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THE Rt. HON PETER BLANCHARD, A JUDGE OF THE COURT OF APPEAL OF NEW ZEALAND

I have selected eight recent cases from Britain, Australia and New Zealand which I think may be of some interest to banking lawyers.

Fortex Group Ltd (In Rec & Liq) v MacIntosh

[1998] 3 NZLR 171

This case in the New Zealand Court of Appeal concerned priorities on liquidation – when the priority of a secured creditor might (or might not, as here) be displaced by a party claiming a trust.

Fortex Group Limited ("Fortex") was the trustee (and participating employer) of a management superannuation scheme for a group of its employees, the plaintiffs. The employees all contributed to the superannuation fund (through deductions from their pay), and these contributions were supplemented by Fortex. But for the 1993/94 financial year no contributions were paid into the account, either from employee deductions or by Fortex. When Fortex collapsed, the employees brought an action claiming these unpaid contributions.

The employees sought a declaration that the unpaid contributions were held by Fortex on an express or constructive trust, or that the employees were entitled to a remedial constructive trust. (A remedial trust is imposed by the Court as a remedy where, before the order of the Court, no trust of any kind existed). If such an order were made, this would give the employees priority in the insolvency of Fortex over the secured debenture holders.

1. Express/Constructive Trust

Delivering the leading judgment, Tipping J quickly determined that no express or constructive trust had existed in this situation. Express trusts and constructive trusts must have a separately identifiable subject matter. In this case, there were two factors which meant that the subject matter could not be separately identified:

1. The retained money was never held separately. It could not be distinguished from other money held by Fortex in its general accounts.
2. Fortex was in overdraft at all relevant times. Money which is applied to an overdraft ceases to exist: *Re Diplock* [1948] Ch 465.

2. Remedial Trust

But the same certainty of subject matter is not required in relation to remedial constructive trusts. All that is needed, said Tipping J, is for some assets to be in the defendant's hands which the Court considers are appropriate to impress with a trust in the plaintiff's favour. But, Tipping J emphasised, before the Court can order such a trust, there must be a principled basis for doing so, both with respect to the defendant and with respect to others who have an interest in the subject matter of the trust. In this case, there was no such principled basis, as others had rights over the subject matter of the trust.

Those "others" were the secured creditors, who had rights at law to the money claimed by the employees. Equity would intervene to prevent the creditors from enforcing those rights only where it would be unconscionable for them to do so – where there was something which affected the creditors' conscience. Fortex's default in not paying its contributions into the trust fund undoubtedly affected the conscience of Fortex. But it could not affect the creditors' conscience.

The employees attempted to argue that the creditors would be unjustly enriched if they were to have access to money which should have been paid into the superannuation scheme. But, Tipping J pointed out, the secured creditors had advanced money which was secured over the company's assets. They were now entitled to enforce that security and claim the assets, and could not be regarded as being unjustly enriched by doing so.

The Court found no basis for the proposition that the creditors' conscience was affected. There was no basis on which to declare a remedial trust.

The Court carefully left open questions about the place of the remedial constructive trust. It was concerned that to recognise such trusts might disturb the settled pattern of distribution in an insolvency. The case is therefore *not* an authority for the existence in New Zealand of such trusts.

Arklow Investments Ltd v I D McLean

[2000] 1 WLR 594 (PC)

This case discusses whether a merchant bank was in breach of a fiduciary obligation to a potential customer with whom it ultimately failed to come to terms.

It concerned the sale of Matakana Island, just off the eastern coast of the North Island of New Zealand. Mr Wingate wished to buy the island using Arklow Investments Ltd as his vehicle. In June 1992 he approached the FAR group of companies ("FAR"), which operated a small merchant banking business, to obtain the group's assistance in financing the purchase. FAR was already considering a forestry project on the island but had not yet taken steps to further its interest. At a meeting on 15 June 1992, Mr Wingate's proposal to purchase the island was outlined in detail to three FAR directors. A copy of the investment document relating to the proposal was left with the directors. The following day FAR sent Mr Wingate a written proposal setting out the terms on which it would assist Arklow. Mr Wingate did not like these terms but said nothing to FAR. One month later FAR withdrew its mandate offer. In the meantime FAR had contacted a forestry company, as a prospective partner, and one of its representatives had visited the island.

FAR proceeded to negotiate arrangements with other parties to purchase the island for forestry purposes. These arrangements ultimately led to the sale of the island to FAR and the other parties in February 1993, in a structure which was somewhat similar to that outlined at the 15 June meeting.

Mr Wingate was displeased with this turn of events, and brought proceedings against FAR claiming that in making the arrangements, FAR had breached its fiduciary duties to Arklow Investments Ltd. He argued that FAR owed a fiduciary duty to Arklow which was wider than the duty simply not to misuse confidential information. Rather, it was a duty not to

promote or become involved in the competitive acquisition of Matakana Island, whether or not this involved the use of confidential information – or, as the Judicial Committee termed it, a duty of loyalty to Arklow.

At first instance, Temm J of the High Court found that FAR had indeed breached its duty of loyalty to Arklow. This decision was overturned by the Court of Appeal, and the plaintiff appealed to the Privy Council.

The Judicial Committee of course accepted that those in fiduciary positions owe a duty of loyalty to their principal. However, they were unable to see any evidential foundation for finding that such a duty arose in these circumstances. As Millett LJ stated in *Bristol and West Building Society v Mothew* [1998] Ch 1,18

> A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence.... [H]e is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary.

Here, FAR did not undertake any obligation, either express or implied, to act on Arklow's behalf. Although it had offered to do so, Arklow did not accept this offer. There was no mutuality giving rise to the undertaking or imposition of a duty of loyalty. The relationship between the two parties never extended beyond that created by the imparting of confidential information.

Mr Wingate and Arklow also alleged that FAR misused confidential information imparted during the June 1992 negotiations. Although Temm J at first instance found that there was such misuse, the Court of Appeal and the Privy Council both confirmed that there was no evidence to support an inference of actionable misuse of confidential information. Arklow's prospects of concluding an agreement to buy the island were not shown to have been adversely affected by FAR's use of knowledge acquired when it was approached by Arklow. The "confidential information" could easily have been obtained by FAR through other means or was of little value until independently corroborated by FAR's own investigations. In the result, there was no basis on which Arklow or Mr Wingate should be granted relief.

Bank of New Zealand v New Zealand Guardian Trust Co Ltd

[1999] 1 NZLR 664

This case discusses the basis upon which a trustee may be liable for carelessness in its administration of a trust.

New Zealand Guardian Trust Co Ltd ("Guardian") was trustee under a debenture deed securing advances to a property investment company ("Comsec") by various banks, including National Australia Bank (NZ) Ltd ("NAB"). Guardian failed in its duty under the deed to use reasonable diligence to detect breaches by Comsec of the deed, by not detecting in July 1987 that Comsec had made certain advances to its non-charging subsidiaries. The breach was not reported to the banks until a year later. Comsec went into receivership for unrelated reasons in February 1989.

Unbeknownst to Guardian, NAB had been searching for an opportunity to exit the debenture arrangement. It claimed that had Guardian been prompt in reporting the breach of deed by

Comsec, it would have used this breach as an excuse to exit the arrangement in 1987, at which stage it would have recovered all of its money. It was alleged on behalf of NAB that Guardian was negligent in carrying out its duties as trustee by failing to detect Comsec's breach in 1987, when NAB still had a chance to exit without loss.

The Court of Appeal examined the test of causation and remoteness where trustees breach their duties. In claims based on breach of trust, the trustee's liability is for all losses which would not have been incurred but for the trustee's breach, subject only to a "common sense view of causation". The Court accepted on the authority of *Target Holdings Ltd v Redferns (a firm)* [1996] AC 421 that losses to the trust estate caused by a breach of trust can be recovered directly by a beneficiary as equitable compensation. NAB sought to recover on that basis the value of the opportunity lost through Guardian's failure to notify NAB of Comsec's breach.

But the Court found that this case did not involve a claim for loss to the trust estate. The opportunity to exit was not part of the estate entrusted to Guardian. The claim was for loss suffered by a beneficiary personally, which was extraneous to the trust estate. The Court had been referred to no authority supporting the proposition that loss suffered by a beneficiary personally but not to the trust estate should be compensated by equitable compensation as if the loss was of trust property.

Nor was this a case of breach of fiduciary duty. The Court of Appeal made it clear that not every breach of duty by a fiduciary is a breach of fiduciary duty. In this case the duty to exercise reasonable care was not a fiduciary duty. The question was whether the breach by a fiduciary of the duty to exercise reasonable care was to attract liability on a restitutionary basis in the same way as breaches of trust causing loss to trust property or breaches of fiduciary duties of loyalty and fidelity.

The restitutionary approach is directed towards deterring breaches of trust and confidence by those in a position to take advantage of the vulnerable. But where a person, even though a fiduciary, breaches a duty to take reasonable care, there is no breach of trust and confidence. The Court could find no reason in principle why the law should treat a fiduciary who breached a duty of care any differently from those who breach duties of care imposed by contract or tort. It was not a sufficient reason that the liability arises in equity.

The "but for" test had been consistently rejected as a sufficient test of both causation and remoteness in contract and tort. In the absence of good reasons for differentiation (such as loss to trust property, or breach of duties of loyalty and fidelity), there was no good reason why it should be sufficient for a breach of duty in equity of equivalent scope.

The proper focus, said the Court, ought to be on the scope of the duty in the circumstances. The Court noted that the scope of a duty to inform has not commonly been found to extend to protection against losses arising from independent causes where the breach of the duty has merely created or preserved the circumstances in which that loss might occur. The scope of the trustee's duty in this case was best determined by construing the debenture deed in its contractual setting. Although the deed embodied a trust, the Court noted that the increasing use of trusts in commercial transactions made it unattractive to compartmentalise trusts for treatment only upon equitable principles. The scope and purpose of the duty was to be ascertained as a matter of construction of the document in its overall context.

Here, the scope and purpose of the duty owed by Guardian was to notify the banks of any breach by Comsec and so to protect them from losses caused by that breach. The loss here was not caused by Comsec's breach, but by the failure of Comsec due to unrelated external causes. The loss was therefore outside the scope of Guardian's duty. Characterising the claim as loss of a chance, as NAB tried to do, should not be a means of circumventing the principles of causation and remoteness – that would be to reintroduce the "but for" test for liability in another guise. The appeal was dismissed.

I come now to an English case about receivers' liability.

Medforth v Blake

[1999] 3 All ER 97 (CA)

This was a decision of the English Court of Appeal, the leading judgment being delivered by Sir Richard Scott, the Vice-Chancellor. It is an important decision because it puts on a sensible basis the duties of receivers when carrying on the business of a debtor. The business in *Medforth* was one of pig farming (it was apparently unincorporated). Mr Medforth's borrowings were secured by charges granted under the Agricultural Credits Act 1928. These entitled the Midland Bank to appoint receivers of the charged property and gave a power of management of the business of the farmer. After their appointment the receivers exercised their power to carry on the farming business. A very substantial element in the trading costs they incurred consisted of the cost of feed for the pigs. Two suppliers had customarily granted discounts on large-scale purchases of pig feed amounting to about £1,000 per week. It was alleged that the receivers had made no attempt over several years to obtain any such discount and that this was a breach of a duty of care owed to Mr Medforth.

Sir Richard Scott said that the proposition that, in managing and carrying on the mortgaged business, the receiver owed the mortgagor no duty other than that of good faith, as the receivers contended, offended commercial sense. If a receiver decided to carry on the business why should he not be expected to do so with reasonable competence?

Counsel for the receivers argued that if a receiver were held to owe obligations to the mortgagor that went beyond a duty of good faith, the advantages intended to be derived by mortgagees from the receivership system would be undermined. This was because if the receiver was held to owe the mortgagor the same sort of obligations as a mortgagee in possession would owe, there would be no advantage to the mortgagee in avoiding being a mortgagee in possession.

The Court was unable to accept these arguments. If receivers who decide to carry on a mortgaged business do owe a duty to the mortgagor to do so with reasonable competence, that would not adversely affect the mortgagee. If the receivers are in breach of that duty they will be answerable to the mortgagor. It had been suggested that mortgagees would then have to indemnify the receivers. But why should they do so? If a mortgagee, on appointing a receiver, has undertaken to indemnify the receiver against any claims for default made against the receiver by the mortgagor, that undertaking might have to be honoured. "But, if mortgagees choose to give indemnities to guard receivers against the consequences of the receivers' defaults, that is their affair. It is no reason at all for contending that the system of receivership is being undermined".

Then it had been argued that the mortgagee might have given instructions to the receiver as to the manner in which the receiver should manage the business that was to be carried on. The Court pointed out that a mortgagee who has appointed a receiver has no general right to instruct the receiver as to how or when to exercise the powers that have been conferred on the receiver. And mortgagees retain their own powers. They do not, for example, lose the power to sell by appointing a receiver with a power of sale.

Sir Richard Scott said that if the mortgagee chooses to instruct the receivers to carry on the business in a manner that is a breach of the receiver's duty to the mortgagor, it seemed quite right that the mortgagee, as well as the receivers, should incur liability. This conclusion did not in the least undermine the receivership system. "What it might do is to promote caution on the part of mortgagees in seeking to direct receivers as to the manner in which they (the receivers) should exercise their powers. I would regard that as salutary".

Turning to the authorities, Sir Richard Scott said that *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949 had modified *Re B Johnson & Co (Builders) Ltd* [1955] Ch 634 to a certain extent and was authority for the proposition that, if the mortgagee decided to sell, reasonable care must be taken to obtain a proper price.

The Privy Council had decided in *Downsview Nominees Ltd v First City Corporation* [1993] AC 295, that the duty lay in equity, not in tort. It had decided that there was no general duty of care in negligence. It held that the receiver/manager owes the same specific duties when exercising a power of sale as are owed by a mortgagee when exercising a power of sale. *Cuckmere Brick* was approved by the Privy Council.

In *Yorkshire Bank plc v Hall* [1999] 1 All ER 879 it had been said that the general duty (owed both to subsequent encumbrancers and to the mortgagor) was for the mortgagee to use his powers only for proper purposes and to act in good faith. The specific duties arose if the mortgagee exercised express or statutory powers. If the mortgagee exercised power to take possession, he became liable to account on a strict basis.

These remarks applied, in the view of the Court of Appeal, equally to the exercise by a receiver of a receiver's powers:

> The *Cuckmere Brick* test can impose liability on a mortgagee notwithstanding the absence of fraud or mala fides. It follows from the *Downsview Nominees* case and *Yorkshire Bank plc v Hall* that a receiver/manager who sells but fails to take reasonable care to obtain a proper price may incur liability notwithstanding the absence of fraud and mala fides. Why should the approach be any different if what is under review is not the conduct of a sale but conduct in carrying on a business? If a receiver exercises this power, why does not a specific duty, corresponding to the duty to take reasonable steps to obtain a proper price, arise? If the business is being carried on by a mortgagee, the mortgagee will be liable, as a mortgagee in possession, for loss caused by his failure to do so with due diligence. Why should not the receiver/manager, who, as Lord Templeman held, owes the same specific duties as the mortgagee when selling, owe comparable specific duties when conducting the mortgaged business? It may be that the particularly onerous duties constructed by courts of equity for mortgagees in possession would not be appropriate to apply to a receiver. But, no duties at all save a duty of good faith? That does not seem to me to make commercial sense nor, more important, to correspond with the principles expressed in the bulk of the authorities. (p108)

An argument had been made for the receivers that *Cuckmere Brick* was inconsistent with *Kennedy v de Trafford* [1897] AC 180 which, it was said, was authority for the principle that the only duty owed by a mortgagee when selling was a duty of good faith. The Court in *Medforth* commented that the duty in equity appropriate to have been owed by a mortgagee selling in 1888 was not necessarily of the same weight as the duty appropriate to have been owed by a mortgagee selling in 1967. "Equity is at least as flexible as the common law in adjusting the duties owed so as to make them fit the requirements of the time". The Court also said:

> The duties imposed on a mortgagee in possession, and on a mortgagee exercising his powers whether or not in possession, were introduced in order to ensure that a mortgagee dealt fairly and equitably with the mortgagor. The duties of a receiver towards the mortgagor have the same origin. They are duties in equity imposed in order to ensure that a receiver, while discharging his duties to manage the property with a view to repayment of the secured debt, nonetheless, in doing so takes account of the interests of the mortgagor and others interested in the mortgaged property. These duties are not inflexible. What a mortgagee or a receiver must do to discharge them depends upon the particular facts of the particular case. A want of good faith or the exercise of powers for an improper motive will always suffice to establish a breach of duty. What else may suffice will depend upon the facts. (p110-111)

In concluding his judgment Sir Richard Scott said:

> I do not, from my part, think it matters one jot whether the duty is expressed as a common law duty or as a duty in equity. The result is the same. (p111)

He enunciated the following propositions:

> (1) A receiver managing mortgaged property owes duties to the mortgagor and anyone else with an interest in the equity of redemption.
>
> (2) The duties include, but are not necessarily confined to, a duty of good faith.
>
> (3) The extent and scope of any duty additional to that of good faith will depend on the facts and circumstances of the particular case.
>
> (4) In exercising his powers of management the primary duty of the receiver is to try and bring about a situation in which interest on the secured debt can be paid and the debt itself repaid.
>
> (5) Subject to that primary duty, the receiver owes a duty to manage the property with due diligence.
>
> (6) Due diligence does not oblige the receiver to continue to carry on a business on the mortgaged premises previously carried on by the mortgagor.
>
> (7) If the receiver does carry on a business on the mortgaged premises, due diligence requires reasonable steps to be taken in order to try to do so profitably.

The appeal was dismissed.

The next case discusses whether it is possible to have a floating charge over book debts where the chargor is free to deal with the book debts.

Commissioner of Inland Revenue v Agnew

[2000] 1 NZLR 223

The question was whether a charge over book debts, although expressed to be a fixed charge, was actually a floating charge where the chargor had authority to deal with the book debts. In New Zealand, this issue will soon be troublesome no longer, as the distinction between fixed and floating charges will disappear, it is hoped, when the Personal Property Securities Act 1999 comes into force.

The dispute was over a debenture issued by Brumark Investments Limited in favour of Westpac Banking Corporation. The Court of Appeal suspected that the debenture deed had been drafted with a view to taking advantage of the decision in *Re New Bullas Trading Ltd* [1994] 1 BCLC 485 (to be discussed later). The deed clearly evidenced an intention to create a fixed charge over the company's book debts. It stated in clause 2.1 that:

- There would be a fixed charge over book debts and their proceeds;
- The company could not dispose of, create or allow any interest in uncollected debts; and
- Westpac had the right to require proceeds to be paid into an account over which the company's access and use were restricted. But this right was not actually exercised prior to the charge crystallising. In the absence of such exercise, there was in practice no restriction on the ability of the company to collect debts or to deal with the proceeds.

The Commissioner, a preferential creditor, argued that the true nature of the above arrangement was to be characterised as a floating charge over book debts.

In the High Court, Fisher J, noting the many disparate views over the issue of fixed and floating charges, returned to first principles. He stated that the central feature of a floating charge is that, pending crystallisation or contrary direction, the chargor has a general licence to dispose of the charged property in the ordinary course of business. Conversely, the central feature of a fixed charge is that without specific consent, the chargor is prohibited from conferring interests upon others which might take priority over the charge. Fisher J thus considered the essential distinction between a fixed and floating charge to be the presence or absence of a power of disposition to others.

But, he said, the power to dispose was different from the power to convert the charged asset into a form which no longer attracts the application of the charge. The latter power is not necessarily inconsistent with a fixed charge. Therefore, a charge over book debts which would otherwise be fixed is not rendered floating simply because the chargor has a power to convert the book debts into proceeds which will then lie beyond the scope of a fixed charge. Accordingly, Fisher J concluded, the charge over book debts in this case was fixed.

Gault J, delivering the judgment of the Court of Appeal, disagreed with this assessment. He did not accept that there was any distinction between dealing in uncollected debts by disposal to third parties and dealing by collection. Gault J said the authorities establish that the relevant distinction between a fixed charge and a floating charge is whether the chargor is free to deal with the charged book debts in the ordinary course of business.

Before the *New Bullas* decision most of the authorities had recognised that to leave a debtor in control of book debts and at liberty to apply them in the ordinary course of business was fatal to the characterisation of a charge as fixed (see, for example, *Illingworth v Houldsworth* [1904] AC 355, HL). But in *New Bullas*, a charge over book debts was characterised as fixed even though the debtor was at liberty to apply the proceeds of the book debts in the ordinary course of business.

In the *New Bullas* case, the debenture deed provided that there would be a fixed charge over book debts, with the proceeds to be paid into a bank account and dealt with in accordance with the written directions of the creditor. But in the absence of such written directions, the proceeds were released from the fixed charge and subject to the floating charge. Nourse LJ stated that under such a provision the asset does not cease to be subject to the fixed charge at the will of the company, but by the agreement of *both* parties that the charge will be released if no directions have been given when the proceeds are paid into the account. Nourse LJ was of the opinion that this provision distinguished the case from the earlier line of cases.

The New Zealand Court of Appeal did not agree with this view. Gault J observed that he was unable to see any real novelty in this provision. He pointed out that the effect of debentures in other cases was precisely the same, even if not expressed in this way. For example, in *Re Brightlife Ltd* [1987] Ch 200, the debenture created a specific charge over all present and future book debts and a floating charge over all other property assets and rights. Collection of book debts would have the effect of extinguishing the security, and the proceeds would become "other assets", subject to the separate floating charge. Hoffman J in that case held that because the company was free to collect the book debts in the ordinary course of business, thereby releasing the charge, the charge over the book debts could only be a floating charge. The effect of the debenture in the *New Bullas* case was no different.

In any case, said Gault J, the *New Bullas* decision could not apply here, as there was no express agreement that the fixed charge would be released once Brumark had collected a debt.

Despite the *New Bullas* case, the Court of Appeal stated that the general principle remained that if the chargor is free to deal with the charged book debts, the charge cannot be a fixed charge.

Therefore, the charge in this case was floating. By excluding from the "fixed charge" the proceeds of book debts, Westpac and the company were emphasising the freedom of the company to collect the book debts on its own account. That the company could not dispose of, create or allow any interest in the uncollected debts did not detract from that.

The Court of Appeal left open the question of whether book debts and their proceeds constitute separate security interests.

(This case is now being appealed to the Privy Council.)

G & M Aldridge Pty Ltd v Walsh (as liquidator of Thompson Land Ltd) (rec and mgr appt)

(1999) 169 ALR 710 (Court of Appeal of Victoria)

The issue in this case was whether there had been a voidable preference.

Simplifying the facts to bring out the point of more general interest, what had occurred was that the owner of a shopping complex under construction, Thompson Land Ltd, was indebted to a group of trade contractors. In March 1990 it paid part of the debts and gave the contractors a security over certain of its assets for the balance. When those assets were sold a month later the contractors received that balance. Thompson went into liquidation less than six months later. The liquidator claimed that there had been a preference and obtained judgment against the contractors, who appealed.

Their argument was that they had not been preferred because in March 1990 all Thompson's property was subject to a (crystallised) fixed charge in favour of ANZ Banking Group. The bank had subsequently done nothing to enforce the charge in respect of the assets in question. But the contractors nevertheless argued that the assets they had received had belonged to the bank and had never been available to unsecured creditors in the winding-up. Hence there could be no preference.

The leading judgment was delivered by Phillips JA. He provides a complex and interesting analysis. There is no time to do justice to all he said in this brief summary. I touch on two points only. In passing, referring to and doubting statements in *Wily v St George Partnership Banking Ltd* (1999) 161 ALR 1, Phillips JA considered the position where a payment is made out of the company's assets before the crystallisation of a floating charge in a situation where the assets over which the charge extends are less than are needed to pay the secured creditor's debt in full. He said that when, before the charge chrystallises, that creditor is paid something on account out of assets over which the charge never becomes fixed (if only because the payment is made before crystallisation) the payee should be treated as having received the payment on account of the unsecured portion of the debt. In these circumstances there is no reduction in the amount of the debt secured because the assets were never going to be sufficient to meet the whole of the debtor's liability. That would constitute a preference.

Coming back to the particular facts in *Aldridge v Walsh,* the judgment points out that to say that the property "belongs" to the secured creditor is apt to be misleading. Particularly when crystallisation has occurred automatically, the chargee's security, being an equitable interest only, may be postponed as against third parties who have taken title from the debtor apparently free from any charge. The Judge asked why it should be supposed that if the appellants had not received the money they did, it should not have been available in the winding-up for unsecured creditors generally. There was no evidence to the contrary (apart from the mere existence of the charge). The bank could still have taken steps to enforce its claims under the debenture deed but it had done nothing and it might now be too late for it to do so. He pointed out that when a liquidator takes action to recover payments under s122, the money, once recovered, belongs in the liquidator's hands to the unsecured creditors generally, the fruits of the action being assets to which the charge of the secured creditors does not attach, for neither the right of recovery nor the fruits of the action is ever property of the debtor company (*NA Kratzmann Pty Ltd (in liq) v Tucker (No.2)* (1968) 123 CLR 295).

The position was summarised in the concurring judgment of Buchanan JA:

> The question whether a payment made by the debtor is a preference is not answered simply by determining whether the payment was made from the property of the debtor or another. The basic question remains whether in practical terms the creditor who has been paid gained an advantage at the expense of his fellow creditors. Thompson was able to alienate the property over which the charge had become fixed. It could do so only subject to the bank's charge, but whether that factor diminished the value of the property alienated depended upon whether the bank took steps to enforce its charge. It has taken no step, and the practical result is that some unsecured creditors have received property that was in fact available to all. (p726)

The appeal was dismissed.

Now a case about whether a payment made by mistake can be recovered when the money paid has been lost.

National Bank of New Zealand Ltd v Waitaki International Processing (NI) Ltd

[1999] 2 NZLR 211

The National Bank of New Zealand incorrectly concluded that it owed the respondent, Waitaki, US$500,000, and sought payment instructions from Waitaki. Throughout three months of discussions with bank personnel, Waitaki maintained that it was not owed this money. However, the Bank was adamant, and in the end Waitaki reluctantly accepted the money. Deciding to place the money where it would be available if repayment was later demanded, Waitaki unfortunately deposited it with a small finance company ("AA Ltd"), receiving security in the form of a mortgage over development property.

A few months later AA Ltd went into liquidation. The security became worthless and the whole of the fund was lost. When the Bank eventually discovered its error and claimed the money from Waitaki, it was no longer available.

The Bank brought proceedings against Waitaki alleging unjust enrichment. At first instance, Gallen J, relying on *Lipkin Gorman (a firm) v Karpnale Ltd* [1991] 2 AC 548, found that as Waitaki had acted in good faith and the money was now gone, Waitaki's position had so altered that it would be unjust to require it to repay the amount in full. After balancing the equities, Gallen J determined that Waitaki should be required to repay only 10 per cent of the fund, or US$50,000.

On appeal, the Bank argued first that Waitaki's knowledge of the Bank's mistake when the payment was made prevented it from avoiding repayment in full, and secondly that the Judge erred in the exercise of balancing the equities and that the Bank should have recovered more of the fund.

1. Knowledge of the Bank's Mistake

Lipkin Gorman established the principle that it is a defence to a claim for repayment of money paid under a mistake that the defendant's position has so changed that it would be inequitable in all the circumstances to require restitution in whole or in part. The Court of

Appeal found that this principle applied in New Zealand. (The same principle was recognised by the High Court of Australia in *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353.)

The Bank argued that Waitaki could not rely on this defence because, as it had knowledge of the mistake, it could not have acted in good faith. The Court of Appeal made it clear that knowledge of the mistake does not negate the *Lipkin Gorman* defence. The essential point is whether, notwithstanding the knowledge, the recipient's conscience is clear. In this case, Waitaki more than once pointed out the mistake to the Bank, and accepted the money only after the Bank insisted that it was due. It acted in a responsible manner after accepting the money, and did not seek to spend the money for its own purposes. Thus, there was no reason why Waitaki's conscience should be troubled by its knowledge of the mistake.

As Waitaki's position had been changed by the failure of AA Ltd, it would be inequitable to require it to repay the Bank in full. (Thomas J observed that any change in circumstances is sufficient to invoke the *Lipkin Gorman* defence; there does not need to be an actual alteration of position.)

2. Balancing the equities

In the High Court Gallen J undertook an exercise of balancing the equities to apportion the total loss between Waitaki and the Bank. He noted that the benefit of the money had not been retained by Waitaki, which had not used the fund for its own purposes. However, he was concerned about the nature of the security chosen by Waitaki - a mortgage which would not have been acceptable as a security to a responsible organisation. He pointed out that as the property was for development, the investment could be regarded as speculative, and that the value of the security equalled the money in the fund, leaving no margin at all. In addition, the security was taken out in the name of a nominee company, rather than Waitaki itself.

But against these factors Gallen J weighed the conduct of the Bank. It had insisted on the payment against Waitaki's wishes. It had not followed its own procedures; had it done so the mistake would have been discovered much earlier, before the security was lost. And there was a significant delay before the true position was discovered, despite the Bank being put on notice by Waitaki.

After weighing these factors, Gallen J found that the Bank was entitled to only 10 percent of the fund. The Court of Appeal considered that it was open to the trial Judge to arrive at this apportionment, and while it may itself have placed more emphasis on the weakness of the ultimate security and the fact that the security was taken through a nominee company, it was unwilling to disturb Gallen J's findings.

The Bank's appeal was dismissed.

I finish with a case in which the New Zealand Court of Apppeal dealt with a situation like that in one of the decisions discussed in Chief Justice de Jersey's paper, *Barclays Banks plc v Boulter*. It dealt with the obligations of banks where there may have been undue influence on the part of a debtor in procuring a guarantee from a relative.

Wilkinson v ASB Bank Ltd

[1998] 1 NZLR 674

Mrs Wilkinson, an elderly woman, now widowed, who had long suffered from a disabling psychiatric condition, signed a guarantee and mortgage over her family home to support borrowings from ASB Bank by her husband. The borrowings were for Mr Wilkinson's accountancy practice and for a family company ("PSI") in which Mrs Wilkinson had no participation. For arguments' sake it was assumed that Mr Wilkinson exerted undue influence upon her.

The loan offer from ASB required Mrs Wilkinson, as sole owner of the family home, to take independent legal advice, and also required the independent solicitor to confirm to ASB that her obligation and liability had been explained and fully understood. To this end Mr Clark, the family solicitor, advised Mrs Wilkinson of her liabilities under the mortgage, and certified to ASB that the effect of the guarantee had been fully explained to Mrs Wilkinson and that she appeared to fully understand the nature and effect of the documents. The bank instructed another firm of solicitors to act on its behalf.

After receiving the certificate from Mr Clark, ASB made the advances. The borrowers defaulted and the bank obtained summary judgment against Mrs Wilkinson on the basis of the guarantee. Mrs Wilkinson appealed, arguing that ASB should be prevented from enforcing the guarantee because of the undue influence supposedly exerted by her husband in procuring it. In particular, Mrs Wilkinson argued that:

- The advice received from Mr Clark was not independent. As he was the family solicitor, he had been involved in dealings with both the accountancy practice and the family company, PSI; and
- ASB ought to have appreciated that the advice was not independent. It knew that Mr Clark had been acting for Mr Wilkinson and PSI in relation to the loan, and that Mr Clark was Mr Wilkinson's personal solicitor.

In considering Mrs Wilkinson's appeal, the Court of Appeal noted the importance of keeping a sense of balance, and not allowing sympathy for someone threatened with the loss of her home to obscure the public interest in ensuring that wealth tied up in a matrimonial home does not become sterile. Sympathy for the victim of undue influence or misrepresentation should not lead the Court into the error of imposing an unrealistic standard upon lenders.

The general principle followed by the House of Lords in *CIBC Mortgages plc v Pitt* [1994] 1 AC 200 and by the New Zealand Court of Appeal is that a transaction procured by the undue influence of a husband may be set aside against a bank where the bank has actual or constructive notice of the undue influence or misrepresentation exercised by the husband. The bank will have such notice where it has knowledge of the following facts:

- The guarantor has limited commercial ability;
- The guarantor has no more than a minimal financial stake in the enterprise guaranteed; and
- There is a relationship involving an emotional tie or dependency on the part of the guarantor towards the principal debtor.

Where the bank has such notice, it must, if it wishes the transaction to be enforceable, take reasonable steps to ensure the wife's agreement is properly obtained. The Court of Appeal advised that a prudent course for a bank in such circumstances would be to insist that the guarantor be given advice by an independent solicitor and to obtain a certificate from a solicitor that the effect and implications have been explained and the guarantor appeared to have understood the explanation. If the bank received an unqualified certificate from the solicitor, it could assume that the solicitor had carried out his or her duties appropriately.

However, the Court pointed out, it would be prudent for the bank to insist that the guarantor is advised by a solicitor who is not acting for another party to the transaction. While it is not for the bank to tell the solicitor how to perform his or her duties, in circumstances where it would be clear to an outside observer that the solicitor's independence is compromised, then the bank would not be entitled to rely on the certificate. In addition, there may be rare cases where the substance of the transaction is so disadvantageous that no solicitor could properly advise a client to sign it. In such circumstances, the bank could not rely on the appearance of independent advice.

Here, ASB did have knowledge of certain facts about the circumstances in which Mrs Wilkinson executed the guarantee and the mortgage. Principally this included the fact that Mr Clark, the family solicitor, had at one stage made the unusual suggestion (promptly rejected by the bank) that the documents be signed on Mrs Wilkinson's behalf by Mr Wilkinson under a power of attorney, without any reference to Mrs Wilkinson. The Court of Appeal was convinced that this last circumstance, coupled with other matters, was more than enough to alert the bank to the possibility of undue influence being exerted upon Mrs Wilkinson by her husband.

But ASB had all along insisted upon independent advice being given. A separate solicitor was acting for Mr Wilkinson in this transaction. Although Mr Clark had previously acted for Mr Wilkinson, he was an experienced solicitor, who could be thought by ASB to be familiar with the problems of conflict of interest. And ASB could quite reasonable conclude that Mr Clark, the family solicitor, had been chosen because Mrs Wilkinson preferred to deal with someone who had the confidence of the family. The Court of Appeal cautioned that one should not assume that just because a solicitor has had some involvement with the principal debtor, he or she cannot function independently when advising the guarantor.

The possibility of conflict of interest was not so obvious to an outsider that the bank would have been justified in querying Mr Clark's position. On these facts, ASB was justified in relying on the solicitor's professional judgment and on the terms of the solicitor's certificate. It had done enough to allay any suspicion. Mrs Wilkinson's appeal was dismissed.