

SUNBEACH FIJI LTD T/A TRANS INTERNATIONAL HOTEL v FRANCIS CHUNG, STEVEN PICKERING & ISIKELI MARAKIWAI TUINAMUANA T/A ERNST & YOUNG (HBC00171 of 2011L)

5 HIGH COURT — CIVIL JURISDICTION

TUILEVUKA M

20, 29 May 2012

10 **Practice and procedure — discovery — order for pre-action discovery — alleged failure to discover fraud — auditors — fishing expedition — unsubstantiated allegations — no evidence of fraud — High Court Rules O 18 r 1, O 24, rr 1, 4, 7.**

15 The plaintiff filed a writ of summons against its auditors, the defendants, alleging that they failed to detect some fraud when they audited the plaintiff's accounts, and therefore fell short of their professional duty as auditors. The plaintiffs sought an order against the defendants to discover all the documents the plaintiff had set out in its summons.

Held –

20 (1) Where an innocent third party has information relating to unlawful conduct, a court could compel them to assist the person suffering damage by giving them that information. The relief will be granted to an applicant who can show reasonable belief that a wrong has actually been committed against him and that disclosure from the third party is needed to enable action against the wrongdoer. The present case is not within the scope of that principle. The plaintiff's application is a cleverly disguised fishing expedition.

25 *Norwich Pharmacal Co v Commissioners of Customs & Excise* [1973] 2 All ER 943, distinguished.

30 (2) Even if *Norwich* applied here, the application for discoveries would have failed. First, the defendants against whom discoveries are being sought are the very persons against whom the legal suit is directed. Second, the foundation of the plaintiff's case is unsubstantiated, with no evidence to show that the plaintiff really did uncover the alleged fraud. Third, a brilliantly constructed case theory alone that is devoid of any supportive evidence would not be enough to convince the court of the veracity of an intended claim. Finally, without evidence that the plaintiff uncovered some fraud, the plaintiff could not convince the court that it has a reasonable case of 'failing to discover fraud' against the defendants.

35 Application for discovery was dismissed.

Cases referred to

Martin and Miles Martin Pen Co Ltd v Scrib Ltd [1950] 67 RPC 127, cited.

40 *Parvati Manilal Lallu Ranchod v Sundar Pal Lallu* HBC 0488 of 1991, considered.

Singh v Minjesk Investments Corporation Ltd (Suva High Court Action No 148 of 2006 – 05th May 2008), cited.

Suresh Maharaj & Associates for the Plaintiff/Applicant

45 *O'Driscoll & Co* for the Defendant

Tuilevuka M.

INTRODUCTION

50 [1] Sunbeach Fiji Ltd ("Sunbeach") operates the Trans International Hotel ("hotel"). The hotel is situated alongside the Queens Road opposite Nadi International Airport. On 19 October 2011, Sunbeach filed a writ of summons

against its auditors, Ernst & Young. Indorsed on the writ is a one-paragraph bare allegation that Ernst & Young's auditors failed to detect some fraud involving the sum of \$83,756.11 between 2009 and 2010 when they audited Sunbeach's accounts for the years ending 31 December 2009 and 31 December 2010. It is claimed that in failing to detect the fraud, Ernst & Young fell short of their professional duty as auditors. Sunbeach intends to file a full statement of claim after discovery of all audit documents by Ernst & Young. But that may depend on whether or not Sunbeach succeeds in getting a Court Order pursuant to O 18 r 1 and O 24 r 7 of the High Court Rules 1988 against Ernst & Young to discover the documents. The very issue before me now is whether or not to grant an Order against Ernst & Young to discover all the documents that Sunbeach has set out in its summons. These are as follows:

- (i) details of the audit procedures carried out in terms of the revenues, receipts and banking thereof.
 - (ii) all work papers pertaining to the audit.
 - (iii) bank reconciliation statement with cash book and daily revenue records.
- And:
- (iv) that the plaintiff be granted leave to file a statement of claim within 21 days after discovery by the defendants.

[1] The application is being opposed.

UNCOVERING THE FRAUD

[3] The fraud alleged was purportedly uncovered by Sunbeach in February/March 2011. The identity of the officers and/or agents of Sunbeach who were involved in investigating the accounts is not disclosed in any affidavit filed by and on behalf of Sunbeach. Nor has Sunbeach bothered to set out the exact procedure that its officers/agents applied to uncover the fraud.

ALLEGATIONS AGAINST THE AUDITORS

[4] Sunbeach alleges that the auditors would have detected the fraud if they had performed the audits in accordance with established protocols and procedure. It appears to me that if Sunbeach really did investigate and uncover some fraud as it claims, then its investigations and discovery would have followed from the two preceding audit closing reports of Ernst & Young.

[5] The said reports had highlighted some "internal control procedures" and some "high risk control weaknesses"¹ in the management of the hotel's accounts following the audit. They also warned of potential fraud². Instances of missing receipt books, missing food and beverage dockets, and missing front office guest ledger were highlighted by the auditors. The 2009 report in fact did highlight nine potential high risk areas of concern. And the 2010 report highlighted eleven

1. A copy of the Report is exhibited in the Affidavit of Steven Pickering sworn on 01 December 2011 and filed herein.

2. On 02 June 2011, Shaneel Nandan responded to a letter from Mr Suresh Maharaj as follows:we draw attention to clause 4 of the engagement letter – the approach to planning the audit is obtain reasonable rather than absolute assurance about whether the financial report is free of material misstatement whether due to fraud or error. There are inherent limitations in the audit process including the selective testing of data and the possibility that collusion or forgery may preclude the detection of material error, fraud or illegal acts.

In the case of Sun Beach our audit letter (2009 in particular) highlighted 9 high risk control weaknesses – the 2010 letter also highlighted that these had increased to 13 and in particular there was evidence of potential fraud in terms of missing receipt books, missing food and beverage dockets and not providing the front office guest ledger to us for audit.

(11)³. Mr Steven Pickering, one of the partners of Ernst & Young, would argue that the fact that the 2009 high risk areas persisted through to the end of the 2010 auditing period and with three additional high risk areas emerging - bespoke of a chronic poor accounting management system at Sunbeach.

- 5 [6] Mr Suresh Maharaj, the Managing Director of Sunbeach - alleges that the auditors did not carry out a bank reconciliation in their procedure. Had they done so, they would have been alerted to the discrepancies between the cash balance on the hotel's bank statement and the amount in the hotel's account records. And they would have uncovered the fraud from the auditing matching process.
- 10 [7] Ernst & Young asserts that the audit plan was merely to obtain a reasonable rather than an absolute assurance about whether the financial report is free of material misstatement whether due to fraud or error⁴. Pickering would point out in his affidavit that the bank reconciliation statement with receipts and cash journals are the property of Sunbeach. These documents, he says, are not
- 15 generated by Ernst & Young. And neither do Ernst & Young's reports contain them.

EMAILS

20 [8] In the months leading up to the filing of the claim by Sunbeach, a series of emails were exchanged between Maharaj and Pickering. Maharaj continued to implicate the quality of the audit process in his emails. And he would request (and later persist in demanding) from Ernst & Young the documents pertaining to the audit process (see paragraph 1 above).

25 [9] Pickering would defend the audit's compliance with Fiji Accounting Standards as well as International Standards on Auditing⁵. And he would request from Maharaj details of the fraud.

30 [10] Maharaj however was only prepared to disclose the total amount that was misappropriated – but nothing more. Ernst & Young did send to Maharaj⁶ the Bank Statement of Account for the year ending 31 December 2009 and Bank

3. See footnote 4 below.

4. On 02 June 2011, Shanel Nandan responded to the above as follows:

35we draw attention to clause 4 of the engagement letter – the approach to planning the audit is obtain reasonable rather than absolute assurance about whether the financial report is free of material misstatement whether due to fraud or error. There are inherent limitations in the audit process including the selective testing of data and the possibility that collusion or forgery may preclude the detection of material error, fraud or illegal acts.

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5. On 08 July 2011, Ernst & Young wrote to Maharaj again requesting the following:

45 In order to fully consider your request for information/data relating to our audit procedure, we require a more detailed outline of the alleged fraud. Accordingly, we again request that you provide specific details of the alleged fraud (we note that we made a similar request to you on 1 July 2011).

We have considered your comments in regards to our earlier request for details of the alleged fraud implying that we have requested same in order to improvise our work papers.

We confirm that we stand by the quality of our audit closing reports for both the year ending 31 December 2009 and the year ending 31 December 2010, the accounts being prepared in accordance with Fiji Accounting Standards. We further confirm that our audit was performed in accordance with our obligations under the International Standards on Auditing.

50 In the event that you consider your position to provide us with details of the alleged fraud as requested above, we would be happy to give further consideration to your request.

6. On 21 July 2011, Maharaj responded as follows

Audit Certificate for the year ending 31 December 2010⁷. But – as is now obvious, these documents were not what Maharaj was after.

LODGEMENT OF LATEST TAX RETURN

5 [11] Whilst all that game of cat and mouse was going on, another issue was brewing up between the parties arising from Ernst & Young's refusal to lodge Sunbeach's latest tax return. Ernst & Young's refusal appears to have been a *tit for tat* response to Maharaj's unwillingness to disclose details of the fraud⁸. Maharaj said this was a breach of contract on the part of Ernst & Young. He then threatened a law suit. Pickering retorted that there was no written agreement to
10 obligate Ernst & Young to complete and lodge the returns in question.

We refer to your email dated 18th July 2011 attaching letter dated 15/7/2011 together with "Reconciliation Report".

15 We understand you have forwarded reconciliation report of MYOB Report only. However, we note you have not forwarded proper Bank Reconciliation Statement as requested by us.

It is noted from your reconciliation report that the outstanding deposit (lodgment) is shown as being "NIL" amount.

That as for your assertion in paragraph (1) of your aforesaid letter, that you would not lodge the company's income tax return; we find the same to be in breach of contract and displaying unprofessional conduct on your part. Please refer to our letter dated 13/7/2011.

20 Finally, in the circumstances as you have totally failed or neglected to provide the necessary requisite work papers relating to the audit of the company's account for the years ended 31/12/2009 and 31/12/2010; our Solicitors will be instructed to proceed to issue court proceedings against your firm. The issued court proceedings will be served upon you shortly by our Solicitors.

25 7. Ernst & Young responded by letter dated 25 July 2011 as follows:

We thank you for your letter dated 21 July 2011 and address the matters raised therein as follows:

1. As requested, please find enclosed Bank Statement of Account for the year ending 31 December 2009 and Bank Audit Certificate for the year ending 31 December 2010.

30 2. We confirm that there is no signed engagement agreement in place between Ernst & Young and the company in relation to income tax return for the year ended 31 December 2010. As such, please provide the contract that you allege we have breached in this regard.

3. The Inland Revenue Department has been informed that we are not the company's tax agent. It follows that your suggestion that we are required to lodge the company's income tax return is incorrect.

4. We further confirm that we retain ownership of all of our working papers as per the terms of our audit engagement

35 8. On 13 July 2011, Ernst & Young sent an email to Maharaj attaching a letter and stating categorically that "**in light of your letters we are unable to prepare your income tax return for the company for the year ended 31 December 2010 which is due for lodgment on 30 September 2011**". The letter attached to this email stated inter alia as follows:

We note that your letter fails to fully address our request for details of the alleged fraud on the basis that you are unable to provide details as requested.

40 We do not understand the basis upon which you are unable to provide us with such details, and in these circumstances, we are unable to consider your request for information/data relating to our audit.

On the same day, 13 July 2011, Maharaj sent a letter to Ernst & Young which states inter alia as follows:

45 We note from our record that copies of signed accounts were returned to your Lautoka Office on 11th April, 2011 for lodgment with the Tax Office. The accounts were sent to us vide their letter dated 7th April, 2011.

The copies of audited accounts have already been given to Fiji Development Bank and Native Land Trust Board and as such, we request that you do lodge the accounts with the Income Tax Department than sending the same to us for lodgment.

50 Once you have provided your working papers and Bank Reconciliation with Cash Book details; we will provide you details of misappropriations.

We wait to hear from you together with the confirmation that the income tax return has been lodged with Fiji Revenue and Customs Authority.

[12] Maharaj's reply to this, and Pickeing's observations on that reply, are particularly noteworthy. Maharaj said Ernst & Young's Lautoka office had already prepared and sent to him for signing the latest annual tax returns of Sunbeach. He had signed the documents and had returned them to the Lautoka office for lodgement with Fiji Revenue & Customs Authority. Maharaj also said that Ernst & Young had completed and lodged Sunbeach's tax returns for the year ending 31 December 2009.

[13] Pickering remained unperturbed⁹ as Maharaj persisted in pursuit-mode¹⁰. But by an affidavit he swore in December 2011¹¹, Pickering appears to have turned the table on Maharaj through some observations which I set out below:

(a) The Plaintiff has failed to disclose how any fraud was committed or even if a fraud occurred at all.

(b) The Plaintiff signed various documents after the admission of discovery of the alleged fraud, including accounts for the year ended 31st December 2010 and only based on the accounts having been signed and misrepresentations of the

9. He replied that what Maharaj had signed and returned to Ernst & Young Lautoka on 11 April 2011 were the company's accounts.

We confirm that the company accounts were signed by you dated 11/4/11 in order for Ernst & Young to provide its audit opinion. The financial statements are not a tax return. The audit was completed for the purpose of the owner, financier and Native Land Trust Board. It follows that the company accounts were not received and/or used to prepare and lodge the 2010 tax return. To be clear, the audit and tax return are two distinctly different issues and it appears you have confused the two.

In addition to the fact that we have performed no work for the 2010 tax return, we further confirm that we have resigned as tax agent for the company.

Further, given that there is no signed engagement between Ernst & Young and the company for the 2010 tax return, we fail to understand the contractual duty and/or undertaking we have allegedly "failed to honour".

For the above outlined reasons, we will not be accepting, preparing or lodging the 2010 tax return for the company as requested.

10. Suresh Maharaj replied vide email dated 23 August 2011 as follows:

...you had not only agreed to audit the accounts but also to act as Certified Tax Agent to lodge the Tax Returns with FIRCA. You only renege on acting as Tax Agent vide your email dated 13/07/2011 and which stated as follows:-

"Also in light of your letters we are unable to prepare your income tax return for the company for the year ended 31 December 2010 which is due for lodgment on 30 September 2011"

We note, your clarification that Financial report is not a Tax Return but you must agree that it does form part of the Income Tax Return. You were supposed to forward the income tax return for the year ended 31st December 2010 subsequent to us signing the Financial Report (as we did for the year ended 31st December 2009) and which you have failed to do so?

In passing, we note through your own correspondences that you have advised FIRCA that you will not act for us as Tax Agents without consulting us first in the matter.

Ernst & Young's response by email dated 26 August is as follows:

...As clearly outlined in our previous correspondence to you, we again confirm that there is no signed engagement between Ernst & Young and the company for the 2010 tax return and/or to act as Certified Tax Agent.

It follows that we will not be lodging the 2010 tax return for the company, nor do we agree with your comments that the company accounts form part of the tax return. As we have indicated, the accounts were signed by you for the purpose of our audit opinion, not to prepare and lodge the 2010 tax return.

In regards to our email to you dated 13 July 2011, notice was provided to the company that we would be unable to prepare the 2010 tax return. We further draw your attention pf the to the fact that we confirmed notification of same to the Inland Revenue Department (IRD) in our subsequent letter to you dated 15 July 2011. In the absence of any signed engagement, we note that there was no obligation for Ernst & Young to consult the company prior to notifying that we no longer act as the company's tax agent.

11. At paragraph 10 (a) to (d).

Plaintiff and its director was an audit closing report signed by Ernst & Young and given to the Plaintiff. The *misrepresentation* was that the Plaintiff signed accounts after it had allegedly detected a fraud and it should not have done this because it clearly knew *the accounts would be inaccurate if there was indeed genuinely*
 5 *a fraud committed against it by one of its employees.*

(c).....

(d) If the date of the alleged fraud discovery is correct as deposed in paragraph 8 of the said affidavit the Plaintiff's director seems to have misled the Fiji Islands Revenue and Customs Authority and others in the submission of the 2010
 10 accounts by signing on the 13th April 2011 to state: "Events subsequent to Balance date" and "Unusual Transactions", both of which suggest that no problems were known to the Plaintiff as at 13th April 2011.

[14] (my emphasis)

15 [14] These observations do prompt the question whether Sunbeach has – at all - lodged any complaint to the police to investigate the fraud it alleges.

HIGH COURT RULES

[15] Order 18 r 1 of the High Court Rules 1988 states:

20 PLEADINGS

Service of statement of claim (O 18 r 1)

1. Unless the Court gives leave to the contrary or a statement of claim is indorsed on the writ, the plaintiff must serve a statement of claim on the defendant or, if there are two or more defendants, on each defendant, and must do so either when the writ is
 25 served on that defendant or at any time after service of the writ but before the expiration of 14 days after that defendant gives notice of intention to defend.

[16] Order 24 r 7 states as follows:

Order for discovery of particular documents (O 24 r 7)

30 7. [@@fd](1) Subject to r 8, the Court may at any time, on the application of any party to a cause or matter, make an order requiring any other party to make an affidavit stating whether any document specified or described in the application or any class of document so specified or described is, or has at any time been, in his possession, custody or power, and if not then in his possession, custody or power, when he parted
 35 with it and what has become of it.

(2) An order may be made against a party under this rule notwithstanding that he may already have made or been required to make a list of documents or affidavit under r 2 or r 3.

40 (3) An application for an order under this rule must be supported by an affidavit stating the belief of the deponent that the party from whom discovery is sought under this rule has, or at some time had, in his possession, custody or power the document, or class of document, specified or described in the application and that it relates to one or more of the matters in question in the cause or matter.

DISCOVERIES IN GENERAL

45 [17] In the normal course of a High Court civil action begun by writ, general discovery occurs automatically under O 24 r 1 without a formal Order of the court. This happens after pleadings have closed and after the parties have filed their list of documents. If a party has not included in his or her list certain other documents relevant to the issues in the case, or has not discovered certain
 50 documents which are on the list, the other party may apply for specific discoveries under O 24 r 4.

[18] The principles of discovery, whether it be general or specific discoveries – are more or less settled. In *Parvati Manilal Lallu Ranchod v Sundar Pal Lallu Suva High Court Civil Action No HBC 0488 of 1991* at 3, Byrne J summarized the principles as follows:

5 This text was applied by Menzies J in *Mulley & Marney v Manifold*; (1959) 103 CLR 341 at 345 where His Honour stated that discovery is a procedure directed towards a proper examination and determination of the issues between the parties as disclosed in the pleadings and not towards assisting a party upon a fishing expedition.

10 (see also *Singh v Minjesk Investments Corporation Ltd* (Suva High Court Action No 148 of 2006 – 05th May 2008); *Compagni Financiere Du Picafique v Peruvian Guano Co.* (1882) 11 QBD 55 at 63; *Mulley v Manifold*; *Calvet v Tomkies* [1963] 3 All ER 610; *Jaureguy v Sen* (Lautoka High Court Civil Action No. 218 of 2002 which Mr O’Driscoll cited in his submissions).

15 [19] While there are some specific instances where the courts may allow pre-action discoveries or a pre-action injunction (eg Anton Piller Orders, Mareva Injunctions and Norwich Pharmacal Orders) - courts will not allow the discovery process to be used towards assisting a party upon a fishing expedition such as to fish for witnesses or a new case or for the general purpose of enabling a party (see
20 *Martin and Miles Martin Pen Co Ltd v Scrib Ltd* (1950) 67 RPC 127; *Singh v Minjesk*).

[20] Mr Maharaj relies on the principles of *Norwich Pharmacal Co v Commissioners of Customs & Excise* [1973] 2 All ER 943. But the Norwich principle, in my view, does not apply in this situation before me. In that case, the
25 exclusive licensee of a certain patented product could not sue the party that was breaching its patent rights because it did not know the identity of the offender. That a breach was being committed was obvious from the fact that the product was being imported into Britain over a time span of some ten years or so. The customs authorities held information as to the identity the importer. But the
30 Commissioner would not disclose this information to the plaintiff on the ground that he had no authority to give it. The House of Lords held that where an innocent third party had information relating to unlawful conduct, a court could compel them to assist the person suffering damage by giving them that
35 information. The relief will be granted to an applicant who can show reasonable belief that a wrong has actually been committed against him and that disclosure from the third party is needed to enable action against the wrongdoer¹².

12. **Lord Reid** (at page 948) said:

40 if through no fault of his own a person gets mixed up in the tortious acts of others so as to facilitate their wrong-doing he may incur no personal liability but he comes under a duty to assist the person who has been wronged by giving him full information and disclosing the identity of the wrongdoers. I do not think that it matters whether he became so mixed up by voluntary action on his part or because it was his duty to do what he did. It may be that if this causes him expense the person seeking the information ought to reimburse him. But justice requires that he should co-operate in righting the wrong if he unwittingly facilitated its
45 perpetration.

Lord Morris of Borth-Y-Gest (at page 951) said:

50 It is not suggested that in ordinary circumstances a Court would require someone to impart to another some information which he may happen to have and which the latter would wish to have for the purpose of bringing some proceedings. At the very least the person possessing the information would have to have become actually involved (or actively concerned) in some transactions or arrangements as a result of which he has acquired the information. In all ordinary circumstances there would then be some proceedings in the course of which the machinery of the Court would enable all relevant and admissible evidence to be obtained.

ANALYSIS

[21] I am of the view that the situation before me is not within the scope of Norwhich and that Sunbeach's application is –but a cleverly disguised fishing expedition. But even if Norwhich was to be applied here (though I still maintain its principles do not apply here), the application for discoveries would have failed anyway for the following reasons:

(i) firstly, the partners of Ernst & Young against whom discoveries are being sought, are the very persons against whom the legal suit is directed (cf. Norwhich where discoveries were being sought against an innocent third party which got mixed up in the wrongdoings of the perpetrator).

(ii) secondly, the foundation of Sunbeach's case against Ernst & Young is unsubstantiated – from where I sit. I understand that the case theory is founded on Sunbeach's claim that it (or its officers/agents) did uncover some fraud which the latter should have unearthed – there is no evidence before me to show that Sunbeach really did investigate and uncover the fraud alleged. Normally, as a matter of principle, Courts are reluctant to grant Orders for pre-action discoveries unless the applicant is able to convince the court of the veracity of his or her intended case. Hence, where the intended action is based on an infringed right (patent or copyright)¹³, and where both the alleged infringement and the damage arising from it are both readily established, the pre-action order – whether it be for discoveries¹⁴ or whether it be injunctive¹⁵ in nature - is rarely withheld.

(iii) following from the above, in my view, a brilliantly constructed case theory alone that is devoid of any supportive evidence would not be enough to convince the court of the veracity of an intended claim.

(iv) and following from the above, without evidence before me that Sunbeach (or its officers/agents) actually did uncover some fraud - Sunbeach could not possibly convince me that it has a reasonable case of “*failing to discover fraud*” against Ernst & Young.

ORDERS

[21] I dismiss the application for discoveries with costs to the defendant which I summarily assess at \$650-00 (six hundred and fifty dollars only) to be paid in 14 days. I also grant leave to the plaintiff to file and serve a statement of claim to the defendant within 14 days of the date of this ruling. The case is adjourned to 12 June 2012 for mention at 8.30 am

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Application dismissed.

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13. See *EMI Ltd v Pandit* [1975] 1 WLR 302 – a case which involved the sale of pirate records; *CBS United Kingdom Ltd v Lambert* [1983] Ch 37 – also a case involving pirate records. These cases involved an application for Anton Piller Orders.

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14. eg the *Norwhich Pharmacal* Order.

15. eg the *Mareva* Injunction or the *Anton Piller* Order.