IN THE HIGH COURT OF NEW ZEALAND
INVERCARGILL REGISTRY

AP 32/92

UNDER the District Courts Act 1947

IN THE MATTER of an appeal by M L ANDERSON against District Court Judgment Plaint No 3292/90, Invercargill Registry

BETWEEN M L ANDERSON

Appellant

A N D W CHILTON

First Respondent

A N D THE BANK OF NEW ZEALAND

Second Respondent

JUDGMENT OF WILLIAMSON J

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LOW PRIORITY

Hearing 26 October 1993

Counsel A F Marshall for Appellants
J J G Hitchcock for First Respondent
A D G Hitchcock for Second Respondent

Judgment

JUDGMENT OF WILLIAMSON J

Murray Anderson sold his 16 foot boat, motor and trailer for $13,750.00. On 28th September 1989 the purchaser, Patrick Curtin, paid the full amount to Beck Motors and Marine Limited (the company) who had sold the boat on Anderson's behalf. The cheque was paid into the company's trading account at the Bank of New Zealand. Eleven days later, on 9th October 1989, the bank froze the company's trading account and

placed the company into receivership. Anderson has not received any part of the proceeds of the sale of his boat.

In an effort to recover his money Anderson issued proceedings against the first respondent Chilton who was a director of the company claiming either that Chilton was a party to the company's conversion of his money or in breach of a fiduciary duty owed to him. He also claimed that the bank held the proceeds of sale as a constructive trustee or alternatively converted it by crediting the money to the company's overdrawn trading account. In a thorough and careful reserved decision the District Court Judge rejected the claims saying that while the injustice to the Appellant was "palpable" a judgment against either the first or second respondent would be unjust to them. He said that the appellant was a victim of the company's business failure for which there was no remedy of any value.

Facts

There is very little conflict about the primary facts. On 28th September 1989 Anderson was told by the Chilton that it would take ten days for the purchaser's cheque to be cleared. At the time the cheque was paid into the company's trading account the overdraft was within the limit set by the bank. For general financial reasons the bank decided on 9th October 1989 to freeze the company's trading account and to place it in receivership pursuant to its debenture.

During 1989 the bank had been monitoring the company's financial situation. It had been receiving monthly reports from the company as to its trading performance as against budget. Following a request made in April 1989 Coopers and Lybrand reported to the bank on 15th June 1989 concerning the adequacy of the bank's securities for its advances and the overall viability of the company. In their written report Coopers and Lybrand concluded that the securities held by the bank were

adequate to cover the current level of lending. They recommended two monthly reviews of the security position and said additional capital was to be injected by the existing shareholders into the company. An aspect of the report which has significance in the context of these proceedings is that the report does not mention that any stock held by the company was "on behalf of" private individuals. Indeed the report said "Mr Chilton has advised us that he is not aware of any reservation of title to goods applying to items of stock included in the company's financial statements.

There is no reference to "on behalf of" stock in the company's financial statements although some of the records attached to the report contain a schedule of "motor vehicles and marine stock on consignment". The District Court Judge concluded from the report that "It follows that at the time that Coopers and Lybrand prepared their report either the company held no 'on behalf of' stock or the first defendant failed to disclose the existence of such stock." In his evidence Chilton, a person who had been in the industry for some 43 years, said that the practice of selling on behalf of private individuals was an invariable one in the industry. He said that 5% of the motor vehicles sold and 20% of the marine items sold were "on behalf of". He also stated in evidence that it was an invariable practice in the trade to pay the proceeds of "on behalf of" sales into the seller's agent's trading account.

The Bank of New Zealand's Manager in Invercargill since July 1975, however, said that he was not aware that the company was selling on behalf of persons although the bank was aware that some items were sold on consignment. Reference was made to notes indicating that New Zealand Motor Corporation had challenged the bank in relation to vehicles sold "on consignment". He said that he understood that on consignment vehicles were in fact paid for by the company and that they "took ownership" prior to the sale to the new purchaser. He claimed that, in his

experience, dealers selling vehicles and boats did not sell "on behalf of" but rather bought items into stock and then on sold them.

The evidence of the bank manager and Chilton was in sharp conflict so far as the practice of this company and of other similar companies were concerned in relation to sales "on behalf of". The District Court Judge did not refer to this conflict or Anderson's evidence but he found that the bank manager had not been aware that any part of the company's business comprised "on behalf of" sales.

Did the Company Owe Anderson a Fiduciary Duty?

The proceedings raised a number of questions. The first one dealt with by the District Court Judge and in the submissions of Counsel was whether or not the company owed Anderson a fiduciary duty. In order to resolve this question the District Court Judge referred to the approach of the Court of Appeal in ***Westpac Banking Corporation v Savin*** [1985] 2 NZLR 41. In that case two boat owners had authorised a company, Aqua Marine, to sell their boats on their behalf with the company receiving a commission on the sale. Savin authorised Aqua Marine to keep the proceeds for 28 days before paying him out. Boyle, the other owner, did not make any like authorisation. Both boats were sold and the proceeds paid into Aqua Marine's overdrawn trading account; then Aqua Marine went into liquidation with the result that neither Savin nor Boyle were paid as there were insufficient funds to pay unsecured creditors. The Court of Appeal held that Aqua Marine was in breach of its fiduciary duty. Richardson J said at page 49 -

> "When examining the particular business relationship one consideration which has been given some emphasis in a number of cases is that the ready imposition of separate trust accounting obligations on commercial agents must tend to impede the free flow of commerce (***Henry v Hammond*** [1913] 2 KB 515; ***New Zealand and Australia Land Company v Watson*** (1881) 7 QBD 374; and generally Finn, ***Fiduciary Obligations***

(1967) ss 218 - 225). The reasons are obvious enough and those considerations may well in some circumstances - particularly where the parties are commercial men engaged in regular dealings with one another - justify the inference that they intended that the proceeds of sale should be paid into the agent's account and their final dealings should be settled on a debtor/creditor basis.

However, I am not persuaded that those wider commercial considerations can be regarded as reflected in the matrix of facts against which the agreements between Savin and Boyle respectively and Aqua Marine are to be assessed. These were pleasure boats sold in each case by a private vendor in the only transaction he had ever had with Aqua Marine. The express terms of the contract in each case required Aqua Marine to receive the proceeds of sale on behalf of Savin and Boyle respectively and I have already rejected the argument that in terms of the contract Aqua Marine was impliedly authorised to pay the monies received on behalf of Savin and Boyle into the trading account, at least in the overdrawn state. Not surprisingly there was no evidence that it was a well accepted and understood business practice in the boat dealing field for agents, no matter how shaky their financial circumstances, to pay clients' money into their overdrawn trading accounts. I am satisfied that under these agency relationships Aqua Marine was not entitled to pay the proceeds of sale of the boats into its trading account with Westpac.

There is a further way in which the matter can be addressed. A fiduciary owes duties of loyalty and fidelity. The fiduciary must act with absolute fairness and openness to his client. He must not place himself in a position where his duty and interest may conflict (***Bray v Ford*** [1986] AC 44, 51; ***Boardman v Phipps*** [1967] 2 AC 46, 123). It follows that the fiduciary must not without the informed consent of his client stand to receive any benefit other than his professional remuneration from the transaction which he is retained to carry through. Aqua Marine applied the proceeds of sale in partial discharge of its personal indebtedness to the bank. That was of immediate fiduciary benefit. It did so without securing the informed consent of its client. Had it sought that consent and for that purpose advised its client of its precarious financial state and so of the risk to the client, it is likely if not certain that its proposal that the sums nevertheless be paid into the trading account would have been rejected. In any event where a fiduciary fails in his obligation to make full disclosure of material facts he cannot be heard to maintain that disclosure would not have altered the decision to proceed with the transaction (***Brickenden v London Loan Savings Company*** [1934] 3 DLR 465)."

In this case the District Court Judge held that there was no implied term that the company could use the proceeds of Anderson's boat to reduce its indebtedness under their overdraft. Certainly Anderson did not authorise or agree to his money being blended with the company's in a manner which would enable the company to obtain a benefit for trading purposes. The Judge held that the company was under a duty to pay the proceeds of sale to the plaintiff and that it was in breach of its duty. There was little challenge to this conclusion in the arguments of Counsel.

Was Chilton a Party to This Breach of Fiduciary Duty?

According to the evidence Chilton was the managing director of the company. He was responsible for its day to day management and control. His wife and he owned 44% of the company's shares. Although Chilton had no involvement in the actual contract between the company and Anderson he was responsible for the proceeds of sale being paid into the company's trading account. This responsibility stemmed from his general instruction to his sales persons that all such monies were to be paid into the one trading account operated by the company. Indeed Chilton's dealings with Anderson commenced approximately two days after the sale when Anderson enquired about the proceeds of sale and was told that they would be paid out in about 10 days' time when the purchaser's cheque had been cleared.

The District Court Judge concluded that Chilton had honestly believed that Anderson would be paid when the cheque was cleared because the company's overdraft was still within the limit set by the bank. Indeed the available reports indicated that the company was meeting its monthly budgets and had reduced its net loss. According to the finding of the District Court Judge, "imminent receivership, while on the cards, was not inevitable".

By the time that Anderson's cheque had been deposited Chilton was aware that the financial position of the company was perilous. The company's overdraft was substantial. The injection of capital into the company, which was seen as essential to the company's survival, had fallen through. Chilton had also sold a property with the intention of injecting the funds from that property into the company's capital. Although the proceeds, some $25,000.00, had been realised by September 1989 they had not been paid into the company and the District Court Judge drew the inference that Chilton had, "insufficient confidence in the future of his company to commit his $25,000.00 to its survival".

Counsel for Anderson relies on the principle in ***Barnes v Addy*** [1874] 9 Ch App 244 that a stranger to a trust may incur liability to a beneficiary if he knowingly assists in a fraudulent design on the part of the trustee. In ***Westpac Banking Corporation v Savin*** two categories in which a stranger to a trust may become liable as a constructive trustee are described. These two categories involve either "knowing receipt or dealing" or "knowing assistance". Reference to the distinction between these two categories was made by Sir Clifford Richmond at page 63 in the following way:

> "I now wish to refer to a distinction which has been drawn between two categories of case in which a stranger to a trust may become liable as a constructive trustee. For this purpose it is helpful to cite a passage from ***Snell's Principles of Equity*** 27th ed, 1973) at pp 186-187:
>
> > 'Knowing receipt or dealing. A person receiving property which is subject to a trust may receive it as an express trustee, a constructive trustee, a volunteer, or a bona fide purchaser for value without notice of the trust. He receives it as an express trustee when he has agreed to accept this office. He becomes a constructive trustee if he falls within either of the two heads, namely -
> >
> > (i) that he received the trust property with actual or constructive notice that it was trust property and that the transfer t him was a breach of trust; or

(ii) that although he received it without notice of the trust, he was not a bona fide purchaser for value without notice of the trust, and yet, after he had subsequently acquired notice of the trust, he dealt with the property in a manner inconsistent with the trust.

Knowing assistance. A person who does not actually himself receive a trust property may also incur liability to the beneficiaries if he knowingly assists in a fraudulent design on the part of the trustee. But "strangers are not made constructive trustees merely because they act as agents of trustees in transactions within their legal powers, transactions, perhaps in which a Court of equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees [***Barnes v Addy*** (1874) 9 Ch App 244 at pp 251-252]. The requisite knowledge is knowledge of circumstances which would indicate to an honest, reasonable man that such a design was being committed or would put him on enquiry, which the stranger failed to make, whether it was committed. [***Selangor United Rubber Estates Limited v Craddock*** (No 3) [1968] 1 WLR 1555 at p 1590]. "

There have been several recent decisions which contain interesting discussions as to the degree of knowledge which it is necessary to prove in order to give rise to a constructive trust. The majority of the Judges, and in particular Wylie J in ***Equiticorp v Hawkins*** [1991] 3 NZLR 700, Tipping J in ***Marshalls Futures v Marshall*** [1992] 1 NZLR 316 and Blanchard J in ***Nimmo v Westpac Banking Corporation*** [1993] 3 NZLR 218 conclude that a want of probity must be shown. The minority view is that of Thomas J in ***Powell v Thompson*** [1991] 1 NZLR 610 where a want of conscionability appears to have been the test. In the first three cases the Judges were not satisfied that negligence, even gross negligence, would be enough but held that a defendant must be shown to have consciously acted improperly. The alternative view is that the Court needs only to conclude that a defendant's conduct has been such that it is unconscionable to a degree where the defendant should be required to assume the obligation of constructive trustee. In this case I am not called upon to choose which of

these alternative views I should follow since the facts of this case, in my opinion, meet either of the tests.

The case for Anderson is that Chilton "knowingly assisted" the company in a breach of trust. It must be shown that his knowing assistance was in relation to a dishonest and fraudulent design on the part of the company. The District Court Judge held that the company acted through Chilton who was its director. He said that there was no clear evidence to displace a finding, that Chilton was acting as an officer of the company and not as the company's agent or servant in a way that would render him personally liable. He concluded that Chilton had not assumed any personal fiduciary duty to Anderson and consequently was not in breach of a personal duty. The District Court Judge relied particularly on the fact that Chilton had not dealt initially with Anderson and had no personal involvement in the making of a contract between Anderson and the company nor of any knowledge of the specific depositing of the proceeds of sale in the company's trading account until after those events had occurred.

The Judge also expressed the view that if he were required to decide the matter on the basis of knowing assistance he would decide that issue in favour of Chilton. He accepted that payment of the funds was made into the company's bank account as a result of general instructions issued by Chilton but noted that Chilton had not been involved in the receipt or deposit of those funds. At the time of deposit Chilton was not aware of the bank's intention to freeze the account which was then within overdraft limits.

The law is that an officer of a company may in the course of activities on behalf of the company come under a personal duty to a third party a breach of which might entail personal liability. The test as to whether that liability has been incurred is whether there has been an

assumption of the duty of care actual or imputed. In the case of ***Trevor Ivory Limited v Anderson*** [1991] 2 NZLR 517 Cooke P stated the position in this way:

> "Where damaged property or other economic loss is the basis of a claim it may well be possible to sheet home personal responsibility for an intentional tort such as deceit or knowing conversion and of course if the individual defendant has placed himself in a fiduciary position towards the plaintiff he will be personally liable for breach of his fiduciary duty. But if an economic loss claim depends on establishing a personal duty of care it is especially important to consider how far the duty asserted would cut across patterns of law evolved over the years in the process of balancing interests."

Mr Marshall, for Anderson, has argued that Chilton became personally involved in the transaction when he was asked by Anderson for the proceeds of sale. At that stage he told Anderson that payment would be made in 10 days' time when the purchaser's cheque had cleared. As at that time it was apparent to Chilton that the proposal for a third party to inject $100,000.00 in the company had not eventuated and that receivership, while not inevitable, was imminent. It was contended that Chilton must have well known that the company was in a perilous financial position and that he himself had insufficient confidence in the future of the company to commit his own $25,000.00 from the sale of the property to the company. It was pointed out that Chilton could have paid the purchase monies less commission to Anderson prior to 9th October since the cheque would have been cleared and that in not doing so he had failed to honour his promise and statement to Anderson.

In any particular case personal liability of an officer of a company depends upon the facts. In this case the degree of implicit assumption of personal responsibility by Chilton was slight in that Anderson did not deal with him personally at the time of the receipt and deposit of the proceeds. While Chilton made a personal statement to Anderson about the

proceeds of the sale and the time of payment, there is no indication that he was doing so personally rather than in his role as director of the company. The strength of factors in relation to assumption of personal liability have to be balanced against the need for the Court to preserve the principles of limited liability and separate company identity described in the decisions of ***Salmon & Salmon and Company Limited*** [1897] AC 22, ***Lee & Lees Air Farming Limited*** [1961] NZLR 325, [1961] AC 12(PC).

Having re-examined the facts in this case I am of the view that the District Court Judge was correct and that Chilton's actions were in fact the actions of the company. They constituted the breach of a fiduciary duty owed by the company to Anderson. Although the bank notes point to Chilton being aware of the likely course of action by the bank I have not been satisfied from Anderson's arguments that Chilton did assume any personal responsibility or duty towards Anderson.

Was the Bank in Breach of a Fudiciary Duty?

My conclusions about the bank, however, differ from those of the District Court Judge. In the case of ***Lankspear v ANZ Banking Group (NZ) Limited*** [1992] 4 NZBLC 102,771 Wallace J was faced with a case in which a banker had denied any knowledge for the purpose for which the funds were intended and had argued that the bank was not required to investigate either the purpose for which funds were given to a developer or the purpose to which the surplus was to be put. He said -

> "As I have said an enquiry would certainly have obtained confirmation that the funds were not able to be used to repay the overdraft and I do not accept that considerations of customer confidentiality can be prayed in aid to avoid the obligations to take such a step; nor was an enquiry the only step open to the defendant. He could, eg, simply have ensured that the funds were placed in a separate account. With the defendant not thereafter asserting the right to combine the accounts, I therefore do not see the position of 'knowing receipt' liability in the present case placing any unduly onerous or uncertain obligation on banks.")

In a recent decision of the Court of Appeal in ***Westpac Banking Corporation v Ancell and Eleven Others*** CA 365/92 26 August 1993 the Court considered the position of a bank in relation to sums received into the account of a sharebroker from his clients. Richardson J said at page 23:

> "In accepting a cheque or other payment and crediting it against the customer's private overdraft the bank is advancing its personal interest. Clearly it will not be permitted to profit in that way through a misapplication by a customer of funds entrusted by a third party to the customer if the bank has notice of the customer's breach of fiduciary duty. The more difficult question is what if anything short of express knowledge that the customer was committing a breach of fiduciary duty is sufficient.
>
> Following his analysis of the authorities including the judgment in this court in ***Savin's*** case Greig J concluded that it was sufficient to fix the bank with knowledge of the broker's wrongful receipt of monies into the bank account if the bank had reason to believe, a suspicion or cognisance, that the money was being wrongfully used or that a breach of trust existed and that awareness might arise from reasonable inference as well as direct knowledge. On his assessment of the facts the Judge concluded (p 102, 689) that there was conduct on the bank's part 'amounting to wilful blindness and a refusal to perceive the information before the bank which was strong grounds for suspicion and good reason to believe that what was being received and paid to the bank account included money from clients for the sale and purchase of shares and what was being done was contrary to their interests and in breach of the duty to them.'
>
> Mr McKenzie referred us to numerous cases and invited us to reconsider various existing lines of authority in support of his general submission that a court should not impose a constructive trust on the bank in the absence of (a) some interference with or breach of a legal or equitable interest in property; (b) some benefit designed or stipulated for by the bank; and (c) a degree of knowledge on the part of the bank which involves some moral taint or improper conduct. On our assessment of the facts the case does not call for a review of the authorities."

The trial Judge, Greig J, had decided that there had been wilful blindness on the part of the bank. The Court of Appeal was satisfied that the Judge was entitled to reach that conclusion. In doing so the Court confirmed a process by which the Judge fixed the bank with knowledge as a result of inferences to be drawn from the facts in spite of professed ignorance by bank officers.

The evidence in this case is that the bank had been dealing with the company at least since 1985. It had monitored the company's trading performance against budget on a monthly basis because of the company's poor financial position. In June 1989, ie, three months before the events in question, it had taken the step of commissioning a special report from Coopers and Lybrand as to the company's financial position. The bank was aware that this company only had one account through which it did all its trading. It was also aware that the company sold vehicles on consignment, ie, that it displayed and sold vehicles which it did not own. The manager of the bank said that he was unaware that the company was selling items on behalf of owners.

Having considered the approach of the Court of Appeal in the cases of ***Westpac Banking Corporation v Savin, Westpac Banking Corporation v Ancell*** and ***Gathergood v Blundell & Brown*** [1992] 3 NZLR 643 at 646 I am of the view that the only reasonable inference that can be drawn from all of the facts is that the bank had reason to believe that the company was in breach of trust by depositing monies into its overdrawn bank account without the knowledge or authority of the true owner of those monies. Greig J in the High Court decision in the ***Ancell*** case drew such an inference and effectively discounted the oral evidence of bank officers concerning claimed ignorance of the nature of their customer's business. In this case the bank manager's evidence as to his understanding of vehicles held on consignment and his expressed lack of awareness that the company

was engaging in the invariable practice for motor vehicle dealers of selling on behalf of are unconvincing. According to the evidence a substantial portion of the company's business consisted either of consignment sales or "on behalf of" sales. There is also evidence in the correspondence of the bank being aware of bailment arrangements.

Chilton's evidence was that all companies of this nature engage in "on behalf of" sales and that his company also participated in this invariable practice. It does not appear reasonable to conclude that the bank was unaware of the practice. At the least, the bank would have been expected to make enquiries concerning the source of funds in the company's account since it was closely monitoring the actions of the company and its account during the four months prior to receivership. On this matter the District Court Judge, after referring to the five categories or types of knowledge discussed in ***Westpac Banking Corporation v Savin*** by Richardson J at page 52 and later in ***Equiticorp v Hawkins*** by Wylie J at page 728 decided that he could not hold the bank had the requisite knowledge in any of the five categories or types of knowledge because of the findings of fact he had made. He relied on three factual matters for this conclusion.

1. The bank's branch manager did not know that the company conducted on behalf of sales.
2. The financial report to the bank from Coopers and Lybrand did not record that there were "on behalf of" sales and indeed stated that Chilton had said that the items of stock disclosed in the company's financial statements were free of any reservation of title.
3. The cheque itself did not indicate that the proceeds were the property of anyone other than the company.

In isolating the findings of fact which formed the basis for this opinion the District Court Judge seems to have restated the primary evidence given by

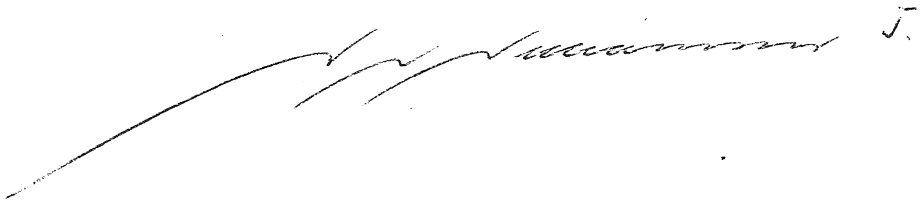
the bank manager. He did not consider the inferences to be drawn from all of the circumstances set out above and in particular from the evidence of Chilton which he also seems to have accepted.

In my view the bank manager's evidence in chief has to be read subject to his evidence during cross-examination as to his knowledge of the nature and effect of goods sold on consignment. It also has to be considered in the light of Chilton's evidence about the invariable practice of such dealers and of the company itself. Since the bank had been closely monitoring the company over a period of months it must have been aware that a substantial portion of the company's business comprised sales on behalf of customers since one fifth of the marine sales and one twentieth of the vehicle sales were in this category. In addition it would have been apparent that approximately 50% of the business of the company comprised the sale of vehicles which it did not own, ie, vehicles sold on consignment or "on behalf of". The bank manager accepted that he was aware that a significant proportion of vehicles were on consignment. In such circumstances it is not possible to accept that the bank had no knowledge that monies being paid into the company's only bank account might substantially represent monies belonging to other persons. Their receipt was a "knowing" one. The advice from Coopers and Lybrand of the statement made by Chilton is consistent with this view since clearly the items of stock which were actually included in the company's financial statements would have been free of any reservation of title because these vehicles were ones which the company had purchased. It would have been equally apparent from the number of items of stock in the company's financial statements that a significant proportion of the vehicles at the company's premises were not owned by them. Such conclusions are more readily drawn in circumstances where, as here, the bank is paying close attention to the business of a particular company and exercising fine control on that company's affairs.

This is not a case where the District Court Judge has made findings of fact in relation to the credibility of particular witnesses. Accordingly I have considered it appropriate to draw inferences and arrive at conclusions after a close study of the evidence, particular of Chilton and of the bank manager.

Conclusions

For the reasons given the appeal is allowed. The judgment for the first Respondent against the Appellant is confirmed but in view of the circumstances of the particular transactions and the hearing there will be no order for costs in favour of the first Respondent against the Appellant. Judgment is entered for the appellant against the Second Respondent in the sum of $13,062.50 being $13,750.00 less 5%. The Appellant is also entitled to interest on the amount of the judgment at 11% from 9th October 1989 until the date of judgment together with costs, disbursements and witness' expenses as fixed by the Registrar. The Appellant is also entitled to costs on this appeal which I fix at $1,000.00.



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