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IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CP No. 733/88

BETWEEN ELITE LIFESTYLES LIMITED a duly incorporated company having its registered office at Wellington

Plaintiff

AND THOMAS McKINNON ANDERSON of Wellington, Company Director

Second Plaintiff

AND LANDBASE NOMINEE COMPANY LIMITED (In Liquidation) a duly incorporated company having its registered office at Auckland

First Defendant

AND A. BHASIN of Wellington, Club Proprietor

Second Defendant

AND PAUL RICHARD PRESTON AND JOHN ANTHONY WALER as Liquidators of LANDBASE NOMINEE COMPANY LIMITED (In Liquidation)

[redacted]

Third Defendant

Date of Hearing: 5 July 1989

Counsel: B.A. Corkill for first and second plaintiffs
P.W.G. Ahern for first and second defendants
P.J. Dale for third defendants

Judgment: 15th August 1989.

RESERVED JUDGMENT OF NEAZOR J

This proceeding arises out of a mortgagee sale in Wellington.

Elite Lifestyles Limited was the owner of the Ohariu Country Club. Landbase Nominee Company Limited was mortgagee. That

company is now in liquidation and by consent the liquidators of it have been substituted as third defendants for the Official Assignee as provisional liquidator. The defendant company exercised its power of sale under the mortgage. The sale was conducted on 20 July 1988. The purchaser at the sale was Mr Bhasin who is the second defendant in these proceedings. The date of settlement by Mr Bhasin was to be Friday 19 August 1988 and it is admitted that settlement took place on that date.

Around about the settlement date, Mr Bhasin found that Mr Anderson, the second plaintiff (and a director of the first plaintiff), was selling chattels at the premises. Many of those chattels were fixtures which were being removed for the purposes of sale. In consequence of what he had found, Mr Bhasin sought an interim injunction from the Court on 19 August 1988 to prevent any further goods being sold. That injunction was refused because of questions which were raised by the wording of the clause relating to chattels in the particulars of sale and an absence of proof of entitlement by Mr Bhasin to the chattels which Mr Anderson was selling.

Those injunction proceedings were not pursued. Mr Bhasin took two steps:

(a) He made arrangements for $100,000.00 to be held in his solicitors trust account from the time of settlement;

(b) He paid to Mr Anderson separately $40,000.00 for chattels which were still at the property.

Thereafter the $100,000.00 became held by the solicitors in their trust account by order of the Court pending resolution of the dispute.

In October 1988 Eichelbaum J by consent made an order pursuant to R 418 that the following questions should be decided before trial:

> "Are the first and/or second and/or third defendants under a mandatory legal duty to pay the sum of $100,000.00 to the first and/or second plaintiff?"

That order indicated that the basis for determination of the question for decision would be the pleadings and affidavits filed already and any further pleadings and affidavits filed pursuant to a timetable then settled.

His Honour's minute then records that:

> "5(a) If the Court holds that all defendants are under a mandatory duty to pay the sum of $100,000.00 to the first and/or second plaintiff, such sum and accumulated interest will be paid to the first and/or second plaintiff forthwith.
>
> (b) The foregoing is without prejudice to any right of appeal and any application for stay of execution or otherwise.
>
> (c) If the answer of the Court is no, the fund will remain in the trust account of McElroy Morrison until further order of the Court or until all parties agree otherwise."

The first and second plaintiffs' Statement of Claim sets out the details of the mortgage, the sale by the mortgagee on 20 July 1988, Mr Bhasin's contract to purchase for $618,200.00 and that settlement was to be on 19 August. It then alleges that settlement was effected on that date and that immediately thereafter the first defendant's solicitors paid to the mortgagee what was owing to it, to various parties

rates, legal expenses and costs relating to the sale, to Mr Bhasin's solicitors $100,000.00 to be held on interest bearing deposit in the joint names of Mr Bhasin and Landbase Nominee Company Limited, and to the plaintiff the remaining sum of $44,402.00.

The Statement of Claim alleges that after the sale the mortgagee held the proceeds of sale as trustee pursuant to s 104 of the Land Transfer Act 1952 and that the payment of $100,000.00 was in breach of the first defendant's obligations as trustee or was contrary to a duty of care which it had to make the payment to the plaintiff.

The pleading then asserts alternative causes of action of conversion of the money by the first defendant as a result of its payment to the solicitors for the second defendant, and of a breach of duty by the first and third defendants as statutory trustee and the second defendant as a constructive trustee of the money in not paying the money to the first plaintiff on demand.

The second defendant (Bhasin) has claimed also against the first defendant. That pleading sets out the mortgagee sale and alleges that it was a term of the contract that the property would be transferred to the second defendant on settlement in substantially the same condition it was in when the contract to purchase was signed, that the property was not in that condition because items had been removed and the property had been damaged. It is pleaded that the second defendant elected to proceed with settlement but reserved its right to sue for loss consequent upon the first defendant's breach. The claim is also advanced on the basis that the second defendant became equitable owner of the property after the signing of the contract and the first defendant a trustee of the property for the second defendant. As such it is said that the first defendant owed a duty to Mr Bhasin to take all reasonable steps to preserve

the property until settlement in the same condition as it was at the signing of the contract and that it failed in that duty.

In their Statement of Defence, the first and third defendants admit the mortgagee sale, the settlement and the making of the payments including the $100,000.00. They admit that demand has been made by the first plaintiff for payment. Their Statement of Defence makes a number of positive averments and raises various defences;

(a) That the proceeds of the sale were not held as trustee, but only the surplus under s 104 (d) of the Land Transfer Act is so held;

(b) That the $100,000.00 in dispute did not come from the proceeds of sale;

(c) That if it is held that the $100,000.00 was from the proceeds of sale it was not surplus within the meaning of s 104 (d).

(d) That if it was surplus, the defendants have a set- off against it;

(e) They dispute that they owed a duty of care or had an obligation to pay the money when demanded.

As a further defence, they say that the contract for the sale of the land entered into by Mr Bhasin and themselves was due for settlement on 19 August, but that Mr Bhasin was not prepared to settle as a result of damage and loss sustained to the property after the agreement had been entered into and prior to settlement. To enable the settlement to proceed, and by way of variation of the terms of the agreement for sale and purchase between Landbase Nominee Company Limited and Mr Bhasin it was agreed between those parties that in consideration of Mr Bhasin paying to Landbase the full amount required to settle in accordance with Landbase's settlement statement, Landbase agreed to

hand to Mr Bhasin the sum of $100,000.00 being the amount to be retained in Mr Bhasin's solicitor's trust account on the following conditions:

> "(i) That the second defendant shall be entitled to withhold $100,000.00 forming part of the purchase price provided that the sum is held by the purchaser's solicitor in trust in the joint names of the first defendant and the second defendant, the funds being held as security against any losses the purchaser may suffer as a consequence of the building of the property being damaged in the period preceding settlement.
>
> (ii) The second defendant's entitlement shall be determined in accordance with the terms of the particulars and conditions of sale and shall be estimated by agreement by the parties and failing agreement by arbitration.
>
> (iii) In any event, the second defendant shall not be entitled to claim against the vendor any amount exceeding the sum held back as security."

They say that in consideration of the variation of the agreement settlement proceeded with Landbase paying to Mr Bhasin the sum of $100,000.00 on the terms set out and that Mr Bhasin's entitlement has not yet been estimated or agreed upon by him and Landbase.

As a further defence they say that clause 8 of the Fourth Schedule of the Property Law Act 1952 is incorporated with modifications into the mortgage from Elite Lifestyles Limited to Landbase, that pursuant to clause 8 of the Fourth Schedule Landbase was entitled to sell the mortgaged property by auction, to execute assurances, to give effectual receipts for the purchase money and to do such acts and things for completing the sale as is might be proper. It is alleged that the variation to the agreement set out was a proper exercise of the mortgagee's powers pursuant to clause 8.

Finally as a further defence it is alleged that provisions of the Fourth Schedule to the Property Law Act 1952 have been incorporated with modifications into the mortgage. One of the modifications placed an obligation on the first plaintiff not to remove, dismantle or structurally alter any building or improvement on the land and in breach of clause 4, Elite Lifestyles failed to keep all buildings and other improvements erected and made upon the land in good and substantial repair and condition and removed improvements on the land. Further, it is alleged that Landbase as mortgagee was entitled to repair the buildings and improvements, to pay all sums required in respect of any breach, and that any monies expended in so doing should be payable by the mortgagor upon demand and until paid should be charged on the land and be monies due and owing under the first defendant's mortgage. It is then alleged that Elite Lifestyles as mortgagor was in breach, that Landbase had elected to pay a sum of money to Mr Bhasin for remedying the first plaintiff's breach and that any sum to be paid by the first defendant represented money due and owing under the mortgage. Finally under this head it is said that the full cost of remedying the first plaintiff's breach has yet to be ascertained and, until it is ascertained, there is no surplus pursuant to s 104 (d) of the Land Transfer Act 1952, so that at this stage the sum of $100,000.00 does not constitute such a surplus.

In his defence Mr Bhasin admits the contract to purchase the land made on 20 July 1988 and that the contract was settled on 19 August 1988. He admits the payment of $100,000.00 to his solicitors but denies that that amount came from the proceeds of sale. His pleading as to whether the first defendant held as trustee under s 104 (d) of the Land Transfer Act 1952 and whether or not $100,000.00 is to be regarded as a surplus exactly follows the pleading of the first and third defendants which I have already recorded, except that in addition to set-off as against the plaintiffs Mr Bhasin says that he has a set-off or claim against the

first defendant in respect of those monies. He denies any present obligation to meet the demand of the first plaintiff for payment.

As a further defence he, like the first and third defendants, says that he was not prepared to settle as a result of damage and loss after the sale agreement had been entered into and prior to settlement and that to enable settlement to proceed Landbase agreed to pay him the sum of $100,000.00 from which fund he would be entitled to recover the cost of damage and loss caused to the property. He says, but without the same particularity as the other defendants that it was a term of the agreement that the monies held by the solicitors would be retained until loss and damage had been quantified and the amount of such loss and damage could be deducted. He said that settlement proceeded on that basis with Landbase paying him the sum of $100,000.00 on the terms set out. He says that the quantum of loss has not yet been ascertained.

As a further defence Mr Bhasin says that the $100,000.00 does not represent part of the proceeds of sale but was an independent payment from Landbase to him and for a further defence he relies on the obligation of the mortgagor by virtue of the provisions of the Fourth Schedule to the Property Law Act 1952 as incorporated and modified in the mortgage not to remove any part of any building on the land, then on an allegation that in breach of the Fourth Schedule provisions the first plaintiff failed to keep the buildings in good repair, and removed improvements from the land, then on the mortgagor's right to put buildings into repair, to pay for repairs and for the cost of such work to become a charge on the land as monies due and owing under the mortgage. This defence then proceeds along the lines of the same defence raised by the first and third defendants and described above.

Then Mr Bhasin raises a counterclaim and set-off against Elite Lifestyles and Mr Anderson. This part of the pleading is drawn specifically against each and concludes with a final claim relating to the $40,000.00 paid by Mr Bhasin to have chattels left at the property. So far as the counterclaim and setoff pleadings are concerned they based on the contract entered into between Landbase and Mr Bhasin on 20 July 1988, completion of settlement of the contract on 19 August 1988, and that between 20 July and 19 August Landbase by itself or its agent removed items from the property which were included in the contract and caused damage to the property, and that those actions caused loss the amount of which has yet to be finally quantified.

The counterclaims then proceed on four bases:

(a) That in the period 20 July 1988 to 19 August 1988 Mr Bhasin was the equitable owner of the property and therefore has a right to claim;

(b) That Mr Bhasin was the equitable owner pursuant to the contract and that Elite Lifestyles was thereafter trustee of the property for him, was under a duty to take all reasonable steps to preserve the property until settlement in the same state and condition as it was at the signing of the contract and that there was a breach of that duty;

(c) That as from the settlement Mr Bhasin was the legal owner of the property and that after settlement and on or about 19 or 20 August property items were removed, which action directly or by reason of it being a breach of the duty of care gave Mr Bhasin a right of action.

The final counterclaim or setoff does not raise issues which are material to the question of law.

The final pleading is by the first defendant to Mr Bhasin's claim. The only new matter that it raises is that paragraph 16 of the Conditions and Sale provided that the property should from the fall of the hammer be at the sole rest of the purchaser as regards fire, accident, tempest earthquake,

landslip or deterioration arising from any cause whatsoever ... and that clause 23 of the Conditions of Sale provided that:

> "All gas and electrical fixtures on or in the property held by the mortgagee under hire purchase were not owned by the mortgagor and all such other appliances or fixtures which might otherwise pass under the sale as fixtures are especially excluded from the sale"

On the basis of those conditions the first defendant says that if Mr Bhasin has suffered any loss then Landbase is not liable for such loss.

Since the pleadings raise the question of when the $100,000.00 was paid and how it was paid it is necessary to go into the factual evidence to some degree. All of the evidence was by affidavit. No deponent was cross-examined.

Mr Bhasin has made three affidavits in the various proceedings to date. In his first, which was in support of his application for an injunction on 19 August, he said:

> "Settlement was set down for 19 August 1988 and all monies have been paid in accordance with clause 6 of the sale contract. I am now entitled to possession of the property"

He went on to say that he had seen an advertisement in the Evening Post on 17 August indicating that there was to be a sale at the property of the complete contents of the restaurant, kitchen, bars, wine cellar, etc. The advertisement included as items to be sold fire equipment, furnishings, chandeliers, brass lights, carpets, drapes, etc. On 18 August he visited the property and he said that whilst he was there he saw a built-in cupboard being removed

with a hammer and crowbar and various instances of damage done to the fabric of the property. He said that when he attended at the property Mr Anderson was in the process of selling everything on or within it. He was concerned about what was going on for two reasons, the first being that he believed all fixtures except those subject to hire purchase agreements or otherwise owned by third parties had been included in the sale; the second being that in removing various of the fixtures and fittings considerable damage was being caused by the second plaintiff. He recorded his unsuccessful application for an injunction.

Mr Bhasin went on to say that settlement had been set down for 19 August, but as the property had clearly been damaged considerably by Mr Anderson and numerous items had been sold which were included in the sale he was not prepared to pay the full purchase price. His solicitors advised the first defendant's solicitors of that fact. It was subsequently suggested that if he paid the full amount required on settlement, the first defendant (Landbase) would then pay to his solicitors the sum of $100,000.00 which would be held by his solicitors and from which he could deduct the cost of remedying any damage done by Mr Anderson. He said that on that basis he was prepared to and did settle. Correspondence passed between the solicitors to which reference will be made later. Mr Bhasin in reference to a letter dated 19 August 1988 from Kensington Swan who acted for Landbase said:

> "My only comment about that letter is the reference to the $100,000.00 forming part of the purchase price. I paid the full amount owed under the contract. Where the $100,000.00 came from I do not know"

He said that had the first defendant not agreed to pay $100,000.00 to his solicitors he would not have agreed to

settle. In this affidavit, made in October 1988, he said that if he was entitled to recover for damage caused to the property he would not be able to recover from Landbase if the $100,000.00 was paid to the plaintiffs because Landbase by that stage was in liquidation. He said that his situation was plain; he was not prepared to proceed with settlement when there was clearly considerable damage caused and he was receiving substantially less than he had contracted for. He said that if he had proceeded he would have had to sue the first defendant for loss sustained but that in view of the first defendant's position, that was an untenable proposition. He said it was only on the first defendant's agreement to pay $100,000.00 to cover losses that he agreed to settle. It appears to be the case that Landbase Nominee Company Limited was in provisional liquidation as at the date of settlement.

In his third affidavit, Mr Bhasin reiterated that he was not prepared to settle with the first defendant on 19 August in view of the actions of the first and second plaintiffs; that it was clear to him before settlement that considerable damage had been caused to the property and a substantial number of items (which he regarded as included in the sale) had been removed. He said that had he settled he would have had to try to recover any loss from either the first defendant or the first or second plaintiff. The first defendant was in financial difficulty and he had no confidence about the plaintiff's position since the property had been sold by the mortgagee. He said that he was not prepared to pay for something that was substantially less than he had agreed to pay for and that:

> "To overcome this problem, it was suggested that the first defendant pay my solicitors $100,000.00 from which the cost of remedying any loss could be recovered. That was the express basis on which the money was paid. I accepted those terms and settled"

In the same affidavit in respect of the damage he said that prior to and following the settlement of the sale on 19 August the plaintiff damaged the property and removed fixtures and fittings that were to have passed to him on settlement. He set out damage done during the removal of fixtures and damage to the electrical system on the property, substantially caused by the way light fittings had been removed.

Mr Bhasin set out his claim in monetary terms as being in total $77,628.00 for the cost of repairing damage to the fabric of the property and the electrical system and the cost of replacing fixtures and fittings which were removed. In addition he claims $40,000.00 which is the refund of an amount that he paid to Mr Anderson to stop him removing further items from the property. There appears to be no question, when regard is had to various photographs which were exhibited, that a number of fittings have been removed from the property and that allegations of damage done in the process of removal may well be made out.

The remaining evidence about what happened in relation to the settlement appears from the affidavits of Ms Marie Dianne Duncan, a legal executive employed by Kensington Swan who were formerly solicitors for the first defendant Landbase Nominee Company Limited, and Mr Graeme Leonard Reeves, who was solicitor for the plaintiff. Mr Reeves became involved in the matter on 12 August 1988. Until that time Mr Bhasin's solicitors had acted also for the plaintiff.

Ms Duncan said in her affidavit that prior to the settlement of the sale, solicitors acting for Mr Bhasin alleged that certain chattels and fixtures had been removed from the property and that damage had been caused to it in the process. As a result, she said, the second defendant indicated that it (sic) did not intend to settle. However, after discussion between herself, the solicitors acting for the Provisional Liquidator and Mr Bhasin's solicitors

settlement was agreed on the basis contained in a letter dated 19 August 1988 and was effected on that date.

Mr Reeves indicated in his affidavit that prior to settlement he was informed that there might be some difficulties as to what chattels it would be permissible for the first plaintiff to remove from the property before settlement. He said that subsequently he was advised by Mr Anderson as director of the first plaintiff that the issue of which chattels should be removed from the premises had been resolved directly between himself on the part of the company and Mr Bhasin. Mr Reeves then set out conversations and referred to correspondence which had passed between him and the solicitors for the first and second defendants. He said that he had sent a letter to the solicitors for the first defendant on 19 August. In that letter he called for payment of the proceeds of sale to his firm's trust account. On the same date he had conversations with solicitors for the first and second defendants. He said that in the early part of the day he was advised that settlement had not proceeded and that there were apparently some difficulties regarding chattels. He then said that later in the day he was informed by Mr Caughley who was acting as solicitor for Mr Bhasin that settlement had proceeded in full without deduction on 19 August.

He then referred to a letter subsequently received from Mr Caughley saying that settlement had been completed, but that from the proceeds of sale the sum of $100,000.00 had been returned to the trust account of solicitors for the second defendant in the joint names of the first defendant and the second defendant. He was later informed that that transaction was achieved by the purchaser's solicitor paying a settlement cheque in full to the mortgagee's solicitors and the mortgagee's solicitors paying a separate cheque for $100,000.00 out of the proceeds of sale to the purchaser's solicitors.

Mr Reeves referred to (and counsel in argument relied on) the statement of account from the solicitors for the first defendants setting out that from the funds received by the mortgagee the amount due to the mortgagee was paid to the first defendant and that $100,000.00 was shown as having been paid to the trust account of the second defendant's solicitors on an interest bearing deposit account "pending damage assessment report". A good deal of the rest of the affidavit is devoted to legal argument rather than any statement of fact, perhaps to be explained by the fact that the affidavit was filed in support of the ex parte application for an order that the fund be held by the solicitors who presently have it until an application to the Court had been disposed of. The affidavit does make the point which featured in submissions for the plaintiffs that whilst the purchaser might have had some rights which he could have purported to exercise prior to settlement, once settlement itself had proceeded, the position was plain and the surplus was payable to the first plaintiff.

The correspondence which has been exhibited is now set out. The solicitors involved were Mr Reeves of Lawrence Elder and Co for the plaintiffs, Ms Duncan of Kensington Swan for the first defendant, Landbase Nominee Co Ltd, and McElroy Morrison for Mr Bhasin:

(a) On 19 August Mr Reeves wrote on Mr Anderson's behalf to Kensington Swan seeking a report on the sale said to be due to take place on 19 August, and requesting payment of the net proceeds of the sale to Mr Reeves' firm. That letter was in confirmation of a telephone conversation with Ms Duncan the previous day.

(b) Also on 19 August Ms Duncan of Kensington Swan wrote to McElroy Morrison in the following terms:

> "We confirm our telephoned advice that we are prepared to settle the above transaction as follows:-

1. That you immediately pay to us the full amount required to settle of $562,645.67 as per our settlement statement dated 29/7/88

2. At settlement we will hand to you our trust account cheque for $100,000.00 being the amount to be retained in your trust account upon the following conditions:-

(a) That the Purchaser shall be entitled to withhold $100,000.00 forming part of the purchase price provided that the sum is held by the purchaser's Solicitor in trust in the joint names of the Vendor (Landbase Nominee Company Limited (In Provisional Liquidation) as Mortgagee in possession) and the purchaser the funds being held as security against any losses the purchaser may suffer as a consequence of the building on the property being damaged in the period immediately preceding settlement.

(b) The Purchaser's entitlement shall be determined in accordance with the terms of the Particulars and Conditions of Sale and shall be estimated by agreement by the parties and failing agreement by arbitration.

(c) In any event the Purchaser shall not be entitled to claim against the Vendor in any amount exceeding the sum held back as security.

Please contact the writer when you are in position to settle."

(c) On 24 August McElroy Morrison wrote to Lawrence Elder and Co. The essential parts of that letter are:

"1. We have completed settlement and under arrangements made with Kensington Swan the solicitors for Landbase received on settlement their cheque for $100,000.00.

2. Those funds have been placed on deposit through our trust account in the joint names of Landbase Nominee Company Limited (in provisional liquidation) and our clients A. & A. Bhasin. Those funds are held as security against any losses

the purchaser may have suffered as a consequence of the building on the property being damaged on the removal of chattels."

(d) On 26 August Lawrence Elder and Co wrote to Kensington Swan referring to a discussion with Ms Duncan on 24 August in which, it was said, it was confirmed that settlement in respect of the property had taken place on Friday 19 August. Possession was given up on the weekend of 20-21 August. Mr Reeves indicated that he had been advised by his client that the purchaser had entered into an agreement with Mr Anderson regarding the purchase of chattels remaining in the property. A demand was made for payment of the settlement funds withheld.

(e) On 25 August Kensington Swan wrote to Lawrence Elder in these terms:

> "Further to our telephoned discussions regarding the above matter we confirm that settlement was duly affected on 22/8/88. At settlement the sum of $100,000.00 was retained (by way of an exchange of cheques) by the purchaser's solicitors (Richard Caughley of McElroy Morrison in Wellington). This sum was retained pending a damage assessment report of the property following allegations which have been discussed with you. We confirm that we have today written to McElroy Morrison asking them to urgently forward to us their client's claim for the damages relating to the property so that the matter may be settled at the earliest opportunity and to the agreement of all parties concerned."

Statements were enclosed showing that the amount payable by Mr Bhasin to settle was $562,645.00, from that sum had been deducted what was payable to Landbase (and the statement recorded that deposit monies had been paid directly to Landbase) and referring to "amount retained in McElroy Morrison Trust Account on interest bearing deposit pending damage assessment report - $100,000.00". A cheque for the balance shown in the statement as payable to Elite Lifestyles under its former name, $44,402.60, was sent with the letter.

(f) On 13 September Lawrence Elder demanded from McElroy Morrison payment of the $100,000.00 held by the latter firm. It was said that Landbase and its solicitors were under a duty to account to the plaintiff in full

for the net proceeds of the sale in terms of s 104 of the Land Transfer Act. Demand was made for payment.

(g) On 13 September Lawrence Elder wrote to Kensington Swan setting out the former firm's view of the transaction as recorded in Mr Reeves' affidavit and asking for payment.

(h) On 16 September Kensington Swan replied to Lawrence Elder. In that letter inter alia it was said:

> "The sum of $100,000.00 is not yet capable of classification as surplus due to your client. If the purchaser is able to demonstrate to our client's satisfaction that there are legitimate deductions as a result of the property not passing in the condition in which it was agreed to be sold then payment will be made to the purchaser from the retention fund accordingly. The retention was agreed to by our client as a practical solution to a problem which was threatening settlement of the entire transaction. We believe that in making such arrangement our client was acting within the ambit of its power of sale. Once the dispute with the purchaser has been resolved the surplus from the retention, less our additional costs, will be paid to your client"

(i) On 16 September also McElroy Morrison wrote to Lawrence Elder. McElroy Morrison's response was:

> "1. Thank you for your letter of 13 September 1988. You misconceive the position. Our client did not deduct $100,000.00 from the sale. Kensington Swan had a responsibility to ensure that the property sold to our client was handed over on settlement and because of the problems threatened it agreed that $100,000.00 of the proceeds of sale would be paid to us on a basis negotiated.
>
> 2. With respect, it is Landbase which is required to account to your client for any surplus on sale..."

The first question raised in the pleadings and on the argument is whether the sum of $100,000.00 is to be regarded as part of the proceeds of the sale of the mortgaged property or as a sum of money arising in some way independently of the sale. It was argued for Mr Bhasin that

the $100,000.00 should be regarded as a deficiency on the sale, being an amount withheld by him by agreement with the mortgagee vendor.

In my view that is not a tenable proposition, and as a matter of fact the $100,000.00 was part of the purchase price paid by Mr Bhasin. The settlement statement was constructed on the basis that he was to pay to Kensington Swan (for the mortgagee) the whole settlement price, the transactions were carried out by an exchange of cheques which had the effect of Kensington Swan receiving the whole settlement amount and returning $100,000.00 to Mr Bhasin's solicitors on terms, including a term that the money would thereafter be held on behalf of Landbase as well as on Mr Bhasin's behalf. Kensington Swan's letter of 19 August recorded the arrangement in that way. Mr Bhasin in his first affidavit said that all the monies had been paid. That was on 19 August, but it seems that in fact the transaction was not completed until 22 August. He said that the settlement had gone ahead on conditions ensuring that $100,000.00 would not be disbursed by Landbase before his dispute with the plaintiff had been settled, but nowhere did he suggest that his solicitors had not paid out the full amount or that Landbase's solicitors had not received that amount. In the letter of 16 September, his solicitor disavowed the proposition that Mr Bhasin had deducted $100,000.00 from the sale.

The next and central question is whether Landbase received the $100,000.00 in circumstances such that it had an obligation to pay it on to the plaintiff. The plaintiffs rely on s 104 of the Land Transfer Act and say that once there has been a settlement there is no room for argument: the mortgagee no longer has power to put right damage at the cost of the mortgagor and recover that cost; it had no power to enter into an arrangement with a third party about compensation for damage and it must account for what it had received subject only to the payments provided for by

s 104. The plaintiff conceded that Landbase could have deferred settlement with Mr Bhasin, remedied damage done to the property, settled with Mr Bhasin and added the cost of the remedial work to the amount due to it by the plaintiffs under the mortgage. The plaintiffs' stance, however, is that not having elected to take that course the mortgagee had no right to make a deduction against some possible future expenditure. The plaintiff is simply asking the Court to make an order in accordance with the legal consequences of the steps taken.

The defendants have two substantial lines of defence: on the part of the mortgagee, that it had power to enter into a variation of the terms of sale so as to secure settlement, that it did so and is bound to give effect to the variation, and secondly that in the circumstances it is not to be regarded as having to account because it has not as yet received the $100,000.00. On the part of Mr Bhasin the argument is that the plaintiffs' rights, even after payment was received by the mortgagee, were subject to equities and that at this stage Mr Bhasin has equitable rights, the issues in respect of which he is entitled to have determined before the plaintiff can be said to be entitled to the money. I have already dealt with the question whether Landbase received the $100,000.00, and this judgment proceeds on the basis that it did.

Moving from that point, it is accepted that a mortgagee is a trustee for the mortgagor in respect of any surplus in his hands once his own debt and costs have been satisfied. That has long been regarded as so: a mortgagee after sale of the mortgaged property is a trustee of the balance held by him for the persons beneficially interested: Charles v Jones (1887) 35 Ch. D. 544.

In Charles v Jones, Kay J put it in this way:

> "He [the mortgagee] takes his mortgage as security for his debt, but so soon as he has paid himself what is due, he has no right to be in possession of the estate, or of the balance of the purchase money. He then holds them, to say the least, for the benefit of somebody else, of a second mortgagee if there be one, or, if not, of the mortgagor. What, then, is he to do? Surely he has a duty cast upon him. His duty is to say, "I have paid my debt: this property which is pledged to me, and in respect of which I now hold this surplus in my hand, is not my property. I desire to get rid of this surplus, and hand it back to the person to whom it belongs." (page 549)

In that case the duty of a mortgagee and trustee in respect of the surplus was held to extend to the mortgagee investing the money at interest whilst it was held. A solicitor who received the funds on behalf of the mortgagee knowing of the circumstances in which the mortgagee held them was held himself to hold the money in a fiduciary character in In re Lake (1886) 34 Ch. D. 462. Once the mortgagee has been paid what is due to him, his possession of the funds must be treated as that of the person rightfully entitled to have the funds handed to him. He has a positive duty to pay, and is not entitled, if the title of the person for whom he holds is clear, to require that person to sue him: In re Thomson's Mortgage Trusts [1920] 1 Ch. 508.

Section 104 of the Land Transfer Act 1952 (or its predecessor, s 108 of the 1915 Act) has been described as a statutory trust operating on monies in the hands of the first mortgagee: In re Dalton [1952] NZLR 167. Given that the obligations of the mortgagee after sale of the security are as described, the question must be on what basis can the mortgagee, however the transaction is managed, assert the right to hold money from the sale for the benefit of the purchaser of the property who may or may not have a valid

claim against the mortgagor for tortious activity in respect of the property? There seems to be no difference in principle between the mortgagee holding money from the sale or allowing the purchaser to hold part of the sale price. An alternative question, but involving the same principle, is on what basis could the mortgagee assert the right to hold money from the sale for his own benefit in case the purchaser succeeded in an action against the mortgagee on or consequential upon the contract of sale, whether or not the mortgagee might in turn have a right of action against the mortgagor?

A subsidiary question is on what basis the mortgagee can assert the right, as it has purported to do in this case without the agreement of the mortgagor, to resolve or have resolved issues arising between the purchaser and the mortgagor and to give effect to that resolution by payment from the monies which result from the sale of the mortgaged property?

The mortgagee's answer is that it was entitled to contract with Mr Bhasin about how the purchase price was to be dealt with in order to persuade him to keep to the contract he had already made. As mortgagee it had an obligation to ensure that Mr Bhasin received no more than he was entitled to at law and the agreement, being related to the conditions of sale, preserved that position. Mr Bhasin had paid the money in reliance on the agreement and it would be inequitable to allow the money retained to be paid out without the merits being determined.

The justification from the mortgagee's point of view for the agreement with Mr Bhasin was argued to lie in the mortgagee's powers as to sale provided in the Fourth Schedule to the Property Law Act 1952, as varied by the mortgage. The plaintiffs dispute that the mortgagee had any right to enter into a variation in respect of the

disposition of settlement monies, at least in so far as would affect their rights.

Clause (8) of the Fourth Schedule, in the event of default by the mortgagor allows the sale of the mortgaged property:

> "subject to such conditions as to ... time or mode of payment of purchase money, or otherwise as the mortgagee thinks fit ... with power [to the mortgagee] to execute assurances, give effectual receipts for the purchase money, and to do all such other acts and things for completing the sale as he may think proper ...
>
> And that the mortgagee will apply the money arising from any such sale as aforesaid, in the first place in payment of the costs and expenses incidental to the sale or otherwise incurred in respect of the mortgage, and in the second place in satisfaction of the principal, interest and other money for the time being owing under the mortgage, and in the third place in payment of monies owing under the subsequent registered mortgages (if any) in the order of their priority; and will pay the surplus (if any) to the mortgagor"

That clause has been modified by the mortgage itself, so far as is relevant in these terms:

> "Clause (8) ... is enlarged to provide that the mortgagee shall not be obliged to account for or apply the monies arising from the sale unless and until the mortgagee shall actually receive payment for the same and that the mortgagor shall remain liable for the monies owing under the mortgage beyond the amount of monies actually received ..."

It is of some interest to contemplate the prospect (remote from likelihood though it undoubtedly is) that if the property on sale had realised only as much as was owed to the mortgagee under its security and precisely the same steps had been taken as were taken, the mortgagee would be

in a position to assert that the mortgagor still was liable to it for $100,000.00. It would have given Mr Bhasin's claim (or so much of it as may be established) priority ahead of its own against the proceeds, but at the cost of the mortgagor. The existence of that possibility at least casts a doubt upon the correctness of the mortgagee's argument as to its powers.

The original conditions of sale as to payment of the purchase money were a deposit of 10% on the fall of the hammer and payment of the balance of 19 August 1988. The vendor specifically sold as mortgagee (Clause 9 of Conditions of Sale) and had power if the purchaser defaulted for 14 days, inter alia, to enforce payment by the purchaser of all monies owing to the vendor under the contract (Clause 11). The contract entered into by Mr Bhasin was specifically to complete the purchase according to and in pursuance of the conditions.

The agreement contained in the letter of 19 August cannot in reality be regarded as one relating simply to the "time or mode of payment of the purchase money" since what was in contemplation was that some part at least, and possibly all, of the purchase price "retained" would never be paid to the mortgagee or to the mortgagor.

The general power "to do all such other acts and things for completing the sale" does not appear to cover what was done. "Completing the sale" on the face of the words means to receive the price which was agreed for the property and to do whatever might be necessary to give the purchaser title or was otherwise incidental to the sale. The mortgagee in terms of the letter of 19 August did not intend to reduce the sale price agreed upon: that is clear from the requirement that Mr Bhasin pay the mortgagee the sum of $562,645.67 which was the final figure of the settlement statement based on the contract purchase price. Agreeing in advance to pay away immediately, whether absolutely or

conditionally, funds not required to satisfy its own claims and which would be impressed with a trust as soon as the mortgagee received them, could not properly in my view be regarded as something done for "completing the sale". It was an agreement as to something which was in no way an integral part of the sale, but which was to be done simultaneously with settlement.

Mr Dale submitted that what the mortgagee did was within power: that it made a prompt settlement, recovered the money, protected the position of the parties over disputed issues, put the money on interest bearing deposit and has placed itself in a position (by reason of the reference in the letter of 19 August to the terms of the Conditions of Sale) to ensure that Mr Bhasin gets no more than he is entitled to. That is correct so far as it goes. It overlooks, however, that the mortgagee has had no obligation to Mr Bhasin in respect of the purchase money which he had already contracted to pay; on the contrary Mr Bhasin had an obligation to pay the mortgagee. There is no provision in the Fourth Schedule which in my view entitles the mortgagee to buy the purchaser's compliance with his contract using funds which will be impressed with a trust once the mortgagee receives them.

It was argued on behalf of Mr Bhasin that the $100,000.00 should not be regarded as surplus because s 104 (1)(a) of the Land Transfer Act authorised application of the funds realised from the sale towards "expenses occasioned by the sale", which should be taken to include such expenses as are incurred by the mortgagee for the preservation of the property in excess of the ordinary expenses of sale. That submission was made in reliance on National Bank of New Zealand v Barclay (1899) 17 NZLR 819, and Stanley v Murphy [1922] NZLR 838 and clauses (5) and (7) of the Fourth Schedule to the Property Law Act.

The short answer to that submission, in my view, is that on no view of the facts could the $100,000.00 or any part of it be regarded as representing expenses (whatever comes within that category) "occasioned by the sale" or "incurred" by the mortgagee. The claim which the money has been put aside to meet relates to damage alleged to have been done by a third party so far as the contract of sale is concerned, and not to be in any direct sense connected with it. The mortgagee does not purport to have incurred any expense in respect of the damage to the property or sale of chattels, and has shown no intention of incurring any: it has denied in the proceedings any liability in respect of the matter, and by its solicitors in the letter of 19 August 1988 made it perfectly clear that it did not intend to put any of its own money in issue in the dispute.

I agree with the argument on behalf of the plaintiffs: what the mortgagee might have done, but did not do, in this respect before the sale is no longer of relevance.

That leaves as justification for the refusal to pay the monies to the mortgagor the claim, substantially raised by Mr Bhasin, that he had an equitable interest to which Landbase must have regard when deciding what amount was the surplus monies under s 104 of the Land Transfer Act to be paid to the mortgagor. For the proposition that the responsibility under s 104 is subject to equities reliance was placed on Beeby v Official Assignee of Pickering [1953] NZLR 832 and Hope v Hope [1977] 1 NZLR 582. In Beeby Smith J held that the surplus arising from the sale by a mortgagee of mortgaged lands and in terms of s 104 payable to the mortgagor, was so payable subject to a charge in favour of a person in whose favour the mortgagor had made an equitable assignment of monies arising from the sale of nominated land after payment of money owing under memoranda of mortgage to which the land was subject. In Hope Wilson J held that s 104 does not abrogate the rights of mortgagees under unregistered mortgages, but s 104 (d) was to be

construed as vesting the surplus on sale in the mortgagor subject to equities, and that the previous equitable charge on the land was converted on sale into a charge on the proceeds.

This case is of course not on all fours with either Beeby or Hope because there is here no question of an equitable charge on the land or on proceeds of sale of the land which pre-dated the sale of the land.

The argument for Mr Bhasin was that he had an equitable interest arising from the agreement between Landbase and himself that the $100,000.00 should be withheld until determination of Mr Bhasin's right in respect of the claimed damage to property and sale of chattels, or because he had a set-off available against the plaintiffs.

It is not clear how Landbase could create an equitable interest in Mr Bhasin in respect of any of the proceeds of sale when it held them, in so far as they were not required to meet Landbase's own debt, as trustee for the mortgagor. Applying the principle in In re Lake (1886) 34 Ch. D. 462 to Mr Bhasin's solicitors and to him (both having knowledge from the conditions of sale that Landbase sold as mortgagee), they also would take and took subject to the same trust. In my opinion, there was no circumstance which would enable Landbase and Mr Bhasin, through their solicitors, between themselves and to the exclusion of the mortgagor to create an equitable interest over the proceeds of sale in derogation of the mortgagor's rights.

The claim of setoff was put in the category described in Meagher Gummow and Lehane: Equity 2 Ed at page 773: "The fourth kind of equitable setoff is the kind which equity recognised wherever 'the party seeking the benefit of it can show some equitable ground for being protected against his adversary's demand'", relying on Lawson v Samuel (1841) Cr & Ph 161, 178; 41E.R. 451, 458. Reliance was placed in

particular on D. Galambos and Son Pty Ltd v McIntyre (1975) 5 ACTR 10 and British Anzani (Felixstowe) Ltd v International Marine Management (U.K.) Ltd]1979] 2 ALL ER 1063.

In D. Galambos and Son Pty Ltd v McIntyre, Woodward J dealt with a claim for the balance of the contract price for the construction of a building which was met with a counterclaim for general damages for deficiencies in the way the work had been performed, including a claim based on loss of enjoyment of the premises. That claim succeeded and the issue arose when the form of judgment was being considered whether the claim by the defendant should be regarded as a matter of equity as a setoff. After reviewing a number of decisions in England and Australia, Woodward J concluded that the principles to be extracted from the decisions were:

> "(i) failure in part to perform a contract or defective performance of a contract requiring work to be done again or directly reducing the value of work done or goods supplied, may be raised as a defence to an action for money due under that contract ...
>
> (ii) claims for money due under a contract and for damages for breach of the same contract (arising, for example, from delay) may be set-off against each other where the equity of the case requires that it should be so. This will depend upon how closely the respective claims are related, particularly as to time and subject-matter. The general conduct of the respective parties will, as always, be relevant to the granting of such such equitable relief ...
>
> (iii) even where one of the claims is not in terms based upon the contract, but flows out of and is directly connected with it, a Court may be prepared to recognise an equitable setoff ...
>
> (iv) The above statements of principle cannot be regarded as having universal application. They do clearly apply to contracts for work and labour, but special considerations are

> relevant in other areas such as bills of exchange ... landlord and tenant ... and carriage of goods ..."

British Anzani (Felixstowe) Ltd v International Marine Management (U.K.) Ltd was a judgment on a preliminary issue arising out of a claim for rent for a leased building which had been constructed as a result of an agreement between the parties. The defendants admitted owing rent, but had a counterclaim for damages in respect of defects which had appeared in floors of the building and which made them unusable. In answer to the claim for rent, the defendants claimed that the amount owing was subject to a set-off in respect of the damages claimed for breach of the agreement as to the construction of the building and the lease.

Forbes J held that whilst:

> "it is proper in principle to allow that a cross-claim could be effective as an equitable set-off against a claim for rent, it by no means follows that such a defence is available in all circumstances. The important qualification is that the equity must impeach the title to the legal demand or in other words go to the very foundation of the landlord's claim" (page 1074)

The central problem facing the Court in that case was that the claim for rent arose under the lease, but the defendant's cross-claim arose under the agreement relating to the construction of the building. Forbes J dealt with the question in these terms:

> "This at once raises, in an acute form, the question I posed earlier and in general terms, does the requirement that the equity must impeach the title for the legal demand mean necessarily that the tenant's cross-claim must at least arise under the lease itself or directly

> from the relationship of landlord and tenant, or is it sufficient that it should arise out of some transaction closely connected with the lease, and if so how closely. The passage I quoted from the judgment of Parker J in The Teno assumes that the claim and cross-claim arise out of the same contract, but that is no doubt because on the facts before him they did so and this question did not arise for consideration. It is clear that in Banks v Jarvis the claim and cross-claim arose under different contracts. In Hanak v Green Morris LJ referring to Banks v Jarvis averred that there was a close connection between the dealings and transactions which gave rise to respective claims. In the Federal Commerce case Lord Denning MR said: 'It is only cross-claims that arise out of the same transaction or are closely connected with it'. In The Brede he said much the same thing: 'It is available whenever the cross-claim arises out of the same transaction as the claim; or out of the transaction that is closely related to the claim.' In view of these passages and in particular having regard to the facts in Banks v Jarvis it does not seem possible to conclude that it is in all cases necessary that claim and cross-claim must arise out of the same contract. Whereas in this case they do not, it still therefore remains for consideration whether in any particular case the two matters are so closely connected that the principles affecting equitable set-off can be said to apply."

Forbes J gave further consideration to comments by Morris LJ in Hanak v Green [1958] 2 Q.B. 9 and concluded that in considering questions of this kind today it is what is obviously fair and just that will determine the solution. He concluded that in his case, notwithstanding that the agreement and lease should be regarded as separate, there was nevertheless "that close connection between claim and cross-claim which equity requires" and that it would be manifestly unjust to allow the landlord to recover his rent without taking into account the damages which it was alleged the tenant had suffered to failure by the landlord to perform his part of the agreement.

In New Zealand, Barker J in Popular Homes Limited v Circuit Developments Limited [1979] 2 NZLR 642 and Thorp J in Parry v Grace [1981] 2 NZLR 273 have considered the basis upon which an equitable set-off can be claimed and in the course of doing so have discussed a difference of approach in English and Australian cases perceived by Mr I.C.F. Spry in an article in the Australian Law Journal (1969) 43 ALJ 265.

Barker J held in his decision in Popular Homes Limited that an equitable set-off would arise in the circumstances of that case. The plaintiff had agreed to take over by way of purchase a partly completed housing project from the defendant. Part of the purchase price was to be satisfied by a mortgage back. The contract of sale included a covenant by the vendor to provide the purchaser with loan finance to enable it to complete the development, but that finance was not made available. The plaintiff claimed damages for the breach of covenant and for the right to set-off any damages against the mortgage back, whilst the defendant claimed repayment under its mortgage.

Barker J held that the defendant's default in making finance available was the direct cause of the plaintiff's inability to complete the project and repay the mortgage on time. A set-off was allowed because the claims were so closely related as to make it unconscionable for the first defendant to recover without allowing the set-off.

In Parry v Grace Thorp J was dealing with a claim for an injunction to restrain a mortgagee from exercising a power of sale under a mortgage. The defendants had agreed to sell to the plaintiffs two residential sections. Part of the consideration for the sale was satisfied by a mortgage back. Each of the agreements for sale and purchase was conditional on the vendors granting a legal easement over an access way, which was never done. The plaintiffs' action was based on breach of contract in failing to provide the easement and for damages in respect of the difference in

value of the land with and without the benefit of the easement. They also sought an interim injunction to prevent the defendants exercising their power of sale under the mortgage (the plaintiffs having ceased payments and been served with a default notice), claiming an equitable set-off against the amount due under the mortgage.

Thorp J held that the relationship between the parties in Parry v Grace was materially different from those in the Popular Homes case: in the latter it was the result of the breach of contract by the vendor which rendered the plaintiff unable to meet his obligations under the mortgage; whereas in the former the issue raised by the purchaser was no more than that the property sold was of less value than it would have been had the vendor's warranties been complied with.

In this case also the second defendant's claim is that the property which he bought is of less value than it would have been but for the mortgagor's allegedly tortious acts, but his claim to be entitled to an equitable set-off faces greater problems than that.

It is not necessary in this case in my view to consider which of the English or Australian approaches discussed by Barker J and Thorp J is to be preferred. The principles in neither the Galambos nor the British Anzani decisions help Mr Bhasin since his claim against the mortgagor plaintiffs bears no necessary relationship to their claim in respect of the surplus funds. The mortgagor's claim is against the mortgagee for payment of the surplus and is against Mr Bhasin only through the mortgagee. Mr Bhasin is, with the mortgagee, the holder of the funds, and as such a trustee for the mortgagor. Mr Bhasin's claim is against the mortgagor in tort and is quite independent of anything arising out of the mortgage contract. The only significance that contract has to Mr Bhasin's claim is that the existence of the contract put the mortgagee in a position to sell the

property at all. So far as their involvement with each other in the transactions in issue is concerned, had it not been for the arrangement involving retention of funds in the name of Mr Bhasin and the mortgagee, no question of set-off between him and the mortgagor would ever have arisen.

It is alleged in Mr Bhasin's counterclaim against the plaintiffs that the latter became trustee of the property for him after 20 July when he became the equitable owner pursuant to the contract and as trustee had a duty to preserve the property for him in the same condition as it was at the time of sale. It is my view that that contention cannot get off the ground because there was never a relationship between Mr Bhasin and the plaintiffs which could give rise to a duty on their part to him. They could become liable to him for damage as tortfeasors but on no other basis.

Having reached the conclusions above, I am of the opinion that the justification for retention based on equitable set-off cannot succeed in relation to Mr Bhasin.

Mr Bhasin's claim in respect of chattels removed may be of dubious strength in light of clause 23 of the conditions of sale under which he purchased and which was in terms:

> "All gas and electrical fixtures or appliances on or in the property held by the mortgage (sic) under hire purchase, or not owned by the mortgagor and all such other appliances or fixtures which might otherwise pass under the sale as fixtures are expressly excluded from the sale."

On one view of that clause, Mr Bhasin did not buy any chattels with the property and the only issue open to him is the damage done in removing them. On the view I have formed on the issues already traversed it is not necessary to

determine, in order to answer the question of law, what the merits of either claim might be.

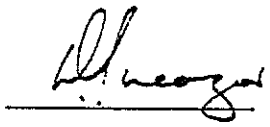
The question is in terms "are the first and/or second and/or third defendants under a mandatory legal duty to pay the sum of $100,000.00 to the first and/or second plaintiff?"

There is no basis on which in my view it can be suggested that any payment ought to have been made to the second plaintiff, who was not the mortgagor. My conclusion is that the first defendant was under a duty pursuant to s 104 of the Land Transfer Act to pay any surplus on realisation to the first plaintiff, that it received the $100,000.00 in dispute and that there is no basis for regarding it as other than part of the surplus from realisation of the security. Mr Bhasin, in my view, holds the money with knowledge of the circumstances under which the party from which he received it, Landbase, became under a duty to pay it over to the first plaintiff and accordingly he is to be regarded as a constructive trustee subject to the same obligations as Landbase to the first plaintiff. The third defendant's liability has been treated by all parties as co-extensive with the first defendant's.

The answer to the question is that all defendants are under a mandatory legal duty to pay the sum of $100,000.00 to the first plaintiff. The consequences of that decision will be those set out in the Chief Justice's minute of 10 October 1988.

The first plaintiff is entitled to costs, but there will be no order as to costs in respect of the second plaintiff.

Counsel may submit memoranda if they are unable to agree on amount of costs.



D.P. Neazor J

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