceptualised by Mr Corlett and the implied term asserted, with Mr Corlett noting that the effect of ss 15(2)(a) and (b) was that "the interpretation of any provisions available to Callaghan must be tempered by its overarching obligation to act fairly and transparently towards Trends in exercising those procedures and remedies".

[56] In response, Mr McLellan's submission on behalf of Callaghan was focused on whether, as per the amended counterclaim, either the statutory duty and/or the implied term as pleaded by Trends could give rise to an independent basis for damages against Callaghan. In any event, Mr McLellan's submission was that Callaghan had not breached either duty and had instead acted in good faith and transparently towards Trends in carrying out its obligations under the Funding Agreement

Discussion – Issue One

[57] Given the position taken by Trends in closing, it is not necessary to determine conclusively whether ss 15(2)(a) and (b) could give rise to an enforceable statutory duty at the suit of Trends.

[58] That said, I accept Mr Corlett's submission that the Callaghan Innovation Act necessarily informs the approach that Callaghan must take to the administration of research science and technology funding entrusted to it. It is immediately apparent that the Funding Agreement cannot be regarded in a vacuum as a commercial contract, given that Callaghan is essentially fulfilling a statutory role in administering the different types of grants, on behalf of both the Government and taxpayers.

[59] It is however wrong to suggest that s 15(2)(a) narrowly imposes an obligation on Callaghan to act fairly and transparently towards Trends in isolation, given its wider

accountabilities which clearly go well beyond those seeking funding. This is reflected, in particular, in s 15(1)(a) which requires Callaghan to “aim to ensure that any activities it undertakes are for the benefit of New Zealand”, as well as complying with the Minister’s Direction as required by s 14(1)(i) of the Callaghan Innovation Act. Those directions make it quite clear that, notwithstanding its obligation to act “fairly and transparently”²⁵ and to “implement systems and procedures”,²⁶ such obligations must be read in conjunction with explicit directions to ensure that funding is only provided for Eligible R&D Expenditure, as defined in the Minister’s Direction. In the event that funding has been wrongly claimed, Callaghan was to exit those claiming that funding from the programme and to recover any funding wrongly paid.

Conclusion – Issue One

[60] The terms of the Funding Agreement are set out in the written contract dated 2 April 2014 but those terms are necessarily required to be interpreted in the light of Callaghan’s broader obligations under the Callaghan Innovation Act. While this includes its obligation to “act fairly and transparently”,²⁷ this duty is owed, not only to those, like Trends, who have sought and/or obtained funding, but also to the New Zealand Government and taxpayers. Such obligations are also necessarily coloured by the Minister’s clear instructions to Callaghan to ensure that funding is only to be provided for Eligible R&D Expenditure, with funding to be terminated where ineligible expenditure has been claimed and monies wrongfully paid to be recovered.

[61] It is those wider obligations that provide context to Callaghan’s obligations under the Funding Agreement. It follows the statutory and/or implied terms sought to be relied upon by Trends do not reflect accurately the wider statutory obligations imposed upon Callaghan in its administration of funding under the Callaghan Innovation Act.

²⁵ Section 15(2)(a).

²⁶ Section 15(2)(b).

²⁷ Section 15(2)(a).

Trends' claims under the Funding Agreement

[62] The backdating of the Funding Agreement to 1 January 2014²⁸ meant that Trends was able to issue an invoice for the Q1 claim as soon as the Funding Agreement was signed, and it wasted no time in doing so. The Q1 claim was prepared by Trends' then Chief Financial Officer, Simon Groves, and lodged with Callaghan on 17 April 2014.

[63] Trends' Q1 claim came to \$156,768.35. This was based upon claimed Eligible R&D Expenditure of \$757,335.00 during the first quarter, being 20 per cent of the total Eligible R&D Expenditure claimed, less the retention plus GST. Mr Groves certified, on behalf of Trends, that the amount claimed was Eligible R&D Expenditure for the purposes of the Funding Agreement. In his evidence, Mr Groves said that he had calculated the Q1 claim by:

- (a) identifying the labour costs from the general ledger;
- (b) confirming with David Johnson that 67 per cent of those costs were attributable to R&D activities;
- (c) removing non-eligible overheads from the general ledger; and
- (d) applying the rate of 67 per cent to eligible overheads to calculate the amount of overheads apportioned to R&D activities.

[64] In particular, Mr Groves confirmed:

Before submitting the first quarter claim, as a substantial part of the claim was for labour costs incurred, I spoke with David Johnson together Louise Messer who was the Trends manager responsible for allocating labour and outsourced contractor labour resources to the Platform project. I asked her whether the labour costs I had previously worked-up, based on the 3 October 2014 template, was still accurate for the purposes of claiming for labour. Louise confirmed to me that the labour costs were still accurate. The labour R&D cost was 67% of the total labour cost.

I then used that percentage to apportion the eligible overheads to R&D. I then submitted a claim for that amount for the relevant period.

²⁸ See [38] of this judgment.

[65] There can be no dispute that obtaining Growth Grant funding was important to Trends. On 30 April 2014, in a report to the advisory board of Trends David Johnson confirmed that Trends was finishing the 2013/14 financial year “in the worst position in the company’s history”. Mr Johnson identified three main reasons for this: problems with a new US distributor, the fact that the “platform” completed with the assistance of the Project Grant had “failed to fire”, and declining sales of print media. Mr Johnson advised that Trends had “lost 100k a month for 12 months [\$]1.2 mill”. David Johnson went on to note the focus of the senior management team on these financial problems. He noted that the general manager of Trends, Louise Messer, had taken “a lot of work off [David Johnson’s] plate so he could get back out on the road”; that Simon Groves had lost a lot of time as a result of health issues and was “full time covering the situation created by our not paying our bills on time”; while Mr Johnson’s son, Andrew Johnson, the director of strategic planning for Trends, was spending a lot of his time looking after an existing key client rather than strategic planning.

[66] Despite Callaghan paying the Q1 claim on 8 May 2014, the financial pressures on Trends had not eased by the time it made its Q2 claim and it is clear from the evidence that Mr Groves was spending a significant portion of his time dealing with Trends’ bank in order to ensure that creditors could be paid. Against that background the Q2 claim invoice was issued promptly at the end of the second quarter on 30 June 2014. Rather than calculating the actual Eligible R&D Expenditure as required by the Funding Agreement, Mr Groves confirmed in his evidence that he simply duplicated the Q1 claim in creating the Q2 claim. The amount of Eligible R&D Expenditure claimed for the second quarter of 2014 was therefore identical to the amount Trends had claimed in its Q1 claim.

[67] However, although further information was sought by Callaghan about Trends’ first quarter losses, the amounts claimed by Trends were not queried by Callaghan. Accordingly, the Q2 invoice of \$156,768.35 was paid by Callaghan to Trends on 11 July 2014.

[68] Trends' Q3 claim was likewise submitted without delay, as the third quarter ended on 30 September 2014.²⁹ The Q3 claim totalled \$151,835.22 excluding the retention but including GST. Upon receipt of the Q3 claim, Callaghan, through Lauren Smith the Callaghan manager responsible for Trends' Funding Agreement, sought updated information on Trends' budgeted cashflows. This was supplied by Mr Groves. Four days later, however, Callaghan advised it was unable to pay the Q3 claim as it needed further information on the amounts claimed. In particular Callaghan requested Trends provide "a detailed breakdown of the R&D claim values for the last three quarters claimed".

[69] Mr Groves responded on 15 October 2014, enclosing a spreadsheet entitled "R&D Costs 1 January 2014 – 30 September 2014" ("Trends' October reconciliation"). This spreadsheet set out a detailed breakdown of the amounts claimed by Trends. It included a spreadsheet of the wages costs of all Trends' personnel said to have been working on the project (36), the cost of AnotherInnovation, together with a schedule of other expenses claimed by Trends in each of the quarterly claims. The percentage claimed was based, not on the 67 per cent described by Mr Groves in his evidence, but the number of employees claimed to have been working on the project divided by the total number of employees.³⁰

[70] The spreadsheet provided by Mr Groves, however, immediately revealed that in no case did the amount invoiced reflect the totals shown in the spreadsheet, nor did the spreadsheets show the Q1 and Q2 claims were in fact identical. As a result, rather than reassuring Callaghan, Trends' October reconciliation led Callaghan to conclude that Trends may have sought payments for items that "may not be R&D by definition" and, therefore, not compliant with the Minister's Direction. As a result, Ms Smith responded by advising Mr Groves:

We have reviewed this information and now require some further information. Unfortunately, this will mean the claim will not be processed for the payment run on October 16. Can you please send through an explanation on how the attached costs are R&D activity, and how they comply with the contract definitions of R&D including our exclusions.

²⁹ Although the Trends Q3 invoice is dated 3 October 2014, Simon Groves' evidence is that the invoice was sent to Callaghan on 9 October 2014.

³⁰ This represented 70 per cent for Q1, 74.4 per cent for Q2, and 77.65 per cent for Q3.

Of particular concern is the lease/rent costs from our specific and general exclusions, and the nature of other expenses which, on face value may not be R&D, and may be claimed in error.

[71] Mr Groves responded immediately and noted:

Given the presumption that the wages speak for themselves the overhead costs were included as R&D costs as outlined in the IAS 38 standard.

These overheads are calculated from the total expenses on a pro-rated percentage based on head count basis. This method having been approved by the Moore Stephens Markhams review in September 2013.

With regard to lease expenses we have none but we do rent some computer hardware from Telecom Rentals and this is what that line refers to, again this was approved by the MSM review as being consistent with the standard.

While we are more than appreciative of Callaghan's support the funding we are committing to this project leaves us dependant on timely pay-outs so is there any way we can review this matter urgently.

[72] The next morning Mr Groves confirmed that Trends believed that it acted in accordance with IAS 38. He suggested removing any contentious items, which he believed at that point were limited to bank fees; travel; and rental equipment, and paying the balance of the revised amount to Trends. This approach was considered by Callaghan and ultimately endorsed. However, rather than restricting the amounts withheld in respect of bank fees, rental equipment, rent, and rates to the Q3 claim, Callaghan withheld an amount equal to those amounts claimed by Trends across the Q1, Q2 and Q3 claims. After retentions, this resulted in payment to Trends of \$60,326.32 plus GST on 22 October 2014.

Issue Two - Did Callaghan breach the Funding Agreement by withholding payment of Trends' Q3 claim?

[73] Trends allege that Callaghan was not entitled to withhold payment of the Q3 claim and, in particular, was not entitled to make retrospective deductions from Trends already approved, and paid, Q1 and Q2 claims. Notwithstanding the claim as pleaded and confirmed in Trends' opening submissions, by the time Trends closed its case this head of claim was no longer specifically asserted, nor submissions made as to why this should be so.

Discussion – Issue Two

[74] Given the lack of obvious reliance upon this breach in closing, **Issue Two** can be addressed relatively briefly. As Mr McLellan noted for Callaghan, to the extent any breach could be asserted by Trends for Callaghan’s withholding payment of Trends’ Q3 claim, it must be based on cl 1.1 of the Funding Agreement which is the commitment by Callaghan to pay Trends 20 per cent of its Eligible R&D Expenditure. Clause 1.1 is however clearly subject to the overall terms of the Funding Agreement including, as noted, the detailed terms contained in the Schedule which confirmed that the quarterly invoices would only be paid if they were “satisfactory to Callaghan Innovation in all respects”. This was not the position in respect of Trends’ Q3 claim.

[75] As noted, the initial request for further information from Ms Smith led to the provision of Trends’ October reconciliation. Far from confirming the amounts that Trends had claimed to date, the October reconciliation made it clear that there was a discrepancy between the amounts claimed by Trends and the information provided by Trends to justify those claims. In those circumstances there was no way Callaghan could be satisfied “in all respects” with the Q3 claim. On the contrary, it is clear that the provision of Trends’ October reconciliation raised a number of additional issues, including with the Q1 and Q2 claims, such that by 16 October 2014 Callaghan had concluded a more formal investigation was required. At that point it was recognised, by both Trends and Callaghan, that such an investigation would take time. This led to Mr Groves’ suggestion that Callaghan withhold only those amounts of the overheads apparently in question which he identified as being fees, travel, and rental equipment.

[76] Picking up on this, Callaghan agreed to pay out the balance of the Q3 claim after withholding the total amount of bank fees, rental equipment, rent, and rates across the Q1, Q2 and Q3 claims, providing for the balance of \$60,326.32 plus GST to be released to Trends. As Callaghan was entitled to suspend payments of funding if Trends had not complied with the Funding Agreement,³¹ Callaghan could clearly have withheld the entire amount of the Q3 claim. In such circumstances, it is difficult to see how agreeing to pay out a portion of the Q3 claim could be a breach of the Funding Agreement, and indeed no issue was taken by Trends at the time. Instead, Mr Groves,

³¹ The Funding Agreement, cl 2.2.

after acknowledging the interim payment, focused on ensuring that Trends was in fact treating its research and development expenditure correctly and requested that if an audit was to take place it could be carried out “as soon as possible due to [Trends’] cash position”.

[77] As Mr McLellan also noted, the bigger issue was not the amount temporarily withheld in October 2014, but rather, whether Trends was entitled to the expenditure it had claimed to that point, or whether Callaghan was entitled to first suspend and then terminate the Funding Agreement.

Conclusion – Issue Two

[78] Trends’ October reconciliation raised a more than sufficient basis for Callaghan to conclude the Q3 invoice was not “satisfactory in all respects”. Having reached that position, it was not necessary to formally suspend the contract prior to establishing a formal investigation of the claims made by Trends under the Funding Agreement. Callaghan therefore did not breach the Funding Agreement by withholding payment of part of the Q3 claim.

[79] Whether Trends is ultimately entitled to be paid the Q3 claim depends on whether Callaghan was entitled to suspend and then terminate the Funding Agreement.³²

Deloitte is brought in to investigate

[80] At the same time as Callaghan agreed to make the interim payment of \$60,326.32 plus GST to Trends, Trends and Callaghan agreed that an audit should be undertaken “to confirm that the R&D cost being claimed for are eligible costs”.

[81] On 24 October 2014 Ms Smith confirmed to Mr Groves that Callaghan were getting the audit process underway “so that the audit can happen as soon as possible to confirm the eligible R&D costs so the balance of costs can be settled”. Mr Groves requested Ms Smith to advise when the auditing could be expected so that Trends

³² See **Issue Five** from [131] and **Issue Eight** from [192] of this judgment.

could “have things organised”. Callaghan proceeded to make contact with Elizabeth Garvie of Deloitte and introduced her, via e-mail, to Mr Groves, noting Callaghan’s understanding that it would suit Trends if the audit commenced on 6 November 2014.

[82] Callaghan provided Ms Garvie with copies of Trends Q1, Q2 and Q3 claims, together with copies of the Funding Agreement and the Ministerial Direction. Deloitte prepared a draft work programme. Following a telephone conversation between Mr Groves and Ms Garvie on 31 October 2014, Ms Garvie confirmed by email that the audit would begin on 6 November 2014 and requested Mr Groves to make available a range of documents when she arrived at Trends. Specifically, Ms Garvie sought information in relation to Trends’ October reconciliation in order to verify the wage costs/salaries of the staff members listed in the wages schedule, confirmation that the staff were paid, information as to how the overhead rates were determined for staff members and timesheet records showing how many hours the staff had worked on the research project. Ms Garvie also sought copies of Trends’ latest financial statements, its financial assets register and invoices to support the register, depreciation expense schedule, and all invoices and bank statements showing payment of external costs incurred under the Funding Agreement.

[83] The day before Ms Garvie and her team were due to arrive, Julie Francis- Butler, the senior investment coordinator at Callaghan, sent the following letter to Trends for the attention of Andrew Johnson:

**REVIEW OF R&D GROWTH GRANT FUNDING RECIPIENT:
TRENDS PUBLISHING INTERNATIONAL LTD (CONTRACT ID:
TRDI1302)**

Notification of audit

This letter is to inform you that ... a review will be conducted in accordance with clause 5 of your funding agreement with Callaghan Innovation.

Objective of audit

The objective of the review is to determine the extent to which the funding recipient has complied with relevant financial and contractual obligations identified and agreed with Callaghan Innovation.

Agent conducting the audit

Callaghan Innovation has engaged Deloitte to conduct the review on its behalf. Deloitte New Zealand provides audit, tax, technology and systems, strategy and performance improvement, risk management, corporate finance, business recovery, forensic and accounting services. For more information about Deloitte in New Zealand, refer to their website www.deloitte.co.nz.

Please provide Deloitte with any information including reasonable access to your staff, third parties and third party research contractors involved in the Growth Grant programme, and premises and equipment used in respect of the Growth Grant programme.

Next steps

A representative from Deloitte will be touch in the next two weeks to make arrangements to visit you and conduct the review.

You will be given the opportunity to comment on the draft audit report and Callaghan Innovation will finalise the draft audit report after receiving and considering your comments (if any). and provide a copy of the final audit report to you.

[84] Andrew Johnson responded by confirming Deloitte were expected the next day.

[85] In the meantime, Deloitte had been working with Callaghan on the terms of its role. To this end, on 5 January 2014, Brooke Treadgold who was assisting Ms Garvie, sent Callaghan an email with regard to the “Growth Grant review of Trends Publishing International”. Ms Treadgold advised that Deloitte had adapted its work programme used in the R&D project reviews and requested Callaghan’s feedback.

[86] The record of Deloitte’s initial instruction was confirmed in a letter from Deloitte to Callaghan dated 6 November 2019, sent to Callaghan after Deloitte had already arrived at Trends. The instructions letter did not refer to an audit but rather noted that Callaghan had requested Deloitte to:

... undertake a review of project grant funding received by Trends Publishing International Ltd ("Trends Publishing") against certain R&D Growth Grant financial and contractual obligations and accounting treatments under IAS 38 - Intangible Assets. This review has been requested by Callaghan Innovation to determine the extent to which there is any potential overfunding and delays in completion of objectives in respect to Part 1 of the Trends Publishing contract.

[87] The letter nonetheless confirmed:

The objective of this engagement is to determine the extent to which Trends Publishing has complied with relevant financial and contractual obligations identified and agreed with Callaghan Innovation by applying the approved Standard Work programme co-developed with the former MBIE and Ministry of Science and Innovation.

In addition, we will analyse Trends Publishing research and development expenditure to determine if these are consistent with the requirements under IAS38.

[88] Deloitte went on to summarise the Standard Work Programme as:

- Determining the extent to which the financial claims as set out in the accompanying Progress Reports submitted by the fund recipient are consistent with the purpose of the funding, approved application and established rules and guidance, and the expenditure was incurred.
- Determining whether any special conditions have been addressed and progress reporting is consistent with information provided.
- Determining, as applicable, the extent to which the grant contract is being or has been funded by the fund recipient and other parties as required.

Issue Three – Did Deloitte undertake an audit or review for the purposes of the Funding Agreement?

[89] It is apparent from the previous section that while Trends and Callaghan both consistently referred to the commencement of an audit after issues emerged in relation to the Q3 claim, Deloitte was referring to an audit in its communications with Trends, to a review in finalising its terms of reference with Callaghan, and Callaghan used both terms in its formal advice to Trends. The question therefore arises, was the investigation carried out by Deloitte on behalf of Callaghan an audit in terms of cl 5 of the Funding Agreement or a review in terms of cl 7?

[90] Trends position is that it is quite clear that what had been proposed, and what it believed was being undertaken, was an audit pursuant to cl 5 of the Funding Agreement “to determine whether [Trends is] complying or [has] complied with [the Funding Agreement]”. Conversely, in these proceedings Callaghan argued that what was undertaken was a review in terms of cl 7 of the Funding Agreement. Mr McLellan acknowledged some confusion and, in particular, acknowledged the formal letter from Callaghan to Trends apparently confirmed that an audit would be taking place. However, Mr McLellan submitted that Callaghan had engaged Deloitte to undertake a

review rather than an audit. More broadly, Mr McLellan submitted the issue was a “distinction without a difference” as no loss resulted to Trends, and no different outcome could have resulted in any event.

Discussion – Issue Three

[91] The communications between Callaghan and Trends following the issues raised in respect of the Q3 claim make it clear that both Callaghan and Trends envisaged that an audit would take place. This was confirmed by the subsequent communications between Trends and Deloitte which contained no suggestion that a review in terms of cl 7 of the Funding Agreement was contemplated. In particular, the subject line of the initial emails between Ms Garvie and Mr Groves was “Trends Audit”, and the Deloitte documentation request³³ was specifically in respect of “the audit of Callaghan Innovation Contract TRE1302”.

[92] In fact the only suggestion of a review rather than an audit that was communicated by either Callaghan or Deloitte to Trends was the formal notification letter of 5 November 2014. The letter switched somewhat confusingly between the use of the terms “audit” and “review”, at times even in the same sentence. However, although the letter referred to the “**Review** of R&D Growth Grant Funding Recipient: Trends Publishing International”, in the subject line, the first subsection of the letter went on to formally notify Trends that Callaghan was undertaking an audit. Subsequent subsections identified the objective of the audit, and the agent undertaking the audit (Deloitte). Most importantly, any confusion resulting from references to a review in each of those paragraphs was clarified by the explicit reference to cl 5 of the Funding Agreement, being the formal audit procedure.

[93] That the audit process was being followed was subsequently confirmed by Callaghan by its use of the term in the Suspension Letter³⁴the Suspension Press Release,³⁵ and at the point Callaghan provided Trends with the full copy of the Deloitte Draft Report in January 2015.³⁶ Likewise, in its reports to the Minister, Callaghan

³³ See [82] of this judgment.

³⁴ See [128] of this judgment.

³⁵ See [129] of this judgment.

³⁶ See [159] of this judgment.

consistently referred to the audit being undertaken by Deloitte. It was in fact only at the point the Funding Agreement was terminated in April 2015 that Callaghan first referred to the completion of a review rather than an audit, and this was the position also taken in the Termination Press Release.

[94] Although it is clear that internally Deloitte had envisaged a review rather than an audit in a financial sense, it is by no means clear that such a distinction was drawn with reference to the Funding Agreement itself. The instruction letter to Deloitte was clearly wide enough to encompass the purpose of an audit as set out in cl 5 of the Funding Agreement.

[95] In any event, the mere fact that Deloitte considered it was undertaking a review rather than an audit cannot, in any way, effect what Callaghan notified Trends was being undertaken, particularly when this was also confirmed by Deloitte to Trends.

[96] In the circumstances, I have no hesitation in concluding that Callaghan initiated an audit of Trends in terms of cl 5 of the Funding Agreement, “to determine the extent to which [Trends] has complied with relevant financial and contractual obligations identified and agreed with Callaghan Innovation”. Callaghan was accordingly required to carry out the audit in accordance with the procedures set out in cl 5 of the Funding Agreement. The extent to which it did so, up to the commencement of the audit and subsequently, is considered in the course of analysis of subsequent issues, and in particular **Issues Four**,³⁷ **Five**³⁸ and **Seven**.³⁹

Conclusion – Issue Three

[97] Callaghan gave notice that it was conducting an audit of Trends’ compliance with its obligations pursuant to cl 5 of the Funding Agreement. Therefore, Callaghan was required to comply with the audit procedure set out in cl 5.

³⁷ See from [98] of this judgment.

³⁸ See from [131] of this judgment.

³⁹ See from [180] of this judgment.

Issue Four - Did Callaghan comply with the procedural requirements of the Funding Agreement as the Deloitte investigation began?

[98] Having concluded Callaghan had embarked upon an audit in terms of cl 5 of the Funding Agreement the question turns to whether Callaghan complied with the procedural requirements of that clause prior to the audit commencing?

[99] The position of Trends is that Callaghan did not. In closing, Mr Corlett submitted:

- (a) Callaghan breached cl 5.4 of the Funding Agreement by failing to give reasonable notice of the audit, alleging Callaghan gave only a single day's notice so that "Trends was given no time to organise its documents for the audit".
- (b) Callaghan breached cl 5.3 of the Funding Agreement by failing to notify what information Callaghan required to be provided prior to the audit.

Discussion – Issue Four

[100] It is clear that Trends' submissions on this issue were based on the formal notification letter sent by Ms Francis-Butler on behalf of Callaghan,⁴⁰ which was only issued the day before the audit commenced, and which did not specify the documents Trends was required to provide for the audit.

[101] As has already been noted above, however, the date of the audit specified in the formal notification letter followed discussion between Mr Groves and Ms Smith, and took into account Trends' wish for the audit to take place as soon as possible.⁴¹ Thus, on 31 October 2014, Ms Smith had noted in her email introducing Mr Groves to Ms Garvie of Trends' wish for the audit to start near the end of next week (being

⁴⁰ See [83] of this judgment.

⁴¹ See [81]–[82] of this judgment.

Thursday 6 November). Ms Smith had then left it for Mr Groves and Ms Garvie “to organise a time that suits you both”.⁴²

[102] It is clear that further communications between Ms Garvie and Mr Groves confirmed that the audit would in fact commence at 9 am on 6 November 2014. It is therefore clear that, far from having a “bare one day’s notice”, the date of the audit was as had been agreed as between Callaghan, Deloitte and Trends, with a result that Trends had approximately one weeks notice of the audit itself and who was conducting the audit on behalf of Callaghan. This was confirmed by Andrew Johnson, in his response to the formal notice of audit, when he confirmed to Callaghan when exactly Deloitte were expected to arrive.⁴³

[103] Although at that point the documentation required by Deloitte had not been specified, Ms Garvie’s document request was provided via subsequent email to Mr Groves on 3 November 2014. As noted above,⁴⁴ the request included payroll documents for the month of September 2014; bank statements for the months of March 2014, June 2014, and September 2014; information on the determination of overhead rates; timesheet records for March 2014, June 2014, and September 2014; Trends’ latest financial statements; depreciation expense schedule; and all invoices and bank statements. Given it was Trends who was pushing for the audit to begin as soon as possible, and Mr Groves did not at any point indicate that he had insufficient time to prepare, I conclude the facts show clearly that there was no breach of either cl 5.3 or 5.4 by Callaghan prior to the commencement of the audit on 6 November 2014.

Conclusion – Issue Four

[104] Callaghan provided reasonable notice to Trends of the intended audit and Trends were clearly advised of the documentation to be provided at the commencement of the audit. As a result, Callaghan did not breach cls 5.3 or 5.4 prior to the commencement of the audit on 6 November 2014.

⁴² See [81] of this judgment.

⁴³ See [84] of this judgment.

⁴⁴ See [82] of this judgment.

The initial Deloitte investigation

[105] The audit commenced with a meeting between Deloitte and Trends. Mr Groves provided the Deloitte team with an updated version of Trends' October reconciliation, also entitled "R&D Costs 1 January 2014 to 30 September 2014" ("Trends' November reconciliation"). The major difference between the two documents was that the November reconciliation showed that the Q3 claims for eight of Trends' employees had been overstated, and an extra employee (T Veale) was claimed in respect of Q1, Q2 and Q3. The spreadsheet also confirmed that 100 per cent of the wages of all 37 Trends staff listed was being claimed as Eligible R&D Expenditure, with the exception of David Johnson; Mr Groves; and Ms Messer, claimed at 25 per cent, 90 per cent and 90 per cent respectively. Trends' November reconciliation also claimed net higher costs as Eligible R&D Expenditure for the Q1 and Q2 claims, \$1,009.45 and \$5,453.91 respectively, and reduced the Q3 claim by \$4,681.76.

[106] After the meeting, Deloitte started reviewing Trends' general ledger. Within a short space of time Ms Garvie recorded:

Initial review of GL identified not only inappropriate looking transactions, the management reports and cash flow spreadsheets did not reconcile. Raised these findings with Simon he could not explain and said he would look into and get back to us. (which he did not)

[107] Subsequent notes by Ms Garvie indicated that Deloitte had difficulties understanding Trends' financial records and how these related to the research project. After two days Deloitte concluded "this matter needs to be escalated to our forensic division and Callaghan be notified", noting in particular:

The subsequent interviews held with Andrew Johnson and Louise Messer did not convince us the R&D project activities were innovative or being conducted by Trends employees claimed by Trends management to be working on the project.

[108] In the meantime word of the progress of the audit had already reached Callaghan. Specifically, at 2.30 pm on 6 November Callaghan advised the office of the Minister:

As discussed, we have had Deloitte auditing Trends because we had become concerned about the legitimacy of some of their claims. Deloitte informed us today via a phone call that they believe Trends may have been fraudulent. Deloitte are meeting Trends again today to challenge them with their findings, prior to formalising any report to us.

[109] It is not clear what the source of Callaghan's information was. Neither Ms Garvie nor Ms Treadgold gave evidence and Mr Teh denied giving Callaghan any such advice. Indeed, fraud was neither ultimately established by Deloitte nor relied upon by Callaghan. At the request of the Minister's office, draft "lines" were prepared in the event the issue became public although, in the event, these were never used.

[110] Deloitte continued working through the information obtained from Trends, including testing samples of expenditure claims and R&D employees. Based on these samples, Deloitte reached the following "findings":

R&D NZ IAS 38

(NZFRS 13)

Expenditure

- Ambiguity over valid R&D expenditure from NZ IAS 38 and NZ FRS 13.

R&D Expenditure Testing Payment Validity

- Further discussion is required to determine what is considered a valid overhead expenses for R&D.

Our initial review notes a high proportion of expenses are business overheads.

Labour Costs

- 34 internal employees have been claimed as working full time on the R&D project. 90% of the CFO' [Chief Financial Officer] time is charged to this project.
- Additional information is required to confirm whether the 34 employees and additional contractors are working exclusively on the R&D project and are being paid.

Financial Stability

- Significant variances between the financial statements provided and management accounts. Both are not audited.

- Decreasing current and quick ratios where the current ratio is significantly below 1.
- Debtor collection days are above 90 days.
- Earnings appear to have improved as a result of amortisation being absorbed and negative wages. Further clarification is required.

[111] Deloitte formally reported to Callaghan on 11 November 2014. After updating Callaghan on the investigation and the headline findings to date, Deloitte’s notes of the meeting recorded that the “key question from Callaghan” was “has there been evidence of fraud?”, to which Ms Garvie was recorded as responding:

No haven't gone down that track. Could be poor record keeping and poor management. To determine if there is fraud would require an additional review. This engagement is based on the facts and Deloitte will present a report to Callaghan that they can choose to take further if they wish. If Callaghan feel they need to take it further, Deloitte could arrange their forensics team.

[112] The minutes went on to note Callaghan’s request to Deloitte “to focus and outline in the report section 10.4 of the Funding Agreement relating to termination of the agreement”.

[113] Following the meeting with Callaghan, Deloitte set out the focus of their ongoing investigation in the following terms:⁴⁵

- Clarify that R&D is research and development
 - Is the research innovative?
 - How has it changed? What is it now vs what it was 12 months ago?
- Determine labour claimed are working on R&D and real
 - Staff interviews - 10-15 interviews of people involved in R&D
 - What are they doing and proportion of time.
 - Need to develop scripts
 - What is the work they are working on
 - IRD numbers

⁴⁵ Subsequently included in a variation of the engagement letter with Callaghan on 19 November 2014 – see [116] of this judgment.

- Copy of IRD statements
- Determine material expenses are real and related to R&D
 - Rent assessment - management agreement from Trends
 - Valuation report provided to the bank
 - Determine reasonableness
 - G/L rent expenses – analyse
 - Intercompany rent - is that reasonable
- Complete expense testing – sample
 - Identify all exceptions for meeting with Simon Groves on Thursday
 - Complete testing.

[114] Deloitte’s workplan specified that the staff interviews would be carried out by James Cowan from Deloitte’s forensic division in Auckland. Mr Cowan, along with Ms Treadgold, carried out those interviews on 13 and 14 November, with all but one having David Johnson present at the interview. Deloitte noted a number of the staff that they wished to interview were absent. Meetings also took place to discuss the detail of Trends’ research project and project documentation as Mr Cowan and Ms Treadgold attempted to understand the nature of the project from the R&D claim to have been undertaken by Trends. In the course of the meeting between Mr Cowan, Ms Treadgold, Mr Johnson and Mr Groves, on 14 November 2014, Mr Groves confirmed that “everyone is considered to be working full-time on the project except for three people” – David Johnson, Louise Messer and Simon Groves himself.

[115] Following the 13 and 14 November meetings, Deloitte again retired to review its findings and provided a further update to Callaghan on 17 November 2014. Explaining that analysis was ongoing, Deloitte continued to identify issues with regard to rent, insurance, and rental equipment as well as labour costs, and noted that the ongoing analysis was made more difficult due to the quality of the records available from Trends.

[116] Following the update to Callaghan on 19 November 2014, Callaghan signed off on a variation to the engagement letter. The variation confirmed that Deloitte was to focus on the following key areas:

- Research and development with support from Callaghan's Investment Manager, understand the nature of the R&D being undertaken and analyse evidence supporting the R&D activities and progress being made.
- Labour costs - analyse and determine the extent to which claimed costs are supported by personnel who have worked/ are working on the R&D project over the time period/s claimed for and that those costs are supported by evidence and do not appear unreasonable (applying a sample basis through staff interviews and examining contracts).
- Rent and indirect costs - for rent, and other material indirect costs, on a sample basis, analyse and determine the extent to which costs claimed are supported by contracts, invoices or other documentation and do not appear unreasonable.
- Payments – understand the extent to which funding received by Callaghan has been paid /applied against above material costs.
- Solvency- provide an indication on Trends' solvency.
- Tax obligation - to determine the extent to which tax obligations are being met.

[117] On the same day, that is 19 November 2014, Mr Cowan and Ms Treadgold were approached by one of Trends' staff who advised that he had been instructed to lie by Trends' management when interviewed by Deloitte.

[118] This issue, coupled with technical issues including sending follow up emails to the Trends staff that had been interviewed, and ongoing perceived difficulties with the obtaining of financial information from Trends, led to further concerns being expressed by Deloitte about Trends. One concern, being the possibility that evidence relating to the Funding Agreement may be destroyed, led to Deloitte approaching the Serious Fraud Office ("SFO").

[119] At the same time, David Johnson wrote to Callaghan on 21 November 2014. He noted that the audit had been underway for three weeks and, while Trends was looking forward to the outcome, it was concerned about Deloitte's overall approach to

the audit. Of particular concern was that Deloitte “did not fully understand what we have applied for and what we have delivered in terms of the scope of the Grant”.

[120] Notwithstanding what appears to have been some apparent tension between Deloitte and Trends, Deloitte continued to work on its draft report to Callaghan and further requests for information continued to be made by Deloitte and were dealt with by Mr Groves.

[121] In anticipation of receiving the report, Callaghan prepared a draft media strategy with regard to Trends but noted that such would have to be agreed with the SFO prior to any release. On this issue, Callaghan noted, in its report to the Minister on 28 November 2014, that the SFO had requested that the fact that Trends had been referred to the SFO should be kept absolutely confidential. The media strategy was subsequently referred to the SFO who confirmed that they had by then commenced a formal investigation and were unlikely to have any comments.⁴⁶

[122] In the event a draft of the Deloitte Draft Report was provided to Callaghan on 2 December 2014. An amended version was formally provided to Callaghan on 9 December 2014, the 9 December version including an executive summary prepared by Deloitte.

[123] The executive summary of the Deloitte Draft Report set out the scope and focus of its engagement, and the background to the Funding Agreement, before setting out a summary of its key findings. Deloitte noted it had “found indications that Trends may have intentionally set out to mislead Callaghan to obtain funds to keep its business afloat financially whilst transitioning from a paper based to an on-line business operation”. Deloitte noted in particular that “only part of the work planned by Trends qualifies as R&D under IAS 38 in the Callaghan Innovation Funding Agreement”. The Draft Report reads:

The totality of the R&D activity is undertaken by [AnotherInnovation] contractors in conjunction with just five Trends employees. This contrasts with the average 32 employees recorded in the Trends claims as being connected with the R&D project. It appears Trends staff who are employed

⁴⁶ On 13 June 2017 the SFO completed its investigation into Trends and decided not to lay any charges against Trends or any individuals associated with the company.

to support the business doing usual MyTrends platform activities, are included in the funding claims. This is despite the launch of the MyTrends site occurring on or around July 2013 and now being used to generate revenue.

[124] Deloitte also noted concerns with the quality of Trends' accounting records and financial management practices and, in consequence of which, noted that it was "unable to fully analyse and assess the extent to which expenditure claimed for was not in accordance with the Funding Agreement". Deloitte elaborated further on its concerns with regard to the costs claimed by Trends in the full report:

Our recalculation of the labour costs claimed for the period 1 January 2014 - 30 June 2014 determined approximately 76% of these costs are not attributable to the R&D project, based on the identified employees (refer paragraph 2.10).

We have calculated the full ineligible labour cost for the period to be \$1,179,799.20 (excl. GST), resulting in potential over claimed labour costs to Callaghan of \$235,959.84 (excl. GST).

Based on the employees identified (refer paragraph 2.10) as working on the R&D project we estimate the total labour costs (i.e. wage and contractor costs) for the period 1 January 2014 to 30 September 2014 claimed should have been \$74,155.39 (excl. GST), rather than the \$319,615.20 claimed for the period.

[125] The Deloitte Draft Report went on to identify ongoing issues with regard to rent, insurance, and rental equipment, noting that the total value of potential and reasonable overheads claimed over the period 1 January 2014 – 30 September 2014 was \$104,257 excluding GST.

[126] Callaghan's thinking upon receipt of the Deloitte Draft Report was relevantly set out by a weekly report to the Minister dated 10 December 2014:

On 9 December 2014, we received the Deloitte's draft audit report. The report indicates that Trends may have intentionally set out to mislead Callaghan Innovation to obtain funds to keep its business afloat financially whilst transforming from a paper based to an on-line business operation; specifically:

- Only part of the work claimed by Trends qualifies as R&D under IAS38 and the Callaghan Innovation Funding Agreement. The totality of the R&D activity is undertaken by HubStar contractors in conjunction with just five Trends employees. This contrasts with the 32 employees recorded in the Trends claim as being connected with the R&D project.

...

- The financial ratios indicate poor liquidity and negative equity as at 30 September 2014. Trends are consistently exceeding or close to exceeding its \$650,000 approved overdraft limit each month. The auditors became aware of employees not receiving full wage payments during the period of this review. When Trends management were questioned about this they advised that they were relying on the Callaghan funding to pay staff.

In addition, the auditor's interviews with Trends employees were hindered by senior management's insistence that a Trends managing director sit in on all employee interviews - it appeared that there had been coaching and staff seemed nervous. Further, the quality of accounting records and financial management practices raised a number of red flags including lack of supporting document for payments, lack of review of reconciliations of expenditure and bank statements, inconsistent categorisations of expenditure resulting in drawings not being recognised as such and included in the business expenditure. Finally, there were indications that Trends may have been trading while insolvent.

The auditors analysed Callaghan Innovation's actions and correspondence with Trends during the application process. The auditors found that Callaghan Innovation did not appear to make any representation to Trends that Trends were legally or contractually entitled to alter claim information in order for their application to comply with the rules set out in the Direction to Callaghan Innovation - Criteria for Assessing Proposals for Funding.

[127] Callaghan confirmed to the Minister that it proposed “to follow a process similar to that set out in cl 5.6 of the Funding Agreement, which states that the contractor would be given an opportunity to comment on the Draft Audit Report within a reasonable time frame”.

[128] Notwithstanding the indication given to the Minister, Callaghan did then consider whether or not it should immediately terminate the Funding Agreement. However, by mid-December 2014 Callaghan had resolved to suspend the agreement while waiting for a response from Trends. To this end, it sought a meeting with Trends which took place on 17 December 2014. Callaghan were represented by Toby Litten and Paul Stephens, and Trends by David Johnson and Louise Messer. At the meeting Mr Stephens provided Trends with the Suspension Letter which advised:

On 8 December 2014 Callaghan Innovation was provided with a copy of a draft audit report prepared by Deloitte. The draft audit report sets out the results of Deloitte's review of the R&D growth grant funding provided to Trends Publishing International Limited by Callaghan Innovation under our funding agreement dated 2 April 2014. A copy of the executive summary of the draft audit report is enclosed.

Callaghan Innovation considers that Trends Publishing International has:

- a. used some or all of the R&D funding that was provided under the agreement other than as set out in the agreement, which gives us the right to terminate the agreement under clause 10.4(a); and
- b. claimed funding that it was not entitled to claim, including by claiming for expenditure that is not eligible R&D expenditure, which gives us the right to terminate the agreement under clause 10.4(c).

Callaghan Innovation also considers that Trends Publishing International has breached the following obligations under the agreement:

- a. its obligation to keep appropriate accounting and other records of its eligible R&D expenditure and its use of the funding (clause 5.1); and
- b. its obligation to provide Callaghan Innovation or its authorised agents (in this case, Deloitte) with any information that they reasonably require to determine whether Trends Publishing International is complying, or has complied, with the agreement, including reasonable access to staff, third parties and third party research contractors involved in the programme (clause 5.3).

In addition, Trends Publishing International may have breached clause 4.2 of the agreement, which requires that Trends Publishing International have in place intellectual property management practices and procedures in respect of its programme that will ensure that it maximises the benefits arising from the programme. Callaghan Innovation also considers that Trends Publishing International may be presumed to be insolvent, which is a ground for termination under clause 10.4(e).

Given the seriousness of the audit findings and breaches, Callaghan Innovation is giving you notice that is immediately suspending the agreement with Trends Publishing International.

Callaghan Innovation wishes to give you an opportunity to comment on the findings of the draft audit report, as set out in the executive summary, before it makes a decision as to whether to terminate the agreement.

Accordingly, please provide any comments to Callaghan Innovation by 4:00 pm on a date which is 5 days from the date of delivery of this letter. If you do not provide Callaghan Innovation with information that demonstrates, to our absolute satisfaction, that Trends Publishing International has claimed and used funding in accordance with the agreement and complied with all of its obligations under the agreement, we will terminate the agreement.

[129] As noted in the Suspension Letter, Trends were provided with a copy of the Executive Summary of the Deloitte Draft Report. Trends were also given a draft of the Suspension Press Release which provided:

Callaghan Innovation statement on Trends Publishing International Ltd

Callaghan Innovation has suspended a research and development (R&D) Growth Grant awarded to Trends Publishing International Ltd (Trends) following an audit of its funding claims.

Trends received approval for a three-year Growth Grant on 31 March 2014 following a detailed eligibility, assessment process. The company had received \$332,966.60 before the grant was put on hold.

All Growth Grant recipients are regularly monitored by Callaghan Innovation. Concerns about the legitimacy of some of Trends' claims against the approved R&D funding led to an internal investigation, followed by an independent audit. The matter has also been referred to the Serious Fraud Office.

Growth Grants are a non-discretionary R&D incentive programme which provide 20 per cent public co-funding for qualifying firms' eligible R&D expenditure. To qualify businesses must:

- Have spent at least \$300,000 on eligible R&D in each of the last two years
- Have spent at least 1.5 per cent of their revenue on R&D occurring in NZ over the last two years
- Be domiciled in New Zealand and maintain or increase their spending on R&D over the course of the funding.
- Have met financial and due diligence requirements
- Have provided a sufficiently detailed R&D plan, including an estimate of R&D expenditures over the next three years.

There are clawback provisions should a change occur that reduces the benefit to New Zealand. Breaches to the terms of Growth Grant funding agreements can incur remedial action including contract termination and the requirement to repay funds paid plus interest.

Suspension of a grant allows a company time to respond to notification of breaches before a decision is made on terminating the grant.

[130] At the meeting Mr Stephens and Mr Littin made it clear that they had no authority to discuss the audit findings and confirmed, notwithstanding the opposition of Trends, that the Suspension Press Release would be issued. In the event the Suspension Press Release was distributed to media from 5 pm on 17 December 2014.

Issue Five - Was Callaghan entitled to suspend the Funding Agreement on 17 December 2014?

[131] As Trends noted, in order for Callaghan to suspend the Funding Agreement it was required to comply with cl 5.10 which provided:

Callaghan Innovation may suspend payment of the Funding from the date of the notice of Audit if Callaghan Innovation considers that you may have breached this Agreement. In such case:

- (a) Callaghan Innovation will give notice that specifies that payment of the Funding has been suspended; and
- (b) if the final Audit report shows that you have not breached this Agreement, Callaghan Innovation will recommence payment of the Funding, and provide an amount equivalent to the amount of Funding that would have accrued if the Funding had not been suspended. If there has been a material delay to the Programme as a result of the suspension of Funding under this clause, the matter will be deemed to be a Change Event.

[132] Trends' submission is that Callaghan's decision to suspend the Funding Agreement was not lawful. However, no detail has been provided as to the basis of this submission other than to note that rights to suspend under clauses 2.2 and 9.2(c) were not available.

Discussion – Issue Five

[133] The power to suspend pursuant to cl 5.10 must be seen in the context of the Funding Agreement as a whole which, as noted, not only allowed either party to terminate upon two months' notice⁴⁷ and immediately for breach.⁴⁸ It also provided for a number of general powers for Callaghan to suspend payments to Trends in addition to cl 5.10, namely if Trends “[has] not complied with this agreement”,⁴⁹ and “if in the reasonable opinion of Callaghan Innovation [Trends] ability to carry out the programme is adversely affected”⁵⁰.

[134] Consistent with those other powers, the power to suspend under cl 5.10 did not set a high threshold, allowing Callaghan to suspend if it “considers that [Trends] **may** have breached the agreement”.⁵¹ Having triggered an audit under cl 5 and having been appraised of the progress of the Deloitte investigation throughout, given the strength of the conclusions contained in the Deloitte Draft Report, there can be no doubt that this provided a more than sufficient basis for Callaghan to conclude Trends may have

⁴⁷ The Funding Agreement, cl 10.1.

⁴⁸ Clause 10.3.

⁴⁹ Clause 2.2.

⁵⁰ Clause 9.2(c).

⁵¹ Clause 5.10 (emphasis added).

breached the agreement for the purposes of cl 5.10. In particular, the Deloitte investigation to that point had effectively substantiated Callaghan's own initial concerns with regard to rent, insurance, and rental equipment⁵² whilst raising additional significant issues with labour costs and other overheads, as well as broader issues regarding the solvency of Trends. In such circumstances, there can be no dispute Callaghan was entitled to suspend the Funding Agreement pending receipt of any response from Trends.

Conclusion – Issue Five

[135] The conclusions reached in Deloitte's Draft Report provided a more than sufficient basis for Callaghan to conclude Trends may have breached the Funding Agreement and therefore, pursuant to cl 5.10, Callaghan was entitled to suspend the Funding Agreement on 17 December 2014.

Issue Six - Did Callaghan breach the Funding Agreement by issuing the Suspension Press Release?

[136] Irrespective of whether Callaghan was entitled to suspend the Funding Agreement on 17 December 2014, Trends alleges that the issue of the Suspension Press Release independently breached the Funding Agreement. Trends took issue, in particular, with the information that the suspension had occurred after an audit of Trends' funding claims, that there had been an internal investigation followed by an independent audit, and that the matter had been referred to the SFO.

[137] Trends alleges that it is this breach that has been the cause of massive and ongoing loss to Trends. In particular, the evidence of both David Johnson and Andrew Johnson was that the development of Trends' digital platform had reached a point that Trends was poised to not only realise significant revenue through the operation of the platform in its core area of business, but that there was also considerable potential to market the platform as a package to be utilised by other businesses. Trends' evidence was that there were at least two investor opportunities being pursued at the time of the suspension decision and that these could not be pursued following the issue of the

⁵² See [124] of this judgment.

Suspension Press Release and its implication, with reference to the SFO, that Trends had engaged in fraud.

[138] Not only did Mr Corlett take issue with the accuracy of the Suspension Press Release itself, but submitted that the issue of the Suspension Press Release was “unlawful”, being in breach of Callaghan’s duty to act fairly and transparently towards Trends.⁵³ In addition, Mr Corlett submitted that it was in breach of cl 8 of the Funding Agreement which provided:

8. CONFIDENTIALITY

- 8.1 You acknowledge that Callaghan Innovation is required to release information relating to this Agreement, its investment in the Programme, the progress of the Programme, and the benefits to New Zealand from the Programme, from time to time.
- 8.2 You agree that Callaghan Innovation may release the following information relating to this Agreement, the Programme:
- (a) your name and contact details;
 - (b) the Contract ID;
 - (c) the title of the Programme;
 - (d) the fund from which Funding for the Programme is provided;
 - (e) the relevant sector;
 - (f) the total amount of Funding paid;
 - (g) the total amount of Funding payable over the duration of this Agreement;
 - (h) the year Funding was approved; and
 - (i) statistics relating to the Programme in aggregated form.
- 8.3 You acknowledge that Callaghan Innovation may release information relating to this Agreement to its duly appointed agents and advisors, the Ministry of Business, Innovation, and Employment, and New Zealand Trade and Enterprise.
- 8.4 Except as provided for in clauses 8.2 and 8.3, Callaghan Innovation will not release information relating to this Agreement unless Callaghan Innovation is obliged to release that information under the Official Information Act 1982, the Privacy Act 1993, at law, under any regulation or to provide an answer to any parliamentary questions, meet any parliamentary requirements, or provide information to a Minister.

⁵³ Callaghan Innovation Act 2012, s 15(2)(a).

8.5 Callaghan Innovation will advise you if it receives a request under the Official Information Act 1982 or the Privacy Act 1993 for any information relating to this Agreement, and will consult with you before responding to the request.

[139] In response, Mr McLellan submitted that Trends' allegation of breach of cl 8 was misconceived, namely a "defamation cause of action thinly disguised as a breach of contract". Mr McLellan noted that the allegation had in fact begun as a defamation pleading but that was ultimately abandoned in November 2016.

[140] More broadly, Callaghan contends that the information in the Suspension Press Release was "not confidential, simply a public statement by Callaghan about its actions, and its publication did not breach cl 8.4", noting that there was no suggestion that the confidential nature of the information disclosed had caused the loss but rather the fact of the disclosure had caused damage to Trends' reputation. In Mr McLellan's submission:

Although cl 8.4 does not expressly refer to confidential information, the clause is in the "confidentiality" section of the contract. A reasonable person reading cl 8.4, and having all relevant background knowledge, would understand it to mean that Callaghan was prohibited from releasing any confidential information communicated to Callaghan for the purpose of the Funding Agreement including the application for a grant.

The fact that the word 'confidential' is not included in the body of cl 8.4 does not affect the scope of the protection afforded. A reasonable reader would see it as applying to information that justifies a restriction on release. While the notional reasonable person may not be familiar with legal authorities delineating the scope of confidentiality obligations, they will have a general understanding that confidentiality provisions are intended to limit the release of information that is rightly the property of another person.

Confidentiality obligations protect the confidentiality of information for the benefit of the owner of that information. In equity, confidentiality obligations arise where confidential information is 'communicated to another party in circumstances importing an obligation of confidence'. Confidentiality obligations are owed to the owner of that information by persons to whom that information has been communicated. The prohibition in cl 8.4 applies only to confidential information belonging to Trends that has been communicated to Callaghan, and not to information belonging to Callaghan or information about Callaghan's own views and conduct.

This is particularly so considering that cl 8.4 only binds Callaghan – it accordingly restrains only the disclosure of information which is Trends' confidential property. Clause 8.4 applies only to Callaghan because the information that it covers is information in respect of which Trends, but not Callaghan, has an expectation of protection. Clause 8.4 was included in the Funding Agreement to protect the confidentiality of the considerable amount

of commercially sensitive information that grant recipients provide to Callaghan, particularly under the audit and reporting obligations set out in the Funding Agreement. The grants, by their nature, are in respect of innovative research and development which are likely to involve valuable intellectual property. Clause 8.4 provides Trends with the necessary assurance that all such information will be protected.

(footnotes omitted)

[141] As a result, it was Mr McLellan’s submission that the information objected to by Trends, and indeed the rest of the Suspension Press Release, was not “information relating to the agreement for the purposes of clause 8.4”, but rather:

Information about Callaghan’s decisions and steps that had been taken in relation to the review that Callaghan was at liberty to disclose or not. It was not confidential information belonging to Trends.

[142] Finally, it was Mr McLellan’s submission that even if the information in the Suspension Press Release was “information relating to the agreement” for the purposes of cl 8.4, it was required “at law” to release this given the obligation of Callaghan to act “fairly and transparently” in carrying out the allocation and administration of funding under its Act,⁵⁴ and the implementation of systems and procedures to give effect to that.⁵⁵ Mr McLellan noted, for example, the publishing of Callaghan’s investment decisions on its website. As a result, it was Mr McLellan’s submission that Callaghan did not breach cl 8 of the Funding Agreement.

Discussion – Issue Six

[143] The issue to be determined is whether the three pieces of information contained in the Suspension Press Release to which Trends has objected was information relating to the agreement in terms of cl 8.4, namely that:

- (a) a suspension took place after an audit;
- (b) there had been an internal investigation followed by an independent audit; and

⁵⁴ Section 14(1)(f).

⁵⁵ Section 15(2)(b).

(c) that Callaghan had referred Trends to the SFO.

[144] It is no answer to suggest that, as cl 8 was entitled “confidentiality”, the information had to be confidential in the sense of information which could justify a restriction, given the whole of cl 8 is far more widely drafted. As Mr Corlett submitted, the general power for Callaghan to release information pursuant to cl 8.1 was restricted by cls 8.2 and 8.3 to specific information,⁵⁶ and/or to specific parties,⁵⁷ with cl 8.4 expressly providing that, other than as provided in these two clauses, Callaghan “will not release information relating to this Agreement”. In those circumstances, the cases relied upon by Mr McLellan in *SBJ Stephenson Ltd v Mandy*⁵⁸ and *Lasing Lude Ltd v Kerr*⁵⁹ do not assist Callaghan.

[145] In *SBJ Stephenson*, Bell J considered an alleged breach of confidentiality in an employment contract which provided:

CONFIDENTIAL INFORMATION

12(A) The Executive shall not either before or after the termination of his employment hereunder disclose to any person or persons any information in relation to the affairs of the Company or any other Group Company or any client thereof of which he has become or may have become possessed whilst in the service of the Company except in the proper course of his duties hereunder or as authorised by the Board or as ordered by a Court of competent jurisdiction.

[146] The Judge held that the use of the word “confidential” in the heading was “to tell the reader at a glance what the clause is about”.⁶⁰ He added:⁶¹

The ordinary sensible person reading clause 12(A) would read it as applying to information which could justify a restriction. That ... meant information which its owner used in a trade or business; dissemination of which he limited or at least did not encourage or permit on a widespread basis; and which, if disclosed to a competitor, would be liable to cause real or significant harm to the owner. The class of such information was wider than trade secrets, strictly so called, but narrower than confidential information, generally so called.

⁵⁶ The Funding Agreement, cl 8.2.

⁵⁷ Clause 8.3.

⁵⁸ *SBJ Stephenson Ltd v Mandy* [2000] FSR 286 (QB).

⁵⁹ *Lasing Linde Ltd v Kerr* [1991] 1 WLR 251 (CA).

⁶⁰ *SBJ Stephenson Ltd v Mandy* [2000] FSR 286 (QB) at 297.

⁶¹ At 297-298.

[147] In arriving at this conclusion, the Judge cited *Lasing Linde Ltd v Kerr*, another decision discussing the scope of a confidentiality clause in an employment contract.⁶²

[148] There are two issues with the application of these decisions in this case. First, both are clearly directed toward the same issue, namely the use of trade secrets and confidential information by employees, which is not relevant to the present case. Second, and perhaps more importantly, as a matter of construction cl 8 in the Funding Agreement is explicit about what information may be provided by Callaghan. In particular, the type of information specified in cl 8.2 of the Funding Agreement makes it clear that cl 8.4 is considerably wider in scope in the type of confidential information referred to in *SBJ Stephenson* and relied upon by Mr McLellan.

[149] It is also difficult to see how the information objected to by Trends, set out at [143](a) and (b) cannot be seen as “information relating to this Agreement” given that cl 8.2 makes it clear that the year funding was approved,⁶³ and the total amount of funding paid and payable,⁶⁴ are all information relating to the agreement. It must be the case that information about the suspension or termination of the funding by Callaghan is “information relating to this Agreement”, as are any steps that have been taken to get to that point including internal investigations and audit or reviews.

[150] On the other hand the reference in the Suspension Press Release to the referral to the SFO is not directly related to the funding obtained by Trends and, therefore, “information relating to this Agreement” nor, as Mr McLellan pointed out, was it information confidential to Trends. On this basis Callaghan was not precluded by clause 8 from disclosing the reference to the SFO. While then, the reference in the Suspension Press Release that Callaghan had referred Trends to the SFO appeared somewhat gratuitous, it was nonetheless information that Callaghan could be expected to provide as part of the obligation to all its stakeholders. Callaghan’s duty to act fairly and, in particular, transparently for the reasons discussed in relation to **Issue One**,⁶⁵ is not only towards those organisations who apply for, or are awarded grants, but is owed to New Zealand society at large. By noting that the “matter had been referred to the

⁶² *Lasing Linde Ltd v Kerr* [1991] 1 WLR 251 (CA).

⁶³ The Funding Agreement, cl 8.2 (h).

⁶⁴ Clauses 8.2(f) and (g).

⁶⁵ See from [53] of this judgment.

Serious Fraud Office” it demonstrated that it was taking its obligations seriously. Given those circumstances I am therefore satisfied that Callaghan did not breach cl 8 of the Funding Agreement by noting the “matter had been referred to the Serious Fraud Office”.

[151] With regard to the information that was “information relating to this Agreement”, the suggestion that Callaghan was required “at law” to disclose the information is without merit. The obligation under s 15 to “act fairly and transparently” in the administration of funding falls well short of being an obligation to release specified information, particularly when there was no suggestion otherwise that such information had been requested.

[152] Despite this, for the reasons noted in the discussion with regard to **Issue One**, Callaghan’s broader statutory obligations including acting fairly and transparently to ensure that the activities it undertakes are for the “benefit of New Zealand” and complying with the Minister’s Direction are still relevant.⁶⁶ The Minister’s Direction, in particular, makes it clear that funding is only provided for Eligible R&D Expenditure and, if not, that matters are taken seriously allowing Callaghan to immediately remove businesses from the initiative. In such circumstances, it follows that as cl 8.2 authorised Callaghan to release details of the approval of funding⁶⁷ it must also be able to release the corollary of that information, details as to whether funding has been suspended or terminated and, in broad terms, the reasons for doing so.

Conclusion – Issue Six

[153] Callaghan did not breach cl 8 of the Funding Agreement by issuing the Suspension Press Release. The reference to the referral to the SFO was not information relating to the agreement which was required to be released, nor was it precluded from doing so. Instead it was information which fairness and transparency to the New Zealand public entitled Callaghan to release. The remaining information objected to by Trends were necessary corollaries to information that Callaghan was

⁶⁶ Callaghan Innovation Act 2012, s 15(10(a)).

⁶⁷ The Funding Agreement, cl 8.2(f), (g), and (h).

specifically entitled to release and required to do so pursuant to its wider obligations to act fairly and transparently.

The Trends response to the suspension decision

[154] Following the 17 December 2014 meeting and the suspension of the Funding Agreement, Deloitte prepared a further redacted version of the Deloitte December report which it provided to Callaghan on 22 December 2014. The redacted report was not provided to Trends prior to the closure of Callaghan's office for Christmas, which took place on 23 December 2014, as Callaghan sought clarification from Deloitte as to the nature and scope of the redactions made. Copies of the appendices to the Deloitte Draft Report were however provided to Trends on 24 December 2014.

[155] On 16 January 2015, and before any redacted copy of the full Deloitte Draft Report was made available to Trends, Trends provided its first formal response to the suspension entitled "Response to Deloitte Executive Summary of the Draft Audit Report" ("Trends' January response"). In this document Trends argued that it had carried out its obligations in accordance with the Growth Grant application and noted in particular:

Deloitte have made the assumption that our research was purely technically based and failed to read our application or listen to our explanation that you can not come to a conclusion on how you will create a technical solution, without understanding the range of areas our project ultimately interacts with; such as but not limited to industries, systems, global logistics, manufacturing, retail, business models, expert knowledge, home building or renovating system, existing research. The R&D project was never limited to technical research only. We believe that this is at the heart of Deloitte's flawed assessment of what Trends is doing.

[156] Trends went on to criticise Callaghan's lack of understanding of the project, the lack of any meetings between Callaghan and Trends prior to the audit, and the approach of Deloitte to the audit itself. Trends reiterated its position that it was Callaghan that had breached the Funding Agreement through breach of cl 8 and that Callaghan had otherwise not followed due process. As a result, Trends argued:

By breaching the section 8 Confidentiality clause and not following due process, significant damage has been done to public perception of the Trends brand, personal reputations and internal staff moral. These include the

postponement and cancellation of major business partnerships. We believe responsibility for these negative effects lies 100% with Callaghan.

Trends strongly contends that it would have been in the best interest of both parties to adhere to the terms of the contract in order to ensure a fair and reasonable process was undertaken.

[157] In relation to the R&D labour costs Trends advised:

Information was supplied as requested at 11.53 am on Wednesday 15 October but, with the pressure put on us to produce this as urgently as possible, Simon named R & D staff with titles that would relate to what he believed matched the milestones, as these were the only reference to our R & D that Callaghan would understand.

[158] In addition:

We offered to produce for Deloitte an exact breakdown of staff tasks, time, associated costs and milestone-to-R & D relationships. This was declined as they only wanted to see existing documents supplied to Callaghan.

[159] Following receipt of Trends' January response, an updated redacted copy of the Draft Deloitte Report (still dated 22 December 2014) was provided by Deloitte to Callaghan on 22 January 2015. This was in turn provided to Trends under cover of a letter from Callaghan dated 29 January 2015. At this point, Callaghan gave Trends a further 10 working days "to review the full draft report and advise [Callaghan] of any modifications [Trends wishes] to make to [its] response to the Executive Summary".

The letter went on to advise:

We are still analysing your response to the Executive Summary, but for clarity we reiterate that Callaghan Innovation's main concerns are that Trends Publishing International has:

- a. used some or all of the R&D funding that was provided under the agreement for purposes other than those as set out in the agreement, which gives us the right to terminate the agreement under clause 10.4(a); and
- b. claimed funding that it was not entitled to claim, including by claiming for expenditure that is not eligible R&D expenditure, which gives us the right to terminate the agreement under clause 10.4(c).

Callaghan Innovation also considers that Trends Publishing International has breached the following obligations under the agreement:

- a. its obligation to keep appropriate accounting and other records of its eligible R&D expenditure and its use of the funding (clause 5.1); and
- b. its obligation to provide Callaghan Innovation or its authorised agents (in this case, Deloitte) with any information that they reasonably require to determine whether Trends Publishing International is complying, or has complied, with the agreement, including reasonable access to staff, third parties and third party research contractors involved in the programme (clause 5.3).

Callaghan Innovation also considers that Trends Publishing International may be presumed to be insolvent, which is a ground for termination under clause 10.4(e).

We have, accordingly, given you notice of the suspension of the agreement with Trends Publishing International.

Please advise us of any modifications you wish to make to your initial response by 4:00 pm on Wednesday 11 February 2015.

We remind you that if you do not provide Callaghan Innovation with information that demonstrates, to our absolute satisfaction, that Trends Publishing International has claimed and used funding in accordance with the agreement and complied with all of its obligations under the agreement, we will terminate the agreement.

[160] Following the provision of the Deloitte Draft Report, Trends somewhat surprisingly requested a copy of the Funding Agreement from Callaghan, as well as a part of the Deloitte Draft Report which had been redacted; namely the “Callaghan’s Representations to Trends” section. The Funding Agreement was provided immediately, however, the redacted section requested was not provided prior to Trends next response on 12 February 2015 (“Trends’ February response”).

[161] Trends’ February response confirmed that its January response remained relevant and that the February response constituted additional comments. Overall, it was Trends’ position that the Deloitte conclusions were “wrong in fact and law” and disputed that Callaghan had any basis to terminate the Funding Agreement.

[162] In relation to research and development contracted under the Growth Grant, Trends relevantly advised:

The R&D funded under the growth grant related to many areas of content production, logistics, processes as well as software development.

- The R&D activity outlined in section 5 of the application highlights work in many areas such as but not limited to industries, systems, global logistics, business models, expert knowledge, home building or renovating system, content production. It was never limited only to technical research and development. It had to include processes required to run the system and to be able to run within it once the R&D was completed.
- The R&D was never solely focused on the development of software.

[163] Trends then went on to deal with a number of specific matters including confirming that 32 staff had been involved in eligible R&D activities, denying that the platform had been launched in July 2013, and minimising the role of the whistleblower referred to in the Deloitte Draft Report. Overall, Trends went on to confirm that it considered cl 3.2 of the Funding Agreement had been adhered to and that it had been Callaghan that had breached cl 8 of the Funding Agreement.

[164] Following receipt of Trends' February response, Deloitte provided feedback to Callaghan on the matters raised by Trends. Overall, Deloitte's advice was that no changes to its findings or conclusions were required.

[165] This position was confirmed on 25 February 2015 when Deloitte sent Trends a document headed "Trends Draft Report Response" dated 20 February 2015. This document confirmed that Deloitte had "considered all information provided to [it] and have not identified any material factual errors to change [its] view".

[166] Deloitte did however note that, with regard to a range of factual errors alleged by Trends, it was prepared to "consider those upon receipt of specific information to support the statements made by Trends, and in particular:

- Validity and Progress of R&D Activities paragraphs:
 - 2.3, 2.4, 2.7, 2.8, 2.9, 2.10, 2.11, 2.12, 2.13, 2.14, 2.25 to 2.27
- Quality of Accounting Information and R&D Expenditure Analysis paragraphs:
 - 2.32, 2.39, 2.41, 2.44 to 2.46, 2.48, 2.51, 2.52
- Solvency of Trends Publishing International:
 - 2.58.

[167] Trends was given until 2 March 2015 to respond, but on 27 February 2015 David Johnson emailed Callaghan requesting an extension until 16 March 2015, at the same time raising various other specific procedural matters with regard to the Deloitte Draft Report.

[168] Callaghan denied Mr Johnson's request for an extension commenting:

You were first formally put on notice that the outcome of the audit was not in Trends favour on [17] December 2014 and at that time you were provided with an Executive Summary of the audit report. You have subsequently been provided with the full draft report and further time to respond, and now we have given you further time to provide source documents. The documentation requested is no more than what would be expected in any audit of your business, and we have advised that Deloitte staff are available to attend at your offices to view any documents. Accordingly, we see no reason to extend the response deadline of 5 pm on Monday 2 March.

[169] Given this position, Trends provided its further response by email on 2 March 2015 ("Trends' March response"). In relation to the request for evidence of the R&D work done since January 2014 by every individual claimed for in the three quarterly claims Trends commented:

The R&D work relates to many areas and milestones.

Evidence has already been provided for the milestones (tagging, messaging etc) that were achieved during the claim period. This can be re-provided if necessary.

We are providing a matrix of all staff members claimed for work on R&D that shows their contribution to the milestones that were achieved as well as work they undertook during the claim periods that relates to future milestones.

Within the timeframe enforced to deliver this response, we are unable to provide additional evidence such as software and coding that has been developed.

Appendix A: All Staff: Current and Past claimed for - Previously Supplied

Appendix B: All current eligible staff at time of Audit - Claimed and Unclaimed and accurate percentage of time.

Appendix C: Trends R and D Staff Matrix.

[170] The Appendix A referred to in Trends' March response was Trends' November reconciliation provided by Mr Groves to Deloitte at the commencement of the audit on 6 November 2014. Appendix B was a new document which changed the relative

apportionment of R&D expenditure for 26 Trends staff previously listed in both the October and November reconciliations. In addition it added a further four staff not previously claimed as having been involved in the project in either the quarterly claims or the previous reconciliations. Only two of Trends' staff listed in Appendix B remained at 100 per cent Eligible R&D Expenditure, namely Andrew Johnson and Marenka Simunac, with the remainder now being claimed at between 50 and 90 per cent. The three staff previously not claimed at 100 per cent (David Johnson, Simon Groves and Louise Messer) remained at 25 per cent, 90 per cent and 90 per cent respectively. The amount of David Johnson's claimed wages was however significantly increased across the three quarters from \$45,303 to \$72,484.50 without any explanation. The four employees not previously claimed for (C Moxham, A Nortje, P Taylor and N Adams) were stated to have been claimed at between 30 and 50 per cent but not only referred to a non-existent "original claim" but the amounts claimed were apparently based on significantly inflated wages that were not able to be reconciled with any other documents provided by Trends. Appendix C purported to provide a description of tasks undertaken on the project by each staff member.⁶⁸

[171] The remainder of Trends' March response largely confirmed Trends' position on various issues with reference to particular documents.

[172] Callaghan obtained comment from Deloitte. With regard to the wages claimed by Trends in respect of the research and development activities Deloitte noted:

- Trends [were requested to] provide evidence of the R&D work done since 1 January 2014 by every individual claimed for in the three claims is for R&D [para 2.4, 2.7, 2.8, 2.9, 2.10]
- Trends provided the following documents to support the R&D work completed since 1 January to 30 September 2014:
 - **Appendix A:** An excel spreadsheet that outlining current and past employees' wages for the periods claimed for and this is the same copy of what was provided to us at the outset of this review.

⁶⁸ In the course of the hearing various Trends' witnesses claimed that Appendix C had been supplied to Deloitte in November 2014, although there is no record of it having been provided. There is no reference to Appendix C having been previously supplied (in contrast to Appendix A) and indeed Trends' January response referred only to the offer of the provision of such a schedule (see [157] of this judgment). I am therefore satisfied that it was in fact provided for the first time in March 2015 and that it was a document prepared by Trends in response to the audit. In any event it did not represent any form of contemporaneous record of staff activities but rather was a retrospective reconstruction, providence unknown.

- **Appendix B:** An excel spreadsheet identifying the percentages of time staff have been working on R&D activities and an R&D matrix. We note this information does not reconcile to Appendix A or the initial information provided to us by Trends.
- **Appendix C:** An excel spreadsheet setting out the R&D milestone and status. As noted during our review some of these milestones are not "eligible" phases under the agreement.
- We require that Trends provide on-site access to sight relevant supporting source documentation / information from core or source systems including:
 - Timesheets, payroll extracts, and wage slips, and job descriptions for new employees.
 - Assembla rosters for milestone development for the "software as a service"
 - Access interview Hubstar employees to understand what R&D is attributable to the "software as a service" (R&D component) and MyTrends platform code refinement for clients advertising on this platform (i.e. as claimed by Trends as being attributed to the Revenue).

[173] Deloitte went on to note that Trends had failed to provide information to support its claims that the work carried out by AnotherInnovation was research and development, that Trends had not received advertising revenue on the MyTrends platform, and that Trends had relevant IP on the work undertaken and related to information it required to address those issues.

[174] A copy of Deloitte's analysis of Trends' March response was emailed to Trends on 4 March 2015. Callaghan's covering email noted with specific reference to the labour costs claimed by Trends "the appendices are not 'source documents' and, therefore do not allow Deloitte to complete a full and proper audit". To address this Callaghan proposed that Trends allow Deloitte:

... access to the premises and unimpeded access to the Trends' files and general ledger ... so as to allow Deloitte to conduct [a] full and proper audit.

[175] Callaghan went on to note that if this did not occur Callaghan would request Deloitte to finalise its report on the information currently held, and Callaghan would make a decision based on that.

[176] Trends responded and agreed to provide the information Deloitte required to complete the audit. Following emails between the parties, rather than Trends providing a further written response it was agreed that Deloitte would attend Trends' offices on 11 March 2015.

[177] Prior to the meeting taking place, on 10 March 2015, Trends provided a further document "outlining how [Trends] will be responding". This document noted, in particular, Trends would explain Appendix A and B at the meeting and confirmed that timesheets had not been kept by Trends.

[178] The meeting between Trends and Deloitte proceeded on 11 March 2015. Much of the discussion focussed on the apportionment of the staff in Trends' November reconciliation/Appendix A, B and C as Eligible R&D Expenditure against the criteria for Eligible R&D Expenditure in the Funding Agreement. In the course of that discussion, Trends accepted that the percentages allocated to staff, and in particular those still recorded as being 100 per cent involved in the project in Trends' November reconciliation/Appendix A, and not referred to in Appendix B, would have to be reviewed. Based on this, Trends accepted at the meeting that the initial quarterly invoices were not accurate but suggested that this would have been sorted out through the end of year report mechanism in the Schedule to the Funding Agreement. As Mr Groves explained at the meeting, Trends "still need to work out exactly who is involved in the project thing".

[179] The meeting on 11 March 2015 concluded Trends' response to the Deloitte Draft Report.

Issue Seven - Did Callaghan comply with the procedural requirements of the Funding Agreement in providing an opportunity for Trends to respond?

[180] In my consideration of **Issue Three** I concluded that Callaghan had initiated an audit for the purposes of cl 5 of the Funding Agreement, and that it had complied with the procedural requirements for initiating the audit. The focus of **Issue Seven** is whether Callaghan complied with cl 5.6 of the Funding Agreement which provides:

You will be given the opportunity to comment on the draft Audit report within a reasonable timeframe. Callaghan Innovation will finalise the draft Audit report after receiving and considering your comments (if any), and provide a copy of the final Audit report to you.

[181] Trends' position is that Callaghan did not comply with cl 5.6. Mr Corlett submitted that the Deloitte Draft Report was not provided within a reasonable timeframe. Mr Corlett noted, in particular, that Trends was only provided the Executive Summary of the Deloitte Draft Report on 17 December 2014, the appendices referred to in the Executive Summary on 24 December 2014, and the full (redacted) copy of the Deloitte Draft Report on 29 January 2015. Notwithstanding those submissions, Mr Corlett accepted that this alleged breach "was not directly causative of loss" as Trends had already sustained its most significant loss with the Suspension Press Release on 17 December 2014.

[182] There was no suggestion by Mr Corlett that Callaghan failed to comply with the other components of cl 5.6, namely that Callaghan finalised the draft Audit report after receiving and considering Trends' comments, nor that a copy of the final report was ultimately provided to Trends.

Discussion – Issue Seven

[183] The requirement in cl 5.6 was for Trends to receive the Deloitte Draft Report within a reasonable time. "Reasonable time" is not defined in the Funding Agreement but clearly the fact that a copy of the Deloitte Draft Report was not made available until 29 January 2015 did not result in any material prejudice for Trends. On the contrary, as the preceding section makes clear, while Trends' January response was, of necessity, limited to the Executive Summary provided by Callaghan to Trends on 17 December 2014, Trends was subsequently given time to make detailed submissions on the Deloitte Draft Report itself, which it did so in Trends' February response. Following Deloitte's analysis of Trends' February response, Callaghan then gave Trends a further chance to comment and provide further information on a range of specific matters which it elected to do (Trends' March response), before the final request for clarification by Callaghan led to the 11 March meeting between Deloitte and Trends.

Conclusion – Issue Seven

[184] There can be no doubt Trends was given ample opportunity to respond to the Deloitte Draft Report, not only in time but also on the guidance provided by Callaghan and Deloitte as to the areas in which a response was required. The report was only finalised after receiving and considering Trends' comments. I therefore conclude that Callaghan complied with cl 5.6 of the Funding Agreement.

The termination of the Funding Agreement

[185] Following the 11 March 2015 meeting, Deloitte proceeded to finalise its report. A finalised report was forwarded to Callaghan on 23 March 2015, however, Callaghan identified an issue with capitalisation which resulted in further changes being made, essentially removing capitalisation as an issue in the final report. While those changes were being made, Trends sent a letter of demand from its solicitor to Callaghan advising that it intended to pursue a claim for damages caused by Callaghan's actions and its failure to follow due process as set out in the terms and conditions of the Funding Agreement. The letter went on to advise:

Our client also wants assurances that the next stages in this review process will follow a fair and reasonable protocol.

Trends Publishing International should have the right to review Deloitte's full audit report when it is finally completed - and have the opportunity to discuss this with Callaghan Innovation before there is any further release of information to the public. ·

Could you please confirm what the process will be?

Regardless of that process, our clients believe that the situation warrants some discussion between them and you, as soon as possible.

[186] No response appears to have been made. Instead, Deloitte completed the amendments and reissued the Deloitte Final Report to Callaghan on 1 April 2015.

[187] After setting out the process followed, and the objective of the investigation, the Executive Summary of the Deloitte Final Report advised:

Trends was approved for a Growth Grant to assist with the R&D for a digital platform it was developing that includes innovative lead generation "software as a service", a CRM engine and project management functionality.

Trends believe that the eligible R&D is more than just development of a piece of software. It encompasses the development of the operating support systems that are required to sell the service to clients.

Due to the commercial sensitivity of these R&D goals, Trends has told us that staff are unaware of the innovative solution that Trends is working towards and their staff will not always be able to articulate the research element of their work. On the face of the records on site, Trends appears to be developing the existing myTrends website, however Trends insist that this work is actually part of the (“confidential”) R&D project.

Trends has now amended their apportionment of staff time spent on R&D by staff included in the claim, but maintain that the staff in the claim are working on R&D, albeit at the amended apportionments. Despite this, Trends has not been able to provide us with any supporting source evidence that satisfies us as to the accuracy of their claim. The only evidence that has been provided (job descriptions, staff interviews and a retrospectively prepared staff allocation matrix) is in our opinion inconclusive and lacks substance.

In Section 4 of this report we set out our detailed analysis and findings. This analysis has led us to form a view that Trends may have misled Callaghan, in that the funding has, at least in part, been used to support their transformation from a paper based to an on-line business operation.

In our view, there are potential breaches of the Trends funding agreement with Callaghan. We set out these potential breaches in Section 5. In summary they are:

- Trends has provided Callaghan Innovation with inaccurate or misleading information relating to the cost of internal labour associated with R&D.
- No detailed project management documentation has been maintained to support the research activities completed by staff.
- Trends started generating advertising revenue on its live platform (myTrends which is now the Trends website) since at least August 2014. Due to lack of documentation the live platform/website is indistinguishable from 'the Project' in terms of determining what has generated the revenue.
- We have identified ineligible expenditure that has been claimed as overheads and labour costs. This includes, but is not limited to, director's life insurance premiums, bank fees, and international travel insurance.
- Trends is under significant financial pressure. There are a number of concerning indicators that suggest that Trends is at high risk of being insolvent.

[188] The basis for the Deloitte findings of suspected breach were set out in Section 4 of the Deloitte Final Report. In relation to the labour component Deloitte provided a robust analysis of the inconsistencies in the Trends claims for wages, the lack of any

contemporaneous documentation backing up Trends' claims. In Section 5 of the Deloitte Final Report Deloitte set out its view as to whether Trends had breached the Funding Agreements and, in particular, identified potential breaches to clauses 10.4(b) and (c), 5.1 and 3. Deloitte also noted that Trends was balance sheet insolvent and, therefore, potentially in breach of cl 10.4(e). On this issue Deloitte set out a solvency analysis of Trends at Appendix A of the final report but noted that further information would be required before a definitive conclusion could be drawn on whether Trends was in fact insolvent.

[189] After considering the Deloitte Final Report, Callaghan briefed the Minister on Deloitte's conclusions and advised that it intended to terminate the agreement and seek to recover all of the funding paid by Callaghan to Trends under the Funding Agreement. On 21 April 2015, Callaghan personnel visited Trends' offices and delivered to Trends:

- (a) a copy of Deloitte's Final Report dated 1 April 2015;
- (b) the Termination Letter; and
- (c) a copy of the Termination Press Release, to be released to the media after the meeting.

[190] The Termination Letter stated that Callaghan was terminating the agreement:

In accordance with clause 10.3, for breach of clause 5.1, on the basis that Trends has not kept appropriate accounting and other records of its Eligible R&D Expenditure and its use of the Funding, nor managed its records in accordance with recognised research and accounting best practice standards, so as to enable Callaghan Innovation to carry out an audit to determine whether Trends is complying or has complied with the Agreement;

In accordance with clause 10.4(b), on the basis that Trends has provided Callaghan Innovation with misleading or inaccurate information;

In accordance with clause 10.4(c), on the basis that Trends has claimed for funding that it is not entitled to claim under the Funding Agreement, including claiming for expenditure that is not Eligible R&D Expenditure as described in clauses 3.1 and 3.2, by reference to NZ IAS 38 and NZ FRS 13.

[191] The Termination Press Release was issued following the meeting. This relevantly provided:

Callaghan Innovation has terminated a Research and Development Growth Grant awarded to Trends Publishing International Ltd (Trends).

The grant was suspended on 17 December 2014, after concerns were raised over some of Trends' R&D funding claims. The decision to terminate follows a thorough investigation including an independent review that found Trends breached the terms of its funding agreement and was unable to demonstrate that amounts claimed against the grant were for eligible R&D.

Callaghan Innovation is now seeking full repayment of the funding it has paid to Trends (\$382,911.97 incl GST).

Callaghan Innovation Chief Executive Mary Quin says, "It is important the public is confident government R&D funding is being managed in a responsible and robust way and that businesses know that the system designed to help them innovate is being run transparently and fairly."

Issue Eight - Did Callaghan have grounds to terminate the Funding Agreement on 21 April 2015?

[192] Trends strongly disputes that Callaghan had grounds to terminate the Funding Agreement on 21 April 2015 and relied upon a wide range of matters to support this proposition, both procedural and substantive.

[193] First, Trends takes issue with the lack of identification of any breach of the Funding Agreement at the time the Funding Agreement was suspended. Trends also takes issue with defects in the Termination Letter, including references to Deloitte's Draft Report rather than Deloitte's Final Report and the ostensible lack of reliance by Callaghan upon the final report.

[194] With regard to the identified breaches of the Funding Agreement noted in the Termination Letter and purportedly relied upon by Callaghan:

- (a) Trends relied upon the evidence of Dr Murray Milner, an engineer with over 40 years' experience in the ICT industry and Jai Basrur, a management accountant and corporate finance adviser who both analysed the work undertaken by Trends pursuant to the Growth Grant. On the basis of that evidence Trends disputed it had failed to keep

appropriate accounting and other records and that, on the contrary, Trends' record keeping was sufficient for the purposes of the Funding Agreement, noting in particular that timesheets were not required under the Funding Agreement.

- (b) Trends accepted inaccurate information had been provided to Callaghan, particularly in relation to the calculation of labour costs, but nonetheless disputed that such was not sufficiently material to enable Callaghan to terminate the Funding Agreement.
- (c) Trends likewise disputed that there was any basis for termination as a result of claiming expenditure that was not Eligible R&D Expenditure. In particular, Trends relied upon its detailed application for the Growth Grant to support its submission that Callaghan was always aware of what Trends was doing. In any event, Trends submitted that any expenditure that was not Eligible R&D Expenditure was relatively minor (some \$16,000) and did not therefore give rise to any right for Callaghan to terminate, given both its lack of materiality and the availability of the End of Year Claims process in the Schedule to the Funding Agreement.
- (d) Instead, Trends alleged Callaghan had pre-determined it wanted to terminate the Funding Agreement in breach of its duty to act fairly and transparently towards Trends, and any breach by Trends was in fact due to Callaghan's own breaches of the Funding Agreement and/or its implied terms, through:
 - (i) Callaghan not implementing systems and procedures so that Trends knew what Callaghan's requirements were;
 - (ii) Callaghan failing to wait for the end of year claims process to run its course which in Trends' view would have dealt with any of the issues that ultimately were identified; and

- (iii) that it was Callaghan who, in any event, breached the Funding Agreement, through withholding payment on Trends' Q3 claim, failing to follow the cl 5 audit process and releasing confidential information in breach of cl 8.

Discussion – Issue Eight

[195] I observe at the outset that even after hearing Trends' evidence and in particular from those involved in the project that it is difficult to say with any degree of certainty just what it entailed. In particular, it is difficult to identify what had been achieved by the time the Project Grant was finished given the terminology used was very similar and much of what was described in the Project Grant completion report still appeared to be a major focus of the work subsequently undertaken pursuant to the Growth Grant. Aside from the application for the Growth Grant itself, there was otherwise no internal documents setting out clearly what was being done or internal reports on progress after the funding agreement was signed. Finally, it is by no means clear exactly what Trends was looking to market. Prior to the suspension of the Funding Agreement, at least one of the potential investors, Maverick Mob, seemed more interested in Trends' existing digital library to populate other websites rather than in any proprietary software or other systems developed by Trends.

[196] Ultimately however such an understanding is not necessary in order to determine any of the issues before the Court and in particular **Issue Eight**.

[197] This is because, as is apparent from Trends' submissions and the evidence on which Trends' relies, that Trends has a fundamental misconception of the terms of the Funding Agreement and, in particular, what it was entitled to seek to be reimbursed by Callaghan.

[198] It is this misconception that permeates Trends' submission that Callaghan should have looked more closely at Trends' application for the Growth Grant and the relevance of, to what extent, the milestones identified in that application had been met.

[199] On the contrary, the Funding Agreement makes it clear it was never envisaged that Callaghan would meet 20 per cent of the costs of the project as it was articulated

by Trends in the Growth Grant application. Instead, cl 1.1 is specific; Trends was only entitled to be reimbursed for 20 per cent of its Eligible R&D Expenditure as defined in cl 3.

[200] This is emphasised in the Background section to the Funding Agreement which confirmed Trends had applied to Callaghan “for a funding grant to cover a portion of the costs of [Trends] research and development programme”⁶⁹ and to that end Callaghan would “provide the funding specified in the Schedule”.⁷⁰

[201] The Schedule likewise emphasised that Callaghan’s obligation to pay was limited to 20 per cent of Trends’ Eligible R&D Expenditure, that is funding as defined in cl 3 of the Funding Agreement being research or development as defined in NZ IAS 38 and NZ FRS 15,⁷¹ and not otherwise specifically excluded in cl 3.2. In addition, the Schedule specifically provides that funding is limited to 20 per cent of the “actual amount” of the Eligible R&D Expenditure spent by Trends in that quarter.

[202] The importance of only funding Eligible R&D Expenditure as defined in the Funding Agreement was explained in the Minister’s Direction which, as noted, made it clear that Callaghan was expected to exit anyone claiming expenditure that they were not entitled to claim. The specific exclusions noted by the Minister were carried through to cl 3.2 of the Funding Agreement. Callaghan’s focus on funding claimed by Trends that was not Eligible R&D Expenditure was therefore required as, unless the expenditure claimed met that definition, Trends was not entitled to receive funding from Callaghan.

[203] Similarly, notwithstanding Callaghan was required to “implement systems and procedures”⁷² so as to “act fairly and transparently”⁷³ in “allocating and administering R&D functions”⁷⁴, it is clear that there was more than sufficient detail in the Funding Agreement for Trends to be clear on exactly what it was being funded, what it was

⁶⁹ The Funding Agreement, Background B.

⁷⁰ Background C and cl 2.1.

⁷¹ Clause 3.1.

⁷² Callaghan Innovation Act 2012, s 15(2)(a).

⁷³ Section 15(2)(a).

⁷⁴ Section 14(1)(f).

entitled to claim for, and what the likely consequences would be if it claimed expenditure to which it was not entitled.

[204] It follows that the fact that Trends had provided a detailed summary of what it was working on in its application for a Growth Grant, and that it had carried out the milestones referred to in that application, is irrelevant. The application was successful in obtaining Trends a funding agreement but, regardless of the scope of its project, it was still only able to claim for Eligible R&D Expenditure as detailed in the Funding Agreement. It is in fact clear from Trends' application that a large proportion of both the Technical Objectives and Milestones identified in the application were obviously not within the definition of Eligible R&D Expenditure in terms of cl 3. In particular, in terms of the specific exclusions contained in cl 3.2, a majority are, on their face excluded, clearly falling within cl s 3.2(g), (j), (k) and/or (l).⁷⁵

[205] From that starting point, it is clear that Trends was not entitled to simply invoice Callaghan 20 per cent of expenditure on the project, but it could claim 20 per cent of the Eligible R&D Expenditure it had incurred on the project. A valid claim under the Funding Agreement would therefore have required an analysis of exactly what was done in the project, against cl 3 of the Funding Agreement and, in particular, cl 3.2.

[206] It is clear from the evidence including, in particular, that of Mr Groves who prepared each of the quarterly claims on behalf of Trends, that no analysis was undertaken as to what proportion of time spent on the project was in fact Eligible R&D Expenditure, prior to the claims being submitted, and indeed it is telling that it was only after the provision of the Deloitte Draft Report that Mr Groves, who was clearly

⁷⁵ See [34] of this judgment and in particular -
Technical Objective 1 – work plans, milestone work plans 1.2 and 1.3;
Technical Objective 2 – work plans and milestone work plans 2.1, 2.2 and 2.3;
Technical Objective 3 – work plans and milestone work plans 3.1, 3.2 and 3.3;
Technical Objective 4 – work plans and millstone work plans 4.1, 4.2 and 4.3;
Technical Objective 5 – work plan and milestone work plan 5.1;
Technical Objective 6 – workplan and milestone work plan 6.1;
Technical Objective 8 – work plan;
Technical Objective 9 – work plan; and
Technical Objective 11 – work plan.

the key Trends staff member involved in the administration of the Funding Agreement, sought to obtain a copy of the Funding Agreement from Callaghan.⁷⁶

[207] As a result it is not really surprising that the explanations given by Mr Groves about the quarterly claims made by Trends were necessarily vague.

[208] Mr Groves' evidence was that he had calculated the Q1 claim by "identifying the labour costs from the general ledger" and "confirmed with David Johnson that 67 per cent of those costs were attributable to R&D activities".⁷⁷ Such an approach was clearly inadequate given nothing in the general ledger identified what labour was attributable to the project, let alone what proportion of that labour could be claimed as Eligible R&D Expenditure for the purposes of the Funding Agreement. Furthermore, not only did Mr Johnson in his own evidence deny advising Mr Groves that 67 per cent of the costs were attributable to research and development activities, in the absence of any contemporaneous records to support the labour attributable to research and development activities, it is not clear how he could have so advised Mr Groves. In any event, Mr Groves did not apply a 67 per cent rate to eligible overheads. On the contrary, in Trends' October reconciliation, the ratio Mr Groves specified was 33/47 or 70 per cent for the Q1 claim. Mr Groves, in cross-examination, was unable to explain the difference.

[209] As has been noted, Mr Groves then made no attempt to confirm what Trends had expended on the project, let alone what Eligible R&D Expenditure had been incurred, before preparing and submitting the Q2 claim invoice to Callaghan, identical to the Q1 claim. Mr Groves provided no explanation as to how he ultimately determined the labour committed to the project in the Q2 and Q3 claims as it evolved through Trends' October and November reconciliations and Appendix B. Nor, indeed, did he provide any explanation for the 74 per cent (Q2) and 77 per cent (Q3) costs being attributable to research and development activities set out in the October reconciliation.

⁷⁶ See [160] of this judgment.

⁷⁷ See [64] of this judgment.

[210] The inconsistencies noted demonstrate that while Mr Groves retrospectively attempted to bolster Trends' position through Trends' October and November reconciliations and Appendix B, none of those documents, nor the figures within, can be verified or reconciled with each other. Instead, the documents only confirm the latent inaccuracy of the quarterly claims prepared by Trends.

[211] The expert evidence Trends relies upon to justify its claims from Dr Milner and Mr Basrur likewise provides no justification for the amounts claimed. Instead, it is fundamentally misconceived. It focusses on whether Trends was completing the project as set out in the application, rather than whether the funding claimed was Eligible R&D Expenditure for the purposes of the Funding Agreement.

[212] In particular, Dr Milner's evidence focused on describing the project before he made an assessment as to what research and development had been undertaken by Trends. In particular, it focussed on the Technical Objectives and Milestones identified in the Growth Grant application, and whether Trends' costs incurred were reasonable. To this end in particular, Dr Milner assessed the technical work that had been undertaken and capability achieved against both the Technical Objectives and the relevant Milestones and was quite open that this involved assessment and adaptation of existing software as well as market research type activities. Importantly, Dr Milner did not purport to make any assessment as to whether all those claimed by Trends as working on the programme actually did so and was therefore reliant on what he was told by Trends given the absence of any contemporaneous documentation to support the allocation. Even more fundamentally, Dr Milner confirmed in cross-examination that he did not assess whether any of the work undertaken was Eligible R&D Expenditure for the purposes of the Funding Agreement. Indeed, at no point did Dr Milner discuss the terms of the Funding Agreement, let alone provide any consideration of the work undertaken by Trends against cl 3.

[213] Similarly, no detailed analysis was undertaken by Mr Basrur as to whether the amounts claimed by Trends were Eligible R&D Expenditure in terms of the Funding Agreement and he was equally dependent on the accuracy of the figures provided by Trends as to who had worked on the project. Instead, Mr Basrur's focus was whether the amounts allocated to the project by Trends were accurate and reasonable, with

Mr Basrur's cost allocation methodology purporting to allocate \$1,575,919 of labour costs as research and development activities to the different components of the project identified in Trends' Growth Grant application. Specifically, Mr Basrur's calculations and conclusions were based upon a spreadsheet provided to Mr Basrur by Trends purporting to show how the labour of particular Trends employees was allocated to the particular work programmes identified in the Growth Grant application ("the Basrur spreadsheet"). As Mr Basrur finally accepted in response to questions from the Court, if the labour inputs to his model were not accurate it would result in his labour apportionment and subsequent overhead calculation to be also inaccurate. As a result, the quality of Mr Basrur's analysis and its value to the Court was entirely dependent on the accuracy of the labour apportionment carried out by Trends.

[214] It is not clear by whom or when the Basrur spreadsheet was prepared. Mr Basrur gave evidence that it was Ms Messer who provided the information but despite initially apparently accepting responsibility, Ms Messer ultimately denied it was her worksheet, and was not able to say who had provided it. While superficially appearing precise, the apportionment of time to 10 decimal places was self evidently ridiculous given the lack of any contemporary source documents to base such an apportionment on. Likewise, a number of salary inputs and apportionments detailed in the Basrur spreadsheet could not be reconciled with any of the other reconciliations of labour costs provided by Trends in the October and November reconciliations, and/or Appendix B. In the absence of any contemporaneous source documents to support the apportionments set out in the Basrur spreadsheet, like those earlier reconciliations, the Basrur spreadsheet simply cannot be relied upon. As a result, I conclude it is impossible to give any weight to Mr Basrur's cost allocation model. As Mr McLellan accurately summarised:

Ultimately the provenance of the spreadsheet was unexplained and its reliability was wholly discredited; neither it nor the figures presented in Mr Basrur's brief at paragraph 80 (which are entirely reliant on the reliability of the spreadsheet) should be treated as having any evidential value, and accordingly it provides no basis for Trends' claim that it has demonstrated that the original quarterly claims were accurate – or if anything were slightly understated.

[215] Even if this were not the case it is clear that Mr Basrur, notwithstanding noting cl 3 of the Funding Agreement and commenting on certain aspects of the claim, did

not undertake any detailed analysis as to whether the work claimed by Trends to have been undertaken by particular Trends employees in relation to the project, and detailed in the Basrur spreadsheet, was in fact Eligible R&D Expenditure in terms of the Funding Agreement. In particular, Mr Basrur did not address whether or not the activities of any of the employees claimed for carried out work which, as a result of cl 3.2 (g), (j), (k) or (l) of the Funding Agreement, meant that it was not Eligible R&D Expenditure.

[216] Mr Basrur's analysis was equally lacking in terms of the expenses other than labour claimed by Trends. Not only were Mr Basrur's calculations materially different from those carried out by Mr Groves, claiming an overhead rate of 67 per cent in contrast to the variable rates ultimately calculated by Mr Groves, he did not consider cl 3.2(n) of the Funding Agreement which precluded claims "for interest expenses or lease payments of any kind nor overheads not closely linked to research and development activities". This is particularly relevant in Mr Basrur's case given that the overhead figures his calculations were based on were the figures for the entire Trends group of companies, not just Trends Publishing International Limited. There is no evidence before the Court that the costs of other companies in the Trends Group were involved in the project, still less that a proportion of their expenditure could in any way be claimed as Eligible R&D Expenditure in terms of the Funding Agreement.

[217] In contrast to the approach taken by Trends, and subsequently replicated by Dr Milner and Mr Basrur, it is clear that the issue of whether the amounts claimed by Trends were Eligible R&D Expenditure was at the forefront of the Deloitte investigation.

[218] As has been noted,⁷⁸ from the beginning Deloitte attempted to assess all the expenditure claimed by Trends to determine whether it was Eligible R&D Expenditure for the purposes of the Funding Agreement. Significantly, and contrary to the suggestions consistently made on behalf of Trends, Deloitte did not limit its investigation to Trends' overhead expenses but was always clearly concerned with the labour costs that made up the overwhelming majority of each of Trends' quarterly

⁷⁸ For example, see [110] and [116] of this judgment.

claims to Callaghan. This was evident from the initial reports made by Ms Garvie to Callaghan,⁷⁹ as well as in the first formal progress report to Callaghan, presented on 11 November 2014.⁸⁰ The focus on labour costs also formed a significant part of the variation agreed on between Deloitte and Callaghan.⁸¹

[219] Labour costs were then identified as one of the key issues in the Deloitte Draft Report that led to the suspension letter in December 2014,⁸² and in the Deloitte Final Report, underpinning the decision by Callaghan to terminate in April 2015.⁸³ Ultimately, Deloitte were unable to conclude that any of the labour claimed by Trends was Eligible R&D Expenditure.⁸⁴ It is therefore a fundamental misunderstanding of both the Deloitte Final Report and Callaghan's termination decision, for Mr Corlett to submit, on behalf of Trends, that there was only some "\$16,000 in grant funds" at issue. On the contrary, in addition to all the labour claimed by Trends all other expenses were also in issue given the percentage of those expenses that could be claimed by Trends was directly linked to the proportion of the labour that could properly be claimed as Eligible R&D Expenditure.

[220] As Deloitte noted consistently Trends had no records detailing either the project or the expenses incurred. Strictly speaking, Trends were not required to have timesheets but there was in fact no other contemporaneous records to support that any of the expenses claimed by Trends, including labour, was Eligible R&D Expenditure. The inevitable result was that, as Deloitte ultimately found, what was claimed was unbelievable, inconsistent and only served to confirm Callaghan's initial concerns.

[221] Having reviewed the process followed by Deloitte, I am also satisfied that it was not only thorough but that there was no suggestion of any bias against Trends at any point in the investigation. Any contrary impression that Trends may have obtained was the result of the erroneous view taken by Trends as to what it was entitled to be reimbursed under the Funding Agreement and, as a result, what it considered Deloitte should have focused its investigation on. In contrast, Deloitte focused throughout on

⁷⁹ See [107] of this judgment.

⁸⁰ See [110] of this judgment.

⁸¹ See [116] of this judgment.

⁸² See [128] of this judgment.

⁸³ See [187] of this judgment.

⁸⁴ See [187] of this judgment.

whether the expenditure Trends sought to be reimbursed was Eligible R&D Expenditure in terms of the Funding Agreement. For completeness, I note that Deloitte quite properly identified possible breaches, rather than breaches, because it was for Callaghan to determine whether or not Trends had breached the Funding Agreement, which it did so.

[222] Nor indeed was there any evidence of bias on the part of Callaghan towards Trends. As I have previously concluded Trends response to Callaghan's initial queries with regard to the Q3 claim raised issues that warranted further investigation but Callaghan nonetheless arranged for an interim payment of \$60,326.32 against the Q3 claim, which negates any suggestion that it had already decided to terminate the Funding Agreement.⁸⁵ The resulting audit was appropriate and followed the procedure set out in cl 5,⁸⁶ and the suspension on 17 December 2014 was justified given Deloitte's initial conclusions.⁸⁷ Following the suspension Callaghan appropriately allowed the Deloitte investigation to be conducted thoroughly, giving Trends every chance to justify its claims, before Callaghan made its decision to terminate the contract following the provision of the Deloitte Final Report. It was entitled to request Deloitte to investigate particular issues, including whether fraud had been committed but it is clear that this did not influence the conclusions ultimately reached by Deloitte. Given the contents of the Minister's direction, which Callaghan was required to implement, I am satisfied that Callaghan's approach throughout was proportionate and appropriate given the nature of its role in providing public funding.

[223] Likewise, there is no basis for Trends to contend that Callaghan should have waited until the end of the year, following a Q4 Claim, to allow any errors in the Quarterly claims to be addressed through the "End of year claims" process in the Schedule to the Funding Agreement. This was not how the Funding Agreement worked. The Quarterly claims process set out in the Schedule made it clear that the quarterly invoice had to specify the actual amount of Eligible R&D Expenditure spent, and that the funding claimed "must be 20% of the Eligible R&D Expenditure spent by [Trends] in the quarter". There was no suggestion in the Schedule that the Quarterly

⁸⁵ See [78].

⁸⁶ See [104].

⁸⁷ See [135].

claims could be less than accurate, nor did the End of year report provide a mechanism to adjust what had been paid out. Instead, the End of year claims simply provided a mechanism, by which the amounts retained by Callaghan from the Quarterly claims could then be paid out to Trends. This was made clear by the Minister’s Direction, translated through to relevant terms in the Funding Agreement that enabled Callaghan to suspend if Trends did not comply with the agreement,⁸⁸ or may have breached the agreement,⁸⁹ and to terminate immediately if any of the conditions in cl 10.4 were met. There is nothing in the Funding Agreement that required any of these various powers to suspend and/or terminate to be exercised only after an End of year report had been provided, and to have done so would have been entirely inconsistent with Callaghan’s task of administering public funding.

[224] Finally, from a procedural perspective, it was not necessary to do more than Callaghan did on 21 April 2015 when it met with Trends and provided the Termination Letter. Clause 5.7 required only that “if the Audit report has revealed a breach by you, and following discussions with you Callaghan Innovation **may** do one or more [of the actions set out in cl 5.7(a) – (f)].”⁹⁰ Therefore, although the discussions between Trends and Callaghan on 21 April 2015 were limited to advising that the Funding Agreement would be terminated on the facts of this case, no more could have been expected.

[225] For example, the option under cl 5.7(b) for Callaghan to provide Trends with notice of remedial actions which, in turn, would have engaged cls 5.8 and 5.9, requiring Trends to carry out any remedial actions and provide any report or objection to those actions, was only one option available to Callaghan. However, given the sheer magnitude of Trends’ breaches of the Funding Agreement identified by Deloitte, coupled with the terms of the Minister’s Direction it was not realistic to suggest that Callaghan could have taken no further action.⁹¹ Likewise given the lack of records relating to the project, there were no remedial actions that could have been realistically taken.⁹² Similarly, Trends’ breaches could not be addressed by negotiating a variation

⁸⁸ The Funding Agreement. cl 2.2.

⁸⁹ Clause 5.10.

⁹⁰ Clause 5.7 (emphasis added).

⁹¹ Clause 5.7(a).

⁹² Clause 5.7(b).

of the Funding Agreement,⁹³ nor could what had occurred be construed as a “Change Event” in terms of cl 9.⁹⁴ On the contrary, given the Growth Grant funding was public money, the need for Callaghan to act fairly and transparently, and the conclusions reached by Deloitte, the only realistic actions were termination and the recovery of the funding provided by Callaghan to Trends to that point.

[226] In the end the evidence was overwhelming that each of the grounds identified by Callaghan in the Termination Letter was established, both at the time and on the evidence presented before me. In particular:

- (a) **Breach of clause 5.1 – Trends failed to keep sufficient records to enable Callaghan to conduct an audit of Trends’ compliance with the Funding Agreement:** Trends failed to keep any records to support its claims that any of its staff and contractors had in fact been engaged in eligible research and development activities which could be claimed as Eligible R&D Expenditure for the purposes of the Funding Agreement. To all intents and purposes all Trends’ staff, including senior management like David Johnson, Andrew Johnson, Mr Groves and Ms Messer⁹⁵ were simply carrying on their normal tasks as there was otherwise no contemporaneous evidence to suggest they were carrying out eligible research and development. It was clear from Appendix B that Trends’ original suggestion in the October and November reconciliations that most of its staff were spending 100 per cent of their time on eligible research and development was plainly false, while there was no evidence to suggest that the final percentages claimed were any more accurate. Likewise, it is clear from the evidence that Andrew Johnson, Mr Groves and Ms Messer were not working at the percentages claimed and while Andrew Johnson and Ms Messer maintained that they were, their respective explanations were quite

⁹³ Clause 5.7(c).

⁹⁴ Clause 5.7(d). See [49] of this judgment.

⁹⁵ For example see [65] of this judgment.

unbelievable,⁹⁶ casting further doubt on Trends' overall claims. Ultimately it is absolutely clear that Trends did not create or retain sufficient records to enable Callaghan to check whether the labour component of the expenditure claim by trends was Eligible R&D Expenditure. The failure to create and/or retain such records also undermined the claim for any recovery of overhead expenditure as Eligible R&D Expenditure. The lack of such records was a clear breach of cl 5.1 and Callaghan was therefore entitled to terminate pursuant to cl 10.3.

- (b) **Breach of clause 10.4(b) – Trends provided misleading or inaccurate information:** As Mr Corlett conceded in closing submissions Trends did provide inaccurate information to Callaghan. He could not have submitted otherwise. Trends had certified that its quarterly claims amounted to 20 per cent of its Eligible R&D Expenditure, only for it to be clear, as early as Trends' October reconciliation, that the amounts claimed were not in fact accurate.⁹⁷ The Trends' November reconciliation demonstrated errors in the October reconciliation in respect of Trends' Q3 claim.⁹⁸ However, Trends subsequently maintained in both its January and February responses that the labour claims contained in the November reconciliation were accurate. The provision of Appendix B, in the course of its March response demonstrated however that the majority of its staff had been over claimed to that point, with Trends attempting to make up the difference by claiming additional staff not previously claimed to have been involved in the project and for which no documentary support was available.⁹⁹ Even then the inconsistencies in Appendix B and the difficulty in reconciling Appendix B with the claims for staff not included in Appendix B but still being claimed at

⁹⁶ Andrew Johnson contended he had spent 100 per cent of 40 hours per week on "R&D based activities" with his other duties being carried out outside those 40 hours. Similarly, Ms Messer insisted she "gifted" her "out of time hours to the company".

⁹⁷ See [75] of this judgment.

⁹⁸ See [105] of this judgment.

⁹⁹ See [170] of this judgment.

100 per cent in the November reconciliation, raised further questions which Trends' representatives at the 11 March 2015 meeting conceded would require further review.¹⁰⁰ The level of inaccuracy exhibited in the constantly changing, internally inconsistent and ultimately irreconcilable information provided by Trends on its labour claims was not minor. It went to the heart of its claims for Eligible R&D Expenditure and was of such a scale that ultimately the information provided by Trends, which as noted was not based on source documents, could not be relied on by Callaghan at all. As a result there was a clear breach of cl 10.4(b) and Callaghan was entitled to terminate.

- (c) **Breach of Clause 10.4(c) – Trends claimed funding it was not entitled to:** This breach flows out of the matters set out above. In the absence of clear evidence to support Trends' claims that eligible R&D expenditure was incurred, coupled with clear evidence that the information given to Callaghan in support of Trends' claims was inaccurate there was in fact no identified basis for any of the amounts claimed by Trends. It was therefore open for Callaghan to draw the conclusion that Trends had claimed funding to which it was not entitled. I am therefore satisfied there was a clear breach of cl 10.4(c) of the Funding Agreement for which Callaghan was entitled to terminate.

[227] It will be apparent from this analysis that there can be no argument that each of the breaches was not material, as they do not involve some discrete or minor aspect of the amounts claimed by Trends but rather the totality of the amounts claimed.

Conclusion – Issue Eight

[228] Trends clearly breached clauses 5.1, 10.4(b) and 10.4(c), and Callaghan was therefore entitled to terminate the Funding Agreement without notice on 21 April 2015.

¹⁰⁰ See [178] of this judgment.

[229] There can be absolutely no doubt that Deloitte's findings provided a more than ample basis for Callaghan to terminate the Funding Agreement. The conclusions reached by Deloitte have been confirmed by the evidence heard in this trial.

[230] In these circumstances given its responsibilities under the Callaghan Innovation Act, including the Minister's Direction, when presented with the conclusions reached by Deloitte, Callaghan had no choice but to terminate and seek repayment of monies paid by Callaghan. Callaghan would have been seriously derelict in its duties under the Callaghan Innovation Act, including its obligation to carry out the Minister's Direction, had it not done so.

Issue Nine - Did Callaghan breach the Funding Agreement by issuing the termination press release?

[231] For the same reasons that Trends submitted the Suspension Press Release breached cl 8 of the Funding Agreement, it likewise submitted that the Termination Press Release breached the same clause, albeit acknowledging that from Trends' perspective the major damage to Trends' reputation had already been done by the time Callaghan terminated the contract.

Discussion - Issue Nine

[232] For the same reasons I have concluded that Callaghan was entitled to issue the Suspension Press Release,¹⁰¹ it follows it was also entitled to issue the Termination Press Release. As noted, the Funding Agreement specifically provided that Callaghan could release information about when funding was approved, and the corollary of this was for Callaghan to advise when funding had been suspended or terminated. In this case, the requirement that Callaghan acted fairly and transparently, and to comply with the Minister's Direction, imposed an obligation to advise publicly that the Funding Agreement had been terminated following the investigation carried out by Deloitte.

¹⁰¹ See **Issue Six** from [136] of this judgment.

Conclusion – Issue Nine

[233] Upon termination of the Funding Agreement, Callaghan was entitled to issue the Termination Press Release on 21 April 2015.

Decision

[234] Trends' claims fail in their entirety and Callaghan is entitled to judgment accordingly.

[235] Callaghan is entitled to costs. In the event that the costs payable cannot be agreed I will determine the issue following the filing of memoranda.

Powell J