

PRODUCT RULING – BR PRD 18/04

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by Harbour Fund III G.P. Limited.

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BD 1(4), BD 1(5), BG 1 and YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt by Harbour Fund III LP (the Fund) of proceeds (Proceeds) under individual funding agreements that the Fund will enter into with litigation claimants (the Claimants) in a proposed class action against Steel & Tube New Zealand Limited and/or Steel & Tube Holdings Limited (Steel & Tube) (and possibly other steel manufacturing companies) under which the Fund will agree to pay all legal and other costs incurred by the Claimants in return for a share of the Proceeds.

Further details of the Arrangement are set out in the paragraphs below.

The offshore parties to the Arrangement

1. The Fund is a limited partnership registered in the Cayman Islands and has been established to make litigation and arbitration funding available for all types of claims other than personal injury, divorce or defamation proceedings. The Fund is not a trustee of a trust.
2. Under the law of Cayman Islands, the Fund does not have separate legal personality from its partners (Limited Partners). The Fund is not the beneficial owner of its assets, which are held by Harbour Fund III GP Limited (the General Partner), in accordance with the terms of the Fund's limited partnership agreement.

3. The Fund provides funding for litigation claimants all around the world who have met certain criteria. The criteria include the creditworthiness of the defendant, the legal merits of the case, the expertise of the legal team and the likely legal fees.
4. The Fund is advised by Harbour Litigation Cayman Limited (the Investment Advisor) a company incorporated in the Cayman Islands. The Investment Advisor has been contracted by the General Partner under an investment advisory agreement (Investment Advisory Agreement) to perform investigation, evaluation and due diligence services in respect of potential claims for which funding is sought.
5. Preliminary investigation and due diligence services have in turn been subcontracted by the Investment Advisor to Harbour Litigation Funding Limited (the Sub-Advisor) which is a company incorporated in England and Wales, under a sub-advisory agreement (Sub-Advisory Agreement).
6. Details of the activities undertaken by the Investment Advisor and by the Sub-Advisor (together the Advisors) when investigating and evaluating potential claims are set out below.

Summary of the normal investment procedures

7. The Advisors ensure that the business of the Fund is known to interested parties. However, the Advisors do not actively or routinely seek to identify and locate specific claims for which funding might be provided.
8. Once a request for funding is received a confidentiality agreement is entered into, and the Advisors conduct a preliminary assessment. Information is gathered regarding the claim, and an immediate analysis is conducted to assess whether the claim is likely to satisfy the Fund's criteria. If the claim is unlikely to satisfy the criteria, it will generally be rejected at this stage.
9. If a claim passes the first stage of analysis, the Sub-Advisor will, if appropriate, enter into a letter of intent, usually with the claimant directly, but in the case of a class/group action, with the legal representative seeking funding on behalf of the claimants. This procedure has been adopted because there are too many claimants to execute separate documents with and they may not yet have been identified. The Sub-Advisor will then conduct a more detailed due diligence to ascertain whether the claim would be likely to meet the criteria for funding.
10. An Investment Committee established by the Investment Advisor then meets every few weeks to evaluate the legal merits of the cases for which funding is **sought which satisfy the Fund's criteria. The Investment Committee also receives updates on the progress of existing funded claims.**
11. At the conclusion of each meeting the Investment Committee, where appropriate, make a formal recommendation to the Board of the Investment Advisor, about investing in proposed new claims. The Investment Committee also reports to the Board of the Investment Advisor on existing funded claims if there have been material adverse developments in the case of existing funded claims.

12. The Board of the Investment Advisor then considers the recommendations made by the Investment Committee at its monthly meeting. Where the Board of the Investment Advisor considers that a proposed claim is likely to meet the Fund's criteria for funding, a recommendation is made by the Board of the Investment Advisor to the Board of the General Partner, which has the authority to invest in claims on behalf of the Fund.
13. The Board of the General Partner then meets to consider the recommendations made by the Board of the Investment Advisor.
14. Where the Board of the General Partner (on behalf of the Fund) considers that a recommended claim is meritorious, the Fund will make funds directly available for the claim by entering into a funding agreement or funding agreements with the claimants.

How the decision to fund this Claim was made

15. The Sub-Advisor was approached in June 2016, via email, by Adina Thorn of Adina Thorn Lawyers, in relation to the possible funding of a representative action in relation to the quality of seismic mesh and the supply of non-compliant seismic mesh for use in building construction, predominantly in and around Christchurch. The potential claim, would be based in negligence and breach of statutory duties, and was expected to involve over 317 Claimants with a claim for damages in excess of NZ\$44 million (the Claim). This matter was the subject of an investigation and subsequent prosecution by the Commerce Commission.
16. In accordance with the normal procedure summarised above, this approach for funding was subjected to the preliminary review and assessment process. It was subsequently concluded that the Claim could potentially satisfy the Fund's criteria.
17. Due diligence was then undertaken by the Advisors, and ultimately a recommendation was made to the Board of the General Partner that the Claim be approved for funding.
18. At its July 2017 meeting in the Cayman Islands, the Board of the General Partner approved the Claim for funding.
19. The parties then attended to the finalisation of anticipated timetables and funding amounts, and appropriate documentation was prepared for the Fund to record the terms on which funding would be provided to Claimants.
20. A draft of the funding agreement (Funding Agreement) was prepared, to record the terms on which the Fund will make funding available to Claimants for their legal and other costs incurred in relation to the Claim. A draft relationship agreement (Relationship Agreement) was prepared to record the various invoicing and reporting requirements that will apply to the legal representative (Legal Representative) acting for the funded Claimants throughout the proceedings (Proceedings).
21. The Relationship Agreement was finalised and entered into on 2 August 2016 by the Board of the General Partner and the Legal Representative. At the date that

this Ruling is signed Adina Thorn Lawyers are the Legal Representative, but the Claimants have the ability to appoint a replacement Legal Representative. The Funding Agreement was finalised by 29 June 2018 with Claimants progressively entering into the Funding Agreement from that time.

Funding Agreement

22. The Funding Agreement records the terms on which the Fund agrees to make funds available to Claimants (ie, individuals or groups who have suffered damage **within the scope of the Claim**) for the **"Claimant's legal costs"** (Claimant's Legal Costs). The phrase **Claimant's Legal Costs is defined in cl 20.1 of the Funding Agreement**. It includes legal fees incurred in relation to the Claim, and any costs incurred by the Claimants (subject to certain exclusions) should the Claimants be ordered to pay the legal costs of the defendant or any other party involved in the Claim. Under the terms of cl 9 of the Funding Agreement the Claimants have agreed that in the event that the Claimants are successful, the Fund will receive the Proceeds.
23. The Claimants will comprise individuals, groups of individuals and companies (or their respective representatives, such as liquidators or administrators) that are home and building owners, affected by defects in the design and/or manufacture of seismic mesh used in their homes and buildings.
24. Virtually all of the Claimant group is located in New Zealand, and all of the properties to which the Claim relates are located in New Zealand. This Ruling only considers or rules on the Arrangement to the extent it relates to New Zealand properties.

Funding process

25. Funding for the Claimants Legal Costs will be made available under the Funding Agreement in two stages. The first stage comprises the point up to which all the pre-conditions for full funding are satisfied, and a statement of claim has been filed.
26. The Applicant advised that due to the process of confirming Claimants taking time, Claimants will be confirmed as being part of the Claimant group on a progressive basis during the first stage of funding. Claimants will continue to be confirmed up until (and potentially after) the time that the statement of claim is filed. It is possible that Claimants could be confirmed and enter into the Funding Agreement after the second stage of funding has commenced.
27. During the first stage, legal fees will be incurred for work which will benefit all Claimants including Claimants who are accepted towards the end of the first stage. The definition of Claimants Legal Costs (cl 20.1 of the Funding Agreement) overcomes a potential problem associated with the timing of, and allocation of, legal costs, which were incurred before a Claimant entered into the Funding Agreement. This clause provides that Claimants will agree that each Claimant's proportionate share will be allocated by reference to the value of their claim, regardless of when each Claimant entered into the Funding Agreement.

28. Provided that the Claim satisfies the preconditions for full funding, the Fund will, after the completion of the first stage, fund the second stage of the Claim. Funding will be provided for the second stage of the Claim until such time as the Fund terminates its obligations under the Funding Agreements or the Proceedings are concluded (whether by settlement or judgment of the courts).

Fund's entitlement to Proceeds

29. In the event that the Fund funds stage one and two of the Claim, and the Claim is successful, the Fund will be entitled to receive the Proceeds. The amount of the Proceeds will be calculated on the basis set out in the Funding Agreement. Clause 9.1(a)(i) to (vi) outlines how the Proceeds will be allocated between the Fund and the Claimants.
30. In accordance with the Funding Agreement, the Legal Representative will receive and hold any damages, costs and settlement sums received in respect of a Claim on bare trust for the Fund and the Claimants in the proportions agreed until such time as the relevant amounts are paid to the Fund and to the Claimants. All amounts received from the defendant must first be paid to the Fund who will be paid in priority to the Claimants, who shall each receive such sum as is equal to their share of the remaining damages, costs or settlement sum.

Control of Claim

31. Control of the Claim will rest with the Claimants. The Fund will have no ability to instruct the Legal Representative or dictate how the Proceedings are to be conducted. Clause 5 of The Funding Agreement expressly acknowledges that the Fund has no control over or right to make decisions about the Proceedings. Only the Claimants, through the Representative Claimant (Representative Claimant) may instruct the Legal Representative and determine, for example, the claims that will be pursued and what actions will be taken or decisions made on a day to day basis in respect of the conduct of the Proceedings.
32. Clause 6.1(e) of the Funding Agreement provides that at any time Claimants will be entitled to change the Legal Representative. While the prior written agreement **of the Fund is required, this clause provides that the Fund's consent to such a change is not to be unreasonably withheld.** However, in order to continue to receive funding under the Funding Agreement, the Claimants will be required to ensure that the new Legal Representative executes a deed in favour of the Fund under which the new Legal Representative agrees to be bound by the terms of the Relationship Agreement as if they were the prior Legal Representative.
33. Clauses 5, 6 and 13 of the Funding Agreement outline the Claimants obligations under the Funding Agreement. They include taking certain actions and to provide certain instructions to the Legal Representative in relation to certain anticipated future events including: in relation to the pursuit of an appeal should the Fund wish to provide funding for an appeal, and in relation to settlement decisions should settlement be recommended or not recommended (as the case may be) by the Legal Representative.

34. The Applicant states that because this is a class action, Claimants will also agree on entering into the Funding Agreement the manner in which the Proceedings will be conducted and the Representative Claimant will instruct the Legal Representative. This is to ensure that the funded Claimants agree at the outset how the Proceedings will be conducted, and so that the Fund can be confident that the Proceedings are being conducted in an optimal manner.

Termination

35. Clause 1 of the Funding Agreement contains an initial cooling off period of 20 days. Clause 12 of the Funding Agreement provides that a Claimant will not be able to unilaterally terminate its obligations under the Funding Agreement. Claimants will only be entitled to actively terminate their obligations if there has been a material breach by the Fund which has adversely affected the Claimant's interests and which has not been remedied by the Fund within 30 days.
36. Clause 12 of the Funding Agreement enables a Claimant to opt out of the class action if the Claimant gives instructions to the Legal representative or otherwise exercises a right to opt out of the Proceedings. However, if the Claim is subsequently successful the Fund is still entitled to recover its share of the Proceeds as if the Claimant had not opted out of the class action.
37. Clause 11 of the Funding Agreement provides that the Fund will have the right at any time to terminate its obligation to contribute to future legal costs in respect of the Claim.

Key contractual terms relating to process

38. Claimants will agree to take certain actions and provide certain instructions to the Legal Representative in relation to the manner in which the Proceedings will be conducted, and in relation to certain potential future events. These obligations are contained in the following clauses of the Funding Agreement:
- Clause 5: Conduct of Proceedings.
 - Clause 6: **Claimant's Obligations.**
 - Clause 9: Application of Proceeds and Interim Recoveries.
 - Clause 13: Settlement Decisions.
 - Clause 19: General Provisions.
39. Under cls 5, 6 and 13 of the Funding Agreement, each Claimant will agree:
- That the Representative Claimant will determine, in consultation with the Legal Representative and without direction from the Fund, what claims will be pursued (cl 5.1(a)).
 - That the Representative Claimant will, without direction from the Fund, give day to day instructions to the Legal Representative and will make binding decisions on behalf of Claimants (cl 5.1(c)).
 - That the Claimant will provide all information and documents required by the Legal Representative, will deal promptly with all requests made by the Legal

Representative and will co-operate generally with the Legal Representative (cls 6.1(m) to 6.1(o)).

- That the Claimant will act reasonably and commercially in the prosecution of the Proceedings and in accordance with the advice of the Legal Representative (cl 6.1(d)).
- **That the Claimant will accept and follow the Legal Representative's reasonable legal advice including advice in relation to settlement (cl 6.1(i)).**
- That the Representative Claimant is authorised to make or take any action constituting a settlement decision provided that the Legal Representative has advised such action is reasonable (cl 13.1).
- That the Legal Representative is authorised to and instructed to accept on the Claimant's behalf, any settlement proposed where the Claimant has not initially wanted to act in accordance with the advice of the Legal Representative and the matter has been referred to independent counsel for opinion, with the independent counsel having recommended that the Legal **Representative's advice is reasonable** in all the circumstances (cls 13.3 and 13.4).

40. In addition, each Claimant will agree under the Funding Agreement that the Fund is entitled to communicate directly with the Legal Representative, and that the Fund is entitled to receive any information which has or may have a material impact on the Claim and/or the Proceedings (cls 5.1(d) and 6.1(b)).

The Relationship Agreement between the Legal Representative and the Fund

41. The terms and conditions in the Relationship Agreement are consistent with the above provisions in the Funding Agreement. The Relationship Agreement provides that the Legal Representative must:
- Act consistently with all authorisations and instructions given by the Claimant as contemplated in the Funding Agreement, subject to having received such instructions or authorisations (cl 2.4).
 - **Only enter into a "Retainer" (as that term is defined in the Relationship Agreement) with a Claimant if the Claimant gives the Legal Representative all the authorisations and instructions contemplated and referred to in the Funding Agreement (cl 2.5).**
 - Ensure the Claimant is given all necessary information to facilitate informed instructions (cl 8.2).
 - Keep the Fund fully informed by providing a monthly report in the form set out in the Relationship Agreement (cl 8.1(b)) and until Proceedings are issued provide a fortnightly report in relation to the progress of the book build and other matters (cl 8.1(a)).
 - Give the Fund access to, and when requested provide the Fund with copies of, all material documents produced by or for the Claimants in relation to the Proceedings (cl 8.1(c)).
 - Immediately inform the Claimant, and in accordance with the Claimant's instructions as contemplated in the Retainer and the Funding Agreement,

notify the Fund if the Legal Representative becomes aware of any information which has or may have a material impact on the Claim (cl 8.2(b)).

- Immediately notify the Fund in the event that the Claimant receives a settlement offer, and prepare for the Claimant a written recommendation on whether to accept such an offer and provide a copy of that recommendation to the Fund (cl 8.1(f)).

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- a) None of the General Partner, the Limited Partners of the Fund, nor the Investment Advisor or Sub-Advisor is resident in New Zealand for income tax purposes.
- b) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or Sub-Advisor own or lease any property located in New Zealand.
- c) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or Sub-Advisor has any employees based in New Zealand.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any condition stated above, the Taxation Laws apply to the Arrangement as follows:

- a) Amounts received by the Fund and the Limited Partners under the Arrangement **are "non-residents' foreign-sourced income" under s BD 1(4).**
- b) Amounts received by the Fund and the Limited Partners under the Arrangement are not assessable income under s BD 1(5).
- c) Amounts received by the Fund and the Limited Partners under the Arrangement are not "interest" as defined in s YA 1.
- d) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 19 September 2018 and ending on 18 September 2023.

This Ruling is signed by me on the 19th day of September 2018.

Howard Davis
Director (Taxpayer Rulings)