IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2008-404-007571

BETWEEN	STEFAN ADRIEN JEAN CROCHERIE Plaintiff
AND	ERNEST WILLIAM TRAVERS First Defendant
	KELVIN TRAVERS Second Defendant

Hearing: 23 February 2009

Appearances: M J Fisher for the Plaintiff
No Appearance of or for the Defendants

Judgment: 30 April 2009

JUDGMENT OF DUFFY J

This judgment was delivered by Justice Duffy
on 30 April 2009 at 4.30 pm, pursuant to
r 11.5 of the High Court Rules

Registrar/Deputy Registrar
Date:

Counsel: M J Fisher P O Box 3236 Shortland Street Auckland 1140 for the Plaintiff

[1] This is an application by the plaintiff for judgment against the first defendant by way of formal proof. The plaintiff seeks recovery of funds of $273,580, which the plaintiff paid to a boat builder for the construction of a motorised catamaran but which were not used for that purpose, as well as $59,785.21 for the costs of remedial works to the vessel.

[2] Judgment is not sought against the second defendant, as he was adjudicated bankrupt on his own application some time in late 2008. Neither the first defendant nor the second defendant have taken any steps in the proceeding since the case management conference on 12 May 2008. At that conference each defendant was ordered to file and serve an affidavit of documents. Neither of them complied with that order. There was no appearance on their behalf at the hearing.

Facts

[3] The plaintiff, who lives in New Caledonia, wanted to purchase an 11 metre motorised catamaran built in New Zealand (a power cat). In the spring of 2003 he came to New Zealand to find a suitable boat builder. He met, among others, the defendants. They represented to him that they were experts in building power cats. The defendants carried on their boat building business through a company, TDL Industrial Coatings Limited (TDL), subsequently named Imation Holdings Limited.

[4] The plaintiff entered into a contract with TDL on or about 17 December 2003. The fixed contract price of the power cat was $554,996. This amount was payable by instalments: $166,500 was payable on execution of the agreement, five progress payments of $61,416 were payable thereafter, and a final payment of $20,000 was payable upon launching. The launch date was anticipated to be around May 2004. Between December 2003 and May 2004 the plaintiff paid to TDL $473,580, this being all instalments due, other than the final instalment of $20,000 payable upon launching, and the residue payment to amount to the fixed contract price.

[5] The plaintiff came to New Zealand in the latter half of 2004 to discuss possible modifications to the power cat's hull. On arrival he found that the power cat was only about 30 per cent complete. There were discussions between the plaintiff and the defendants and they agreed to suspend further work pending a decision on whether the plaintiff would have the vessel completed.

[6] Around October 2005 and while the works were under suspension, the plaintiff engaged a naval architect, John Harrhy, to inspect the power cat. Mr Harrhy assessed the value of the work done to that stage to be worth $200,000. This was much less than the $473,580 the plaintiff had already paid to TDL.

[7] The plaintiff and TDL were not able to reach agreement on the resumption of construction works, with the result that on 6 April 2006 the plaintiff cancelled the contract with TDL.

[8] On 3 June 2006, the plaintiff entered into a separate contract with New Zealand Multi Hulls Limited to complete construction of the power cat. The plaintiff paid a further $668,420.06 to fund completion of the power cat, which included the cost of remedial works.

[9] The remedial works were required because Mr Robin Williams of Marine Consulting Inspections Limited identified some fundamental problems with the boat while assessing the quality of workmanship.

[10] On 25 July 2007, the High Court appointed liquidators to TDL on the application of a creditor of the company, who had previously successfully obtained judgment against TDL (which by then had changed its name to Imation Holdings Limited) for negligent construction of a power cat (see *Pier v Imation Holdings Limited* HC AK CIV 2005-404-503 5 December 2006, Rodney Hansen J).

[11] On 19 November 2007, the plaintiff lodged a creditor's claim with the liquidators. By letter dated 29 November 2007, the liquidators advised that there was little, if any, likelihood of money being available to pay the plaintiff's claim. The plaintiff's contention that the company held the deposit and progress payments

on trust for the plaintiff was rejected. The liquidators were of the view that none of the information in their possession was consistent with the funds being held on trust.

[12] On 4 December 2007, the plaintiff commenced proceedings against the defendants. The claim falls under three heads: first, that the funds the plaintiff paid to TDL were subject to a trust which required TDL to hold the funds on trust for the plaintiff and to apply the trust funds towards the costs of construction of the power cat as they became due. The claim alleges that TDL acted in breach of trust by not holding the funds on trust and by not employing all such funds towards construction of the power cat. The claim then alleges that the defendants, as the directors and controlling minds of TDL, knowingly assisted the company in breach of trust by causing it to employ the plaintiff's trust funds for purposes other than funding the construction costs of the power cat. Accordingly, the plaintiff seeks the difference between the value of the works carried out on the vessel ($200,000) and the amount of money paid by the plaintiff to TDL ($473,580).

[13] The plaintiff also alleges that the defendants owed him a duty of care in tort and assumed responsibility to exercise reasonable skill and care in carrying out the construction of the power cat and that they breached that duty. The consequences of the breach are alleged to be liability of the first defendant for the costs of the remedial works totalling $59,884.74. In recognition of an arithmetical error this amount has since been amended to $59,785.21.

[14] There is also a claim under the Fair Trading Act 1986, which the plaintiff has indicated will not be pursued should he be successful in his claim in tort.

Judgment under first cause of action

[15] The equitable cause of action of knowing assistance has three essential requirements. First, that the subject funds are impressed with a trust. Secondly, that the trustee has improperly used the trust funds and thereby caused the plaintiff to suffer loss. Thirdly, that the party against whom the cause of action is brought has knowingly assisted in the trustee's improper (dishonest) use of the trust funds (see

e.g. *Lankshear v ANZ Banking Group (New Zealand) Ltd* [1993] 1 NZLR 481 at 492].

[16] Paragraph 5 of the statement of claim pleads that:

> It was an implied term of the agreement that the company would hold the funds on trust and would apply the funds towards the cost of purchasing materials and paying for labour and factory overheads directly connected with the construction of the power cat.

[17] Paragraph 18 of the statement of claim pleads that the funds TDL received were subject to an express or implied trust or were impressed with a constructive trust in favour of the plaintiff on terms that the funds were to be applied by the company solely and exclusively for the purpose of funding the construction of the power cat.

[18] The defendants have filed a statement of defence to this claim. Paragraph 5 of their statement of defence admits paragraph 5 of the statement of claim. Paragraph 18 of their statement of defence admits paragraph 18 of the statement of claim and goes on to say that the funds were applied under the trust and expended in carrying out additional work at the plaintiff's express request. It follows that the first requirement of the cause of action of knowing assistance is established by the admissions of the defendants in their statement of defence.

[19] The next element is were the trust funds employed for purposes in breach of trust? There is evidence the plaintiff has supplied $473,580 to the company in payment of the contract price for the power cat's construction. All but the payment of $20,000 on launching has been paid. The plaintiff had paid about 85 per cent of the contract price. That contract payments of this extent were made would suggest that the vessel's construction had advanced to the point where it should have been close to the launching stage.

[20] The plaintiff has produced evidence from an independent expert, a marine architect, John Harrhy, that when he inspected the vessel in October 2005 it was a bare wooden hull. This is inconsistent with a vessel that should by then, in terms of contract instalments paid, have been almost ready for launching. Mr Harrhy

assessed the value of the vessel as constructed by the defendants (no more than a bare wooden hull) to be $200,000.

[21] The proper inference to be drawn from this evidence is that the full amount of the funds the plaintiff has made available to the company for the construction of the power cat have not been applied for that purpose. There is no direct evidence to show how the funds were used. But the fact that the vessel as constructed has a worth of $200,000, and there is no evidence from the records available to the liquidators to show the funds were applied solely towards the construction of the power cat, supports the inference that the remaining funds ($273,580) must have been applied for other purposes dishonestly.

[22] The liquidators have expressed the view in a letter to the plaintiff's solicitors dated 29 November 2007 that their investigations have not revealed any evidence that the plaintiff's funds were held on trust. This assertion is effectively repeated in paragraphs 1 to 7 of the affidavit of Gareth Russell Hoole sworn on 1 December 2008. Mr Hoole deposed that of the TDL documents they had received from the defendants, there were no documents in the liquidators' possession or under their control that could support the contention the funds the plaintiff had advanced to the company were held on trust or otherwise applied solely towards the vessel's construction.

[23] The draft financial accounts for TDL as at 31 March 2004 and the profit and loss account for the period April to September 2004 indicate that the plaintiff's funds were not kept separate but deposited in the company's working capital account, along with the monies of other customers. Over the relevant period, TDL suffered an operating loss of $134,721. This suggests that the trust funds were intermingled with TDL's working capital and applied for TDL's purposes, rather than the trust's purposes.

[24] The first defendant has deposed in paragraphs 75 and 76 of an affidavit dated 25 February 2008 that the liquidators now hold all financial records of the company, including invoices that would show the funds paid by the plaintiff were spent on construction of the vessel. The plaintiff tenders these paragraphs of the first

defendant's affidavit as admissions against interest made by the first defendant. The plaintiff does not rely on or seek to have admitted into evidence any other parts of the affidavit.

[25] The plaintiff invites the Court to infer from the admissions of the first defendant and the evidence from the liquidators that $273,580 of the trust funds for the vessel's construction have not been applied for trust purposes, nor have the funds been properly accounted for by the company. This being the only logical explanation for the absence of any records supporting the existence of a trust in circumstances where the first defendant has admitted such a trust existed and all records relating to it are in the possession of the liquidator.

[26] The evidence from the plaintiff is consistent with $273,580 of the trust funds not having been applied for trust purposes, that is towards the cost of the vessel's construction. I am satisfied on the balance of probabilities that the proper inference to be drawn from the evidence is that the defendants have applied $273,580 of the trust funds elsewhere and for other purposes (dishonestly). It follows that the plaintiff has established the second requirement of knowing assistance.

[27] The next requirement to establish is whether the first defendant knowingly assisted TDL in the breach of trust of employing the plaintiff's funds for purposes other than funding the vessel's construction. A helpful formulation of the legal test to establish the knowledge required is to be found in *US International Marketing Limited v National Bank of New Zealand Limited* [2004] 1 NZLR 589 at 592. The case involved an allegation a bank had breached its obligation to its customer by refusing to release funds to the customer on the ground that to do so could amount to knowing assistance, the funds being allegedly subject to a trust. The Court of Appeal recognised the bank was in a difficult position as, if it froze the funds, it would later be liable to compensate its customer for any ensuing loss, but if it declined to freeze the funds and the customer was acting in breach of trust, the bank would be vulnerable to a claim for dishonest assistance by the trust beneficiary. The Court considered there were strong policy reasons for ensuring that the position of a bank in such circumstances was as clear and straightforward as possible. I think the same policy reasons apply here. Both cases raise questions as to when commercial

entities and persons working with those commercial entities will be made subject to equitable obligations.

[28] The test formulated in *US International Marketing Limited v National Bank of New Zealand Limited* was (at 592):

> … a bank is entitled to freeze its customer's account entirely or *pro tanto* if, but only if: (1) in all the circumstances actually known to the bank; (2) a reasonable banker would know it was dishonest to pay the funds in question to or to the order of its customer; and (3) the bank itself appreciates that to be so.

The test combines subjective and objective elements. The conduct of the person alleged to have knowingly assisted in the breach of trust is to be assessed in the light of what he or she actually knew at the relevant time. Against those subjectively determined circumstances, the honesty or otherwise of his or her conduct is objectively assessed. The standard of assessment is what a reasonable person would regard as honest or dishonest in the relevant circumstances. Dishonesty may be inferred: see *Caswell v Powell Duffryn Associated Collieries Ltd* [1940] AC 152 (HL). The standard of proof is the civil standard: *Z v Dental Complaints Committee* [2009] 1 NZLR 1(SC).

[29] As regards the actual knowledge of the first defendant, the following is known. He and the second defendant have both admitted to knowing that the funds received from the plaintiff were to be held on trust by TDL for the purpose of paying for the construction of the plaintiff's vessel. I have concluded that $273,580 of the trust funds were misapplied by TDL in breach of the trust. As one of the directors of the company, he was one of the controlling minds of the company. The logical inference to be drawn from these facts is that the first defendant actually knew of and was responsible for TDL misapplying trust funds and, therefore, breaching the trust.

[30] I consider that in the circumstances as I have found them to be, a reasonable company director in the first defendant's position would know it was dishonest to apply the trust funds for purposes other than construction of the plaintiff's vessel.

[31] As regards the first defendant's appreciation that the misapplication of the trust funds was dishonest, I think it is open to me to infer that he had this

appreciation. The first defendant has in paragraphs 75 and 76 of his affidavit stated that invoices to show TDL properly accounted for the trust funds were with the liquidator. This shows he knew how TDL should have applied the trust funds. I also consider that the first defendant's admission of the existence of a trust and the terms of the trust means he would have known TDL was to use the funds for trust purposes only and they were not generally available to TDL for its own use. The liquidators' evidence proves the funds were intermingled with other money and treated as available for general use by TDL. I consider the logical inference to draw from all this is that the first defendant would have known that TDL's handling of the trust funds and the application of the trust funds for other purposes was dishonest.

[32] The strength of this inference is reinforced by the circumstances of:

a) The first defendant's failure to comply with an order to file and serve an affidavit of documents;

b) His evidence in paragraphs 75 and 76 of his affidavit that the documents (which he has failed to discover) would have assisted him to disprove the plaintiff's case were taken by the liquidators; and

c) The liquidators' evidence from Mr Hoole that the liquidators have produced all the documents the first defendant supplied to them and that such documents do not support the first defendant's contention.

[33] The plaintiff has established that the first defendant knowingly assisted TDL in its breach of trust through the misuse of the plaintiff's trust funds. The remedy for loss suffered as a result of a defendant's knowing assistance in a breach of trust is equitable compensation: see *Equiticorp Industries Group Ltd (In Statutory Management) v The Crown (Judgment No. 47)* [1998] 2 NZLR 481. In *Target Holdings Ltd v Redferns (a firm)* [1995] 3 All ER 785 at 794, Lord Browne-Wilkinson said:

> … there does have to be some causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable …

> … The measure of such compensation is the same, ie the difference between what the beneficiary has in fact received and the amount he would have received but for the breach of trust.
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> … The losses [as a consequence of the breach] are to be assessed as at the time of the trial using the full benefit of hindsight.

[34] In this case the plaintiff had provided TDL with funds of $473,580 to be used in the construction of the vessel he had purchased. But for the breach of trust, those funds would either have been entirely applied to the construction of the vessel, in which case the vessel would have been almost ready for launching, or held by TDL and recoverable had the plaintiff pursued remedies for breach of contract resulting from TDL's failure to construct the vessel in accordance with the contract. It follows that the plaintiff is entitled to recover the difference between the $473,580 he paid to TDL and the $200,000 value of the wooden hull he received from TDL. That is, he is entitled to recover $273,580.

[35] In this case the plaintiff seeks interest under the Judicature Act 1908 from 6 April 2006, that being the date of the cancellation of the contract. Since he would have been able to recover his trust funds from that date, had they been kept separate from TDL's funds, I consider this is an appropriate date from which the calculation of interest should run.

Judgment under third cause of action

[36] I now turn to the claim in tort. The claim is based on an alleged failure to construct the vessel in accordance with a reasonable standard of care. The expert evidence of Mr Harrhy is to the effect that the work complained of is well below satisfactory industry standards. Another independent expert, Robin Williams, marine surveyor, expressed the opinion that the standard of workmanship was the poorest he had seen in his 42 years in the boat building industry. He also expressed the opinion that it would have been unsafe for the plaintiff to take the vessel to sea had the remedial works not been carried out. Full details of the defects are provided in the schedule to the statement of claim. The nature and extent of the defects and costs of repairs comes to $59,785.21. I have no trouble accepting the evidence of Mr Harrhy and Mr Williams that the construction defects come to that amount. The

key question is whether or not the first defendant can be liable for the loss the plaintiff has suffered from the cost of repairing the defects.

[37] Whether or not the first defendant can be liable depends upon whether he assumed a personal responsibility to the plaintiff to exercise a reasonable standard of care in constructing the vessel. The evidence of the defect shows that if such a duty were assumed, there has certainly been a failure to discharge the duty.

[38] The relevant principles for when an employee of a company can become personally liable in tort are to be found in *Trevor Ivory v Anderson* [1992] 2 NZLR 513. The starting point is that formation of a limited liability company, even when it is a one or two man company, is notice to the world that limited liability was intended. Where a one or two man company owes an obligation of skill and care to another party, it does not necessarily follow that a working director will owe a corresponding duty of care. Whether he does or not will turn on whether he has held himself out as personally assuming responsibility for the discharge of the work, as opposed to performing the obligation by way of being an employee of the limited liability company. Indeed, the fact that two men have formed a limited liability company in itself evidences a clear desire on their part to distance themselves from personal liability. Whether or not personal liability arises depends upon the facts of individual cases and the degree of assumption of personal responsibility.

[39] The plaintiff says he was attracted by the expertise of the first and second defendants when he chose to contract with TDL for the construction of the vessel. But that is not the issue. What matters is the nature of any representations that were made at the time the contract was made. It is a matter of looking to see whether there were representations, express or implicit, of personal involvement as distinct from routine involvement for and through the company. The task involves looking for features which would justify belief that the first defendant was accepting a personal commitment, as opposed to the known company obligation.

[40] The only evidence is that of the plaintiff. He says that when he travelled to Auckland in late 2003, he met the defendants at their boat yard in Henderson; he was assured by them they were expert boat builders and industry leaders in power cat

construction. He says they represented to him they had custom-built dozens of power cats for owners all around the world and they maintained a high standard of workmanship. The plaintiff noted that at the time of his visit, there were several power cats under construction in their yard. He says that in reliance on their representations, he entered into a contract with TDL for the construction of his power cat. Before me the plaintiff submitted that the change of company name indicated it was not the company that matters but the defendants who were the ones offering the skills contracted for.

[41] I have no doubt the plaintiff heard the representations he has described. However, his evidence does not go far enough for me to be persuaded that the representations went beyond representations made for and on behalf of the company as to the skill and expertise of its workers. There is nothing in the plaintiff's evidence that indicates to me that the representations were made on the basis the first and second defendants were assuming a personal responsibility for the vessel's construction.

[42] The plaintiff knew at all times he was contracting with TDL. This means he would have known the work would actually be done by TDL's employees. He was entitled to expect that TDL could provide expertise through its employees of a level that matched the representations that were made to him. But there is nothing in this that can displace the implicit representation that is present when dealing with a limited liability company that the individuals who are its officers and shareholders have chosen to avail themselves of the protection that comes from forming a limited liability company as a vehicle for doing business.

[43] It follows that the plaintiff has not established its claim in tort against the first defendant.

Judgment on third cause of action

[44] I have found the first defendant liable on the first cause of action. Therefore, there is no need to deal with the part of third cause of action that seeks recovery of the same amount as I found recoverable under the first cause of action, being

$273,580. The only outstanding amount the plaintiff seeks is recovery of losses associated with the remedial work on the vessel, that being the sum of $59,785.21. Since I have rejected the plaintiff's claim in tort for this loss, unless he is able to establish his claim against the first defendant for this loss under the third cause of action, the cost of the remedial works will not be recoverable.

[45] At the hearing, the plaintiff did not advance submissions on this cause of action as he took the approach that it was only necessary to determine the third cause of action if he failed on the second cause of action. As matters have turned out, the plaintiff has failed on the second cause of action. I propose to grant him leave to file submissions in writing to address the first defendant's liability under the third cause of action, should the plaintiff want to proceed with that cause of action.

[46] The plaintiff has 21 working days from the date of the issue of this Judgment to file further submissions addressing the third cause of action insofar as it relates to the claim for losses of $59,785.21.

[47] Given the success the plaintiff has achieved, he is entitled to costs.

Result

[48] The plaintiff has succeeded in his first cause of action against the first defendant. The plaintiff is entitled to recover the sum of $273,580. The plaintiff is also entitled to interest under the Judicature Act 1908 to be calculated from 6 April 2006. Quantification of this amount is to be determined by the Registrar.

[49] The plaintiff has not succeeded in his second cause of action against the first defendant.

[50] The plaintiff has leave to make further submissions to advance his third cause of action in respect of the recovery of the sum of $59,785.21.

[51] The plaintiff has leave to file a memorandum on costs.

Duffy J