OPUHA WATER LTD
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Board Paper
February 2013

Title: Legal Opinion on Agreement for Supply of Incremental Water

Purpose

This paper covers the legal opinion received from Goodman Tavendale Reid regarding the agreement to supply water to Mr Peter Scott.

The paper is provided **for information of the Board in consideration of determining a way forward on this issue.**

Background

In February 2012, OWL finalised a letter of agreement with Mr P Scott for the supply of water to a block of land on Opihi Rd referred to as the Collett block. The agreement was part of a proposal by Mr Scott to purchase and develop the Collett block through increased irrigation.

Circumstances that were unforeseen by either party arose during the process of Mr Scott getting a consent for the additional water use and as a result of this change in circumstance, OWL was of the opinion that the original agreement was not operable and sought Mr Scott's agreement to terminate the agreement.

Mr Scott has instead sought to retain the agreement and has engaged legal support in this regard. There has been some correspondence, meetings and subsequent discussions involving legal representation of both parties on the matter.

OWL has sought a legal opinion from GTR on whether the agreement constitutes a valid and legal binding agreement, whether OWL has grounds to terminate it and, if OWL cannot terminate it, what action Mr Scott could take and what liability OWL may have.

The response from GTR is presented in the attached letter.

Conclusion

The opinion concludes that the letter of 22nd February does constitute a valid and legally binding agreement and there are not sufficient grounds for OWL to unilaterally terminate it.

The options that Mr Scott has to "enforce" the agreement are not entirely clear.

To assist with the understanding and interpretation of this opinion and with determining the appropriate way forward, I have invited Andrew Leete to attend the next Board meeting for discussions with the Directors.

Recommendation

It is recommended that Directors review this legal opinion in preparation for discussion on the topic at the Board meeting on the 28th February.

Tony McCormick
Chief Executive
22nd February 2013

Attachments:

Letter from GTR Law – Contractual Arrangements with Peter Scott 20th February 2013

20 February 2013

Tony McCormick
Opuha Water Limited
875 Arowhenua Road
TIMARU 7974

Dear Tony

CONTRACTUAL ARRANGEMENTS WITH PETER SCOTT

1 We refer to the above matter and our recent discussions including the recent meeting with Mr Scott and his lawyers, Russell McVeagh.

2 You have asked us to advise on the following:

2.1 whether there is a valid and binding legal agreement between Opuha Water Limited (*OWL*) and Mr Scott;

2.2 if there is a binding and valid agreement, then whether OWL has any grounds to terminate it; and

2.3 if OWL can not terminate the agreement:

(a) what action Mr Scott could take; and

(b) the extent to which OWL has any liability or obligations to Mr Scott as a result of the requirement for Mr Scott to hold shares under the Opihi River Regional Plan (the *Plan*).

Executive Summary

3 We consider that the 22 February 2012 letter (the *February Letter*) creates a valid and legally binding agreement between OWL and Mr Scott. While there may be some arguments to the contrary, we think such arguments are reasonably weak, particularly given the background facts and actions of the parties leading to the execution of the letter.

4 OWL can not unilaterally terminate the agreement. In the absence of any material breach by Mr Scott of his obligations under the agreement, termination of the agreement could only occur by agreement between Mr Scott and OWL. Given that the parties appear to have been unaware of the shareholding affiliation requirements under the Plan at the time of entering into the agreement, we have considered at a high level whether OWL could rely on any general contractual law doctrines (such as the doctrine of frustration or the doctrine of mistake) to terminate the agreement in the circumstances. However, we believe it is unlikely OWL could rely on such doctrines to terminate the agreement.

5 At this stage Mr Scott and his lawyers have suggested Mr Scott will "enforce the agreement" and that OWL is responsible for Mr Scott being in the position of needing to be "shared up" and therefore OWL is liable to Mr Scott. OWL has refuted such suggestions. Neither Mr Scott nor his lawyers have articulated their legal arguments for suggesting that OWL is liable and has obligations to Mr Scott in these circumstances. Therefore, in considering what action Mr Scott could take (if other arrangements or solutions can not be found), at this stage we can only try to anticipate what Mr Scott's legal arguments may be.

6 We have considered the approaches Mr Scott could take and think his options are reasonably limited. For example, given our understanding of the background to the arrangements, we do not consider that Mr Scott could bring an action on the basis of misrepresentation by OWL, i.e. allege that OWL represented to him that he did not require a shareholding affiliation which representation Mr Scott relied on to his detriment.

7 Mr Scott could possibly seek to make out a case under the doctrine of mistake. However, even if Mr Scott could make out a case under this doctrine, we think it unlikely in the circumstances that a Court would award damages against OWL. Further, the agreement provides that the risk of obtaining the consent and any conditions attaching to it remain with Mr Scott.

8 If Mr Scott "enforced" the agreement and required OWL to comply, then OWL's key obligations relate to supplying water. Assuming OWL can supply the water, then Mr Scott must use the water in accordance with his consent (which requires as a condition of using the water that he is shared up). Given Mr Scott is leasing shares, he may meet that condition and it is difficult to see how OWL would not be complying with its obligations under the agreement. The difficulty for OWL may be if Mr Scott is not shared up as OWL may well be uncomfortable supplying water to Mr Scott if OWL thought Mr Scott was going to be using the water in breach of his consent.

9 Obviously we will need to revisit the strength of any claim that Mr Scott may have if and when we have correspondence from his lawyers articulating exactly what they consider his legal position to be.

10 In the meantime, we note that the restructuring of the Opuha Group provides a potential opportunity to resolve this issue. While the exact method of resolution would need to be worked through in detail, the restructuring may provide the ability to issue shares to Mr Scott to allow him to meet the shareholding requirements, and in these circumstances this would provide the ability to negotiate the termination of the agreement or amendments to the existing arrangements that are acceptable to OWL.

Background

11 By way of the February Letter, OWL set out various terms relating to the supply of water to Mr Scott for irrigation. The February Letter was signed by Mr Scott, Tony McCormick and a director of OWL.

12 We understand that the content of the February Letter had been subject to a reasonable amount of negotiation, including direct discussions between Edward Sullivan (OWL's solicitor) and Grant Proudfoot (Mr Scott's solicitor). Among other things, we understand that:

12.1 it was important from Mr Scott's perspective that the February Letter was legally binding as this was a requirement from Mr Scott's bank; and

12.2 Mr Scott sought confirmation directly from Edward Sullivan that it was legally binding (after the February Letter was signed) and this confirmation was given.

13 Sometime following 22 February 2012 it became apparent to OWL that the Plan effectively requires that in order for a person within the scheme area to take water, that person must hold

shares in the relevant entity within the Opuha Group (i.e. must have a shareholding affiliation). We understand that:

13.1 the requirement to hold shares was not known to either OWL nor Mr Scott at the time of the February Letter;

13.2 Mr Scott held the view that there was no shareholding requirement; and

13.3 following entry into the February Letter ECan has effectively confirmed that its view is that shares are required to be held in these circumstances.

14 The February Letter does not specify that Mr Scott must hold shares although it does contemplate that OWL may at its option issue shares to Mr Scott after a period of three years (presumably from the date of the February Letter or the time of first supply of water to Mr Scott). Mr Scott (through his relevant entity) has obtained a consent in respect of the take of water. However, the use of water under the consent is effectively subject to the consent holder holding the required number of shares in the relevant company within the Opuha Group.

15 OWL raised with Mr Scott the issue relating to the requirement to hold shares as soon as OWL became aware of it. We understand this occurred prior to Mr Scott obtaining his consent but after his purchase arrangements became unconditional.

16 OWL has sought to discuss this issue and the status of the February Letter with Mr Scott on various occasions but Mr Scott has not been willing to engage on it. Mr Scott has entered into lease arrangements in respect of shares so that he has sufficient shares to take water as required by his consent. Given that Peter has shared up (through leasing shares), OWL queried whether there was any need for the arrangements set out in the February Letter to continue on the basis that Mr Scott would pay lesser charges under the standard arrangements for irrigators holdings shares and could get greater reliability from receiving water under those standard arrangements rather than the arrangements set out in the February Letter. After various attempts to discuss this matter with Mr Scott, OWL sent Mr Scott an email attaching a draft "termination letter" indicating that they would like to discuss the arrangements with Mr Scott and whether such arrangements should or need to continue.

17 No response was received in respect of this email until receipt of a letter from Russell McVeagh dated 5 December 2012 (the *RM Letter*). In broad terms, the RM Letter:

17.1 stated that Mr Scott does not consider that there is any reason to terminate the agreement provided for in the February Letter;

17.2 asserted that the fact that Mr Scott needed to obtain shares was essentially OWL's issue and OWL must find the appropriate solution;

17.3 asserted that due to OWL's correspondence with ECan the resource consent required Mr Scott to hold shares (the implication being that OWL has caused this consent condition which is not the case);

17.4 stated that OWL did not support Mr Scott's consent application;

17.5 stated that should OWL not find a solution to the issue then Mr Scott would have no choice but to undertake legal proceedings; and

17.6 sought a without prejudice meeting with OWL to discuss potential solutions to this issue.

18 We responded to this letter refuting the various assertions and incorrect statements but nevertheless noting a willingness to meet to discuss potential issues.

19 Tony McCormick and us met with Mr Scott and Russell McVeagh representatives on 31 January 2013. The meeting was focused on possible "solutions" under which the issue relating to the shareholding requirement could be resolved from Mr Scott's perspective. It is unlikely that any of the possible solutions put forward by Russell McVeagh are likely to be acceptable to OWL.

20 It seems that Mr Scott considers that:

20.1 compared to his position under the strict terms of the February Letter (on the basis that there is no shareholding requirement), the fact that he is required to hold shares has an additional capital cost to him of $800,000;

20.2 leasing shares is not an acceptable solution as there is a lack of "permanence" given the short term nature of the lease arrangements; and

20.3 he will "enforce his rights" under the terms of the February Letter.

21 For the purposes of this letter, references to Mr Scott include any relevant entities of Mr Scott's that are involved such as Two Penny Farms Limited which we understand is the holder of the resource consent that has been issued.

Is the February Letter valid and legally binding?

22 We consider that the February Letter represents a valid and binding agreement between OWL and Mr Scott.

23 While there is reference in the February Letter to a subsequent formal legal agreement incorporating the provisions of the February Letter being entered into (which may suggest that the parties did not intend to be bound until that legal agreement was entered into), nevertheless:

23.1 OWL was aware that the February Letter was considered to be legally binding by Mr Scott and that Mr Scott's bank required a legal binding arrangement;

23.2 earlier drafts of the February Letter provided that the arrangements in the February Letter were expressly subject to a formal detailed legal agreement but such provision was removed in later drafts;

23.3 OWL's solicitor, Edward Sullivan, confirmed directly to Mr Scott that it was legally binding; and

23.4 while lacking some detail, the content of the February Letter contains all of the essential details required for a valid and binding contract and there is a dispute resolution provision to deal with any disputes or issues arising from it.

24 While OWL may possibly raise the argument in the future (depending on how this matter progresses) that the February Letter does not constitute a valid and legally binding agreement, the better view is that it does and that OWL should proceed on the basis that there is a valid and binding legal agreement between OWL and Mr Scott.

Can OWL terminate the agreement evidenced by the February Letter?

25 The terms of the February letter itself do not provide any ability for OWL to terminate the agreement. Therefore, OWL could only terminate the agreement:

25.1 if Mr Scott agreed; or

25.2 if there was a material breach of the agreement by Mr Scott so as to give rise to a right of termination by OWL; or

25.3 if OWL could rely on any relevant contractual law doctrine or principles of general contractual law doctrines or principles to seek termination of the agreement.

26 On the basis that Mr Scott has indicated he will not agree to termination of the agreement, and the fact that Mr Scott has not materially breached the agreement, we have considered possible general contractual law doctrines and principles and whether any such doctrines and principles may apply in the current circumstances (essentially where the parties have not contemplated the shareholding requirement under the Plan).

27 We have considered and discounted contractual law principles such as frustration and the law relating to misrepresentation. Frustration of a contract occurs when a supervening or unanticipated event renders some or all of the parties' contractual obligations incapable of being performed or it becomes totally different to what the parties contemplated when they entered into the contract. Although neither party anticipated the requirement to hold shares, this requirement existed prior to the February Letter coming into effect and therefore it is not a "supervening" event that would allow a party to seek amendment or termination of the agreement on the basis of the law of frustration.

28 We have also discounted any possible action by OWL on the basis of there being a misrepresentation by Mr Scott. Our understanding is that both parties were of the view (independently formed) that there was no requirement to hold shares. Neither party relied on the other party's representation to this effect and neither party has been induced to enter into the agreement on the basis of the other party's representation to this effect.

29 We have also considered the law of contractual mistake. Under the Contractual Mistakes Act 1977 a Court may grant relief to any party to a contract if:

29.1 when entering into that contract all the parties to the contract were influenced in their respective decisions to enter into the contract by the same mistake;

29.2 the mistake resulted at the time of the contract in the conferment of a benefit, or in the imposition or inclusion of an obligation, which was, in all the circumstances, a benefit or obligation substantially disproportionate to the consideration provided for it; and

29.3 the party seeking relief is not obliged by a term of the contract to assume the risk that that party's belief about the matter in question might be a mistake.

30 Applying the above broad principles to the current circumstances:

30.1 it may be considered that the parties were influenced in their respective decisions to enter into the February Letter by the same mistake (i.e. that shares were not required to be held by Mr Scott);

30.2 however, it is difficult to see how OWL has suffered disproportionate obligations or benefits, although Mr Scott may argue that he has suffered a disproportionate obligation on the basis that he is now required to hold shares;

30.3 there is an argument that the risk around this issue in any event rests with Mr Scott given that the terms of the February Letter are clear that the conditions attaching to any resource consent are Mr Scott's risk; and

30.4 if either party is able to successfully argue that the law of mistake applies then the Court has a very wide discretion in providing remedies, which may range from termination of the agreement, to the award of damages, to effectively amending the provisions of the agreement to reflect the position that the parties would have been in but for the mistake.

31 In summary, at this point we believe it is unlikely that the law of mistake gives any ability for OWL to terminate the agreement but it may be a possible angle that Mr Scott may take in seeking a remedy in the circumstances (see paragraph 33.5 below).

What action can Mr Scott take, and is OWL liable for the fact that Mr Scott must hold shares?

32 At this stage Mr Scott and his lawyers have suggested Mr Scott will "enforce the agreement" and that OWL is responsible for Mr Scott being in the position of needing to be "shared up" and therefore OWL is liable to Mr Scott. OWL has refuted such suggestions. Neither Mr Scott nor his lawyers have articulated their legal arguments for suggesting that OWL is liable and has obligations to Mr Scott in these circumstances. Therefore, in considering what action Mr Scott could take (if other arrangements or solutions can not be found), we are somewhat "second guessing" the legal arguments Mr Scott may raise. Mr Scott appears to suggest that his loss or detriment is either:

32.1 approximately $800,000, being the difference between the price he would need to pay for shares on market compared with the $500,000 he agreed to pay for shares under clause 7 of the February Letter; or

32.2 if he did not acquire shares but rather "leased" shares, the lack of tenure applying in a leasing context and the risk he will not be able to meet the shareholding affiliation requirement on a long term basis.

33 As an initial comment, based on the terms of the agreement itself, OWL does not have any express obligation to ensure that Mr Scott holds the relevant shares. In this regard we note the following:

33.1 the obligation on Mr Scott to hold shares effectively arises under the conditions attaching to his consent. Clause 4 of the February Letter makes it quite clear that the "*risks of obtaining the consent and the conditions that are applied remain with [Mr Scott]*".

33.2 There is no express representation by OWL that there is no shareholding requirement. Having said that, clause 7 (which provides an option for OWL to issue shares to Mr Scott after three years) implies that OWL did not consider it was necessary, but again, as noted above, this was also Mr Scott's view that we understand he had formed independently of any representations by OWL.

33.3 If Mr Scott sought to "enforce the agreement", then we assume this means that Mr Scott would be essentially requiring OWL to comply with its obligations under the agreement. OWL's obligations under the February Letter are essentially to supply water at the rates specified in, and subject to the terms of, the agreement. The potential difficulty for OWL in these circumstances is that, in the event that Mr Scott did not hold shares, OWL in complying with the terms of the February Letter (i.e. supplying water) would be doing so knowing that the irrigator was in breach of his consent and the Plan and OWL would not want to supply water in these circumstances.

33.4 Having said that, Mr Scott has leased shares and we doubt his legal advice would be to deliberately breach the terms of his consent by taking water without continuing to hold shares (on a leased or other basis).

33.5 Mr Scott may seek to bring a Court action on the basis of the law of mistake (as described above). Mr Scott may seek to argue that the law of mistake applies and that the Court needs to remedy the terms of the agreement so that he is in no worse position than if the mistake had not occurred. It is unclear whether a Court would be willing to remedy the agreement in these circumstances (the case law on the law of mistake makes it very clear that it is very dependent on the individual facts) but we think it unlikely a Court would award damages against OWL in these circumstances. There is also an

argument that the law of mistake may not apply given that the person seeking to rely on it (Mr Scott) has assumed the risk relating to the mistaken matter (i.e. the conditions attached to the consent are Mr Scott's responsibility).

33.6 Based on our background understanding, we do not think that Mr Scott could successfully bring a misrepresentation action against OWL as the background facts indicate that Mr Scott has not relied on OWL in forming the view that there is no shareholding requirement and so has not relied on any OWL representation to this effect to his detriment.

33.7 In considering any actions that Mr Scott may have, it is also relevant to consider that OWL notified Mr Scott as to the shareholding requirement as soon as OWL became aware of it. To this extent, Mr Scott has a general obligation to mitigate his risks to the extent possible. The timing of OWL's advice to him, and the position Mr Scott was in in respect of the property purchase at the time that he received that advice, will be relevant to the extent that Mr Scott was in a position to mitigate his risk given his knowledge of the shareholding requirement. Having said that, we understand Mr Scott's property purchase was unconditional at this time so his ability to mitigate his position may have been limited.

Where to from here?

34 Following our recent meeting with Russell McVeagh and Mr Scott, it was left that Russell McVeagh was going to put in writing how OWL could support some solutions for Mr Scott. The primary solution that was going to be documented was the possible arguments that Mr Scott could raise with ECan as to the interpretation of the Plan and why a shareholding requirement was not required. We consider that it is unlikely that OWL would want to support any such approach to ECan. On the basis that OWL would not want to support such a move, then we suggest it is likely that Russell McVeagh will subsequently take more of a legal approach to this issue. At this point, OWL may have the opportunity to try and understand the legal position asserted by Russell McVeagh, and we can assess more thoroughly the merits of Mr Scott's position and OWL's possible liability (if any).

35 We consider the proposed restructure of the Opuha Group is relevant to this issue in so far as providing a possible solution to it. In particular we anticipate that the restructuring will provide the opportunity to issue different classes of shares which may possibly provide the ability for OWL to issue shares to Mr Scott on terms which are generally consistent with the wider commercial transactions provided for in the February Letter.

36 Please contact us should you wish to discuss any of the above further at this time.

Yours faithfully
Goodman Tavendale Reid

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