THE NEW ZEALAND

LAW
JOURNAL

21 SEPTEMBER 1988

Closing the books

In 1983 the decision of the House of Lords in *Junior Books v Veitchi* [1982] 3 All ER 201, [1983] AC 520 was hailed by many commentators as marking a significant development in the law of negligence. It was seen as building on and extending the principles enunciated in *Anns v Merton Borough* [1977] 2 All ER 492. It has been followed or at least favourably referred to and applied in a number of cases. The articles by John Cadenhead, now Judge Cadenhead, in the *New Zealand Law Journal* in 1984 and 1986, (see [1984] NZLJ 262 and [1986] NZLJ 303) explain and emphasise the importance attached to *Junior Books* and other cases in the line from *Anns*. It was the *Takaro Properties* case [1986] 1 NZLR 51 (CA), and [1988] 1 All ER 163 (PC) that marked the apogee of the new law of negligence in the New Zealand Court of Appeal and its decline, or perhaps more accurately its confinement in the judgment of the Privy Council. *Junior Books* has now been said to have a very restricted application. In *D & F Estates Ltd v Church Commissioners* [1988] 2 All ER 992 all their Lordships have indicated that it is not to be interpreted in English law as quite the milestone and even less the sign-post to the future that many commentators had assumed it to be. Lord Bridge said at p 1003:

> The decision of your Lordships' House in *Junior Books Ltd v Veitchi Co Ltd* [1982] 3 All ER 201, [1983] AC 520 has been analysed in many subsequent decisions of the Court of Appeal. I do not intend to embark on a further such analysis. The consensus of judicial opinion, with which I concur, seems to be that the decision of the majority is so far dependent on the unique, albeit non-contractual, relationship between the pursuer and the defender in that case and the unique scope of the duty of care owed by the defender to the pursuer arising from that relationship that the decision cannot be regarded as laying down any principle of general application in the law of tort or delict. The dissenting speech of Lord Brandon on the other hand enunciates with cogency and clarity principles of fundamental importance which are clearly applicable to determine the scope of the duty of care owed by one party to another in the absence, as in the instant case, of either any contractual relationship or any such uniquely proximate relationship as that on which the decision of the majority in *Junior Books* was founded.

This view was echoed by Lord Oliver at p 1013:

> Since *Anns* there have, of course, been the decision of the Court of Appeal in *Batty v Metropolitan Property Realizations Ltd* [1978] 2 All ER 445, [1978] QB 554 and the decision of this House in *Junior Books Ltd v Veitchi Co Ltd* [1982] 3 All ER 201, [1983] AC 520. I do not, for my part, think that the latter is of any help in the present context. As my noble and learned friend Lord Bridge has mentioned, it depends on so close and unique a relationship with the plaintiff that it is really of no use as an authority on the general duty of care and it rests, in any event, on the *Hedley Byrne* doctrine of reliance. So far as the general limits of the general duty of care in negligence are concerned, I, too, respectfully adopt what is said in the dissenting speech of Lord Brandon in that case.

The case is also of particular interest in that the judgments give explicit consideration to two New Zealand cases that were relied on in argument. Their Lordships declined to follow the New Zealand Court of Appeal which at least by implication, their Lordships seemed to consider had engaged in an unjustifiable degree of judicial legislation.

Lord Bridge at p 1009 quoted the following extract from the judgment of Cooke and Somers JJ in *Mount Albert BC v Johnson* [1979] 2 NZLR 234 at pp 240-241 and then commented on it:

> In the instant type of case a development company acquires land, subdivides it, and has homes built on the lots for sale to members of the general public. The company's interest is primarily a business one. For that purpose it has buildings put up which are intended to house people for many years and it makes extensive and abiding changes in the

landscape. It is not a case of a landowner having a house built for his own occupation initially – as to which we would say nothing except that Lord Wilberforce's two-stage approach to duties of care in *Anns* may prove of guidance on questions of non-delegable duty also. There appears to be no authority directly in point on the duty of such a development company. We would hold that it is a duty to see that proper care and skill are exercised in the building of the houses and that it cannot be avoided by delegation to an independent contractor.

His Lordship then commented on this passage as follows:

As a matter of social policy this conclusion may be entirely admirable. Indeed, it corresponds almost precisely to the policy underlying the Law Commission's recommendations in para 26 of the report "Civil Liability of Vendors and Lessons for Defective Premises" (Law Com No 40) to which I have already referred and which was implemented by s 1(1) and (4) of the 1972 Act. As a matter of legal principle, however, I can discover no basis on which it is open to the court to embody this policy in the law without the assistance of the legislature and it is again, in my opinion, a dangerous course for the common law to embark on the adoption of novel policies which it sees as instruments of social justice but to which, unlike the legislature, it is unable to set carefully defined limitations (at [1988] 2 All ER 1009.)

Then at p 1013 Lord Oliver merely noted that while the law in New Zealand now seemed to be set in agreement with the English decision *Batty v Metropolitan Property Realizations Ltd* [1978] 2 All ER 445, it was not to be adopted as the law in England. At pp 1013-1014 he said:

The decision in *Batty's* case was based on *Anns*, but in fact went one step further because there was not in fact any physical damage resulting from the builders' negligence, although Megaw LJ appears to have considered that what mattered was the occurrence of physical damage to some property of the plaintiffs, however caused (see [1978] 2 All ER 445 at 457, [1978] QB 554 at 571). As in *Anns*, the cause of action was related not to damage actually caused by the negligent act but to the creation of the danger of damage, and the case is therefore direct authority for the recovery of damages in negligence for pure economic loss, a proposition now firmly established in New Zealand (see *Mount Albert BC v Johnson* [1979] 2 NZLR 234).

My Lords I confess the greatest difficulty in reconciling this with any previously accepted concept of the tort of negligence at common law and I share the doubt expressed by my noble and learned friend Lord Bridge whether it was correctly decided at any rate so far as the liability of the builder was concerned. The case was, however, one in which the builder and the developer, with whom the plaintiffs had directly contractual relationship, were, throughout, acting closely in concert and it may be that the actual decision, although not argued on this ground, can be justified by reference to the principle of reliance established by the decision of this House in *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1963] 2 All ER 575, [1964] AC 465.

My Lords, I have to confess that the underlying logical basis for and the boundaries of the doctrine emerging from *Anns v Merton London Borough* are not entirely clear to me and it is in any event unnecessary for the purposes of the instant appeal to attempt a definitive exposition. This much at least seems clear: that in so far as the case is authority for the proposition that a builder responsible for the construction of the building is liable in tort at common law for damage occurring through his negligence to the very thing which he has constructed, such liability is limited directly to cases where the defect is one which threatens the health or safety of occupants or of third parties and (possibly) other property. In such a case, however, the damages recoverable are limited to expenses necessarily incurred in averting that danger. The case cannot, in my opinion, properly be adapted to support the recovery of damages for pure economic loss going beyond that, and for the reasons given by my noble and learned friend Lord Bridge, with whose analysis I respectfully agree, such loss is not in principle recoverable in tort unless the case can be brought within the principle of reliance established by *Hedley Byrne*. In the instant case the defective plaster caused no damage to the remainder of the building and in so far as it presented a risk of damage to other property or to the person of any occupant that was remediable simply by the process of removal. I agree, accordingly, for the reasons which my noble and learned friend Lord Bridge has given, that the costs of replacing the defective plaster is not an item for which the builder can be held liable in negligence. I too would dismiss the appeal.

These judgments of their Lordships have to be read in the light of the comments by Lord Templeman in the *Amstrad* case [1988] 2 All ER 484 at 497, quoted in the June editorial in this *Journal* [1988] NZLJ 181. Lord Templeman said:

My Lords, it is always easy to draft a proposition which is tailor-made to produce the desired result. Since *Anns v Merton London Borough Council* [1978] AC 728 put the floodgates on the jar, a fashionable plaintiff alleges negligence. The pleading assumes that we are all neighbours now, Pharisees and Samaritans alike, that foreseeability is a reflection of hindsight and that for every mischance in an accident-prone world someone solvent must be liable in damages. In *Governors of the Peabody Donation Fund v Sir Lindsay Parkinson & Co Ltd* [1985] AC 210 the plaintiffs were the authors of their own misfortune but sought to make the local authority liable for the consequences. In *Yuen Kun-Yeu v Attorney-General of Hong Kong* [1987] 3 WLR 776 the plaintiff chose to invest in a deposit-taking company which went into liquidation; the plaintiff sought to recover his deposit from the commissioner charged with the public duty of registering deposit-taking companies. In *Rowling v Takaro Properties Ltd* [1988] 1 All ER 163 a claim for damages in negligence was made against a Minister of the Crown for declining in good faith to exercise in favour of the plaintiff a statutory discretion vested in the Minister in the public interest. In *Hill v Chief Constable of West Yorkshire* [1987] 2 WLR 1126 damages against a police force were sought on behalf of the victim of a criminal. In the present proceedings damages and an injunction for negligence are sought against Amstrad for a breach of statutory duty which Amstrad did not commit and in which Amstrad did not participate. The rights of BPI are to be found in the Act of 1956 and nowhere else. Under and by virtue of that Act Amstrad owed a duty not to infringe copyright and not to authorise an infringement of copyright. They did not owe a duty to prevent or discourage or warn against infringement.

It might be tempting for some who see in judicial decisions reflections of political fashions to suggest that Thatcherism is having an effect on the judiciary. One does not need to go so far as to see any direct causal relationship, although as Mr Dooley of the United States said: "The Supreme Court follows the election results." While perhaps the tide of radical conservatism in England has had some effect on the approach of the House of Lords to developments in the law, it needs to be remembered that it was in 1985 the High Court of Australia that refused to follow *Anns*. In *Sutherland Shire Council v Heyman* (1985) 60 ALR 1, Mason, Brennan and Deane JJ specifically decided not to follow *Anns* and for all practical purposes Gibbs CJ and Wilson J explained it away.

In *D & F Estates Ltd* the House of Lords has explicitly chosen to adopt the reasoning in decisions of the Supreme Court of Canada and the Supreme Court of the United States and rejected the views of the New Zealand Court of Appeal in *Bowen v Paramount Builders* [1977] 1 NZLR 394 as well as *Mount Albert Borough Council v Johnson* [1979] 2 NZLR 234. As far as the English law is concerned the door on *Anns* might still be a little ajar, but the books seem to be firmly closed on *Junior Books*.

The idea of New Zealand evolving its own distinctive jurisprudence is one that has considerable appeal for many people. And we should not be unduly subservient to English precedent in the common law any more than we are in our statute law. But we also need to avoid the risk of becoming so set on being different that we become a jurisprudential oddity. Finding a balance is always a challenge.

P J Downey

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Armstrong RL	Auckland	17 June 1988
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Case and Comment

Forum conveniens and service overseas

There can surely be no doubt, if I may be so bold as to say so, that the decision of Hardie Boys J in *Cockburn v Kinzie Industries Inc* [1988] BCL 766 is a masterful tackling of a difficult fact situation, within a matrix of confusing law. The problem arose out of the purchase of a helicopter by the plaintiff from the first defendant in 1979. The helicopter crashed in North Canterbury on 17 October 1982 as a result of a faulty needle in the automatic mixture control assembly on the fuel injector unit. The plaintiff sued Customs Airmotive Inc, the firm responsible for fitting the unit, in negligence, and the first defendant in contract and negligence.

The two defendants were both incorporated under the laws of Oklahoma. Leave to serve on the defendants was granted in terms of HC R 220 on 19 December 1986 and the proceeding was duly served. The first defendant filed an appearance to protest jurisdiction under R 131(1); the second defendant, being in a weak financial state, wrote to the Court, expressing a similar objection. The judgment raises several interesting points.

Use of R 131 procedure
In two decisions, *Kingsway Industries Ltd v John Holland Engineering Pty Ltd* (unrep HC Auckland, 14 May 1986, A 1586/85) and *Wendell v Club Mediterranee NZ* (unrep HC Auckland, 25 March 1987, CP 1425/86), Hillyer J has stated that a *forum non conveniens* objection is not strictly speaking an objection to jurisdiction and that the R 131 procedure is inappropriate to raise it. (In both cases he nevertheless entertained the matter in order to avoid wasting time.) Following McGechan's classification, he suggested that the R 131 procedure was generally applicable (a) where a statute accords exclusive jurisdiction to some other Court or tribunal; or (b) where the case falls outside the categories of RR 219 and 220. In other cases, application should be made for a stay of the proceedings.

In contrast to this, Barker J in *Sodamaster Inc v Micallef* (unrep HC Auckland, 19 June 1986, A 1652/85) decided a *forum conveniens* matter on a R 131 application without any adverse comment on the procedure and granted a stay (presumably under R 131(7)) without specifically setting aside the R 131 appearance. In *Cockburn v Kinzie Industries*, Hardie Boys J also appeared to have no qualms about the use of the procedure and followed the mandatory directions of R 131(4)(b) by setting aside the appearance. He too granted a stay, which it is clearly within the power of the Court to do under R 131(7). As a question of practicalities, there is much to be said for allowing the R 131 procedure to be used in this way: it is a clearly established procedure and the issue of *forum conveniens*, although not always negating the Court's jurisdiction in a technical sense, is nevertheless intimately bound up with it. Even though the rule may not have been designed for this purpose, *forum non conveniens* objections seem to sit happily under it and appropriate orders can readily be made. If recourse is to be had to R 477 to apply for a stay (an alternative relied on in *Cockburn*), it would have to be established that no cause of action was disclosed, or that the proceeding was frivolous, vexatious or an abuse of Court. None of these was applicable in any of the cases thus far mentioned. The only possibility left is the inherent jurisdiction of the Court; it would be undesirable if this last resort had to be relied on in such a common situation.

On a more technical aspect, it could well be said that the *forum conveniens* question does in fact fall to be considered as a R 220 category of jurisdiction. Where none of the R 219 grounds is present a Court would be unlikely to allow service overseas unless it appeared that New Zealand was the right place to sue. As Hardie Boys J said in *Cockburn*:

> [W]here the Court's jurisdiction is discretionary, the appropriateness of the local Court as the forum will usually determine whether that Court will accept jurisdiction. (at 3)

A *forum conveniens* objection can be raised in either a R 219 (specified grounds of jurisdiction) or R 220 (other cases) situation. In the case of R 220, there may indeed then have to be a decision between jurisdiction (on the basis of *forum conveniens*) and no jurisdiction. It would, however, be artificial to limit the use of R 131 in *forum conveniens* matters to R 220, insisting on a different procedure where some ground of jurisdiction already existed under R 219.

The Court of Appeal, in affirming the High Court decision in *Club Mediterranee NZ v Wendell* [1988] BCL 128, unfortunately made no comment on the use of the R 131 procedure. Although no doubt the matter was not argued, some guidance on the issue could have resolved what is now an irreconcilable conflict. The ultimate solution probably lies in an appropriate amendment to R 131.

Jurisdiction of the High Court
The Court summarised the jurisdiction of the High Court, stating that it derives from the common law through s 16 of the Judicature Act 1908 and the Rules of Court. The basic tenet of jurisdiction is service. This is either of right, where the defendant is within territorial limits, or by virtue of the "assumed jurisdiction" whereby service is permitted outside territorial limits in terms of RR 219 and 220. The new High Court Rules have altered the prior law by allowing service outside the country without leave in a large number of cases – ie those which fall in the categories specified in R 219.

Rule 220 permits service outside New Zealand with the leave of the Court in a situation which is within the jurisdiction of the Court but which does not come within the R 219 categories. The question which arose in *Cockburn* was this: what in fact creates the "jurisdiction" on which the R 220 discretion is to be exercised and what is its extent? The Court ruled out the possibility that the jurisdiction referred to was created by the Rule itself (at 7) but found it difficult to establish another source because service – the basis of jurisdiction – was the very question in issue. Hardie Boys J referred to the immense difficulty involved in construing R 220 and was mindful of the possibilities that to claim potential jurisdiction in every proceeding would amount to "an assertion of sovereignty that would probably cause surprise elsewhere" (8). In the end, construing the Rule to give it practical effect, however, he concluded that

> . . . it was intended to enable the Court to assume jurisdiction in every kind of case which it is otherwise competent to deal with (8).

A New Zealand Court may therefore:

> . . . grant leave, and so assume jurisdiction, in every proceeding not covered by R 219 that it would be entitled to hear and determine were the defendant served in New Zealand (9).

The only matters excluded from this jurisdiction are those excluded by New Zealand statutes and actions involving foreign immovables, tax or penal laws and matrimonial status, which are presumably excluded by the common law of jurisdiction: see Cheshire & North *Private International Law* (10 ed) 78.

This interpretation appears to be an eminently sensible one, neatly reconciling RR 219 and 220. It does, however, have the effect of arrogating a very extensive jurisdiction to New Zealand Courts. A local Court would no doubt be reluctant to assume jurisdiction in a matter with no connection at all to New Zealand, or even where the only connection is a New Zealand plaintiff. To cope with any possible criticism of "exorbitant" jurisdiction (a phrase conveniently played down by Lord Goff of Chievely in *The Spiliada* [1986] 3 WLR 972 at 990) the Courts will undoubtedly pay close attention to *forum conveniens* principles and their application in particular fact situations. In this regard, it is important to note the caution of the Court in *Cockburn* that the existence of a R 219 ground or the initial grant of leave to serve is not conclusive of the matter (3,6), a point well illustrated by the *Cockburn* decision.

Forum conveniens principles
One of the chief concerns of the plaintiff was that Oklahoma law apparently imposed a limitation period of two years from the date of the accident. To avoid this being raised against it, the first defendant agreed to waive the limitation defence; no such concession was made by the second defendant.

The principles to be applied were taken from *The Spiliada*, as approved by the Court of Appeal in *Wendell*. The defendant must establish that there is another available forum, in which the matter can be more suitably tried for the interests of all the parties and the ends of justice. The factors to be considered are convenience, expense, residence and place of business of parties, the law governing the transaction, the "natural forum" and any "legitimate personal or juridicial advantage" of which the plaintiff may be deprived.

Relating these to the facts, the Court concluded that the only connections with New Zealand were the occurrence of the accident and the establishment of its cause. Although some witnesses would have to travel to Oklahoma, the first defendant had offered to have evidence taken in New Zealand on video; the majority of witnesses were resident in Oklahoma. In the final analysis, the Oklahoma Court was clearly the appropriate forum:

> [T]he truly significant feature of this case is that the act or default which lies at the heart of both causes of action occurred in Oklahoma. It is on what happened there that the case will focus. The New Zealand connection is in a sense both incidental and coincidental: on the plaintiff's case, as I understand it, the helicopter would have crashed wherever it was. (12-13)

The one obstacle in granting a total stay, however, was the position of the second defendant. Although the mere existence of a time bar is not decisive (*The Spiliada* 992-3) a Court would obviously be reluctant to deprive a plaintiff of its claim (but see the warning by Lord Goff at 993, concerning the duty of a solicitor to take appropriate action in both fora). In *Cockburn* the Court considered whether the best alternative was perhaps to allow the whole action to be tried in New Zealand. Having decided that Oklahoma was the *forum conveniens*, Hardie Boys J rejected this possibility, holding that the first defendant should not be penalised by the inaction of the second defendant; the action was accordingly stayed against the first defendant. It was decided, however, that no stay should be granted against the second defendant. While this result may be open to criticism on the grounds of possible conflicting decisions, the truth of the matter seems to be that the first defendant was the real defendant and there was little hope of recovery against the second. It is of some interest to note, however, that the only ground for assuming jurisdiction in the action against the second defendant was the existence of a time bar in the appropriate forum. This will no doubt provide an incentive to defendants in a similar position to waive limitation defences where they are able to do so.

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Charities — Lapse

Court of Appeal decisions on charity property are relatively few and far between. It is therefore at first sight a little disappointing to find that in *Alacoque v Roache* (Court of Appeal, 88/85, 17.5.88) the matter in issue was (merely) the interpretation of the trust document. Nevertheless, the judgment of the Court, reserved for eight months and delivered by Somers J, contains several points of more general interest.

Under the will of Miss Catherine Mannex, who died in September 1968, one-third of her residuary estate was left

> for the benefit absolutely and exclusively of the Saint Joseph Convent at Eltham. . .

The Convent was a house of an order of nuns now known as the Sisters of Our Lady of the Missions and it was closed down eight months before Miss Mannex's death. The question therefore arose: who was entitled to the one-third residuary share? For reasons not satisfactorily explained to the Court of Appeal, the matter was not approached for 15 years, during which period the share increased in value to $33,000. The present litigation was begun in 1983 when the trustees for the time being of the will sought the directions of the Court as to the distribution of the gift.

It was not disputed that if the Convent had still been open at the date of her death, Miss Mannex's gift would have been a valid charitable bequest. In the circumstances, however, Ongley J at first instance in a reserved judgment held that the facts disclosed a situation of initial failure with no paramount charitable intention. He therefore found that the gift lapsed and the property passed as if on an intestacy. The Mother Provincial of the Order appealed.

The Court of Appeal upheld the first instance decision. Despite the efforts of counsel for the Order, the Court found as Ongley J had done,

> that benefit of the Convent named was the sole and indispensable purpose of the gift and that the case is not one which exhibits any relevant general charitable intention.

The continued activity of the particular Convent was "fundamental" to the gift. As with many interpretation decisions, the Court acknowledged that their finding was

> not a point upon which it is possible to expand in any useful way. It is essentially a matter of the impression conveyed by the words used.

This construction determined the destination of the property. It could not be applied for the general purposes of the Order, being expressly restricted to the Convent of St Joseph. Nor could it be "saved" for charity by the provisions of s 32(1) of the Charitable Trusts Act 1957, the "statutory cy-pres" provisions. Section 32(1) provides that:

> Subject to the provisions of subsection three of this section, in any case where any property or income is given or held upon trust, or is to be applied, for any charitable purpose, and it is impossible or impracticable or inexpedient to carry out that purpose, or the amount available is inadequate to carry out that purpose, or that purpose has been effected already, or the purpose is illegal or useless or uncertain, then (whether or not there is any general charitable intention) the property . . . shall be disposed of for some other charitable purpose.

Section 32(3)(a), however, provides that the statutory powers to re-deploy property for charitable purposes are not available

> if in accordance with any rule of law the intended gift . . . would otherwise lapse or fail and the property . . . would not be applicable for any other charitable purpose.

The Court of Appeal held that this provision "clearly" preserves the general rules of law about lapse which apply where the stated purposes or objects are an indispensable part of the trust; where, in short, there is no paramount charitable intention. Having already reviewed the "general law" as illustrated by *Re Wilson* [1913] 1 Ch 314, the Court found that the Mannex trust was precisely within the proviso of s 32(3). The gift could not be saved for charity at large by the Act and the property therefore fell to be treated as if subject to an intestacy; the appeal was dismissed.

Despite the narrow point of interpretation which gave rise to this litigation, *Alacoque v Roache* is of general interest to those working with charity law. First, the case provides an admirably clear example of one type of case falling within s 32(3). Since its revision for the 1957 Act this provision has suffered from cumbersome drafting and questions still remain: what precisely is the significance of "otherwise" for example? One clear application of the section is very welcome.

Secondly, counsel advising in subsequent cases might take note of the criticism voiced in *Alacoque v Roache* of the affidavit evidence presented in this case. Somers J described the material available to the Court as "exiguous" and pointed out that it was

> hardly possible to assume the testatrix's armchair for apart from the fact that she was a spinster and, as the will itself records, a cripple, we know virtually nothing of her, or of her connection with or interest in the foundation she intended to benefit.

In the event this was not significant. If a paramount charitable intention *had* been found, however, and a scheme been prepared, some more accurate indication of the testatrix's general disposition would have been required, since the Court's touchstone in considering schemes remains a consideration of the testator's underlying intention and assumed desires: *Re Twigger*, HC Chch. M724/85; 24.8.87.

Apart from these points, two other incidental comments of Somers J will require further elaboration if an appropriate case permits. Speaking of cases of initial impossibility, the learned Judge suggested:

> It is arguable that s 32 of the Charitable Trusts Act 1957 applies to inter vivos trusts which have not and cannot take effect because of initial impossibility of purpose.

Section 32 in many places is most obscure. However, despite some discussion in *Re British School of Egyptian Archaeology* [1954] 1 All ER 887 of possible distinctions between testamentary and inter vivos provisions in a somewhat different context, it is not altogether obvious why s 32(3) should apply differently depending on the donor's timing of his/her attempted benefaction.

Finally, just at the end of his judgment, Somers J referred to argument made in the case on the principle of *Re Palmerston North Halls Trust Board* [1976] 2 NZLR 151. This has frequently been quoted as authority for the proposition that cases which fall within the statutory scheme making powers of s 32 should be treated exclusively under those powers and not under the inherent jurisdiction. The learned Judge, obiter, chose expressly to reserve the opinion of the Court on that point. If that is to be further clarified it may well help to bring some more order into a notoriously thorny corner of the law.

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LAWASIA Conference: Hong Kong 1989

Advice has been received that the next LAWASIA Conference is to be held in Hong Kong, 18-21 September, 1989. The theme of the Conference will be Commercial Law.

The Conference will be followed by a two day seminar in Beijing on 23 and 24 September. This will be hosted by the China Law Society. The topics for discussion there will be *Intellectual Property Laws in the People's Republic of China* and *Foreign Investment Laws of the People's Republic of China.*

The convener of the papers sub-committee for the Hong Kong Conference is Judith Sihombing, who is Senior Lecturer in Law at the University of Hong Kong. At this stage she is seeking an indication of anyone who might be interested in writing papers. The topics for the Conference have been decided upon and will be as follows:

CONSTITUTIONS IN A MODERN SETTING with especial reference to the independence of the judiciary, the Basic Law, and the language of the practice of the law. This segment will be hosted by the Faculty of Law as part of its 20th anniversary celebrations.

COMPLEX COMMERCIAL CRIME with especial reference to commercial fraud, investigatory bodies such as an Independent Commission Against Corruption, and the movement of money.

COMMUNICATIONS AND MEDIA LAW with especial reference to the licensing of satellites.

WOMEN AND THE LAW with the especial reference to child and spousal abuse, the status of women within the law, medical treatment of and experimentation on women, and property rights.

COMMERCIAL ARBITRATION

REGULATION OF CAPITAL AND MONEY MARKETS with especial reference to banking, the stock exchange, and futures markets regulation.

THE LEGAL PROFESSION with especial reference to foreign lawyers, incorporation of legal practices, limited liability, and office management.

Any one interested in writing a paper on one of these topics, or seeking further information about what would be required, should write direct to:

Judith Sihombing
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Pokfulam Road
HONG KONG

Further details about the Conference and the following Seminar will be publicised at a later date, but those interested in attending should note the date of 18 to 24 September 1989. □

Speaking out:

Members of Parliament and the judicial process

The following report was issued on 5 August 1988, by the Public Issues Committee of the Auckland District Law Society. Its views are its own. By the terms of the reference under which the Committee was set up it cannot and does not necessarily represent the views of all lawyers, nor has the subject under discussion necessarily been considered by the Council of the Auckland District Society. The members of the Committee at present are D M Carden (Convener), Dr R E Harrison, D J Jenkin, R R Ladd, Miss M A Lewis, Miss M J McCartney, I F Williams, W A Smith and W P Sowerby. The Public Issues Committee reports from time to time in an effort to give both lawyers and non-lawyers a background to current issues with a legal content.

Free speech is one of the most important freedoms in any democracy. Without freedom of speech, new ideas (and indeed old ones) will wither on the vine; and public and private wrongs, great and small, will remain unrighted.

Clearly, Members of Parliament are amongst those for whom the freedom to speak out on matters of public importance is crucial. With modern day requirements of caucus loyalty constraining members of the Government of the day, this freedom is particularly crucial for Opposition Members of Parliament. The freedom to speak out is therefore important not merely for the individual Member of Parliament personally. It is, we believe, one of the foundations of democratic government.

In recent times, the "law and order" issue, and in particular the twin topics of violent crime and "white collar" crime have featured as major issues of political debate and public concern. Whether or not these are in fact problems of the magnitude that is currently perceived, they are public issues of considerable importance which our Members of Parliament both Government and Opposition should be able to raise and debate freely.

As a part of this process of debate, the last few years have seen Whangarei MP Mr John Banks speaking out both inside and outside the House of Representatives on the issue of violent crime and criminals, and roundly criticising the Government and the judicial system. The last few months have seen the Leader of the Opposition Mr Jim Bolger pressing the Government on the "white collar" crime issue, with the consequent naming in Parliament of the so-called "Gang of Twenty". Just recently, Mr Bolger, speaking on the "white collar" crime issue, revealed in Parliament the name of an Auckland solicitor charged with conspiracy to defraud. The naming of the solicitor was significant not only because he had by then been charged with a criminal offence and was therefore awaiting trial, but more especially because his name had earlier been ordered suppressed from publication by a District Court Judge. Nor has the naming of persons whose criminal trials are pending been limited to members of the present Opposition. At the beginning of last year, the Prime Minister Mr David Lange publicly described one Peter Fulcher, who was then in the process of being deported from Australia to face criminal charges in this country, as a "drug dealer" and "thug".

It is therefore timely to consider where the balance currently is, and should in future be, struck between the freedom of Members of Parliament to speak out on public issues on the one hand, and the interests of our justice system and of individuals caught up in it on the other. In order to do so, it is necessary to draw a very clear distinction between the rights of Members of Parliament within the parliamentary context, and those which exist outside of that context.

Statements by Members of Parliament within Parliament

In our 1979 paper, "Parliamentary Privilege", we dealt in detail with the history of and the legal foundations for two key aspects of parliamentary privilege, namely freedom of speech and debate within Parliament, and Parliament's power to punish for contempt of its authority or dignity, including breaches of privilege. (It is of interest to note that the genesis of that paper was three then recent incidents of Members of Parliament naming and criticising individuals in the House. This included the reading out in the House by then Opposition Member of Parliament Mr Richard Prebble of the script of a television film concerning drugs which TV2 had declined to screen and, in the course of doing so, naming various people who were allegedly connected with a drug-smuggling ring, including a well known Christchurch lawyer. "Plus ca change . . .") What follows is largely drawn from our 1979 paper.

The parliamentary privilege of freedom of speech in Parliament, subject only to the power of the House to discipline Members and control its own internal affairs, is an important and long-standing principle of our constitutional law. Article IX of the Bill of Rights 1688, which is still in force in this country, declares:

> That the freedom of speech, and debates or proceedings in Parliament ought not to be impeached or questioned in any court or place out of Parliament.

Article IX is therefore the foundation of the absolute privilege which "proceedings in Parliament" enjoy in the law of defamation. A member, speaking from his place in the House, may utter the most startling calumny of someone outside the House and yet suffer no adverse civil consequence. As Lord Denman CJ said in *Stockdale v Hansard*, (1839) 9 A&E 1, at 114:

> For speeches made in Parliament by a member to the prejudice of any other person, or hazardous to the public peace, that member enjoys complete immunity.

This immunity from civil suit or criminal prosecution for words spoken in Parliament applies not only to the law of defamation, but also to the law of contempt of Court, and extends even to words which would otherwise constitute the offences of criminal slander or seditious statement.

However, as is the case with all claims of parliamentary privilege, the outer limits of parliamentary freedom of speech *are* determinable by the Courts. Thus while the House of Representatives is the sole regulator of the privilege of free speech within its established ambit, the Courts are the judges of any disputed or novel claim of privilege. This is because parliamentary privilege is part of the law of the land and not a lawless appendage. As Holt CJ stated in *R v Paty*, (1705) 2 LD Raym 1105, at 1113-4:

> The privileges of the House of Commons are well known, and are founded upon the law of the land, and are nothing but the law . . . . And if they declare themselves to have privileges which they have no legal claim to, the people of England will not be estopped by that declaration.

Although the extent of the protection comprehended in the phrase "proceedings in Parliament" is uncertain, the modern trend of the Courts is to include within it all essential parliamentary functions of members. The concept of a member's "essential functions" was used by Viscount Radcliffe in the Privy Council decision of *Attorney General of Ceylon v de Livera*, [1963] AC 103, at 121, and subsequently adopted by the Ontario Court of Appeal in *Roman Corporation Pty Limited v Hudson's Bay Oil and Gas Co Limited*, (1971) 23 DLR 3d 292. That case concerned a telegram sent by the then Prime Minister of Canada (Mr Trudeau), together with a press release issued by a Minister, both of which were consequential upon announcements made in the Canadian House of Commons. The Canadian Courts were prepared to strike out civil claims for damages founded on the telegram and press release these being extensions of "proceedings in Parliament" and as such within the protection of Article IX of the Bill of Rights.

These are indications that the Courts are prepared to accord a generous interpretation to Article IX and one which is suitable to the workings of a modern-day Parliament. They also confirm that the initiative is very much with Parliament itself to impose reasonable restraints on speech in Parliament, not only to preserve the decorum of its own proceedings but also to ensure that injustice is not done to those outside who may find themselves in the firing line of parliamentary attack.

What therefore is unique about parliamentary privilege is that its regulation and governance is not in the hands of the Courts but in the hands of Parliament itself. It is a segment of our law which is administered outside the normal system. The rights of those affected are therefore outside the protection of the Courts. With such an exceptional jurisdiction, Parliament has an exceptional responsibility. How, then, is that responsibility exercised in practice?

References in the House by Members of Parliament to persons outside Parliament are in fact subject to certain self-imposed restraints on parliamentary freedom of speech. First, there are limited categories of outsider who are privileged even within privilege. Standing Order 182 provides that no member shall use the name of the Queen or the Governor-General disrespectfully in debate. Standing Order 181 similarly proscribes the use of any unbecoming words against any member of the judiciary. A breach of these Standing Orders attracts the disciplinary powers which the Speaker exercises in the name of the House. Usually a withdrawal or apology purges the offence. Clearly, however, these limited categories could not be generally extended without the privilege itself disappearing.

The second restraint is to be found in certain Speaker's Rulings. These record conventions of the House as well as providing, where appropriate, interpretations of Standing Orders. On p 82 of *Speaker's Rulings*, SR 82/1 records:

> Temperate and decorous language should be used with regard to persons outside Parliament.

SR 82/2 reminds members that they are

> . . . supposed to refrain from bringing the names of individuals into their speeches.

These Rulings carry with them the moral authority of the House. An infringement may or may not attract the attention of the Speaker. But as no breach of a Standing Order is involved, and as it is comparatively rare for another member to feel directly affronted when the attack is on an outsider, such Rulings can be and clearly are disregarded, usually with impunity.

Statements in the House naming private individuals, such as those made by Mr Bolger recently, give rise to two separate but related problems:

(i) When the statements in question are in defiance of a Court order as to name suppression, or would, if made outside the House, tend to prejudice the outcome of pending Court proceedings and thus constitute a "contempt of Court", there are significant constitutional implications for the respective roles of Parliament and our Courts, as traditionally recognised.

(ii) The absence of any effective redress for members of the public so named, especially when allegations of criminal wrong-doing are made against them.

It is clear that protection afforded by Article IX of the Bill of Rights 1688 extends to the making of statements in Parliament which would, outside Parliament, constitute a contempt of Court by reason of their tendency to influence existing Court proceedings or by reason of breach of a Court order suppressing publication of an individual's name. It is arguable, but by no means certain, that this immunity from contempt of Court proceedings is extended to the news media in respect of the publication, without malice, of any fair and accurate report of the proceedings of the House of Representatives or of any Committee thereof. See s 17, Defamation Act 1954.

However, notwithstanding the strict legal position, we consider that the naming of individuals in Parliament in connection with alleged criminal activity, particularly when criminal proceedings are pending against that individual, will in general constitute an abuse of privilege. Indeed, we are unable to envisage circumstances in which it will not.

Public criticism of an individual against whom criminal charges are pending, or even the mere release of details of the alleged facts or background of the matter, can only operate to prejudice a fair trial of the individual in question. It matters not whether the naming of the individual has the effect of inspiring prejudice or for that matter sympathy in the individual member of the public. The principle is the same in either case.

Our objections are based on a fundamental principle of our constitutional law and history, namely that an individual accused of a crime is entitled to be tried in the manner and with the safeguards prescribed by law, by a Court duly constituted for that purpose. This is a principle of great antiquity. See the authorities discussed in *Re Royal Commission on Thomas Case* [1982] 1 NZLR 252, especially at p 262. In constitutional terms, Parliament cannot, and in our view must not, be used, whether by Members of Parliament collectively or by an individual Member of Parliament, as a forum to accuse and in effect to try citizens of criminal conduct.

Defiance by a Member of Parliament speaking in the House of a Court-ordered name suppression is in our view a more serious matter still. We acknowledge that in the ordinary case, it is unlikely that the naming of the individual will of itself prejudice his or her right to a fair trial. After all, the individual's name will have to be revealed to the Judge or jury hearing the case. However, in the occasional case it could prejudice a fair trial by fuelling public speculation about a particular individual and thereby increasing the pressure on him or her to plead guilty. What defiance of a name suppression order clearly does do is deprive the individual concerned of the benefit of an order which a judicial officer has seen as necessary in the interests of justice for the protection of the individual concerned or — and this needs to be stressed — for the protection of persons associated with him or her. It is by no means uncommon for name suppression orders to be made out of concern for the consequences of publication on the *victim* of the alleged crime, or on the mental or physical health of some close relative of the accused person. In that way, whether or not the naming of the individual in defiance of the name suppression order prejudices the trial of that individual, it clearly must prejudice the interests of justice. Nor should it be lost sight of that, almost inevitably in the nature of things, the Member of Parliament who defies a name suppression order will have obtained knowledge of the suppressed name in circumstances which themselves involve an actual breach, unprotected by parliamentary privilege, of the name suppression order.

However, in terms of general principle, the most serious consequence of the naming of an individual in Parliament in circumstances which would in the absence of parliamentary privilege constitute a contempt of Court is this. It permits the individual Member of Parliament concerned to frustrate and even to override the functions of the Courts and the Judiciary. The Courts and the Judiciary, together with Parliament and the Executive, constitute the three branches of the state which, in theory at least, are supposed to operate without direct interference from one another.

Mr Bolger has defended his actions referred to earlier, saying that the public good required that he speak out on the issue of white collar crime and corporate fraud. Mr Bolger also stressed the "important need for the public and the investors to be informed".

Clearly, it is in the public interest for Mr Bolger to speak out on the general issues of white collar crime and corporate fraud. However, we have great difficulty in seeing how the public good is served, and those particular general issues advanced, by denouncing individuals in Parliament who either have been or are about to be charged with criminal offences. Such actions are clearly not necessary to ensure that the individuals in question are brought to justice, and can only operate, as we have already stated, to prejudice a fair trial. Moreover, we simply cannot see how the naming of an individual accused person in defiance of a Court ordered suppression of name can possibly ever serve the public good, especially if any imagined benefits of naming individuals are balanced against the tendency of such actions to bring our whole legal system and especially the criminal justice system into disrepute.

The reaction of Justice Minister Dr Geoffrey Palmer to these recent incidents was, initially, to suggest that a change in statute law might be looked at, and, upon reflection, to indicate that an amendment of standing orders to deal with the problem might be introduced. The Acting Speaker Mr Terris issued a ruling warning Members of Parliament to take care not to abuse their parliamentary privilege of free speech, and reminding them of an earlier Speaker's ruling that "while (Members) were not bound in the House by a suppression of name order, they should use their privilege to break such an order only in the most exceptional circumstances" (*Auckland Star*, 22 July 1988).

While we are concerned at the possibility of a recurrence of recent events, we do not think that the evil in question is sufficiently serious to warrant legislative intervention. Particularly as it appears that Speaker's rulings do not go so far as completely to prohibit defiance of name suppression orders, we would support any proposal to amend Standing Orders to impose an absolute prohibition in this area.

This leaves the problem of the current absence of any effective remedy for citizens who consider that their reputations have been subjected to unwarranted attack by a Member of Parliament whose remarks are protected by parliamentary privilege. In our 1979 paper on parliamentary privilege, we suggested a possible procedure for dealing with such complaints, by having them referred to the Committee of Privileges of the House of Representatives for investigation and report. Cases where the Committee found that the allegations were baseless or an abuse of privilege could, we argued, be laid before the House of Representatives with an appropriate recommendation for disciplinary action against the Member concerned. We suggested that provision for a procedure of this kind could be made in Standing Orders. Such a procedure would, we suggested, involve no extension of Parliament's existing powers of self-discipline, yet would provide a mechanism whereby these powers could be invoked in a proper case where advantage has been taken of privilege to abuse or injure an outsider.

Recent events such as the naming of the alleged "Gang of Twenty", a number of whom later complained bitterly that they had been quite unjustifiably brought into disrepute, have left us of the view that it is time that our earlier suggestions, and indeed the other alternatives canvassed in our paper, were given serious consideration.

Statements by Members of Parliament outside of Parliament

Outside Parliament, Members of Parliament have no special immunities or privileges, should they choose to "speak out".

They are liable to be (and indeed have been) sued for defamation. There is no separate defence of general application based on public interest or the public importance of the issues with which the Member of Parliament is dealing: *Brooks v Muldoon* [1973] 1 NZLR 1. If therefore a Member of Parliament defames an individual outside of Parliament, the only sure line of defence will generally be to "justify" (prove the truth of) the allegations. We need say no more about this topic here, which we dealt with at some length in our 1983 paper, "Public Figures and the Law of Defamation".

Another set of legal prohibitions which a Member of Parliament who speaks out outside of Parliament may run foul of, particularly if the utterance relates to the "crime/law and order" debate, is the law of criminal contempt of Court.

We dealt with the topic of contempt of Court committed in or about the precincts of a Court in our 1987 paper, "The Contempt of Court Powers of the District Court". Another separate branch of the law of criminal contempt relates to actions or statements which have the effect of prejudicing the conduct or outcome of criminal or civil matters pending before our Courts.

Some of the dangers and pitfalls of publicly speaking out on the law and order issue are illustrated by the recent decision of our Chief Justice in *Solicitor-General v Broadcasting Corporation of New Zealand and others* [1987] 2 NZLR 100. The background to that decision lay in two sets of proceedings alleging criminal contempt of Court, one against the Broadcasting Corporation and Mr Banks the Member of Parliament for Whangarei in relation to remarks made by him on a radio talkback show, and the other against the publisher of the *Dominion Sunday Times* newspaper and Mr Banks in relation to the publication of part of a press statement issued by Mr Banks. On each occasion, Mr Banks had referred to particular crimes of violence then engaging public attention and in respect of which arrests had been made and charges preferred. He had gone on to refer to, amongst other things, the "re-offending" of a "small group of vicious criminals" (in the case of the radio broadcast) and to "well known monsters" (in the case of the press statement).

The Solicitor-General argued that, although no individuals had been named by Mr Banks, his statements read as a whole necessarily implied that the persons who had been charged with the various crimes of violence had criminal records for violent offending.

Chief Justice Davison accepted the general principle that:

> In general terms, words spoken or otherwise published, or acts done, outside Court which are intended or likely to interfere with or obstruct the fair administration of justice are punishable as criminal contempt of Court. (9 *Halsbury's Laws of England* (4 ed) para 7)

His Honour further referred to the foundations of this area of law in public policy, quoting from a leading English decision:

> [The law of criminal contempt of Court] is there to prevent interference with the administration of justice and it should . . . be limited to what is reasonably necessary for that purpose. Public policy generally

> requires a balancing of interests which may conflict. Freedom of speech should not be limited to any greater extent than is necessary but it cannot be allowed where there would be real prejudice to the administration of justice.

In particular, in the context of pending criminal trials, His Honour held that

> where statements deliberately made by persons or the media have a clear tendency to prejudice the fair trial of an accused then the countervailing public interest in freedom of discussion must be subordinated to the administration of justice.

However, it had to be proved that "as a matter of practical reality" there was "a real risk" that the fair trial of an accused person was likely to be prejudiced.

So far as the particular statements complained of were concerned, His Honour found that it was not established beyond reasonable doubt that the statements made by Mr Banks on the talkback broadcast necessarily implied that the particular two accused whose trials were then pending had previous convictions. Nor was it established beyond reasonable doubt that the comments by Mr Banks published in the *Sunday Times* necessarily referred to a third then pending criminal prosecution. Moreover, in neither case was there any real risk as a matter of practical reality that the fair trials of any of the accused in question would have been prejudiced.

This decision illustrates both the difficulties in sheeting home a charge of contempt in this area, and, at the same time, the careful path which Members of Parliament and others must tread if they seek to introduce events currently before the Courts into their public pronouncements on a general issue such as "law and order". It is implicit in the judgment that, had the connection between the pending trials been an express reference to the particular accused as having criminal records rather than the implicit ones argued for by the Solicitor-General, the outcome may well have been different.

In the light of *Solicitor-General v Broadcasting Corporation of New Zealand*, is the balance between freedom of speech and the proper administration of justice correctly struck by the existing law of criminal contempt of Court? It seems that a Member of Parliament or indeed any other person who speaks out publicly and refers to the broad details of criminal cases which are awaiting trial may do so if it cannot be shown that his or her remarks relate to a particular case or accused person. However, many lawyers, particularly those with experience of practising in our criminal Courts, would still be seriously concerned about such utterances by reason of their *general* tendency to prejudice the trials of all those accused to whom the Member of Parliament might possibly have been referring. If potential jurors are repeatedly told by persons of influence that persons charged with violent crime are, by virtue of their previous offending, monsters who should not have been let loose to roam our streets, that can only in our view have an overall effect prejudicial to a fair trial of persons accused of violent crime.

While we must express our concern that this kind of public statement does not promote the interests of a fair trial, we do not see it as either practicable or appropriate that the law in this area be changed to cover such utterances. Particularly given the importance of the right of free speech to which we referred at the outset, we consider that the balance struck by the present law, which involves drawing the line between permissible comment and criminal contempt on a case-by-case basis, is appropriate. However, irrespective of where the law draws the line, we do urge the need for sensitivity and restraint by politicians who wish to comment on particular cases in this area.

In an article written for the official journal of the Commonwealth Parliamentary Association, Mr Banks has urged reform of criminal contempt of Court, arguing for legislation in this area. Mr Banks expresses concern at the fact that there is no statute prescribing a maximum penalty for the type of contempt of Court of which he was accused, that it is the Solicitor-General who exercises the discretion to determine whether or not proceedings should be instigated, and at the lack of clarity of the present law.

The suggestion that a maximum penalty should be laid down is we believe a good one. Proceedings for contempt of Court in this area are criminal proceedings in all but name, with penalties (a fine or imprisonment) of a criminal nature. As we argued in our earlier paper on the contempt of Court powers of the District Court, we consider that some codification of procedures and penalties, in particular to open up the range of penalties to include all those available in criminal cases, is appropriate in the criminal contempt of Court area.

However, as indicated earlier, we do not consider that there is any present need for change to the substantive law of contempt in this area. Nor do we see it as inappropriate that the Solicitor-General should be the public officer responsible for deciding whether proceedings alleging criminal contempt of Court are initiated.

Conclusion

It can be seen that, at least within Parliament, Members of Parliament enjoy a very large measure of free speech by virtue of their position which is, in both the legal and the popular sense, a privileged one. Outside the House, subject to the laws of defamation and (to a much more limited extent) of contempt of Court, Members of Parliament like the rest of us enjoy a broad freedom to raise and debate issues of public concern and importance.

At the risk of moralising, it should also be said that any freedom brings with it responsibilities. If Members of Parliament (or others for that matter) do not exercise their undoubted freedoms of speech with proper responsibility in relation to such important and constitutionally sensitive areas as the judicial process, they will have only themselves to blame if at some future time it is sought to limit those freedoms. □

Tax avoidance, politics and Privy Councillors

or: how does one mitigate the *Challenge* decision?

By P J H Jenkin, Queen's Counsel, of Wellington

The concept of "fiscal nullity" is one particularly notable example of judicial creativity. In this article P J H Jenkin QC looks at the concept as it was applied by the Judicial Committee in the Commissioner of Inland Revenue v Challenge Corporation *case and the cases on which it was based. The* Challenge *decision is of course binding on the New Zealand Courts, although as far as English Law is concerned the close decision of the House of Lords, 3 to 2, on 21 July 1988 in* Craven v White *indicates a more restrictive interpretation of the principle in the earlier cases. As the author points out the decision may have relatively little impact however in a jurisdiction where there is a legislative general taxation avoidance provision, as there is in New Zealand.*

> *It is the creative function of Judges . . . that makes their job important and makes worthwhile some assessment of the way they behave, especially in political cases.* (J A G Griffith – *The Politics of the Judiciary* (3 ed), p 16)

How does the layman perceive the process of judicial decisionmaking? Probably he believes that a Judge listens to the evidence, makes decisions as to facts, and then applies those facts to the legal framework established either by statute or by precedent. Those of us whose daily toil is in the Courts suspect that the process is rather different. Is it too cynical to suggest that Judges often listen to evidence and (we hope) to our submissions, form a view as to what is a "fair" decision, and then make findings of fact and law which accord with that perception? No great disquiet should arise if that is the case, because we choose our Judges for their human qualities and not just as linguistic mechanics. What is of far greater concern, however, is when Judges don a political mantle and try consciously to change, rather than interpret, the law.

Not all exercises in judicial legislation are objectionable. There may well be occasions when Parliament passes over to the Courts the task of delineating the law in a particular area. What is of concern, is when Parliament has set the boundaries of the law (whether by action or informed inaction) and the judiciary by conscious endeavour subverts that intention. Of course, decisions of this kind will seldom acknowledge such a reality, but there are plenty of examples of so-called "judicial creativity" which quite simply amount to legislation. No better instance can be found than the manner in which the House of Lords has developed the anti-tax avoidance concept of "fiscal nullity", starting with the decision in *Ramsay (WT) Ltd v IRC* [1982] AC 300.

It is a concept which has since been acknowledged by one of their Lordships as an exercise in judicial lawmaking in an area where Parliament had, for whatever reason, neglected to seek such a result. In his Presidential address to the Bentham Club in February 1984 Lord Roskill said of *Ramsay* and its fiscal nullity successors:

> I accept the justice of the criticism that it may in certain areas make the law uncertain and add to the difficulties of professional advisers who cannot know until the case ultimately reaches the highest tribunal (if it ever does) what rule of law is for certain likely to be applied to their client's case. But if every change in the law is to await legislation even where that legislation has been proposed by the Law Commission, changes will be few and far between. . . .Parliamentary congestion is likely to preclude all but a handful of changes however urgent and however necessary. There are no votes in law reform. (Reported [1984] *Current Legal Problems* 247, 256.)

"Fiscal nullity" was developed under taxation legislation which does not contain a general anti-avoidance provision. It is tempting, therefore, to assume that it would have little relevance to New Zealand, which does. Nothing could be further from the truth. There are shades of the doctrine, or at the very least the judicial attitudes which developed it, in the Privy Council decision in *Commissioner of Inland Revenue v Challenge Corporation Limited* ((1986) 8 NZTC 5, 219; [1987] 1 AC 155) a case which may either help us or haunt us (depending on one's perspective) for many years to come. It is a most important decision for both United Kingdom and New Zealand taxation, something which itself is anomalous given the difference in legislative approach in the two countries. It cannot be understood without reference to the fiscal nullity authorities and the manner in which they have been developed.

The Fiscal Nullity cases

The *Ramsay* case was the first of four significant decisions which form the fiscal nullity trilogy. *Ramsay* was decided in March 1981 and was followed by *IRC v Burmah Oil Co Limited* in 1982 [1982] 5 TC 30, and *Furniss v Dawson* in 1984. [1984] 1 AC 474. Recently, there has been a House of Lords decision of remarkable force in *Craven v White* (unreported 21.7.88 — 61 pages). The story, however, started well before *Ramsay*, with *IRC v Duke of Westminster*, [1936] AC 1, the case which gave to English law the classic words of Lord Tomlin:

> Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in order in them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. (ibid at p 19.)

The *Duke of Westminster's* case is significant not so much for its legal analysis, although that has its interesting aspects, but for the reflection in the quoted passage of an attitude towards tax avoidance schemes which was adopted in subsequent English, Australian and New Zealand decisions. In particular, it provided a substantial underpinning for the line of Australian authority known as the "doctrine of choice" cases.[1]

With some limited exceptions, United Kingdom decisions after the *Westminster* case followed a benign approach to tax avoidance (as opposed to tax evasion). By the early 1970s, however, growing numbers of artificial multi-step transactions were in vogue and clearly were concerning the English judiciary. An example of some significance is *Black Nominees Ltd v Nicol* (1975) 50 TC 229, a decision of Templeman J (who as Lord Templeman subsequently gave the majority decision in *Challenge*). It was held that a complex multi-step scheme failed in its attempt to reduce the tax liabilities of actress Julie Christie. The taxpayer company's reliance on the *Duke of Westminster's* case was rejected by Templeman J in terms which, he said, satisfied the British preference for form over substance:

> In *Commissioners of Inland Revenue v Duke of Westminster* [1936] AC 1 sums payable under a deed of covenant were held to be an annuity and not remuneration, although the covenant was by a master in favour of a servant and there were letters which showed that the servant was told he was expected to be content with correspondingly less remuneration. The House of Lords considered the legal effect of the covenant and the letters and rejected the doctrine that the Court might disregard the legal position and regard the "substance of the transaction". In the present case the transactions entered into before and on 22nd December 1965 must be considered in order to determine the legal effect of the transactions in which Black Nominees took part. The legal effect was that Black Nominees disposed of their rights and powers under the first and second settlements and acquired the right to a part of the profits from the Christie Rights. That was the legal effect, not merely the substance. In the *Duke of Westminster's* case the legal effect was that the sums paid were an annuity because they were payable whether the servant continued in employment or not, although so long as he continued in employment it could be said that the sums he received were "in substance" part of his remuneration. The *Duke of Westminster's* case did not involve a disappearing trick or a fake price. (ibid at p 280/1)

By the early 1980s, it appears clear that the House of Lords was sufficiently concerned about tax avoidance schemes for a positive decision to be made to do something about them. That decision is reflected in the manner which in which their Lordships approached the *Ramsay, Burmah* and *Dawson* cases.

Ramsay

The report of the *Ramsay* case in fact covers two separate decisions, the first involving W T Ramsay Limited and the second one, Rawling. (*Eilbech v Rawling*) The cases involved circular, self-cancelling, transactions and the approach adopted by the House was succinctly described by Lord Wilberforce in the following terms:

> If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine [that form is to be preferred over substance] to prevent it being regarded; to do so is not to prefer form to substance, or substance to form. *It is the task of the court to ascertain the legal nature of any transactions to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.* ([1982] AC 300 at 323/4.) (emphasis added)

In addition His Lordship indicated other significant features normally found in schemes of this kind. Firstly, the clear and stated intention that once started each scheme would proceed through its various steps to its predesignated end. Second, although sometimes large sums of money were supposedly involved, in fact in most cases the taxpayer did not actually have to "put his hand in his pocket".

In these circumstances, the

House of Lords was asked by the Revenue to regard the scheme as fiscally a nullity and its submissions were accepted. The House of Lords made it clear that it viewed its approach as having secure foundations in precedent and that it did not involve an entry into a "substance over form" regime.

Burmah

The *Burmah* case was argued some nine months after the decision in *Ramsay*. It involved a scheme which attempted to make deductible for capital gains purposes an otherwise non-deductible loss. That scheme also was struck down by the House of Lords, but in this case there was no real attempt to justify the decision on traditional grounds. Lord Diplock ([1982] S TC 30, at 32) and Lord Scarman (ibid at p 39) both made it clear that the *Ramsay* case marked a "significant change in the approach adopted by this House in its judicial role". It is important to realise, however, that their Lordships saw these changes as being made to pre-existing judge-made law in the absence of any legislative intervention.

Furniss v Dawson

It became clear, following *Ramsay* and *Burmah*, that the lower Courts (and particularly the Court of Appeal), were unhappy with the manner in which the House of Lords had been developing the fiscal nullity doctrine. So it was that both the trial Judge (Vinelott J) and the Court of Appeal in *Furniss* dismissed the Crown's case. *Ramsay* and *Burmah* were distinguished and the doctrine derived from the *Duke of Westminster's* case applied. This provoked a most devastating rebuttal from the House of Lords, in speeches remarkable for the strength of their prose. Their Lordships made it abundantly clear that they were proceeding with a conscious development of law which was ignored by taxpayers (and by implication lower Courts) at their peril. Two extracts from Lord Scarman's brief speech are of considerable significance:

> I add a few observations only because I am aware, and the legal profession (and others) must understand, that the law in this area is in an early stage of development. Speeches in your Lordships' House and judgments in the appellate courts of the United Kingdom are concerned more to chart a way forward between principles accepted and not to be rejected than to attempt anything so ambitious as to determine finally the limit beyond which the safe channel of acceptable tax avoidance shelves into the dangerous shallows of unacceptable tax evasion. ([1984] 1 AC 474 at 513.)

After referring to a passage from Lord Diplock's speech in the *Burmah* case:

> These words leave space in the law for the principle enunciated by Lord Tomlin in *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1, 19 that every man is entitled if he can to order his affairs so as to diminish the burden of tax. The limits within which this principle is to operate remain to be probed and determined judicially. (ibid pp 513-514)

Lord Roskill used more colourful language:

> The error, if I may venture to use that word, into which the courts below have fallen is that they have looked back to 1936 and not forward from 1982. They do not appear to have appreciated the true significance of the passages in the speeches in *Ramsay* of my noble and learned friends, Lord Wilberforce, at pp 325-326, and Lord Fraser of Tullybelton, at p 337, and, even more important, of the warnings in *Burmah* given by my noble and learned friends, Lord Diplock and Lord Scarman, at p 32 and 39, in the passages to which Lord Brightman refers and which I will not repeat. It is perhaps worth recalling the warning given albeit in another context by Lord Aitken, who himself dissented in the *Duke of Westminster's* case, in *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1, 29:
>
>> when these ghosts of the past stand in the path of justice clanking their mediaeval chains the proper course for the judge is to pass through them undeterred.
>
> 1936, a bare half-century ago, cannot be described as part of the Middle Ages but the ghost of the *Duke of Westminster* and of his transaction, be it noted a single and not a composite transaction, with his gardener and with other members of his staff has haunted the administration of this branch of the law for too long. I confess that I had hoped that that ghost might have found quietude with the decisions in *Ramsay* and in *Burmah*. Unhappily it has not. Perhaps the decision of this House in these appeals will now suffice as exorcism. (ibid pp 514-515)

Lord Brightman provided a significant commentary on the *Duke of Westminster's* case in words of such significance that they also deserve quotation in full:

> The extent to which the speeches of the majority in the *Westminster* case still tend to dominate the thinking in this field of the English judiciary is well shown by the judgments in the courts below in the instant case. In particular, the *Westminster* case seems still to be accepted as establishing that the only ground on which it can be legitimate to draw a distinction between the substance and the form of transactions in considering their tax consequences is that the transactions are shams, in the sense that they are not what, on their face, they purport to be. The strong dislike expressed by the majority in the *Westminster* case for what Lord Tomlin described, at p 19, as "a doctrine that the court may ignore the legal position and regard what is called 'the substance of the matter' ", is not in the least surprising when one remembers that the only transaction in question was the Duke's covenant in favour of his gardener and the bona fides of that transaction was never for a moment impugned.
>
> When one moves, however, from single transaction to a series of interdependent transactions designed to provide a given result, it is, in my opinion, perfectly legitimate to draw a distinction between the substance and the

form of the composite transaction without in any way suggesting that any of the single transactions which make up the whole are other than genuine. This has been the approach of the United States federal courts enabling them to develop a doctrine whereby the tax consequences of the composite transaction are dependent on its substance, not its form. I shall not attempt to review the American authorities, nor do I propose a wholesale importation of the American doctrine in all its ramifications into English law. But I do suggest that the distinction between form and substance is one which can usefully be drawn in determining the tax consequences of composite transactions and one which will help to free the courts from the shackles which have for so long been thought to be imposed upon them by the *Westminster* case.

I shall attempt no exhaustive exposition of all the criteria by which, for the purpose I suggest, form and substance are to be distinguished. Once a basic doctrine of form and substance is accepted, the drawing of precise boundaries will need to be worked out on a case by case basis. But I venture to point out what a simple and readily applicable test a distinction between form and substance would have provided to arrive at the conclusions already reached in some of the cases of composite transactions decided by your Lordships' House. It would need no more than a cursory exposition of the avoidance schemes in *Ramsay* and *Eilbeck v Rawling* [1982] AC 300 to lead any intelligent layman to the conclusion that *neither scheme was designed to achieve any substantial effect in the real world* and that the elaborate steps designed to manufacture a tax deductible loss in each case were purely formal in character. If special or general commissioners had been directed to approach either case on the basis that the tax consequences of the interlocking, interdependent and predetermined transactions were to be judged by reference to the substance, not the form, of the composite transaction, I cannot think they would have had any difficulty in arriving at the right answer. (ibid pp 516-517)

(emphasis added)

Challenge v CIR

The facts of the *Challenge* case were relatively simple, particularly compared with the multi-step transactions of the fiscal nullity cases. By purchasing the shares in certain companies owned by the Securitibank Group, Challenge attempted to obtain the benefit of the grouping provisions contained in s 191 of the Income Tax Act 1976. It was quite open about what it was doing and successfully drew the Revenue's attention to its approach by including in the sale and purchase agreement a provision for the consideration to be determined by sharing the tax benefits gained if the scheme was successful. The Commissioner assessed on the basis of s 99, claiming that the transaction was an arrangement void for income tax purposes in that it directly or indirectly either relieved the taxpayer from liability to pay tax or avoided, reduced or postponed such a liability. In the High Court, Barker J decided in favour of the company, largely on the basis that the Income Tax Act allowed a degree of choice to taxpayers in the manner in which they arrange their affairs and that what Challenge had done was acceptable in that context. On appeal to the Court of Appeal a far more intensive analysis was given.

The judgments of the three members of the Court of Appeal reflect considerable differences in approach. Woodhouse P had little difficulty in concluding that s 99, on its face, applied to the transactions. He then considered the problems of definition and the intended extent of the application of the section, concluding that although it may be difficult to find the boundaries of s 99, that was no reason to read down the clear language. After referring to the need for the ambit of the section to be discovered as a matter of fact and degree and on a case by case basis, he concluded, in agreement with submissions on behalf of the Commissioner, that Parliament had left it to the judiciary to draw the dividing line in individual cases. Woodhouse P then rejected the Australian doctrine of choice cases and concluded that the answer to questions of the ambit of s 99, when in conflict with specific statutory provisions, was to be found in the use in s 99(2)(b) of the words "merely incidental purpose or effect". If a tax avoidance purpose had "merely incidental purpose or effect" it would not trigger the application of s 99; if one of its purposes or effects (not being a merely incidental purpose or effect) was tax avoidance, it would be caught.

Cooke J in his judgment was in accord substantially with the approach adopted by Woodhouse P, but took the view that a limited anti-avoidance provision contained in s 191(1)(c) carried with it the implication that by legislating against temporary transfers, permanent transfers (such as in *Challenge*) were acceptable. His Honour took some support also from the Australian "doctrine of choice" cases, although falling short of endorsing them.

Richardson J took a rather different approach to the case. While accepting the importance placed by the legislature on s 99, he nevertheless concluded that the legislature could not have intended that s 99 should override all other provisions of the Act so as to deprive the taxpaying community of "structural choices, economic incentives, exemptions and allowances provided for by the Act itself". (1986) 8 NZTC 5,001 or 5,019) He therefore supported the approach taken in the doctrine of choice cases and concluded that the limited anti-avoidance provision and the specific coverage of grouping in s 191 took the case outside the ambit of s 99.

When the case reached the Privy Council, their Lordships quickly reached the view that neither the specific coverage argument nor the limited anti-avoidance provision could detract from the main thrust of s 99. Having eliminated these matters, they then equally rapidly reached the conclusion that the majority of the Court of Appeal had been wrong and that the clear words of s 99 applied to such an obvious tax avoidance scheme. That would have been sufficient to decide the case (although of little real help as a precedent) but the majority then proceeded to discuss a concept of "tax mitigation" for which argument had been addressed by neither side. It appears that it was also unknown, formally at least, in the United Kingdom, (Nicoll, 1987, *British Tax Review* 134 at 136) although it may well have a more established heritage in the United States.

The majority (Lords Keith, Templeman, Brightman and Goff) recorded their views on "tax mitigation" in the following way:

> There are, however, discernible distinctions between a transaction which is a sham, a transaction which effects the evasion of tax, a transaction which mitigates tax and a transaction which avoids tax.
>
> . . .
>
> The material distinction in the present case is between tax mitigation and tax avoidance. A taxpayer has always been free to mitigate his liability to tax. In the oft quoted words of Lord Tomlin in *C of IR v Duke of Westminster* [1936] AC 1:
>
> > . . . every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be .
>
> In that case, however, the distinction between tax mitigation and tax avoidance was neither considered nor applied.
>
> Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. Section 99 does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an "arrangement" but from the reduction of income which he accepts or the expenditure which he incurs. (1986) 8 NZTC 5,219 at 5,225; [1987] 1 AC 155 or 167-8.

There was a powerful dissent from Lord Oliver, who could not overcome misgivings on the place of the limited anti-avoidance provisions in s 191.

Some problems with the *Challenge* decision

The principal difficulty with the majority decision in the Privy Council was that it contained reference to no New Zealand-derived precedent or, more surprisingly, to any of the line of Privy Council cases which have provided guidance in the past on the manner in which s 260 of the Australian Act and s 108 of the New Zealand Act were to be applied. Similarly, there is no indication explicitly, although perhaps implicitly, whether the Privy Council agreed with the reasoning of Woodhouse P and Cooke J (apart from his difficulties with the limited anti-avoidance provision). As a result we are left to conjecture on the status of such cases as *Newton, Europa No 2, Mangin* and *Ashton.*[2] If by implication the judgment of Woodhouse P is to be accepted as providing the correct rationale for drawing the borderline between acceptable and unacceptable use of specific provisions, it would have been helpful for that to have been said. Woodhouse P had provided a "business reality" test which could, it is suggested, form a workable basis for distinction in most business related cases.

Also, the Privy Council introduced the concept of "tax mitigation" in the absence of any argument from counsel and without putting the concept to counsel in the course of argument. Also, there is little attempt in the judgment to explain how tax avoidance and tax mitigation are to be distinguished in practical terms. It is tempting, therefore, to venture the thought that this part of the majority's judgment was obiter dicta, particularly as it seems to have been directed more to United Kingdom ears than those of New Zealand. That has been the approach consistently taken by the Commissioner in cases argued post-*Challenge* in the New Zealand Courts. (See, for example, *CIR v Cockburn* (1987) 9 NZTC 6,163 at 6,166.)

Craven v White

Against this background came *Craven v White*, itself a trilogy of cases exhibiting different mutations of a *Furniss v Dawson* kind. Two of these instances were held to be unexceptionable by all of their Lordships (Lord Keith, Lord Templeman, Lord Oliver, Lord Goff and Lord Jauncey) as there was no uninterrupted plan carried through from conception to completion.

It was *Craven's* case itself which split the House, Lords Keith, Oliver and Jauncey holding it to be "White" and Lords Templeman and Goff "black". What is fascinating is the immense gulf which can be seen between the approaches taken by majority and minority.

The leading judgment of the majority was written by Lord Oliver. In 29 pages of magnificant prose he:

1. Made it clear that the House was no longer interested in extending the boundaries of the *Ramsay* doctrine;
2. Denied "legislation" as a proper function of the House;
3. Stressed that instead, the fiscal nullity cases were to be seen as an exercise in statutory construction with normal bounds;
4. Denied (and by implication somewhat savaged Lord Templeman's views) that the criterion for decision is what the Courts see as "acceptable";
5. Gave support for the ability of taxpayers to undertake "strategic tax planning";
6. Restated the *Furniss v Dawson* essentials in the following words:

> (1) that the series of transactions was, at the time when the intermediate transaction was entered into it, preordained in order to produce a given result;
> (2) that that transaction had no other purpose than tax mitigation;
> (3) that there was at that time no practical likelihood that the pre-planned events would not take place in the order ordained, so that the intermediate transaction was not even contemplated practically as having an independent life; and
> (4) that the pre-ordained events did in fact take place. (p 38)

Lords Keith and Jauncey expressed agreement with Lord Oliver's judgment, while adding thoughts of their own. Lord Keith's principal contribution was to restate the *Duke of Westminster* test:

> The principle does not involve, in my opinion, that it is part of the judicial function to treat as nugatory any step whatever which a taxpayer may take with a view to the avoidance or mitigation of tax. It remains true in general that the taxpayer, where he is in a position to carry through a transaction in two alternative ways, one of which will result in liability to tax and the other of which will not, is at liberty to choose the latter and to do so effectively in the absence of any specific tax avoidance provision such as s 460 of the Income and Corporation Taxes Act 1970. (p 4)

Lord Templeman vigorously disagreed with the majority and followed the expansionary thrust of *Furniss v Dawson* saying:

> The principle is that a taxable transaction which results from an artifical tax avoidance scheme is liable to tax. Put another way, an artificial tax avoidance scheme does not alter the incidence of tax. (p 13)

and concluding, in relation to his impending defeat at the hands of Lords Oliver, Keith and Jauncey

> In my opinion a knife-edged majority has no power to limit this principle which has been responsible for four decisions of this House approved by a large number of our predecessors. (p 15)

Lord Goff appears to have moved considerably from his position in *Challenge*, but nevertheless concluded that *Craven* should be decided in favour of the Revenue.

Tax Mitigation

If one thing is clear from *Craven* it is that the words "tax mitigation" mean very different things to different Lords. Lord Oliver uses the expression as a synonym for "tax avoidance" and as distinct from "strategic tax planning"; Lord Keith appears now to agree, having shifted his position dramatically since *Challenge*. Only Lord Templeman uses the expression in the same way as in *Challenge*.

For New Zealand purposes, the *Craven* decision has very little direct application, but adds weight to those who perceive "tax mitigation" as providing no real help to a jurisdiction which has a general anti-avoidance provision. With plans to replace the Privy Council before us, it may be best to return to Woodhouse P's judgment in *Challenge* for guidance.

Is the Woodhouse approach workable?

Woodhouse P's approach does not attempt to lay down guidelines for all cases, but does extend beyond its immediate context of business transactions, or those having some commercial flavour. He said:

> In New Zealand the Courts must now ensure that the anti-avoidance provision as it stands is given that purposive construction which will enable it to do its work in the balanced but effective way intended for it.
>
> When construing s 99 and the qualifying implications of the reference in subs (2)(b) to "incidental purpose" I think the questions which arise need to be framed in terms of the degree of economic reality associated with a given transaction in contrast to artificiality or contrivance or what may be described as the extent to which it appears to involve exploitation of the Statute while in direct pursuit of tax benefits. To put the matter in another way, there is all the difference in the words, I think, between the prudent attention on the one hand that can always be given sensibly and quite properly to the tax implications likely to arise from a course of action when deciding whether or not to pursue it and its pursuit on the other hand simply to achieve a manufactured tax advantage. Considerations which would enable an answer as to which side of the line to put a tax purpose in the case of grouped company incomes (as in the present case) would seem to include an assessment as to whether details of the balancing exercise as disclosed by the group accounts could fairly be accepted as a record of real and relevant achievements of what in practical terms was the real and relevant group. (at 5007)

Tests involving "economic" or "business" reality have a long pedigree in the United States and Canada and the recent support of the fiscal nullity cases. Under s 99 (at least if the *Newton* ancestry is retained) the New Zealand test will be objective, rather than subjective, so that the motives of the taxpayer are irrelevant. (eg *Ashton v CIR* at p 723.) The purpose of the transaction will be determined by its effect, or what it achieves: what has been done will speak for itself.

Such an approach can give a reasonable element of certainty. Even the most complex of transactions can be viewed in terms of economic reality and decision made on whether or not its motivating force is tax-inspired.[3]

The Judicial role in the Fiscal Nullity cases

The doctrine of fiscal nullity was significant enough in itself, but of almost greater impact is the role seen by the House of Lords for itself in changing the perspective to be placed on the *Duke of Westminster* case. It must be stressed that the *Duke's* case was itself Judge-made law, reflecting the perceptions of the Courts at that particular time in fiscal history. The House of Lords in *Ramsay*, *Burmah* and *Dawson* indicated clearly that the *Duke's* case had become an anachronism and must be replaced with rules more attuned to the sophistication of the 1980s. In *Craven* that view itself seems to have been turned around and the *Duke* again supported. Woodhouse P's judgment is also an example of judicial activism, but one which was demanded of the Courts by the manner in which s 99 was drafted. Significantly, all Judges in the Court of Appeal agreed that Parliament had intentionally left to the Courts a major part of the job of deciding when the general anti-avoidance provision is to override specific provisions. (See Woodhouse P at p 5007, Cooke P at p 5,013, Richardson J at p 5,019.) Implicitly, the Courts in New Zealand are to develop their own bodies of rules, within the general framework Parliament has provided.

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Fiscal nullity reconsidered

By R B Grantham, LLM, of Auckland

In the preceding article on tax avoidance by P J H Jenkin QC [1988] NZLJ 305 reference was made to the decision in July 1988 of the House of Lord's in Craven v White. *In this article, which can be seen as complementary to the earlier one, the case is considered in greater detail. The author sees the decision, despite the areas of strong difference among their Lordships, as indicating at least judicial agreement as to the nature of the doctrine stated in* Ramsay *[1982] AC 300.*

The decision of the House of Lords in the consolidated appeals of *Craven v White, IRC v Bowater Property Developments Ltd, Baylis v Gregory* ([1988] BTC 268), has been eagerly awaited both in England, and in Australia and New Zealand, as it is the first opportunity the House of Lords has had to reconsider the radical extension given the *Ramsay* ([1982] AC 300) doctrine in *Furniss v Dawson* ([1984] BTC 71). While the decision is obviously of intense interest to those living or trading in England, it is also of considerable interest to taxpayers and planners in New Zealand because, first, it is an indication of the Lords' attitude to tax avoidance, an attitude that so long as we retain appeals to the Privy Council, we cannot ignore, and secondly, the doctrine of fiscal nullity, as the comments of Cooke J in *Mills v Dowdall* ([1983] NZLR 154, 157), and the recent decision of the High Court of Australia in *Controller of Stamps v Ashwick* ((1987) 19 ATR 486) demonstrate, may have direct application here.

The three appeals were consolidated because the essential issue raised was in each case similar. This issue was whether the *Ramsay* doctrine was applicable to a situation that was described as strategic tax planning. The schemes undertaken in these cases were designed to effect a sale by the taxpayer of certain assets without incurring capital gains tax, and in *Bowater*, development land tax. This was done in each case by interposing between the vendor and purchaser, a company controlled by the taxpayer. There then occurred a transfer of the asset to the intermediate company followed by a further disposal of the asset to the ultimate purchaser.

While this basic structure was similar to the scheme that had been struck down in *Furniss v Dawson*, the novel feature of these appeals is that in each case there occurred, to a greater or lesser degree a hiccup in the plan. In *Bowater* and *Baylis* the scheme originally envisaged, and in which the taxpayer had taken the

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Where will we go?

There is a fascination in attempting to predict the future for s 99. Of the myriad of possibilities the most likely are:

- that the Government will yield to the pressure of the "tax planning" professions and enact legislative tests in an attempt to provide specific ground rules; or
- that the Courts will adopt Lord Templeman's concept of "tax mitigation" and try to use it as a basis for separating "black" from "white"; or
- that the Courts will follow the Woodhouse lead and develop a body of precedent which ultimately may enable reasonable certainty to emerge.

The first alternative is a recipe for disaster. No specific legislation has ever been drafted which is good enough to combat the ingenuity of the determined tax avoider. Loopholes will found, plugs will be inserted by the Legislature, and holes found in the plug (and so ad infinitum).

The second approach is likely to be almost as bad. Despite the best endeavours of a worried population of tax advisers, no one has to date been able convincingly to predict how the distinction between tax avoidance and tax mitigation can operate in practice. In *Craven* the concept became so blurred as to have little, if any, weight.

This leaves us with the third, and only real prospect for success. It mixes the benefits of the body of precedent already established under the old form of s 108 of the 1954 Act, with the flexibility to adapt to new situations and attitudes. Its disadvantage is the period of uncertainty which will follow, while the section is tested before the Courts.

There will be some fascinating exercises in politics on show before long. I am not sure which side of Molesworth Street will provide the better viewing. □

1 These commenced with *W P Keighery Pty Ltd v FCT* (1957) 100 CLR 66 and reached their zenith (or nadir, depending on one's point of view) in *Slutzkin v FCT* (1977) 140 CLR 330 and *Cridland v FCT* (1977) 140 CLR 330.

2 *Newton v C of T* [1958] AC 450, *Mangin v CIR* [1971] AC 739, *Ashton v CIR* [1975] 2 NZLR 717, *Europa Oil (NZ) Ltd v CIR (No 2)* [1976] 1 NZLR 546.

3 An objective test has a far better chance of relieving certainty in the law, than a subjective one, as the problems encountered with the "business purpose" test in Canada amply demonstrate.

initial steps, did not proceed. Subsequently, the taxpayer found a new scheme and a new purchaser, and from the platform created by the first scheme the taxpayer was able to complete the second scheme. In *Craven v White* the only difference was that the subsequent scheme was not entirely new but a revival of the original scheme.

The question that arose for consideration was, could the Revenue, pursuant to the *Ramsay* principle, include within a single composite transaction, steps taken pursuant to the initial defunct plan, and steps taken pursuant to the second plan.

The answer to this question was in the case of *Bowater* and *Baylis*, that the Revenue may not do so. However in relation to *Craven v White*, while Lords Oliver, Keith and Jauncey, felt there was no material difference and the *Ramsay* principle could not apply, Lords Templeman and Goff, took the view that the scheme was a single composite transaction, thus, as the other requirements of the doctrine had been conceded, the scheme ought to be struck down

Before considering the basis of this divergence it is interesting to note the points their Lordships agreed upon.

The first point of agreement concerned the rationale of the *Ramsay* doctrine. Their Lordships accepted, contrary it seems to counsel's contentions (p 309), that the *Ramsay* principle was merely a principle of statutory construction. The rationale, which Lord Oliver correctly noted,

> is neither very surprising nor very revolutionary (p 291),

simply seeks to give effect to the presumed intent of Parliament that taxing statutes are to apply only to real events,

> and not merely a manipulated arithmetical difference (p 292).

A rationale most would already appreciate, but it is nevertheless comforting to have it confirmed by their Lordships.

The second point of agreement concerned the status of judicial intervention in tax avoidance. Their Lordships were in agreement that once the decision had been taken to intervene, there was no going back. Even Lord Oliver who confessed to being a "less than enthusiastic convert" (p 289), was prepared to accept the proposition that, having decided to cross the Rubicon, the bridgehead must be maintained. His concern was that that basis of the intervention should be intellectually sound.

While their Lordships may have agreed upon the conceptual basis of the doctrine, there was less agreement as to the circumstances in which it may properly be applied. These circumstances had been set out in *Furniss v Dawson* and required that two findings of fact be made. First, there be a composite transaction or a pre-ordained series of transactions, and secondly there be inserted in the series a step whose sole purpose was to achieve a tax saving. In the instant appeal the second factor had been conceded (p 310), thus the sole issue, as their Lordships noted, was: was there a composite transaction?

In the Court of Appeal ([1987] 3 WLR 660), it had been held that a transaction could not be said to be composite unless at the time of the first step the remaining steps were known and there was no likelihood they woud not be carried out. This requirement quickly came to be called the "practical certainty" requirement. Lord Oliver, who delivered the main judgment for the "majority", upheld this view. In His Lordship's opinion a series could only be said to be composite or pre-ordained where there

> was a degree of certainty and control over the end result at the time when the intermediate steps are taken (p 300).

Thus for a series of events to properly be considered composite there must be; (a) a series of events planned in some detail beforehand; (b) some control by the taxpayer to enable him to procure the completion of the scheme; (c) no likelihood that the scheme would not be carried out.

In imposing this requirement Lord Oliver offered in addition to various passages from the authorities which, as the minority were able to offer just as many, cannot be considered conclusive, three main grounds as justification.

The first took the form of a rejection of the wider meaning of "pre-ordained" that had been contended for by the Crown and accepted by the minority. In Lord Oliver's view if pre-ordained simply meant any series of events designed to produce a rational result (p 289), then that was a description, "that applies to virtually every human activity" (p 289), thus those series of events that were to be dealt with by the *Ramsay* doctrine, could be identified only by the taxpayer's purpose. This, in His Lordship's view, was inconsistent with *Ramsay* itself, where it was stressed that it was not the taxpayer's purpose, but the nature of the transaction, that was the key. (p 296)

A series of events could, in Lord Oliver's view be identified as composite only if there was something in the nature of the steps themselves to suggest this. Thus a series of events would be composite if it could be shown

> that successive transactions are so indissolubly linked together, both in fact and intention as to be properly and realistically viewed as a composite whole . . . (p 295).

Thus what is crucial is that the individual steps are not, and never were, intended to operate other than as part of a whole (p 292). Therefore what makes a series of events composite is that the taxpayer intends them to be so. While it is apparent Lord Oliver considered the minority to have fallen into the error of concentrating upon the taxpayer's purpose, it is submitted that Lord Templeman does accept this view of what makes a transaction composite. This can be seen in the passages quoted by His Lordship as examples

> of the circumstances in which the court will . . . construe and apply the taxing statute to a scheme as a whole . . . (p 278).

The recurring feature of those passages is that the taxpayer should have intended the steps to operate as a single composite transaction.

Bearing this apparent agreement in mind, and the fact this description of what makes a series of events composite, did not lead Lord Templeman to embrace the "practical certainty" requirement, the question that must then be asked is, why is the "practical certainty" requirement necessary? The answer given by Lord Oliver, is that

> if, at the completion of the intermediate disposition, it is not even known to whom or upon what terms any ultimate *disposition will be made* . . . (p 300),

it seems impossible to say the taxpayer intended these unforeseen steps to form part of a single event.

While His Lordship does have a valid point, and a point Lord Templeman clearly accepts when he notes in relation to *Furniss v Dawson* that

> If Dawsons had carried out an exchange of shares with Greenjacket at a time when Dawson were not planning a sale for Wood Bastow there would have been no scheme . . . (p 279)

it is less clear how this supports the "practical certainty" requirement. This requirement does not simply require the taxpayer to have a plan in mind, but in addition that he have the power to procure its completion, and that it is practically certain it will be carried out. While Lord Oliver's reasoning is clearly valid in the situation where the taxpayer has not even contemplated further steps, it is difficult to see how, if a taxpayer has contemplated further steps and plans the scheme as a whole, that his ability or non-ability to procure its implementation, or whether there is any likelihood that his intentions may be frustrated, can have any bearing on the issue of whether the series of steps is composite. For as Lord Oliver has already established, whether a series is to be treated as composite turns on the taxpayer's intent that they should be so.

This indeed is one of the main points made by Lord Templeman in his rejection of the "practical certainty" requirement. In His Lordship's view all that is required is that the taxpayer intend the steps to operate as a whole, that he have control over his part in the scheme, and that the scheme actually take place (p 281). Thus it followed in Lord Templeman's view that

> Two transactions can form part of a scheme even though it is wholly uncertain when the first transaction is carried out whether the taxpayer who is responsible for the scheme will succeed in *procuring the second transaction* to be carried out at all (p 279).

While Lord Templeman produces numerous passages from the authorities to support this, (as does Lord Oliver to support the contrary position), the one telling point drawn from the authorities is, where in relation to *Furniss v Dawson*, he noted that the scheme was a composite one even though the taxpayer could not have procured the total implementation of the scheme.

This point also has bearing on the second justification offered by Lord Oliver.

The second point relates to the decision in *Furniss v Dawson* and the explanation of how their Lordships were able to disregard intermediate steps that quite clearly had real effect.

In Lord Oliver's view this decision can only be explained on the basis that the steps were disregarded because the scheme was analogous to a contractually binding series of events. In such a situation, in His Lordship's view, the Courts are justified in viewing the intermediate steps as having no independent existence. This is so because the first step was subject to an "obligation ab initio to transfer the property" (p 297). Thus if in *Furniss* it was the fact that the scheme was analogous to a contract that entitled that Court to treat it as composite, it follows that a scheme cannot be composite unless it is analogous and that it cannot be analogous unless all the steps are known in advance and will be taken as a matter of practical certainty.

The difficulty with this view, raised by Lord Templeman, is that in all the proceeding cases there was no contractual obligation to carry the scheme out, and in *Furniss v Dawson* the taxpayer did not have the control to make completion of the scheme a practical certainty. Essentially Lord Templeman's point is that once it is accepted that a scheme may be treated as composite even where there is no contractual obligation it must be recognised there will be uncertainty as to whether, and in what form, the scheme is completed, and it must be accepted that the taxpayer has no means to enforce completion and is thus dependent upon the good will of the other parties. Thus it seems

> devoid of logic and contrary to the principles established by . . . *Ramsay, Burmah,* and *Furniss* (p 280)

to accept on the one hand that a contractual obligation is not necessary, and then to require the arrangements to be as certain as contract.

The third and final justification offered by Lord Oliver relates to the length of time that may elapse between the various steps. This point has two facets. First, in Lord Oliver's view, if there are lengthy intervals between the steps in the series it becomes impossible to view the intermediate steps as being "held in limbo" (p 300), so they might be treated as having no independent existence.

Lords Templeman and Goff (p 304) however rejected the contention that a temporal interruption can be relevant once the existence of the plan is established. In Lord Templeman's opinion,

> it is inconceivable that Dawsons would have succeeded before this House in *Furniss* if the exchange with Greenjacket had taken place after the negotiations with Wood Bastow had commenced and about a week or a month before the negotiations with Wood Bastow were completed. (p 280)

The only relevance in Lord Templeman's view of an interval is that

> if there are two transactions separated in time, the Commissioners may conclude that the two transactions did not form part of an artificial tax avoidance scheme. . . (p 281)

A further difficulty, it is submitted, with Lord Oliver's view is that it would appear to be inconsistent with the recent decision of the House of Lords in *Bird v IRC* ([1988] 2 WLR 1237]. This decision dealt with an "off-the-shelf" scheme which took some twenty months to complete. It is no doubt because it involved a ready made scheme, and thus was unquestionably a composite transaction, that explains, initially at least, why this decision was not referred to. Owing to the length of time the scheme took to complete the Revenue had taxed a number of the intermediate steps, but on seeing the scheme as a whole sought to tax it as such. The taxpayer complained that having treated the steps as having effect, the Revenue could not now treat them as part of a scheme. The House of Lords rejected this contention, and it is this rejection that would appear to be inconsistent with Lord Oliver's opinion in the instant case. For if Lord Oliver is correct in saying that unless the scheme takes place over a short space of time the intermediate steps may gain independent existence, and thus cannot be disregarded, the Lords in *Bird* (of which Lord Oliver was one) ought to have upheld the taxpayer's contention. For while the facts were materially different in that the steps in *Bird* were taken pursuant to a plan, Lord Oliver's concern with temporal interruption does not relate to the establishment of the taxpayer's intent (that the steps form a composite transaction), but rather, notwithstanding the taxpayer having intended a composite transaction, if there was an interval, the steps by virtue of that delay, gain independent existence, and thus may not be disregarded.

The second facet is that in Lord Oliver's opinion if there are significant intervals between the steps it leaves open the possibility of double taxation, in that the steps may be taxed separately and then taxed as part of a scheme. While this objection has dismissed by both Lords Templeman and Goff, they did so in a rather unsatisfactory manner as they failed to really address the objection.

However the more difficult point in respect of this ground again relates to the decision in *Bird*. In *Bird* the sort of situation that Lord Oliver envisaged as giving rise to insoluble problems, occurred. The intermediate steps had been taxed and the Revenue had then taxed the scheme as a whole. The taxpayer complained of double taxation, but their Lordships said this was not a situation giving rise to double taxation. Double taxation occurs only where the same taxpayer is taxed twice, but where the Revenue taxes the steps in the scheme (ie A to B or B to C) and the scheme as a whole (ie A to C) all that occurs is that the same proceeds are taxed twice. This their Lordships held was perfectly acceptable. Thus the objection raised by Lord Oliver, and it was also the main ground of Lord Jauncey's decision, seems to have already been answered by the decision in *Bird*. This apparent inconsistency is most difficult to explain, especially in light of the fact that *Bird* was decided a mere five weeks previously.

In conclusion it may be said that this decision does not hold as much for the taxpayer as the result may have indicated. Indeed far from clarifying the status and operation of the *Ramsay* doctrine, it has perhaps served only to cloud the issue. This is so because first, while Lord Oliver's "practical certainty" requirement is a limitation on the doctrine, in view of the forceful dissent, and in light of the rather doubtful reasons given for the requirement, it can not be said with certainty whether the requirement is here to stay. Secondly, as the requirement is rather vague and therefore subject to interpretation by first instance tribunals, the decision in the instant case must necessarily be limited to its facts.

Despite these uncertainties a number of points can however be taken. First, there was a clear commitment by all the Lords to continued judicial intervention to frustrate schemes of tax avoidance. Thus, to continue Lord Oliver's metaphor (p 288), the decision is not the much prayed for cessation of hostilities. Secondly, it is quite apparent that there is a divergence among their Lordships as to the pace and direction the intervention should take. Finally, it is clear that there is agreement as to the nature of the *Ramsay* doctrine. This in itself makes the decision one of considerable importance.

It is perhaps just unfortunate, given the point of division, that Lord Brightman was not available to hear these appeals and to say what he meant in *Furniss* by pre-ordained. □

Recent Admissions

Barristers and Solicitors

Langridge LC	Auckland	17 June 1988	Powell AM	Auckland	17 June 1988
Lim EL	Auckland	17 June 1988	Rainger JWA	Auckland	17 June 1988
Logan AGW	Auckland	17 June 1988	Rice HM	Auckland	17 June 1988
Loveys SE	Auckland	17 June 1988	Richards J	Auckland	17 June 1988
Maidment R	Auckland	17 June 1988	Rowe AG	Auckland	17 June 1988
Mathews SSE	Auckland	17 June 1988	Sheilds AR	Auckland	17 June 1988
McCarty MJ	Auckland	17 June 1988	Smith LJ	Auckland	17 June 1988
McCoach LC	Auckland	17 June 1988	Stirling J	Auckland	17 June 1988
McKenzie LH	Auckland	17 June 1988	Sutton WN	Auckland	17 June 1988
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Nand RK	Auckland	17 June 1988	Urwin KL	Auckland	17 June 1988
Palmer GD	Auckland	17 June 1988	Wagner GJ	Auckland	17 June 1988
Parkes RS	Auckland	17 June 1988	Weir SF	Auckland	17 June 1988
Paton EK	Auckland	17 June 1988	Wild H	Auckland	17 June 1988
Paul EP	Auckland	17 June 1988	Wong ST	Auckland	17 June 1988
Peart RM	Auckland	17 June 1988			

Fiscal nullity in the nether world: The *Ramsay* doctrine in Australia

By A O Ferrers, sometime Barrister and Solicitor of the High Court of New Zealand, Solicitor of the Supreme Court of Queensland

This article considers some recent Australian decisions concerning what is known as the doctrine of fiscal nullity as established in such English cases as Ramsay v CIR *[1981]All ER 865. The article looks at a recent decision of the High Court of Australia and reviews earlier Australian case law on the topic. It was written before the decision of the House of Lords in* Craven v White *[1988] BTC 268.*

Introduction
It is timely to look at the impact of fiscal nullity in Australia since for the first time the doctrine has been argued before the High Court of Australia in *Ashwick* (1987) 19 ATR 486. The Justices handed down their decision on 10 December 1987.

The High Court of Australia
It should be mentioned at the outset that Australia has now severed all links with the Privy Council in London. Formerly final appeals in both Commonwealth and State cases lay to that Board but during the last few years such appeals have been gradually phased out. Nowadays the High Court of Australia is the final court of appeal sitting at the apex of the hierarchy of Federal and State Courts. It is another mark of Australia's nationhood and sovereignty. The High Court of Australia is not bound by decisions of the House of Lords or the Privy Council. While decisions of those august bodies may well be very persuasive, the High Court will tread its own path if it sees fit.

The place of the doctrine
In assailing the moves of taxpayers to mitigate their tax liabilities, the various Commissioners concerned seem to look to their respective armouries in this order:

a a specific section has been contravened;

b the whole set up is a sham;

c some general anti-avoidance provision has been breached;

d the arrangement is a fiscal nullity: a fall-back position when all else fails.

Anti-avoidance provisions
In Australia the Income Tax Assessment Act has long contained specific general anti-avoidance provisions. Until 27 May 1981 the provision was the much litigated, even though the much castigated, s 260. Cases on that section are in fact still being heard by the Courts as the schemes involved were entered into before that date. At one stage it looked as though the High Court under Sir Garfield Barwick had decimated s 260, but the section took on a new lease of life in December 1985 when the High Court relied on it in finding against the medical taxpayers in the well known *Gulland, Watson and Pincus* (1985) 17 ATR 1.

Section 260 has been replaced as from 27 May 1981 with a number of sections contained in Part IV A of the Act. The quiddity of the Part is that, if a taxpayer enters into an arrangement, the sole or dominant purpose of which is to gain a tax benefit (a defined term), then that benefit can be cancelled for tax purposes by the Commissioner reconstructing the tax account of the taxpayer in such a way as to deny that benefit. Public announcements by the Commissioner and his political masters are to the effect that only in cases where a scheme is blatant, artificial or contrived will the powers granted by Part IV A be invoked. Such epithets, however, do not appear in the statute! It would perhaps be mentioned that Hong Kong has adopted a very similar provision into its Ordinances and public announcements there have been in similar vein.

It should be noted, of course, that

these anti-avoidance provisions relate only to income tax.

Seeing that the Commissioner can cancel any attempted tax benefit, then in those circumstances the taxpayer would find himself back where he started before entering upon his scheme. The effect is really the same as the application of the doctrine of fiscal nullity. The scheme is treated as if it never was.

The taxes affected

It is noteworthy that *Ramsay* [1981] 1 All ER 865, *Burmah Oil* [1982] 5 STC 30 and *Dawson* [1984] 1 All ER 530 were all cases concerned with capital gains tax, a form of tax unknown in Australia as such before 1985. Since then there are provisions specifically for taxing capital gains but they are in the *Income* Tax Assessment Act and those gains are taxed *as income.* Originally the question was whether the doctrine was applicable to other forms of revenue. However in England at least, it has now been applied in a stamp duty case in *Ingram* [1986] Ch 585 (albeit "with considerable hesitation") and raised in a development land tax case in *Bowater* [1987] 3 All ER 27 (heard with *Craven v White*). It is perhaps significant that Mustill LJ in his analysis of the doctrine in *Craven v White* [1987] 3 All ER 27, at 68, did not limit it to any particular taxing statute. But Lord Brandon had no difficulty brushing it aside as inapplicable in *Sherdley* [1987] 2 All ER 54 which was a clear income tax avoidance case in the matrimonial property field, after the Court of Appeal had agonised over whether or not it applied and (wrongly) decided that it did.

The Australian cases

Against that background we can now turn to the Australian cases when the doctrine has been called in aid by the Crown.

The first was *Ilbery* (1981) 12 ATR 563 which soon followed *Ramsay* in 1981. This was a decision of the Full Federal Court of three Judges. A solicitor prepaid five years' interest in an income tax avoidance scheme. It was held that at the time the expenditure was incurred, no relevant income-producing activity had begun. Therefore the interest was not deductible. The leading judgment was delivered by Toohey J (with no mention of fiscal nullity) in which Northrop and Sheppard JJ concurred. However, they did refer to fiscal nullity obiter (at p 565). They referred with approval to passages of the speeches by Lord Wilberforce (All ER 873) and the Lord Fraser (All ER 882) on the topic of form v substance:

> It is our opinion that what their Lordships have said is as apt for the Australian legislation as it is for that in force in the United Kingdom. It follows that if, contrary to our opinion, the expenditure was incurred in gaining or producing assessable income, the arrangement pursuant to which it was incurred should be treated as fiscally a nullity, and thus not resulting in an expenditure incurred in gaining or producing the taxpayer's assessable income. (p 565)

Having been prepared to travel that far with the House of Lords, the two Judges were at pains to point out the limitations of what exactly they were saying, even though their remarks were in any event obiter:

> We make it clear that what we have said is said in the context of a factual situation such as arises for consideration in this case. We do not intend it to apply otherwise than to cases of this or the *Ramsay* kind where there are, in the words of Lord Wilberforce, "closely integrated situations". We express no opinion as to whether the principles expounded in *Ramsay's* case may have some wider application.
>
> We also make it clear that the legislation with which we have been concerned is that in force at the time of the transactions here in question. We have not considered what effect, if any, the provisions of Pt IVA of the Act may have upon the application of *Ramsay's* case in Australia. Part IVA of the Act was inserted by Act No 110 of 1981 which came into force on 24 June 1981. It applies to schemes (as therein defined) which have been or are entered into after 27 May 1981. It could be that a full consideration of its provisions would lead to the conclusion that in relation to such schemes there is no room in Australia for the operation of the doctrine espoused in *Ramsay's* case. That is a matter upon which we express no opinion. (p 566)

The next time the doctrine surfaces, albeit fleetingly, in the law reports was in the Supreme Court of Queensland in that year of ominous date, 1984. In *Alloyweld Pty Ltd* (1984) 15 ATR 614 another prepayment of interest scheme was being considered in relation to avoiding income tax. But all Derrington J had to say was:

> I restrain myself from discussing the subject of fiscal nullity which it is now unnecessary to consider. (at p 620)

In the same year there were three other decisions, the first of which was a decision of the Full Federal Court in *Walker* (1984) 15 ATR 847. Another income tax avoidance scheme was involved. A medical practitioner entered into a number of farming partnerships the losses from which offset some of his high practice income. The question was whether the doctor was engaged in the business of farming. The Commissioner argued that he was not, as the arrangements were not genuine, merely being all preplanned for a tax advantage. It was alleged that, when such an advantage had been secured, the partnerships would be dissolved and the artifice recommenced.

The Court found for the taxpayer by a two to one majority. The leading judgment was delivered by Fisher J with whom Davies J agreed although he did add some remarks of his own.

Fisher J acknowledged the fiscal nullity argument pressed on him by the Commissioner and also acknowledged that, if accepted, the Commissioner would succeed. He said:

> On the assumption that the reasoning of their Lordships, based as it is on the different provisions of English revenue legislation, is acceptable in Australia, it will be necessary briefly to consider the essential features of that reasoning.

> Counsel for the Commissioner placed considerable emphasis on *the fact that all steps taken by the* taxpayer and the other partners prior and subsequent to entry into partnership were *pre-determined and pre-ordained.* This may well be the case, and I accept it for the purpose of considering this aspect of the appeals. However, such acknowledgement does not conclude the matter. Equally the fact that the partnerships were engaging in business or commercial activities is not of itself an answer. (at p 859)

He then went on to consider Lord Brightman's leading speech in *Dawson* (supra) noting that there have to be

> two findings of fact, first whether there was a pre-ordained series of transactions, ie a single composite transaction. Secondly, whether that transaction contained steps which were inserted, without any commercial or business purpose apart from a tax advantage. (at p 859)

Having said that, Fisher J continued:

> In the matters before this Court, counsel for the Commissioner was unable to point, or at least to point clearly, to the step or steps which on his contention were the steps which had no commercial (business) purpose apart from the avoidance of tax. (at p 860)

So the Judge, in order to deal with the argument, assumed the doctrine had force in Australia but did not in fact decide that it was part of the Australian law. He proceeded on this basis merely to show the argument could not stand in the case before him. We will find this approach used in later cases as well.

There was yet a third decision in 1984 but this time in the Federal Court at first instance: *Bayford Wholesale Pty Ltd* (1984) 15 ATR 1026. This was a sales tax case which concerned the taxpayer's status under the Sales Tax Assessment Act. It was not one in which any avoidance was alleged. In the event the Judge had no need to decide if fiscal nullity was a part of Australian law. He took Fisher J's line when he said:

> A threshold question arises whether this doctrine should be received as part of the law of Australia. However, this need not now be decided since, even if the principle were part of the law of Australia, it could not, in my view, have any application in the instant case. (at p 1036)

He also made the point that the English cases concerned capital gains tax and hence "the ultimate inquiry (there) was whether a profit or gain had been made". This was not an issue in *Bayford Wholesale.*

The fourth 1984 decision was *Oakey Abattoir* (1984) 15 ATR 1059, significantly a joint judgment of three Judges of the Full Federal Court, Fox, Fisher and Beaumont JJ. It concerned a circular income tax arrangement. It was held that s 260 applied to set the arrangement aside. Again the Commissioner urged the efficacy and the applicability of fiscal nullity. For the first time we see a Court speak out against the likelihood of the doctrine applying in Australia. In a well known passage the judicial triumvirate speak with one accord when they say with rugged independence:

> In our opinion, the *Ramsay* and *Furniss* principles should be perceived as no more than rules governing the statutory interpretation of the United Kingdom legislation for the taxation of capital gains. As such, they have no immediate impact upon the Australian Act. Further, given the presence of s 260 (a matter adverted to in argument and by Lord Wilberforce in *Ramsay* ([1982] AC at 320 and 325 respectively)), and given the doctrine of economic equivalence underlying the approach of the House of Lords, we do not think that this approach affords any useful analogy in the present case, save to point to the possibility that s 260 might well apply here. (at p 1067)

It is interesting to note that in the first case on Part IVA (a late 1987 case (Case 4043) before the Administrative Appeals Tribunal) fiscal nullity was argued by the Commissioner on the basis that *Oakey Abattoir* was wrongly decided. The Tribunal merely noted the submission and decided the case on Part IVA alone.

Such a weighty judicial statement as that in *Oakey Abattoir* has not, however, deterred the Commissioner. He was probably delighted with some comments of Marks J in the Supreme Court of Victoria in *Deputy Commissioner of Taxation v Vereker* (1986) 18 ATR 475. The DCT, who had obtained judgment for $5.12M for unpaid tax and interest, sought the Court's assistance in aid of executing judgment. The allegation was that the taxpayer had "alienated assets to put them beyond reach . . .". The DCT sought declarations that assets in the names of the several defendants were in fact the taxpayer's. There had been a huge investigation lasting many years; over 30,000 documents were sifted. Numerous companies and trusts, round robins and book entries, having no apparent commercial purpose, were involved.

The DCT endeavoured to show many of the transactions were shams. Relying on fiscal nullity, and particularly Lord Fraser in *Dawson* where he said, " *. . . the fiscal* consequences of a pre-ordained series of transactions . . . are generally to be ascertained by considering the result of the *series as a whole . . .*" (1984) 1 AC 474 at 512, the Judge said that in determining whether a transaction was a sham:

> it is now accepted that the Court may look at the circumstances as a whole, which in this case might usefully involve comparison between Vereker's enjoyment and control of the subject assets at the beginning and the end of the activity on which he relies. (at p 479)

So for some purposes one Judge at least is prepared to take cognisance of what has been said in the House of Lords.

All of which preliminary brings us to *Ashwick* (1987) 19 ATR 486, the 1987 decision of the High Court of Australia. It was a stamp duty case arising in Victoria concerning the disposal of an hotel by Carlton United Breweries (CUB) to the licensee. To save stamp duty a scheme was put into operation. There were many such schemes. They worked this way. CUB which owned the land in question issued to Ashwick (A) 10,000 redeemable preference shares. A paid CUB $1M for the shares. When CUB redeemed the shares, instead of returning the redemption amount in cash, it executed a transfer in favour of A of land valued at $899,557 and paid cash of $100,443. Later A lodged the instrument of the land for assessment of stamp duty, claiming that a particular exemption in the Act applied, since the conveyance was made to a shareholder in the course of the distribution of company assets following a reduction of capital.

The Comptroller of Stamps declined to grant the exemption because:

> there had been no reduction of capital;
>
> if there had, the land transfer was not in consequence of it;
>
> the only kind of capital reduction to which the exemption applied was the one referred to in s 123 of the Companies (Victoria) Code and no other; and
>
> fiscal nullity applied and therefore the transfer was not to be treated as consequent on a capital reduction.

The case was initially dealt with by the Full Court of Victoria (1987) 18 ATR 757 which held in favour of the taxpayer, finding against the Comptroller on all his four arguments. Not surprisingly the taxpayer argued that fiscal nullity had no place in Australia at all, let alone in the field of stamp duty. He submitted that *Ingram* (supra) was wrongly decided. The Judges made no comment on this submission.

The leading judgment was delivered by Tadgell J with whom Kaye and Murphy JJ agreed. They were very reticent about importing the doctrine into Australia:

> The justification for the translation of the *Ramsay* principle out of the environment in which it developed or is developing, and into our own, is not self-evident . . . I do not think the present case raised the necessity or provides the occasion to decide whether or to what extent the so-called new approach by the House of Lords "in its judicial role" to some tax avoidance schemes is applicable in Australia, or whether it is possible to apply it in the field of stamp duty legislation. It is sufficient to say that, in my view, the approach is inappropriate in this case. . . . It is not apparent to me why or even how the *Ramsay* principle should be applied to that arrangement. What are the "inserted steps" that are properly to be ignored? . . . (at pp 772-773)

The Comptroller appealed unsuccessfully to the High Court. Seeing that the High Court gave its decision by a joint judgment of the five Justices a mere 35 days after the hearing, it is not surprising to learn that the High Court had no trouble determining its collective mind and finding for the taxpayer.

As had happened in the Court below the High Court did not come to a decision whether fiscal nullity formed part of the law of Australia. It had no reason for so doing. The Justices said:

> In the view we take of the appellant's submission, we do not find it necessary to decide how far, if at all, the *Ramsay* principle is part of the law governing the judicial process in Australia. This is because we think the submission must fail in any event. ((1987) 19 ATR 486 at 494)

Nevertheless in courteous defence to the argument urged by the Comptroller they did look at whether fiscal nullity could have applied "(a)ssuming the availability of the *Ramsay* principle". The Justices asked with Tadgell J what were the "inserted steps" and then said, "It is here that in any event the appellant's case breaks down." After "viewing the transaction in its wider context" the Justices felt confident enough to say, "But it does not follow that the precise steps by which the result was achieved were pre-ordained." They exemplify this from the facts. It was not "one single composite transaction" a la Lord Brightman since there were "distinct and separate steps which called for the making of discretionary decisions from time to time. . . ." So all in all "there is no foothold from which the appellant can invoke the *Ramsay* principle." (at p 495)

Conclusion

Once more the Court concerned left open the burning question whether fiscal nullity applies as such in Australia. The five High Court Justices merely adopted the line (as others had done before them) of accepting the principle for the purposes of the argument and then saying it did not assist. All this would seem to imply that at this stage there is a judicial reluctance to oust the doctrine altogether from Australian law. Nobody wishes to go further than what was said in *Oakey Abattoir* (supra) which extract, it is significant, was quoted in *Ashwick* at p 494, without praise or condemnation. Also it was noted that the Supreme Court of Canada had taken "(a) broadly similar approach" in *Stubart Investments.* ((1984) 15 ATR 942, 84 DTC 6305)

It is the writer's opinion that the doctrine is unlikely to be taken on board in Australia in regard to the taxing of income and capital gains in view of the provisions of Part IVA of the Income Tax Assessment Act. Those provisions are ample enough on their own at this stage to counter any avoidance technique employed which is perceived as blatant, artificial or contrived. □

It's the law

The Arkansas legislature enacted a law stating that the Arkansas River can rise no farther than to the Main Street bridge in Little Rock.

Lawrence J Peter
The Peter Principle Revisited (1985)

In Colorado, the maximum penalty for destroying a house with fire is 20 years, but with explosives, only 10 years. The maximum sentence for stealing a dog is 10 years, but the sentence for killing a dog is six months or a $500 fine.

Lawrence J Peter
The Peter Principle Revisited (1985)

Guarantees

Is there a new duty on banks?

By Stuart Walker, Lecturer, Faculty of Law, University of Otago

This article is an examination of the principle of the possible liability in tort to a prospective guarantor as set out by Wylie J in Shotter v Westpac Banking Corporation and Villars *[1987] BCL 352. The decision has been queried by Hardie Boys J in* Westpac Banking Corporation v McCreanor *[1988] BCL 234.*

Banks can find themselves liable to their customers for a number of reasons. Lender liability litigation which has flooded Courts in the United States since 1984, and more recently making its impact felt in Australia, is poised to become one of the most important topics in New Zealand banking law in the 1990s.

In England and New Zealand the bank-customer relationship has evolved pretty much in the area of contract law – and indeed, the incidents of that relationship have been quite settled. However, as Courts determine lender liability actions, so too the bank-customer relationship will become subjected to increased scrutiny; proper delineation of the relationship goes hand in hand with correct determination of lender liability actions. Already we are faced with a decision of the High Court of New Zealand which suggests an extension to that relationship.

In *Shotter v Westpac Banking Corporation and Villars* [1987] BCL 352 the Court created a new duty founded in tort:

> A duty of explanation, warning or recommendation of separate advice arises when a bank should reasonably suspect that its customer may not fully understand the meaning of the guarantee and the extent of the liability undertaken thereby or that there is some special circumstance known to the bank which it should reasonably suspect might not be known to the prospective guarantor and which might be likely to affect that person's decision to enter into the guarantee.

The duty is examined in this article.

The Question of General Principle
A bank guarantee is one in which the guarantor promises to be responsible for an obligation of a customer to that customer's bank. It is not a contract *uberrimae fidei* – "of the utmost good faith" – and it is a well-established principle that a bank is generally under no duty to volunteer any information about the guarantee to an intending guarantor. (*Hamilton v Watson* (1845) 12 Cl & Fin 109; 8 ER 1339.) It is for the guarantor to ascertain and assess the risk which is being assumed. (*Seaton v Heath* [1899] 1 QB 782, 792 per Romar LJ.) Of course any questions asked of a bank by an intending guarantor must be answered honestly and correctly. Lord Campbell noted the exception to this general rule in *Hamilton v Watson* (supra at 119, 1344):

> . . . I should think that this might be considered as the criterion whether the disclosure ought to be made voluntarily, namely, whether there is anything that might not naturally be expected to take place between the parties who are concerned in the transaction, that is, whether there be a contract between the debtor and the creditor, to the effect that his position shall be different from that which the surety might naturally expect; and, if so, the surety is to see whether that is disclosed to him. But if there be nothing which might not naturally take place between these parties, then, if the surety would guard against particular perils, he must put the question, and he must gain the information which he requires.

The House of Lords held that the way in which the money to be guaranteed was intended to be applied, did not have to be disclosed to the guarantor prior to execution of the guarantee.

The distinction which was created divides matters known to a bank into two categories.

The first category consists of those matters which cannot be regarded as being unexpected or unusual, and thus do not affect the guarantor's position with regard to giving of the guarantee. Included in this category are matters pertaining to the account-holder's "credit", the account-holder's credit worthiness, whether the account has been operated satisfactorily and whether the account-holder has been honourable in dealings with the bank. Whilst such matters are important for the guarantor to know, they do not need to be disclosed.

The second category is that enunciated by Lord Campbell – any unusual facts or matters in respect of the transaction between the bank and the account-holder which the guarantor would not naturally expect. Often included are matters which would affect the nature and extent of a guarantor's liability. Such matters must be disclosed.

Although there are various formulations of these different categories (see, for example *The Commercial Bank of Australia Ltd v Amadio* (1983) 57 ALJR 358, 360, 361 per Gibbs CJ), and despite attempts which have been made to do away with the distinction created by Lord Campbell[1] the two categories are firmly entrenched in English law. The policy reasons for confining the duty of disclosure to the second category are threefold: Firstly, that to disclose matter pertaining to the account-holder's "credit" would be in breach of a bank's duty of confidentiality; secondly, the amount of information which a bank might have to disclose would be vast; and thirdly, commercial reality tended to dictate against any wider burden being cast on banks.

The *Hamilton v Watson* formulation has been applied extensively in England (*Lloyd's Bank Ltd v Harrison* [(1925) unreported] (cited in *Paget's Law of Banking* 9 ed, 502); *Cooper v National Provincial Bank Ltd* [1946] KB 1.) Australia (*Goodwin v National Bank of Australasia Ltd* (1968) 117 CLR 173; *The Union Bank of Australia Ltd v Puddy* [1949] VLR 242) and New Zealand (*Ward v National Bank of New Zealand* (1884) NZLR 3 SC 45; *National Mortgage & Agency Co of NZ Ltd v Stalker* [1933] NZLR 1182), and whilst later Courts have used differing terminology, the distinction between the two categories has been maintained . . . until recently, when Wylie J in *Shotter v Westpac Banking Corporation and Villars* examined the extent of a bank's duty of disclosure.

The *Shotter* case — the facts

In 1981 Shotter formed a business relationship with a property developer, Villars. They agreed to purchase a property (the Fordyce Road property). The property was purchased in the name of Unicorn Holdings Limited (UHL) which was a company owned by Villars. The intention was that the beneficial interest in the property be shared equally between UHL and Shotter.

A further company Unicorn Developments Limited (UDL) was formed in which Shotter and Villars each had a fifty percent shareholding. UDL was formed to acquire and develop properties for horticultural purposes. UDL signed up to purchase a property at Makerau Valley. To assist with funding the purchase, the bank advanced a temporary loan of $100,000.00 to UHL which was secured by way of a second mortgage over the Fordyce Road property. The bank also required the personal guarantees of Shotter and Villars. The guarantees secured, inter alia:

> . . . all of the moneys already advanced or paid by the bank and ALSO all moneys which the bank shall pay or become liable to pay to for or on one or more accounts of the customer whether alone or on joint or partnership account . . . and notwithstanding that the guarantor shall not have any notice thereof . . . Also all moneys which the Bank has paid or shall hereafter pay or become liable to pay the repayment of which the customer may have guaranteed or may hereafter guarantee to the Bank . . .

The guarantee was expressed to be limited to $100,000.00 together with interest and costs.

The loan was uplifted and passed on by UHL to UDL and the purchase of the Makerau Valley property was completed. Difficulties soon developed and the Fordyce Road property was sold by the first mortgagee. The net surplus after sale of $74,249.00 was paid to the bank. Shotter contended that his maximum liability was $100,000.00 less $74,294.00. The bank did not agree. It claimed the full $100,000.00 because UHL, as a result of other transactions between it and the bank, had an indebtedness close to $500,000.00. Shotter was not involved in those other transactions. In essence the bank argued that the guarantee secured not only the $100,000.00 loan, but also the general indebtedness of UHL to the bank.

In the course of his judgment Wylie J examined the extent of a bank's duty of disclosure to a customer. The question of disclosure was important as Shotter claimed that prior to signing the guarantee the bank should have disclosed to him the other liabilities which UHL had to the bank — such duty arising because the guarantee secured a substantial contingent liability which he did not know about, and which, in any event, he would not naturally expect to exist.

One would have thought that it was perhaps possible to bring the facts into line with the *Hamilton v Watson* second category — that is, there was an arrangement between the parties — UHL and the bank — whereby the nature and extent of the liability being undertaken by the guarantor — that the guarantee also secured another contingent liability — were different from that which the guarantor would naturally expect to exist. But Wylie J felt that such a conclusion was "effectively closed" by the decision of the High Court of Australia in *Goodwin v National Bank of Australasia Ltd* (supra). With respect, Wylie J should not have felt compelled to reach that conclusion.

Goodwin's case

Consider the facts. The bank took from the appellant a mortgage to secure the indebtedness of the appellant's son and daughter-in-law to the bank. In the week prior to execution of the mortgage the appellant's son had, unknown to the appellant, guaranteed to the bank an account of a third person. The appellant alleged that the bank was under a duty to disclose the existence of that guarantee.

Barwick C J asked:

> Could it be said that the existence of such a contract was not something which a person in the position of the appellant in relation to the transaction which I have outlined would not naturally expect?

He concluded:

> . . . it seems to me that the present existence of a guarantee by the principal debtor where the intended guarantee includes the indebtedness of the principal debtor arising out of any guarantee to the bank need not be volunteered by the bank to the intending surety. (p 111)

In these circumstances the decision was correct. The Court was not presented with any facts which showed that the appellant would not naturally expect the guarantee of a third person's account to be in existence when signing the guarantee.

It is perhaps unfortunate that Barwick C J in stating his conclusion, adopted language suggestive of a rule with universal application. Whether there is anything between the parties that might not naturally be expected must surely be set and judged against the particular surrounding facts of each case. Barwick C J's words "which a person in the position of the appellant" become all important.

In any event Wylie J considered that *Goodwin's* case stood as authority for the proposition that a bank is *never* under any duty to disclose to an intending guarantor the existence of a guarantee given to a third party by an account holder. That is unfortunate because on the presented facts it would have been open for the Court to find a duty of disclosure under the second category. As Wylie J noted:

> The bank knew that Mr Shotter was not a director or shareholder of Unicorn Holdings Limited. It should have contemplated the possibility that Mr Shotter would be unaware of that very substantial contingent liability . . .

Given the special circumstances known to the bank, it was possible that Shotter would not naturally expect the existence of the further contingent liability – liability which went to the very heart of the nature and extent of the risk which Shotter was assuming – a liability which should have been disclosed.[2]

One senses that whilst Wylie J felt constrained to strictly apply the precise wording of Barwick C J in *Goodwin's* case, he recognised the inequity of the situation and saw his opportunity to remedy that through the creation of a tortious duty of care in negligence.

Duty to explain

In *Cornish v Midland Bank plc* [1985] 3 All ER 513 the Court was asked to consider whether a bank is under a duty to proffer an explanation or give advice when having a customer sign a mortgage. Only Kerr L J dealt with this matter, and as the case was decided on other grounds his comments are obiter. Kerr L J considered that some remarks made by Sachs L J in *Lloyds Bank Ltd v Bundy* [1974] 3 All ER 757 were relevant. Sachs L J said (at 772):

> With all respect to that submission, it seems necessary to point out that nothing in this judgment affects the duties of a bank in the normal case where it is obtaining a guarantee, and in accordance with standard practice explains to the person about to sign its legal effect and the sums involved.

Of that statement Kerr L J said (at 522, 523):

> . . . it appears to be implicit in this sentence that, at any rate in relation to customers, banks may well be under a duty "in accordance with standard practice", to proffer an adequate explanation to persons about to sign a document in the nature of a guarantee.

He later noted:

> I think that I would have inclined to the view that in the circumstances of this case the bank owed a duty to the plaintiff, as the bank's customer, to proffer to her some adequate explanation of the nature and effect of the document which she had come to sign. If expert evidence had been called as to the standard practices of banks in situations as the present, I think that this would have supported the conclusion that bankers themselves recognise that their proper professional standards would not be consistent with mere silence on their part in such situations.

However when one reads the passages from Sachs L J's judgment which precede and follow that first passage, a very different picture emerges from that extracted by Kerr L J. The full passage is as follows:

> There remains to mention that counsel for the bank, whilst conceding that the relevant special relationship could arise as between banker and customer, urged in somewhat doom-laden terms that a decision taken against the bank on the facts of this particular case would seriously affect banking practice. With all respect to that submission, it seems necessary to point out that nothing in this judgment affects the duties of a bank in the normal case where it is obtaining a guarantee, and in accordance with standard practice explains to the person about to sign its legal effect and the sum involved. When, however, a bank as in this case, goes further and advises on more general matters germane to the wisdom of the transaction, that indicates that it may – not necessarily must – be crossing the line into the area of confidentiality. . . .

What Sachs L J was documenting was the distinction between a normal bank–customer relationship, and one where that relationship becomes fiduciary in nature. Where a bank simply explains a document, this does not in itself create a relationship of a fiduciary nature. Indeed in *National Westminster Bank plc v Morgan* [1985] 1 All ER 821 at 829 Lord Scarman stated

> . . . that in the ordinary course of banking business a banker can explain the nature of the proposed transaction without laying himself open to a charge of undue influence.[3]

It is wrong to regard Sachs L J's comments as describing, or delineating, any duty of explanation by banks. At one point in his judgment Wylie J in *Shotter* accepted this, saying:

> . . . I am not convinced that Sachs L J was expressing the view that there was a duty to explain. He was not, as I read his statement necessarily equating the duties of a bank with the standard practice.

Quite right. But he then went on to say:

> However, in a general way I do not disagree with the conclusion reached by Kerr L J . . . but it is important to note that Kerr L J was not purporting to lay down a general proposition that a bank is always under a duty to explain . . . It must always depend on the facts of the individual case.[4]

Wylie J then formulated his tortious duty of care. Some interesting questions emerge.

The tortious "duty"

The duty espoused by Wylie J requiring "explanation, warning or recommendation of separate advice" arises in two situations.

1 *When a bank should reasonably suspect that its customer may not fully understand the meaning of the guarantee and the extent of the liability undertaken thereby.*

2 *There is some special circumstance known to the bank which it should reasonably suspect might not be known to the prospective guarantor and which might be likely to affect that person's decision to enter into the guarantee.*

Wylie J was careful to preface his comments by stating that whether a duty exists depends on the facts of the individual case: the duty does *not* apply in *all* circumstances. Whilst obviously reluctant to enumerate the instances where the duty would arise, his comments suggest that the relationship of the parties, the knowledge possessed by the bank and above all the relative strength or ability of guarantors to protect their interests in the transaction are the key elements:

> It would be absurd to impose such a duty if the guarantor should be a highly competent commercial lawyer, or other person of business whom the bank knows very well is every bit as familiar with the form of guarantee and risks attached as the bank itself. It will always be a matter of degree and circumstance .... If the matter stopped there I might have hesitated to think that the bank was under a duty to explain the guarantee to him, knowing as it did his experience, his association with Mr Villars, the purpose of the loan, and his trust in allowing Unicorn Holdings Limited to hold in its own name land in which he had a half share.

Notwithstanding Shotter's "experience", Wylie J noted:

> The matter which persuades me that the bank did owe a duty of explanation or warning to Mr Shotter was the fact of the guarantee for $300,000 then recently given ... by Unicorn Holdings Ltd to the other and later unsuccessful enterprise of Mr Villars. The bank ... should have contemplated the possibility that Mr Shotter would be unaware of that very substantial contingent liability.

Whilst Shotter was thus successful in establishing negligence on the part of the bank, the extent that a guarantor's "experience" is relevant in attaching liability under the second situation noted above, is not clear from the judgment.

However, as one considers the exposition of this duty one recalls the comments of Kitto J in *Blomley v Ryan* (1956) 99 CLR 362, 415, on "a well-known head of equity" which applies:

> ... whether one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired facilities, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands.

The well-known head of equity was the jurisdiction of Courts to set aside unconscionable bargains — where one person has taken advantage of another to an extent that "the current morality of the ordinary run of businessmen" (Sheridan, *Fraud in Equity*, p 73) would not allow.

One cannot help wondering whether the equitable remedy of unconscionability covers precisely the situation detailed by Wylie J. If it does, is there a need to have this additional duty, a duty based in tort?

Courts have long had the jurisdiction to set aside unconscionable dealings. The flexible nature of the remedy, and its applicability to new and varied situations is well known. The doctrine has been recently examined by the Privy Council in *O'Connor v Hart* [1985] 1 NZLR 159; [1985] AC 1000, and the New Zealand Court of Appeal in *Nichols v Jessup* [1986] 1 NZLR 226. Whilst it is conceded that even today Courts and Judges vary in their perception and formulation of the doctrine, two essential requirements emerge. First, the existence of a "special disadvantage" of such a nature as to affect the ability of guarantors to protect their own interests. Second, the unconscientious exploitation of that disadvantage.

The Bank-Guarantor relationship

That the principle of unconscionability can be applied where a bank takes a guarantee from a guarantor is established. (See *Owen and Gutch v Homan* (1853), IV HLC 997, 1034-1035 10 ER 752, 767; *The Bank of Victoria Ltd v Mueller* [1935] VLR 642, 649.) Its application in this context was recently considered in the High Court of Australia decision in *The Commercial Bank of Australia v Amadio* (1983) 57 ALJR 358.

The facts

A company had an overdraft with the appellant bank. The company account was a valuable one to the bank. From outward appearances the company had a "face of prosperity" which was maintained by an agreement reached between the company's principal shareholder A and the bank whereby certain cheques written by the company were selectively honoured by the bank so as supplies to the company would not be affected.

The bank required further security for the overdraft and A arranged for his parents to give a guarantee and mortgage over property owned by them. When the documents were signed little discussion took place between the parents and the bank officer who attended to the matter, with the parents showing trust in their son's financial abilities. The bank officer did not explain the documents to the parents, nor give any advice to them as to the nature and extent of the liability which they were undertaking. The parents later argued that the circumstances in which the bank took the guarantee made it unconscionable for the bank to retain the benefit of the guarantee, and applied to have the documents set aside.

The Court considered the application of the two requirements necessary for finding unconscionability.

1 *Special disadvantage*

Deane J said of the guarantors (at 370):

> It is apparent that Mr and Mrs Amadio, viewed together, were the weaker party to the transaction between themselves and the bank . . . the result of the combination of their age, their limited grasp of written English, the circumstances in which the bank presented the document to them for their signature and, most importantly, their lack of knowledge and understanding of the contents of the document was that . . . they lacked assistance and advice where assistance and advice were plainly necessary if there were to be any reasonable degree of equality between themselves and the bank.

The "disability" of the guarantors was in marked contrast to the bank which was a major national financial institution, with full and accurate knowledge of the company's affairs, and which had unilaterally prepared the guarantee documents. The special disadvantage was clearly demonstrated.

2 *Unconscientious exploitation of the disadvantage*

Deane J accepted that the officers of the bank had not been guilty of any "dishonesty or moral obliquity", (at 371) but that did not protect the bank. In all the circumstances, given the guarantors' disability, the bank officer knew, or ought to have known, that as a result of that disability the guarantors required advice. It was not proper for the bank officer to assume such advice had been given, and specific inquiry should have been made of the guarantors to ensure that the nature and effect of the documents had been properly explained to them. In these circumstances it would have been unfair for the bank to be able to rely on the guarantee documents. Accordingly, the documents were set aside.

"Knowledge" became an important factor, and in *Nichols v Jessup* Somers J noted that not only actual but constructive knowledge would be sufficient to establish "unconscionability". (supra, at 30.)

Is there any difference between equitable "unconscionability" and Wylie J's tortious duty to ensure a guarantor understands the meaning of a guarantee and the extent of liability being assumed? The answer is "no".

Firstly, the "special disadvantage" requirement of unconscionability and the "guarantor's ability to protect own interests" requirement in Wylie J's duty involve examination of the same matters. Both look to ascertain whether the guarantor is under any "disadvantage", that is whether the guarantor is properly able to look after his own interests in the particular transaction.

Secondly, the "unconscientious exploitation of the advantage" finding necessary to establish unconscionability has its exact parallel in Wylie J's "should reasonably suspect" requirement. "Knowledge" is critical in both; actual or constructive knowledge of the disability can establish liability in both. *Amadio's* case shows implicitly that where a bank takes a guarantee where it knows or "should reasonably suspect" or "ought to know" that the guarantor is under a "disability" it would be wrong and unfair to allow the bank to be able to rely on the guarantee.

The doctrine of unconscionability has altogether far wider application than Wylie J's tortious duty, but when applied to guarantees, the respective tests are essentially the same; both have their base in the wish to ensure "fairness in bargaining". In essence, unconscionability already encompasses Wylie J's tortious duty.

Is there a need for Wylie J's tortious duty?

There are a number of reasons for suggesting that an additional duty is not needed.

1 Wylie J's duty produces no different result from what can and would properly be achieved under the doctrine of unconscionability. The wider doctrine has had something of a chequered career in New Zealand law but it is still developing, and as the principles behind the doctrine are explored so too its wide-ranging application will become evident. In short, there is simply no advantage in creating another duty founded in tort where the duty is already properly covered at equity.

2 Wylie J states the duty in terms of a bank-customer relationship. On the facts he did not need to consider whether it could apply to a bank taking a guarantee from a non-customer. In any event the doctrine of unconscionability is not confined to any given set of relationships, and indeed that is the proper starting point. A functional analysis comes very much into play. There is every reason for suggesting that banks should be equally liable whether they take a guarantee from a customer or a non-customer; the distinction is really rather illusory — should a person who has a savings account containing $10.00 qualify for better treatment from a bank than a person who does not have an account with the bank? It is thought not. There is no need to *limit* such obligations to the strict bank-customer relationship (See *Royal Bank of Scotland v Greenshields* [1914] SC 259, 271.)

3 If it is found that a guarantee has been obtained improperly, there is no reason to limit a guarantor to merely recovering damages for breach of a tortious obligation. The wider relief, including the setting aside of the document should be available. The equitable doctrine provides that flexibility.

4 Wylie J expresses the test as applying to guarantees. There is no need for such limitation — the doctrine of unconscionability looks to the type of document signed and the nature of the advantage gained by the bank as one factor in ascertaining whether the tests have been satisfied. Admittedly the doctrine will perhaps find its greatest expression where a guarantee is taken because the guarantor will commonly receive no tangible

benefit from the bank in return. But it can and should be applicable to other documents where the bank itself arranges for their execution.

5 The importation of a tortious duty into the bank-customer relationship, a relationship which is essentially contractual in nature, is a proposition which differs from the recent statement of the Privy Council in *Tai Hing Ltd v Lin Chong Hing Bank* [1986] 1 AC 80, 107 by Lord Scarman:

> Their Lordships do not believe that there is anything to the advantage of the law's development in searching for a liability in tort where the parties are in a commercial relationship. Though it is possible as a matter of legal semantics to conduct an analysis of the rights and duties inherent in some contractual relationships including that of banker and customer either as a matter of contract law when the question will be what, if any, terms are to be implied or as the matter of tort law when the task will be to identify a duty arising from the proximity and character of the relationship between the parties, their Lordships believe it to be correct in principle and necessary for the avoidance of confusion in the law to adhere to the contractual analysis . . . their Lordships do not, therefore, embark on an investigation as to whether in the relationship of banker and customer it is possible to identify tort as well as contract as a source of the obligations owed by the one to the other. Their Lordships do not, however, accept that the parties' mutual obligations in tort can be any greater than those to be found expressly or by necessary implication in their contract.

Whilst these words have provoked considerable comment from proponents of concurrent "contract-tort" law, the last sentence in this passage is of the utmost importance — that the obligations in tort will be no greater than those in contract. Given the established non-*uberrimae fidei* contractual status of guarantees, Wylie J's duty faces some formidable obstacles.

6 The doctrine of "unconscionability" is ideally suited for regulating the activities of banks. Banks are usually large institutions, and will more often than not have pre-prepared set forms of security containing extremely complex wording. That they invariably fit into the "dominant party" role, with those with whom they deal being the "weaker party", is only to be expected.

Given the existing equitable doctrine of unconscionability, with its established body of judicial comment, there is seen to be no need to persist in attempting to develop a further duty based in tort of the nature suggested by Wylie J. There is, in short, no need to reinvent the wheel.

Judicial comment

The decision in *Shotter* has drawn comment from Hardie Boys J in *Westpac Banking Corporation v McCreanor* [1988] BCL 234. More judicial comment is likely.

Westpac involved an application for summary judgment for moneys alleged to be owing pursuant to a guarantee. The defendant, raising a defence of equitable set-off, alleged that at the time he signed the guarantee the bank owed him a duty of disclosure — a duty which arose not only in an ordinary creditor-guarantor situation, but also (based on the *Shotter* decision), in tort. Hardie Boys J, after reviewing the cases in this area noted of *Shotter*:

> I have difficulty in accepting that by invoking a tortious duty of care the Court should negate the very clear line of authority based on equitable principles that a Bank is under no duty to explain, except in the circumstances described in *Hamilton v Watson* and the authorities that have followed it . . . . Thus with great respect I cannot agree with the conclusion reached by Wylie J in the Shotter case . . . [there is then set out the tortious duty of care].

In *Shotter*, Wylie J did not think that his new tortious duty conflicted in any way with the *Hamilton v Watson* principle, saying that the case of *Goodwin v The National Bank of Australasia Ltd* (which followed *Hamilton v Watson*) concerned "an alleged duty of disclosure, breach of which would have been tantamount to a misrepresentation vitiating the contract. Negligence was not an issue in that case." With respect that is not the point. Both rules relate to the same subject matter. The limited *Hamilton v Watson* duty applies to all guarantees, and is established as a necessary incident of the bank-guarantor relationship — that rule provides for disclosure in some circumstances and not in others. It is implicit in Wylie J's judgment that in those cases where the rule does not apply it is permissible for a Court to apply the tortious duty to see if liability can be established. With respect this is not acceptable and it is suggested that Hardie Boys J was correct in refusing to apply Wylie J's wider tortious duty of care.[5]

Hardie Boys J makes no mention of the principle of unconscionability. Of course, the application of that principle does not upset the *Hamilton v Watson* principle, for as Mason J commented in the *Commercial Bank of Australia v Amadio* (supra, at 364) application of the principle of unconscionability in this area ". . . involves no contradiction of the well-entrenched proposition that a guarantee is not a contract *uberrimae fidei* . . ." and the traditional limited duty of disclosure established by the cases ". . . has no bearing on the availability of equitable relief on the ground of unconscionable conduct." It is the doctrine of unconscionability which the Courts can, and indeed should, superimpose on the bank-guarantor relationship to ensure that banks do not unconscientiously take advantage of guarantors unable to protect their own interests.

The future

In this age of developing consumerism the laissez-faire non-interventionist morality evident in *Hamilton v Watson* is arguably quite out of place. Reform in this area is required — reform to correct a law which has been described as being "manifestly unjust".[6] The correct and dedicated application of the equitable principle of unconscionability will overcome many of the injustices which now

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Mortgagee sales (II): Duty of care to mortgagor

By S Dukeson, an Auckland practitioner

This is the second of three related articles concerning mortgagee sales. In this article the author looks particularly at the duty of care that is owed to the mortgagor as well as for Guarantors and others. The final article will give special attention to the standard form of Particulars and Conditions of Sale.

The author wrote this article, an earlier one published at [1988] NZLJ 268, and one that will be published next month, early in 1988 while he was in practice in Whangarei and before he moved to Auckland where he is now practising. The only alterations that have been able to be made have been references to a few recent cases, some of which have justified the interpretations the author anticipated.

General nature of duty of care

One could be forgiven for thinking that as the mortgagee and the mortgagor are in a contractual relationship, the law of contracts should govern their conduct and that any obligations which the mortgagee might have in regard to exercise in a power of sale should be purely contractual.[1]

There are two reasons why this is not so. The first is historical. The power of sale was apparently an equitable creation. (Tyler, "Enforcing Mortgagee Securities" (1981) 55 ALJ 559, 567) The equitable concept of good faith (deriving from the equitable doctrine of fraud on a power) was the yardstick by which the mortgagee's conduct was judged, this being superimposed on the contractual relationship.

Secondly, the modern trend, both with respect to company receivers and mortgagees, has been to impose a tortious duty of care to obtain the best price reasonably obtainable for the property in the circumstances.[2] Although it was only assumed (because no argument was made on the point) in *Alexandre v New Zealand Breweries Limited* [1974] 1 NZLR 497, that the mortgagee owes this tortious duty of care, the point has been affirmed by the Privy Council – *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349.

Applicability of the general duty of care in relation to Registrar's sales

Becauses cases like *Tse Kwong Lam* (supra) do not concern Registrar's sales, one of the vogue issues at the present time is whether the mortgagee owes a duty of care when selling through the Registrar. The question is whether there are any reasons why the same duty of care that applies to private sales should not apply to Registrar's sales. In my view, there are none.[3] Having said that, the scope for the duty to operate in the context of Registrar's sales is probably narrower because the mortgagee has less discretion when selling through the Registrar.

So far as I am aware, two main arguments have been advanced to support the proposition that a mortgagee selling through the Registrar may not be under a duty of care to the mortgagor. First, it has been suggested that any duty of care would be modified by the wide discretion given to the mortgagee in fixing the redemption price, (Hinde, McMorland and Sim, *Introduction*, op cit, para 8.129.) The suggestion has some force if it simply means that, because the mortgagee has a statutory right to buy in at the redemption price, the mortgagor cannot *necessarily* complain if this is what in fact occurs. However, the suggestion should not be taken too far.

For one thing, to focus on the redemption price is to focus on only one aspect of sales through the Registrar. Consider the position where the mortgagee's advertising is deficient in some way. (The question of advertising is considered shortly.) As a result, few purchasers attend the auction and bidding is low. For one reason or another, the mortgagee considers that it is necessary to buy in at the redemption price. If the mortgagor can show that a better price would have been obtained had the advertising not been deficient, the mortgagor may well have an action against the mortgagee in negligence. In my view, if the mortgagee acts negligently, the fact that he has exercised his statutory right to buy in at the redemption price will not, of itself, protect him.

For another thing, the redemption price is not of universal relevance in relation to the price obtained. Though the redemption price might influence bidding by third parties, it is essentially irrelevant if a third party buys in.

Secondly, it has been suggested that because the Registrar has "absolute control" of the sale procedure, the mortgagee cannot be liable except in the case of fraud. (See Myers CJ in *Public Trustee v Wallace* (supra), at GLR p 258-259.) However, this suggestion is, to some extent, misconceived. The Registrar has absolute control in terms of what directions he is prepared to give and in terms of approving "proper" Particulars and Conditions of Sale. But there are matters which are beyond his control such as the contents of the mortgagee's advertisements. (The question of advertising is considered in more detail shortly.)

If the existence of a duty is accepted, the main reason for the popularity of Registrar's sales (ie safety) disappears and Flaws conclusion that the Registrar's sale is an overworked concept must be correct. "Mortgagees and Registrars Sales" [1986] NZLJ 266, 268 Cf Adams [1972] NZLJ 139.

Specific aspects of duty in relation to private and Registrar's sales

If the mortgagee is under the same general duty of care with respect to both Registrar's sales and private sales how might the mortgagee breach that duty in relation to each type of sale?

(a) *Private sales and obtaining a "proper" price*

With respect to private sales in particular, one often sees statements to the effect that the mortgagee must obtain the "market price" or a "proper price" or a "reasonable price". In themselves, these terms are probably unobjectionable, but it is in defining and applying them that difficulty arises. In this respect, it is submitted that some statements in the literature should be viewed with suspicion.

For example, the *Legal Practice Manual* states that once the mortgagee has obtained a valuation of the property, the mortgagee should set a reserve at the valuation. (Vol 2, p 3.11.3, 3.11.7) But the mortgagee is not a trustee for the mortgagor. The mortgagee must have the right to realise the property without being unreasonably hindered. As Hinde, McMorland & Sim state, the mortgagee's duty is "to take reasonable precautions to obtain [the best price reasonably obtainable] although not necessarily in fact to obtain it".[4]

Accordingly, while there may be circumstances in which it might be appropriate for the mortgagee to set a reserve, I do not believe that it should be a rigid requirement or that any reserve should be necessarily set at "valuation". If there is little interest in the property, and if the mortgagee has done all that he can to obtain the best price reasonably obtainable in the circumstances, it cannot be doubted that the mortgagee can sell at a figure less than "valuation". In such circumstances, the valuation figure would not represent the "market price".

The *Legal Practice Manual* also states that having set a reserve, it would be possible for the mortgagee to force the price up so that the reserve is at least met. (Vol 2, p 3.11.3) However, this assumes that there is an active market. If there is little interest in the property, there will not be much that the mortgagee can do to force the bidding upwards.

Thus, the use of terms such as "the market price" and "a fair and proper price", though not necessarily objectionable, is not particularly helpful.[5] I believe that practitioners would benefit more from recognising that the steps taken by the mortgagee in the exercise of the power of sale are more important in many respects than the end result and, as will hopefully be demonstrated, this applies in the context of Registrar sales as well as private sales. The requirement is only to obtain the best price reasonably obtainable in the circumstances.

Also of relevance in this context is the question whether appraisals by real estate agents might not be more appropriate than valuations. What is at stake is a determination of the "market value" of the property in the particular circumstances. I doubt the value of placing any particular emphasis on obtaining valuations and incline towards the view that competent real estate agents may be better judges of what a willing purchaser would be likely to pay for the property in the circumstances.

I suggest that a mortgagee can sell, privately, below valuation if the mortgagee has taken reasonable steps to obtain the best price reasonably obtainable in the circumstances. I think that this is borne out by what Salmon LJ had to say in *Cuckmere Brick Co v Mutual Finance Limited* [1971] 2 All ER 633, 643.

(b) *Advertising*

In the context of a private sale by auction, the mortgagee will breach his duty of care if he has not given sufficient notice of the auction or has not sufficiently advertised the property in terms of the number of advertisements placed, or in terms of the areas in which the advertisements are circulated, or in terms of the contents of the advertisements.[6]

Sheard asserts that, with respect to Registrar's sales, there may be cases where the mortgagee should advertise nationally and that if the mortgagee does not, the mortgagee may breach his duty of care to the mortgagor notwithstanding that he has complied with the Registrar's directions as to advertising. (1985) 4 BCB 9, 11. This raises the question of whether the Registrar can direct the mortgagee to engage in such advertising and if the Registrar cannot or does not, whether the mortgagee can (or should) "unilaterally" engage in such advertising (and recover the costs thereof).

Section 99(2) of the Property Law Act 1952 requires the Registrar to:

(a) Fix a convenient time . . . and a convenient place for the conduct of the sale; and
(b) Give written notice . . . of the time and place at which the sale is to be conducted . . .; and
(c) Give such notice of the sale by advertisement in newspaper circulating in the neighbourhood as he considers sufficient; and
(d) Approve of proper conditions of sale, employ an auctioneer, and do all other things necessary for the proper conduct of the sale.

Because s 99(2)(c) only directs the Registrar to give directions as to local advertising, any duty on the part of the Registrar to direct the mortgagee to engage in more extensive advertising would have to derive from s 99(2)(d). Would such a direction be "necessary for the proper conduct of the sale"? It might be desirable but I doubt whether it could ever be said to be "necessary".

I make this comment for two reasons. First, it is arguable that because s 99(2)(c) specifically addresses the question of advertising, the reference to "necessary" acts in s 99(2)(d) is not intended to embrace advertising. Secondly, the Registrar is not in a position to determine what is "necessary" in the context of advertising. He is not an expert on marketing or selling realty.

It has been suggested that the Registrar can accept suggestions from the mortgagee when determining what directions to give[7] so that it might be argued that the Registrar could direct the mortgagee, at the mortgagee's request, to engage in extensive advertising. However, this does not overcome the Registrar's difficulty of having to determine what directions are "necessary" for the purposes of sale. At best, the necessity of extensive advertising could only be determined retrospectively.

It could be argued that what is "necessary" has to be determined in the light of the mortgagee's overall duty of care ie that the Registrar should give appropriate directions if extensive advertising is a necessary step in the mortgagee's quest to fulfil his duty of care. However, s 99(2) was not drafted on the basis that the mortgagee owes a duty of care to the mortgagor. At that time, the Courts had not begun applying tortious duties to receivers and mortgagees when exercising their powers of sale.

Accordingly, I have my doubts as to whether the Registrar can direct the mortgagee to advertise other than as specifically stipulated in s 99(2).

The question remains whether the mortgagee can unilaterally engage in extensive advertising if the Registrar cannot (or will not) give appropriate directions. In my view, the answer should be yes if it is accepted that the mortgagee is under a duty of care to obtain the best price reasonably obtainable in the circumstances and that the Registrar does not have absolute control of procedure. After all, the fact that the Registrar does not have absolute control of procedure is what makes it appropriate, in my view, to regard the mortgagee as being under a duty of care when selling through the Registrar. The corollary is that if the mortgagee does not advertise widely, he may be held to have breached his duty of care. (The reopening/oppression provisions of the Credit Contracts Act 1981 may even have some application.)

Nevertheless, as recent debate on these issues demonstrates, the position can hardly be said to be certain as a matter of law. If, as I believe should be the case, the mortgagee should be regarded as being under a duty of care when selling through the Registrar, there should be some guidance or indication as to what steps a mortgagee should be able (or should be expected) to take to fulfil that duty. The position of the Registrar should also be certain. The Property Law Act 1952 should be amended to enable the Registrar to give appropriate directions as to advertising (whether on his own initiative or on the mortgagee's request) and/or to make it clear that a mortgagee may take such steps (additional to those directed by the Registrar) as a prudent mortgagee should take to obtain the best price reasonably obtainable for the property in the circumstances.

I agree with Sheard that there are other circumstances in the context of advertising where the mortgagee could be held to have breached his duty of care to the mortgagor even when selling through the Registrar.[8] I believe that the mortgagee has (or should have) a duty, irrespective of what method of sale is adopted, to couch advertisements in such manner as is likely to produce the best possible price reasonably obtainable in the circumstances. A case like *Cuckmere Brick Co v Mutual Finance Limited* [1971] 2 WLR 1207, should therfore apply equally to Registrar's sale as to private sales. (Cf Adams [1972] NZLJ 139.) In that case, the mortgagee was held to be liable in negligence to the mortgagor because of the mortgagee's failure to ensure that readily available or ascertainable information as to planning permission was included in the advertisements. It was held that the price obtained would, most likely, have been greater had that information been included.

(c) *Auctions*

With respect to private sales there is always the question as to whether an auction is the best form of sale and whether the mortgagee will be deemed to have fulfilled his duty of care if he has sold by auction. (Butt (1982) 56 ALJ 39, 40 – 41) This is obviously a practical matter. For example, it may be that a better price could be obtained if the property is listed with a number of real estate agents and if there is the opportunity to negotiate by private treaty. It may even be that the mortgagor will be more co-operative with respect to a private sale.

What is the position of a mortgagee who sells through the Registrar to avoid having to decide whether a private sale or a private auction is the best alternative? If the mortgagee owes a general duty of a care irrespective of whether he sells privately or through the Registrar, and if it becomes clear that a sale by private treaty would have, foreseeably, produced the best price reasonably obtainable for the property in the circumstances, could it not be argued that the mortgagee has been negligent by opting for the Registrar's sale? I do not see why not provided that the normal negligence tests can be satisfied. In my view, the mortgagee's position should be looked at in global terms, not just in relation to the type of sale opted for. I recognise that this argument will seem heretical to many and that it may well call into question the sanctity or even usefulness of Registrar's sales particularly if the mortgagee does not wish to buy in. However, it is an issue which I think should be addressed. There should be no soft options for mortgagees once it is accepted that a duty of care exists.

(d) *Private sales by receivers and by mortgagees to parties with whom or in which the mortgagee has a personal interest*

With respect to private sales, questions arise as to whether a receiver appointed by a mortgagee could sell to the mortgagee and whether the mortgagee could sell to a company or group of people in which or with whom the mortgagee is interested.

There seems to be some doubt as to whether a receiver could sell to the mortgagee.[9] However, if the receiver is the mortgagor's agent, such a sale would be by the mortgagor and not the mortgagee and should be unobjectionable.[10] The re-opening/oppression provisions of the Credit Contracts Act 1981 might provide something of a check if the mortgagee has exercised the right to appoint a receiver in an oppressive manner.

There is no hard and fast rule that the mortgagee cannot sell to a company or group in which or with whom he has an interest.[11] It will depend on the facts whether such a sale can be impugned or not. Some Courts have used the notion of an "independent bargain". Sykes states that this term means "independent of the mortgagee or his influence". (p 111, 114) However, the term might be better interpreted to mean that the transaction should be "bona fide" or "at arm's length". The latter use of the term seems to accord with the comments of the Privy Council in *Tse Kwong Lam v Wong Chit Sen* (3 All ER 54 PC at p 59 per Lord Templeman) where the emphasis was said to be on the mortgagee acting in good faith and obtaining the best price reasonably obtainable in the circumstances.

The precise meaning of the term is of considerable importance. For example, a sale by a company to its subsidiary seems to me to be more likely to be impugned, notwithstanding the principle of separate legal entity, if the sale has to be independent of the mortgagee or his influence than if the main criterion is obtaining a "proper" price in good faith.

There seems to be a general principle that the mortgagee must use the power of sale honestly (Hinde, McMorland & Sim, op cit, para 8.127, fn 7) though I am uncertain what this principle would add to the modern tortious duty.

(e) *Conclusions*
It is submitted that the mortgagee should be considered to be under a duty of care irrespective of whether the sale is private or through the Registrar. Examples have been given as to how the mortgagee may breach that duty of care in both contexts. However, save for the kinds of actions or omissions referred to (by way of example), it is also submitted that it should generally be difficult to establish a breach of duty simply because the mortgagee has obtained a lesser price than the mortgagor thinks fit or, in the context of a private sale, than has been suggested by a registered valuer. (Butt (1979) 53 ALJ 172, 181) The mortgagee's interest must prevail over the mortgagor's.

The mortgagee's duty of care cannot be considered in vacuo. On the one hand, it is possible at least to modify the mortgagee's duty of care by contract. Most mortgages attempt to do this to some extent. On the other hand, there are some checks on this. Exclusion and limitation clauses are construed strictly and s 5 of the Contractual Remedies Act 1979 may have to be considered. There is also the statutory overlay of the re-opening/oppression provisions of the Credit Contracts Act 1981.

In general terms, the nature of the mortgagee's duty of care could be resolved by legislation. It would appear that some of the Australian States have legislated the mortgagee's duty of care although I do not know how successful the legislation has been. (Sykes, p 271) One advantage of a properly couched statutory duty would be that the mortgagee would not be able to contract out of it. This might give rise to a greater use of attorney and receiverships, depending, in the case of receivership clauses, on whether receivers are placed under the same duty of care to mortgagors as are mortgagees.

Duty of care to guarantor and subsequent mortgagees and creditors
The same duty of care that is owed by the mortgagee to the mortgagor is also owed to guarantors (*Standard Chartered Bank v Walker* [1982] 1 WLR 1410 followed in *Clark v UDC Finance Limited* [1985] 2 NZLR 636) and to subsequent encumbrancers.[12] With respect to subsequent encumbrancers, note that the duty is not to act as their protector or insurer but simply to obtain the best price reasonably obtainable in the circumstances having regard to the fact that there are other interested parties. One aspect of the tortious duty of care is that it might eventually spread to creditors other than subsequent encumbrancers. In the company context, directors may owe a duty of care to general creditors in some circumstances.[13] Though it seems unlikely at present, it may be that company receivers will eventually be deemed to owe duties to general company creditors. (Cf *Re B Johnson & Co (Builders) Limited* [1955] If the law develops in this way, it may be the mortgagees will eventually have a duty to unsecured creditors.

Redemption Price
Interpretation of ss 99 and 100 Property Law Act 1952
I believe that some practitioners at least are somewhat mystified by the concept of the redemption price and that there are probably many practitioners who have not given much thought to how s 100 of the Property Law Act 1952 should be interpreted. I believe that redemption prices are often calculated on the basis of incorrect assumptions. I would therefore like to consider these issues in some detail and to approach s 99 and 100 of the Property Law Act 1952 as if they were new statutory provisions.

Section 99(1) of the Property Law Act 1952 states that the mortgagee must, in his application to sell, "state the price (. . . the redemption price) at which the Mortgagor may redeem the land to be sold". Section 100 reads as follows:

> Mortgagor may redeem at redemption price — At any time before the sale the mortgagor may pay to the mortgagee either the redemption price of the land or the amount due and owing under the mortgage, *together with the expenses already incurred by the mortgagee in connection with the intended sale, and any moneys expended by him on or about the land subsequently to the time when he fixed the redemption price in his application for sale*; and on such payment the mortgagee shall do the acts required by clause (10) of the Fourth Schedule to this Act:

Clearly, the redemption price is (or can be) something different to the amount due and owing under the mortgage. It is the redemption price which has to be stated in the mortgagee's application (which of course may be calculated on the basis of the amount due and owing under the mortgage). The mortgagee has an absolute discretion in fixing the redemption price. (Hinde, McMorland & Sim, op cit, para 8.1.32 citing *Wellington City Corporation v Government Insurance Commissioner* [1938] NZLR 308; Cain [1961] NZLJ 94, 95) Thus, the mortgagee could in theory set an extremely high or an extremely low redemption price. As the mortgagor can never be required to redeem at an amount greater than that due and owing under the mortgage, the mortgagee can only be penalised by fixing too high a redemption price ie if the mortgagee buys in, he will have to pay in cash the equivalent to the difference between the redemption price and the amount due and owing under the mortgage. Conversely, there may be good reason to set a low redemption price eg the value of the land may be less than the amount due and owing under the mortgage.

Before one can attempt to set a redemption price, one must first make sense of s 100 particularly in so far as it makes a reference to expenses already incurred by the mortgagee in connection with the intended sale and moneys subsequently expended by the mortgagee on or about the land. Does this reference relate back to the redemption price or to the amount due and owing under the mortgage? The latter would, at first sight, seem unlikely because it is unnecessary. It has been the law for some time that the mortgagee may recover the kinds of expenses referred to in s 100 as "just allowances". (Garrow, *Law of Real Property*, 4 ed, p 513.)

If the reference to expenses relates to the redemption price, it would follow that the redemption price should be less than the amount due and owing under the mortgage. This is because the mortgagor can never be obliged to pay an amount greater than that due and owing under the mortgage and that, as has been stated, would generally include such expenses. Accordingly, the redemption price plus expenses should never exceed the amount due and owing under the mortgage.

This could have some logical appeal because it is difficult to see why any mortgagee would want to set the redemption price at an amount greater than that due and owing under the mortgage.

Again, if the reference to expenses in s 100 relates to the redemption price, it might suggest that the redemption price should be set at the date of application ie because subsequent expenses would be recoverable in terms of s 100 without having to be included in the redemption price. This could also have some logical appeal because it would avoid the need to anticipate and estimate future expenses when setting the redemption price.

The difficulty with this analysis is that if the redemption price is set at the amount due and owing under the mortgage as at the date of application, no provision is made for interest which will accrue under the mortgage between the date that the redemption price is set and the date of sale. Interest is not an "expense". It must be included in the redemption price because the mortgagor is entitled to redeem at the redemption price or the amount due and owing under the mortgage at the time of redemption, *whichever is less*. If interest is not included in the redemption price, the mortgagor could redeem exclusive of interest thus forcing the mortgagor's personal covenants to recover any shortfall. Such covenants can be of little value.

Accordingly, because the redemption price is (or can be) something different to the amount due and owing under the mortgage, and because the mortgagee has an absolute discretion in fixing the redemption price, the conclusion must be that the reference in s 100 to expenses relates to the amount due and owing under the mortgage. The mortgagor can therefore redeem either at the redemption price or at the amount due and owing under the mortgage including the expenses referred to in s 100, whichever is less.

The redemption price should be calculated at the estimated sale date (ie auction date) and if the value of the land will stand it, on the basis of the amount of principal and interest that will be due as at the estimated sale date together with the expenses which will have been incurred by that date (provided they are properly recoverable in terms of the mortgage and s 104(a)(b) of the Land Transfer Act 1952).

Functions of the redemption price

Before referring to some items which are commonly included in redemption prices, it might be worthwhile to briefly refer to the different functions of the redemption price. It is only by understanding the functions of the redemption price that a solicitor can correctly decide what items should be included in the redemption price. There are three identifiable possible functions of the redemption price. The first is the statutory function of informing the mortgagor of an amount which the mortgagor must pay to the mortgagee to prevent a sale. The second function, which is largely reconcilable with the first, is to state the amount which the mortgagee must give the mortgagor credit for if the mortgagee buys in. These functions are reconcilable because on the one hand, the redemption price should only contain (at most) those amounts which the mortgagor will be liable to pay to the mortgagee under the mortgage as at the date of sale (ie as if the mortgagor leaves redemption until the last possible moment) and on the other hand, if the mortgagee buys in, the mortgagee would not want to have to give the mortgagor credit for any unnecessary amounts (either because the mortgagee will not want to have to pay cash to the mortgagor if the redemption price exceeds the amount due and owing under the mortgage or because the mortgagee may want to reserve his right to sue the mortgagor on the mortgagor's personal covenants).

The third possible function of the redemption price, sometimes adverted to, is to advise third parties of the minimum price that they must pay in order to obtain the property. (See for example Hinde, McMorland & Sim, para 8.132.) However, this is a defacto function and is not necessarily reconcilable with the first and second functions outlined above. This is because in pursuit of this function, the mortgagee could be tempted to include all possible costs in the redemption price (and to estimate the amount of those costs on the generous side) in the hope that the minimum bid by a prospective purchaser will cover all estimated costs. If the mortgagee sets the redemption price on the high side and then finds that he is forced to buy in for some reason, he will have to pay to the mortgagor the difference between the redemption price and the amount due and owing under the mortgage. Accordingly, if the mortgagee wants to ensure that all costs are covered in a sale to a third party, the mortgagee should try to force the bidding up rather than to set an excessive redemption price.

Specific items in the redemption price

Bearing in mind the primary functions of the redemption price, what items should be included in the redemption price?

(a) *Rates*

One often sees an apportionment of rates in redemption prices. However, unless the mortgagee has actually paid rates or will (have to) pay rates prior to sale rates are, strictly speaking, irrelevant to the redemption price. At no stage prior to sale will they become amounts due and owing under the mortgage so at no stage will they be "recoverable" from the mortgagor. Nor, in the circumstances, is there any point in giving the mortgagor credit for them if the mortgagee is going to buy in. (Cf Hinde McMorland & Sim, para 8.133; Cain [1961] NZLJ 105.)

Subject to comments made in the next paragraph, if the mortgagee will pay rates prior to sale, the full amount of those rates should be included in the redemption price not just an apportionment. If the mortgagor offers to redeem, the mortgagee will want to recover the full amount of the rates paid.

The mortgagee could take a mercenary approach in calculating the redemption price (not only with respect to items such as rates but also with respect to other items). If the mortgagee is fairly sure that he will be able to buy in, and if rates will have to be paid prior to sale, the mortgagee might prefer not to include rates in the redemption price so as to preserve his right to sue the mortgagor for the rates (and any other items not included in the redemption price but which might otherwise be recoverable from the mortgagor). As the mortgagee has an absolute discretion in fixing the redemption price he must have the right to take this approach![14] On the other hand, at least in theory, if the mortgagee does not include the rates in the redemption price, the mortgagor may find it easier to redeem and if he does so, the mortgagee will be faced with releasing his security (without the benefit of having bought in) and having to sue the mortgagor to recover the rates.

(b) *Insurance premiums and solicitor's costs*

Similar comments apply with respect to insurance premiums and legal costs. Generally, all legal costs which will be incurred prior to sale should be estimated as at the sale date and included in the redemption price. I do not believe that truly contingent costs should be included particularly if there is any suggestion that the mortgagee might buy in. If the redemption price is greater than the amount due and owing under the mortgage because it includes contingent costs not yet incurred, and if the mortgagee buys in, he will have to pay the mortgagor the difference between the redemption price and the amount due and owing under the mortgage.

It is probably worth emphasising at this stage that the redemption price is not relevant when the mortgagee sells to a third party. If a sale to a third party is contemplated, the mortgagee's goal will be to obtain a sufficient price to cover (at least) all the amounts due and owing under the mortgage not only as at the date of sale but also as at the date of settlement. For example, assuming that the mortgagee has not paid rates prior to sale, the mortgagee will have to pay a share of rates on sale (as with any conveyancing) and will want to recover his share of rates from the sale proceeds. To the extent that some legal costs will be incurred after the auction but prior to settlement of the sale (eg lapsing caveats), the mortgagee must have estimated those costs before going to the auction so as to know what bid is required to cover all likely costs. Provided that the price is achieved, the expenses of sale and all amounts properly due and owing under the mortgage can be deducted from sale proceeds before paying any surplus to subsequent encumbrancers or the mortgagor. (See s 104(a), (b) Land Transfer Act 1952 and Garrow, *Law of Real Property*, 4 ed, p 513-517; Hinde, McMorland & Sim, para 8.136.)

(c) *Registrar's and Auctioneer's commissions*

The Registrar's commission is, strictly speaking irrelevant to the redemption price. (Cf Hinde, McMorland & Sim, para 8.133.) No commission is payable if there is no sale so that at no stage will the mortgagor have to pay commission to redeem. Remember that the primary function of the redemption price is to advise the mortgagor of the amount required to redeem and the amount due and owing under the mortgage marks the ceiling of the mortgagor's liability to pay. Further, if the mortgagee buys in, the Registrar's commission is assessed on the redemption price. The Registrar should not be given the bonus of assessing his commission on the basis of a redemption price which already includes an amount for the Registrar's commission.

Because the mortgagee has an absolute discretion in fixing the redemption price, the mortgagee could include the Registrar's commission in the redemption price. The consequence of doing so, if the mortgagee buys in, is that the mortgagee would have to give the mortgagor credit for the commission and could not sue the mortgagor for it.

The position is more or less the same with respect to the auctioneer's commission. The general recommendation is that only the withdrawal fee be included in the redemption price (provided the auctioneer will agree to this). There are at least two reasons for this. First, the withdrawal fee is all that the mortgagor will have to pay to redeem if the sale does not take place (ie in regard to the auctioneer's fee). Secondly, if the mortgagee buys in, the Registrar's commission will be based on the redemption price and the redemption price will be greater than it should be if it includes auctioneer's commission based on anything other than the withdrawal fee.

(d) *Prior mortgages*

Flaws states that the right of redemption given to subsequent encumbrancers by s 83 of the Property Law Act 1952 enables subsequent mortgagees to include the amounts of prior mortgages in the redemption price ([1986] NZLJ 266, 267) and that it is sensible to include the amounts owing under prior mortgages in the redemption price on the basis that by repaying prior mortgages, the subsequent mortgagee can sell a clear title. It is, therefore, only where the mortgagee will pay off prior mortgages before sale that the amounts of the prior mortgages will be relevant to the redemption price.

Though it may be labouring the point, it might be useful to consider a number of possible situations. The first is where the mortgagee intends to sell subject to prior mortgages and does not therefore intend to repay these mortgages. The prior mortgagees might (unusually) be prepared not to call up their mortgages or the mortgagee who is selling might intend to leave it to the purchaser to pay off the prior mortgages. In these circumstances, the amounts owing under the prior mortgages are not (strictly speaking) relevant to the redemption price. The amounts, not having been paid, are not due and owing under the mortgage under which the power of sale is being exercised and the mortgagor cannot be required to pay these amounts to the mortgagee if he wishes to redeem. Nor would the mortgagee want to give the mortgagor credit for the amounts owing under the prior mortgages if he buys in. No useful purpose is served by including these amounts in the redemption price in these circumstances.

The second situation is where the mortgagee intends to repay the prior mortgages prior to sale (irrespective of whether he intends to buy in or to sell to a third party). Here, the amount of the prior mortgages should be included in the redemption price. These amounts, once paid by the mortgagee, are deemed to be due and owing under the mortgage and are recoverable from the mortgagor. (Clause 12 of the Fourth Schedule to the Property Law Act 1952.)

If the mortgagee intends to buy in, he may not want to include prior mortgages in the redemption price. He may want to preserve his right to recover these amounts from the mortgagor. There is no doubt that a mortgagee can calculate the redemption price exclusive of these amounts. The mortgagee has an absolute discretion in this regard. However, it is at least arguable that by calculating the redemption price in this way, and by attempting to recover the amount of the prior mortgages from the mortgagor, the mortgagee could be deemed to be acting oppressively in terms of the Credit Contracts Act 1981. The mortgagee would be attempting to obtain the property at the cost of his mortgage.

The third situation is where the mortgagee only intends to purchase prior mortgages if he secures a sale to a third party. The prior mortgages will be purchased some time between the sale and settlement dates. In these circumstances, the amounts secured under the prior mortgages are not relevant to redemption price and should not be included. The mortgagor does not have to pay these amounts to redeem (if he is in a position to do so before sale) and the redemption price is irrelevant in the case of a sale to a third party. The mortgagee's primary concern will not be with the redemption price but to ensure that the price obtained is sufficient to cover (at the very least) all the amounts secured under the mortgage including the amounts secured under the prior mortgages.

Even if the mortgagee buys in under the circumstances outlined in the previous paragraph, the amount of the prior mortgages will be irrelevant to the redemption price. As the prior mortgages will not be repaid until after sale, the mortgagor is under no obligation to pay the amounts of the prior mortgages to the mortgagee if the mortgagor wishes to redeem. Further, the mortgagee will not want to give the mortgagor credit for these amounts unnecessarily.

Note that s 104 of the Land Transfer Act 1952 prohibits the mortgagee from repaying prior mortgages from sale proceeds. If the mortgagee wishes to purchase prior mortgages, he must do so with recourse to other funds and then reimburse himself from sale proceeds.

Should the mortgagee repay prior mortgages?

As Flaws has suggested (p 267), a clear title may serve as something of a carrot to prospective purchasers. However, so long as the eventual purchaser realises that the prior mortgages have to be repaid by *someone* to obtain clear title, it should not matter to the purchaser whether the mortgagee or the purchaser repays the prior mortgages. In either case, the outlay by the purchaser should be substantially the same and the end result would be that clear title is obtained![16]

Cain suggested that there is no advantage to a second mortgagee in selling through the Registrar if a prior mortgage contains a provision requiring the principal sum to be repaid in the event of a transfer by the mortgagor unless the second mortgagee has sufficient funds in hand to pay off the prior mortgage or can persuade the prior mortgagee to allow a transfer to be registered. ([1959] NZLJ 93.) However, it would seem to me that equally there would be no disadvantage in selling through the Registrar. In my view, whether the mortgagee who is selling is a first or subsequent mortgagee has no real bearing on what method of sale should be adopted.

A word might be said about prior mortgages and private sales. The *Legal Practice Manual* states that it may be preferable for a subsequent mortgagee to sell privately so that a reserve price can be set which will include the amount of prior mortgages. (Vol 2, p 3.11.3) However, unless the mortgagee intends to repay prior mortgages before the settlement of the sale (and to reimburse himself from sale proceeds), the amount owing under prior mortgages should not be included in the reserve price. The mortgagee cannot repay prior mortgages from sale proceeds. (Section 104 Land Transfer Act 1952 makes no distinction between the two types of sale.)

Unregistered mortgages

It is recommended in the *Legal Practice Manual* that an unregistered mortgage should be registered if it is intended to proceed to a mortgagee sale. (Vol 2, p 3.11.4) No rationale is given and at first sight, it might be thought that if an unregistered mortgage is "protected" by caveat, it should not matter whether the mortgage is registered or not.

However, doubts have been expressed as to what are an equitable mortgagee's rights to possession and to sale. (See fn 4 & 5 in Part I of this article, [1988] NZLJ 273.) If these doubts are well founded, it might be prudent to register a mortgage before proceeding to sale. □

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1 See the comments of Lord Scarman, in the general context of contract law, in *Tse Hing Cotton Mill Limited v Liu Chong Hing Bank Limited* [1986] AC 80, at 107. Chitty J stated that the mortgagee's power of sale derived from contract — *Farrar v Farrars Limited* (1888) 40 Ch D 395, 398.

2 The intrusion of the Law of Torts has not gone without criticism. See for example Hinde, McMorland & Sim, *Introduction to Land Law* para 8.127 (though Hinde, McMorland & Sim earlier state that the standard required of the mortgagee in regard to the equitable yard stick and the tortious duty may effectively be the same — ibid); Tyler, op cit, p 568.

3 Cf Williams (1984) 2 BCB 61; 73, 74 – 75; *Public Trustee v Wallace* [1932] NZLR 625, 635 Myers CJ; *Hamilton v Bank of New Zealand* (1905) 24 NZLR 109, 138 (CA); *Wellington City Corporation v Government Insurance Commissioner* [1939] NZLR 308, 321-322.

While not too much emphasis can be placed on *Alexandre* (supra), it is a fact that the assumption made in that case (that the Mortgagee's duty is to obtain the best price reasonably obtainable in the circumstances) was made in the context of a Registrar's sale.

4 Introduction, para 8.127, p 442. See also *Alexandre v New Zealand Breweries Limited* [1974] 1 NZLR 497, 501-502 per Richmond J; Hinde, McMorland & Sim, op cit, para 8.127; Sykes, op cit, p 112; Tyler, op cit, p 562.

5 Compare the *Legal Practice Manual* Vol 2, p 3.11.3, 3.11.7, Adams [1955] NZLJ 10, 12, and Salmon LJ in *Cuckmere Brick Co Limited v Mutual Finance Limited* [1971] Ch 945, 968-9, with Butt, "The Mortgagee's Duty on Sale" (1979) 53 ALJ 172, 181. I believe that the latter contains a better analysis of this aspect of the mortgagee's duty of care.

6 See for example, Hinde McMorland & Sim *Introduction to Land Law*, para 8.127.

Breach of itself will not, of course, result in liability. The breach must cause foreseeable loss. Thus, in *Alexandre* (supra), though the mortgagee's advertisements were defective, they were not proved to have caused loss.

7 In *Public Trustee v Wallace* (supra) Myers CJ stated that although the Registrar's control is "absolute", the Registrar may be able to accept suggestions from the mortgagee – GLR, p 259. See also Blair J referring to Edwards J in *Hamilton v Bank of New Zealand* (1985) 24 NZLR 109 – GLR, p 262.

8 (1985) 4 BCB 9, 11. See also Eichelbaum J in *United Commercial Travellers Association of New Zealand v Broadlands Finance Limited* HC, Wellington 23 /8/83 A322/83. Cf Cain [1961] NZLJ 94; Williams (1985) 4 BCB 11, 12; *Hamilton v Bank of New Zealand* (1905) 24 NZLR 109; *Public Trustee v Wallace* [1932] NZLR 625; *Wellington City Corporation v Government Insurance Commissioner* [1939] NZLR 308.

9 Hinde, McMorland & Sim, op cit, para 8.104, Cf Cain [1961] NZLJ 314, 315, citing *Welsh v Nilsson* (1961) NZLR 644, 657-658.

10 The appointment of and sale by a receiver would avoid the need for a s 92 notice (because the Mortgagor would be deemed to have sold through his agent). The position of a receiver appointed by a debenture holder is different – see s 348(8) Companies Act 1955.

11 *Farrar v Farrars Limited* (supra); *The Australia and New Zealand Banking Group Limited v Bangadilly Pastoral Co Pty Ltd* (1978) 52 ALJR 529; *Tse Kwong Lam v Wong Chit Sen* (supra); Sykes, op cit, p 111, 114; Butt (1979) 53 ALJ 172.

12 Hinde, McMorland & Sim, op cit, para 8.127, which only refers to subsequent mortgagees. The duty would be owed to subsequent encumbrancers, not just mortgagees. This was recognised in *National Westminster Finance Limited v United Finance & Securities Limited* [1987] BCL 1313, 1408.

13 *Nicholson v Permakraft (NZ) Limited (In Liquidation)* [1985] 1 NZLR 242 CA. See also Lord Templeman in *Winkworth v Edward Baron Development Co Ltd* [1987] 1 All ER 114, though his comments are not free from difficulty.

14 While the mortgagee has an absolute discretion in fixing the redemption price, there may still be room for the operation of the reopening/oppression provisions of the Credit Contracts Act 1981. On the other hand, given this discretion, I do not believe that there can be any question of a mortgagee having breached his duty of care to the mortgagor if he takes a mercenary approach to setting the redemption price.

15 Op cit, p 267. Though Flaws cites Cain in support, it is clear that Cain's preference was that prior mortgages should not be included in redemption prices – [1961] NZLJ 105.

16 If the mortgagee has repaid prior mortgages, the mortgagee will expect a bid from the purchaser sufficient to cover the full amount due and owing under the mortgagee's mortgage, including the amount of the prior mortgages. If the mortgagee has not repaid prior mortgages, the purchaser should bid a lesser amount and if successful, should then attend to repayment of the prior mortgages to obtain a mortgage-free title. In theory at least, the end result should be the same in monetary terms.

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continued from p 324

occur. Indeed, the principle of unconscionability may well be the key to properly achieving fairness and equity – this will however be dependent on its application by the Courts, and the consequential balancing of the essentially competing interests of bank and customer and the nature of the "special disadvantage" which the Courts will require a guarantor to show in order to bring doctrine into operation. However, the non-*uberrimae fidei* status of contracts of guarantee has been something of an insurmountable obstacle which some Courts have simply been unable to see past when examining guarantees and delineating bank responsibilities. In the end, legislation may have to be the answer. □

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1 In *London General Omnibus Co Ltd v Holloway* [1912] 2 KB 72, 79 Vaughan Williams L J said the second category was "only an example of the general proposition that a creditor must reveal to the surety *every* fact which under the circumstances the surety would expect not to exist." See the observations on the phrase by Gibbs L J in *The Commercial Bank of Australia Ltd v Amadio* supra, 361.

2 The Supreme Court of British Columbia in *Bank of Nova Scotia v Boehm* [1973] 3 WWR 757 ruled that on the facts with which it was presented, there was no duty on the bank to disclose to an intending guarantor the existence of earlier loans granted by the bank to the account holder – loans which would be secured under the proposed guarantee. The Court held that it was in order for the bank to assume that the intending guarantor was aware of those earlier loans. On the facts, that was probably correct. But again, unlike *Shotter* there were no unusual circumstances which would have allowed the Court to find a duty of disclosure.

3 See also Hardie Boys J's discussion on this point in *Westpac Banking Corporation v McCreanor* (supra).

4 Interestingly, A L Tyree in *Banking Law in New Zealand*, Butterworths (1988), suggests that Kerr L J's statement "... seems likely to be an accurate statement of the law", and appears to interpret that statement as requiring explanation whenever a bank takes a guarantee from a customer.

5 In Practice Statement (Judicial Precedent) [1966] 1 WLR 1234 it was noted: "Their Lordships ... will bear in mind the danger of disturbing retrospectively the basis on which contracts, settlements of property and fiscal arrangements have been entered into and also the special need for certainty."

6 Thirty-ninth Report of the Law Reform Committee of South Australia (1977). The Committee recommended "that the law be altered and that the person seeking the guarantee should be required by law to disclose to the surety all matters material to the decision of the proposed guarantor as to whether or not to enter into the proposed contract of suretyship before he enters into it" (p 4). See also: Law Reform Commission of British Columbia's Report on Guarantees of Consumer Debts (1979). See also *Cooper v National Provincial Bank Ltd* [1946] KB 1 where the Court held that a bank was under no duty to disclose to a guarantor that the account which was to be guaranteed for a friend, also allowed the friend's husband – who was an undischarged bankrupt – signing authority; further, the account had in the past been operated in an improper and irregular manner. It is noted in *Rowlatt on Principal and Surety* 4 ed (1982) p 122, Sweet & Maxwell, London that "perhaps the extreme boundary of this rule" was reached in that case.