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Lenin, Mao and the Rule of Law

The irresistible, said Justice Cardozo, is often simply that which is not resisted. If not said by Cardozo then it was said by someone with equally impeccable liberal credentials like Justice Brandeis. In other words, in both the political and legal contexts it is often just a matter of nerve — of whose cracks first.

"People power" in Beijing in 1989 is probably an example. In itself the demonstration seems to be as irresponsibly irrelevant (although exciting to see on TV) as "les evenements de Mai" of 1968 or the "flower power" of Haight Ashbury in San Francisco in the revolting 1960s — and most significantly of course the rampaging Red Guards of the infamous Cultural Revolution of the Gang of Four.

Student unrest is of course no new thing. The students of Paris in the thirteenth century were notorious for their brawling and rioting. Youth, with its physical vitality, emotional immaturity and intellectual simplification is naturally a time for enthusiasm, and for some it is even a period of ideological fanaticism.

Anarchy of course cannot be permanent. Even the French Revolution from Robespierre and the Terror to the Code Napoleon; and the autocracy of Lenin and Stalin is passing from the hypocrisy of socialist legality (like the great show trials and bloody purges of the 1930s) to the *glasnost* and *perestroika* of Gorbachev.

Eventually it is the rule of the law, that sometimes overworn phrase we use without much thought, that provides a framework for change. Lawyers must be able to raise their eyes from their conveyancing deeds and their Court briefs to discern in political activities those issues of legality, of the rule of law that are so important here and in other parts of the world.

The developments in Russia for instance have legal as well as political implications. It is not just a question of who exercises power, but how it is exercised and on occasions restricted. This has been noted in the course of a long article on the present situation in Russia by Abraham Brumberg in *The New York Review of Books* for 30 March 1989. The author is a Visiting Fellow at the School for Advanced Studies at John Hopkins University. His article refers briefly to a development in the Russian legal system that is of interest to lawyers since it touches on the significance and importance of an independent legal profession as an essential element in the concept of the rule of law. At p 40 he writes:

> Another issue that has come about as a result of the growth of freedom and the erosion of the fear that once paralysed Soviet society is that of an independent *advokatura*, or association of lawyers. In the past, the role of defence lawyers, especially in political trials, was largely to assist the prosecution in bringing the defendants to "justice". The presumption of innocence was dismissed as nothing but a "bourgeois concept" and the lawyers, by way of defence, could, at best, enter appeals for milder sentences.
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> The new criminal code installed under Khrushchev put an end to this, as well as to many other grotesque features of the Stalinist system of justice. However, the defense attorney's freedom to defend his client remained severely circumscribed by the power of public prosecutors and the Judges, all controlled by the Party and by local administrative bureaucracies. Lately, a number of legal scholars have called for the creation of an association of defence lawyers that would be independent of government control. This proposal was much discussed at meetings of various "collegiums" — ie, local associations sanctioned by and completely subordinated to the Ministry of Justice — and it was approved by the Nineteenth Party Congress last July; but it was attacked as illegal by the Ministry of Justice. Moreover, the Ministry sabotaged a conference called to discuss the creation of an independent lawyers' association by telling 162 lawyers' groups that the conference had been called off, and having the participants' hotel reservations cancelled. Nevertheless, twenty-two of these lawyers' groups managed to hold a meeting and voted unanimously for an independent association. They were later joined by twenty-two other lawyers' groups. The first congress of the new association was set to take place in December.
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> By the time I arrived in Moscow, the Ministry had taken a new tack: Boris Kravtsov, the Minister of Justice, said the idea of an independent lawyers' association was fine — so long as it was under the control of his Ministry. A prominent jurist then wrote in an article in *Ogonek* that the tactics of the Ministry were a farce. On December 19, *Pravda* published an open letter from seven prominent professors and writers denouncing the Ministry's "arbitrary methods." Yuri Feofanov, *Izvestia's* legal correspondent, told me that the Ministry's proposal was a "mockery of justice". "We are not going to take it lying down," a lawyer I talked to said. And, indeed, they haven't. On February 25, two thousand lawyers gathered in Moscow to set up a Soviet Advocates' Association, in the face of the opposition from the Ministry, and despite the energetic efforts of

some of their own "conservative" colleagues (called "bootlickers" and "provocateurs" at the meeting) to subordinate the association to the Ministry. Among the topics discussed at the meeting were the right of defence attorneys to see their clients from the moment of arrest, guarantees for the independence of Judges, and equal rights for the defence and prosecution. The question now is whether the Ministry of Justice will try to sabotage the new association.

In China, it is not possible at the time of writing to guess at the eventual results of the student demonstrations in Tiananmen Square. They are probably more a result and a continuing part of the changes taking place in China than marking any dramatically new change in themselves. One problem that does seem clear is that they have no focus, no programme of action. In themselves the demonstrations do not seem to be a clear sign of any new constitutional arrangements. The slogans about democracy are just that – slogans. Possibly it is just that the new style Red Guards have taken to wearing white head-bands and passing out flowers as they chant their slogans. Some apparently carried portraits of Chairman Mao!

An article in the London *Spectator* of 27 May 1989 has an interesting piece concerning the concept of the rule of law in the context of Chinese history and culture. The interview is with a Chinese exile, Dr Wang Bing-zhang, whose political activities in themselves may not be all that significant. What he had to say about the Chinese Communist Party is however of interest. The student unrest he views as a symptom of the failure of the present government leaders. The present leadership he argued will not be able to continue indefinitely along the path they have been following:

"Because they have no moral authority. In a Western country that might not matter, but in China it's crucial. Right now China is in an ideological vacuum. The Marxists destroyed Confucianism, then Mao himself destroyed Marxism. Now nobody in China believes anything. That can't continue. China must have an ideology. Any political system is held together partly by laws, partly by moral authority. In the West, law is the most important ingredient. In China, the moral authority of the state is the main thing."

Some years ago an academic colleague in China remarked to me: "We Chinese don't need complicated laws such as you have in England. Here, everybody knows what's right and what's wrong!" I repeated this little nugget of Confucianism to Dr Wang. He laughed. "Yes, that's our traditional view. Of course, it needs modifying. We must have laws. To say the least of it, we couldn't function as a trading nation without laws. But for us Chinese there must first be an ideological foundation."

Did he have any ideas for an ideology suitable to modern China?

"Why, our traditional ideology, Confucianism – modified as necessary."

Could that be made to work in the 20th century?

"It has been. Look at Japan: a Confucian society, operating successfully, very successfully, in the modern world."

I expressed some doubt that Japan was really Confucian.

"Do you know the proportion of engineers to lawyers in Japan? Seven to one. And in America? One to seven – just the opposite. That's the difference between a modern, civilised Oriental society and a modern, civilised Western society. China should naturally belong to the first group."

Even in Japan however the rule of law certainly has its place. It has recently resulted in a number of politicians, including the Prime Minister and his predecessor in office having to resign as a result of the Recruit company scandal. For ourselves we need to bear in mind that the rule of law is a concept that requires an independent judiciary, and that presupposes an independent legal profession. There is no inherently necessary form for a legal system, or a Court structure for that matter, but certain principles must be preserved if the rule of law is to have meaning and significance. It is for the legal profession to ensure the preservation of these principles within our own country; and to recognise them and encourage them when this is appropriate in other countries.

P J Downey

Addendum

Since the above was written the student attempt to remove the leaders of the Chinese government and their continued defiance of martial law have resulted in tragic blood-letting. The students seem to have forgotten or ignored the dictum of Chairman Mao that revolution grows out of the mouth of a gun – that is that people get killed. The message to us of these sad events, is to remind us all that the present leaders of the Chinese government came to power by violence which was part of their ideology. The Long March was not a Sunday excursion, and the point has been underlined that the Politburo in Beijing should not be thought of as the Chinese equivalent of the Committee of the Ladies Croquet Club of Much-Binding-in-the-Marsh. Whatever might be said about the rule of law in China, the world now knows that the rule of martial law is a reality.

PJD

Revolution and reality

[The principal character Rubashev, contemplates, in prison, the rationale for his being incarcerated.]

It is said that No 1 [Stalin] has Machiavelli's Prince lying permanently by his bedside. So he should: since then, nothing really important has been said about the rules of political ethics. We were the first to replace the nineteenth century's liberal ethics of "fair play" by the revolutionary ethics of the twentieth century. In that also we were right, a revolution conducted according to the rules of cricket is an absurdity. Politics can be relatively fair in the breathing spaces of history; at its critical turning points there is no other rule possible than the old one, that the end justifies the means.

Arthur Koestler
Darkness at Noon (1940)

Case and Comment

A trilogy of copyright cases

Samsung Electronics Company Limited and another v ASDA Holdings Limited and others [1989] BCL 360; *Thornton Hall Manufacturing Limited v Shanton Apparel Limited* [1989] BCL 38; *UPL Group Limited and others v Dux Engineers Limited and another* [1989] BCL 201.

In his address at the launch of two recent works on New Zealand intellectual property law, John McGrath, QC, spoke of "the exploding amount of local case law on the subject, itself reflecting the increased importance that the commercial community is attaching to the protection of the rights concerned", [1989] NZLJ 68. The truth of this statement was illustrated in late 1988 when three cases on copyright were decided in the course of six weeks. In the first, *Samsung Electronics Company Limited and another v ASDA Holdings Limited and others* [1989] BCL 360, Thorp J refused an interim injunction against the importation of television sets in which a foreign copyright was claimed. In the second, *Thornton Hall Manufacturing Limited v Shanton Apparel Limited* [1989] BCL 38, Hillyer J held that copyright in the sketches, drawings, pattern and sample of a woman's dress resided in these works, that the plaintiff was the owner of the copyright, and that the defendant had infringed the copyright. In the third, *UPL Group Limited and others v Dux Engineers Limited and another* [1989] BCL 201, Somers J rejected the appellants' claim that there had been infringement of their copyright in the drawing and tooling of a deluxe toilet seat and the connector piece which joined seat and lid to the cistern. I propose to analyse the contribution which these three judgments have made to the development of New Zealand copyright law.

Requirements for establishing breach of copyright

Thornton Hall Manufacturing Limited v Shanton Apparel Limited [1989] BCL 38;

New Zealand Courts have held, in a series of cases, that, for a plaintiff to establish breach of copyright, four elements must be proved. These are: there is a work in which copyright can subsist, copyright does exist in such work, the plaintiff is the owner of such copyright, and copyright has been infringed (see, eg, *Klissers v Harvest Bakeries (No 2)* [1985] 2 NZLR 143 at 156). The judgment in *Thornton Hall* [1989] BCL 38 shed new light on all four requirements. First, Hillyer J was required to determine whether copyright sketches, patterns and a sample of a dress were works in which copyright could subsist. He had "no doubt" that sketches came within the definition of artistic work, which included drawings irrespective of artistic quality (at 7; see s 2(1) of the Copyright Act 1962). On the question of copyright in a pattern cut out from a cardboard drawing, Hillyer J expressed agreement with the comment of Oliver J (in *Radley Gowns Ltd v Costas Spyrou* [1975] Fleet Street Patent LR 455 at 466) who doubted whether "that which was a drawing beyond dispute on the virgin sheet ceases to be a drawing because it is cut out". Hillyer J noted that the pattern in question "started as a drawing and the fact that it is cut out would not destroy its artistic quality or prevent it being a drawing" (at 11). In relation to the third object in which copyright was claimed – the sample dress, made by the plaintiff company from the drawings and sketches – counsel for the plaintiff argued that this was a model, included within the definition of artistic work by the Copyright Amendment Act 134 of 1985. Hillyer admitted that the research of counsel and his own knowledge had "not brought before [him] any other case in which the word ha[d] been interpreted in this context" (at 14). But, in the light of the dictionary definition of the word "model", "the overall scheme of the Act and the purpose of the dress that was made in this particular case", Hillyer J held that the sample dress came within the term "model" in the definition of artistic work. He added: "the sample dress [was] a prototype, . . . intended as a model for the subsequent dresses (at 14-15).

The second essential element in proof of breach of copyright is that copyright does exist in the work, in the sense that the work is original and (in the case of published works) that the first publication took place in New Zealand or the author of the work was a New Zealand citizen or was domiciled or resident in New Zealand at the time when the work was first published (s 7(2)). Hillyer J noted that the "question of originality is one which is always of some difficulty in copyright cases" (at 12). He noted the judgment of Fox J in *J Bernstein Limited v Sydney Murray Limited* [1981] RPC 303, where it was held that artistic copyright "subsisted in sketches which although composed entirely of known features, made use of the known features in a novel way" (at 12-13). Hillyer J said that, in the case before him, many of the features of the dress in question

were not unusual, but what was original was "the way in which each of the individual characteristics of the dress have been brought together by [the designers] without copying the dress as a whole from any other dress" (at 13). He therefore held that the sketches and pattern of the dress were original. Later in the judgment he held that the sample dress was also an original work because "the skill and labour which went into producing it was substantial" (at 15). Hillyer J was required to consider a further objection in relation to copyright in the sketches: counsel for the defendant said that there was no evidence that the first publication of the work had taken place in New Zealand (and pointed to evidence that the dress was retailed in Australia), and that there was no proof that the designers of the dress were citizens of or were domiciled or resident in New Zealand at the time the work was made. On the question of publication, Hillyer J referred to s 3(4) of the Act, which provides that a publication in New Zealand will be treated as the first publication as long as a prior publication elsewhere took place within a period of thirty days before. His Honour stated that he had no doubt that, even if the dress was first shown to the public in Australia, it would not have been more than thirty days before it was shown to the public in New Zealand (at 10). On the issue of citizenship/domicile/residence, Hillyer J acknowledged that there was no proof of the citizenship or residence of one of the designers at the time the sketch was made, but stated that the whole of the evidence (including the fact that the two designers had worked at the registered office of the plaintiff's company in Auckland) conclusively showed that both designers were at least domiciled in New Zealand at the time that the sketches were drawn (at 10).

In relation to the third element in proof of breach of copyright — ownership of the copyright by the plaintiff — a query was raised about the authorship of the sample dress. This dress was produced by the combined efforts of the designers, a cutter and machinist, and the question to be answered was whether a team of people could be an author. Hillyer J referred to s 12 of the Act, which provided for works of joint authorship, and on this basis decided that the whole team engaged in the making of the sample dress was the author of the finished product (at 15). Because this team was employed by the plaintiff company, ownership of the sample dress resided in the company (in terms of s 9(3)).

The final question for Hillyer J was whether there had been an infringement of the plaintiff's copyright by the production by the defendant of a dress shown in advertisements. For Hillyer J, "the best test that appears to have been formulated is simply that something is a copy if it brings to mind the original . . . a copy is a copy if it looks like a copy" (at 18). He noted the differences between the two dresses — such as the width of the waist elastic and of the skirt — but stressed that "there must always be differences however minute, between any dress which is a copy of another, and that other" (at 17-18). Hillyer J went on to hold that:

> particularly in the absence of any evidence from the defendant to say "We did not copy" I have no hesitation in saying that the dress produced by the defendant is a reproduction . . . of the dress produced by the plaintiff (at 19).

Infringement of copyright

The judgments in *UPL Group Limited and Samsung Electronics Company* also shed light on the question of infringement of copyright. In the *UPL Group Limited* case, [1989] BCL 201, the appellants claimed infringement of the drawing and tooling of two copyrights in a toilet design: these related to the features at the rear of the seat and extending through the connector up to the cistern, and those of the front area of the seat and lid. In the first part of his judgment, Somers J had discussed the implications of the registered design that the appellants held in relation to the toilet seat and accessories. He now noted the effect of the new s 20A of the Act (in force on 1 October 1985) which provided that the making of a three-dimensional object does not infringe copyright in an artistic work if the work forms part of a representation of a design for which registered protection in New Zealand has ceased. Therefore, he stated, in so far as the copyright claimed to be infringed related to the registered design, the action in copyright could relate only to infringement prior to 1 October 1985. Somers J began his analysis of the alleged infringement of the two copyrights by noting:

> Where a composite work is claimed to infringe one copyright as to a part and another copyright as to another part each requires to be separately considered. This seems self-evident in the case of a literary work where a defendant is said to have plagiarised two works and we do not think it can be different in the case of an artistic work. No doubt if copying is proved in one case, similarity in the other may more easily lead in the latter case to a finding of infringement (at 18).

Somers J turned his attention first to the alleged infringement of the appellants' copyright in the rear of the toilet seat, the back flap and the connector piece. His outline of the test for infringement closely followed that enunciated by text writers such as Laddie, Prescott and Vitoria, and approved in earlier judgments (see eg *Wham-O MFG Co v Lincoln Industries Ltd* [1984] 1 NZLR 641 at 650):

> There need not be an exact imitation; it is enough that there has been a substantial appropriation of the appellants' skill, work and labour. What is substantial is a matter of fact and degree in which the quality of what is appropriated is more important than the quantity (at 19).

Somers J reiterated the oft-repeated rule that there is no claim to protection for the idea or concept which a work illustrates (the claim relates only to its concrete expression). Thus, despite the fact that the Court of Appeal had "little doubt" that the respondent had "filched the idea of a connector piece" from the appellants, the Court held that there had not been infringement as "that which [the respondent] has produced is in our opinion not substantially the same as that of [the appellant]" (at 20). Somers J went on to hold that "whether each of the parts [of the appellants' and respondents' products, relating to the first copyright] are looked at individually

or all are looked at collectively", they did not evidence a sufficient degree of resemblance to constitute infringement by the respondent (at 21). Somers J then addressed the alleged infringement of the second copyright held by the appellants, and here the appellants asserted that "the lid appearance and the front area of the [respondents'] seat and lid components are virtually identical" with those of the appellants (at 21). His Honour admitted that the Court of Appeal had concluded from the whole of the evidence that the question of deliberate copying was "finely balanced", as it was not inconsistent with the appellants' case but was consistent also with the respondents' claim that the features were independently produced (at 23). Somers J stated that

> [i]n that state of affairs a visual comparison of the features of the two seats is critical. It has to be made in the light of the existing state of the art and the trends of fashion (ibid).

According to Somers J, a further factor in the case of common domestic appliances such as lavatory seats and lids was that the range of features "is probably not large and small differences will be enough to rebut the inference of copying" (at 24). His Honour concluded that sufficient differences existed between the products of the appellants and respondents, and therefore the Court rejected the appellants' claims for breach of copyright (ibid).

Copyright in imported article

The case of *Samsung Electronics Co Limited* [1989] BCL 360 concerned an allegation of infringement different from those in *Thornton Hall Manufacturing Limited and UPL Group Limited*. Here the plaintiffs (a Korean manufacturing company and its New Zealand distributor) asserted that the defendants had imported and were selling television sets, in which the plaintiffs claimed copyright, in breach of s 10 of the Copyright Act. The relevant wording of the section is that copyright in an artistic work is infringed by a person who, without the licence of the owner of the copyright, imports an article (not for his private and domestic use) into New Zealand if to his knowledge the making of that article would have constituted an infringement of that copyright if the article had been made in the place into which it is so imported (s 10(2)). Further, copyright in an artistic work is infringed by a person who, in New Zealand, and without the licence of the owner of the copyright, sells or exposes for sale any article if to his knowledge the making of the article would have constituted an infringement of that copyright if the article had been made in the place into which it was imported (s 10(3)). (The expression "the place into which it is imported" has been held to refer to New Zealand. See *Albert & Sons v Fletcher Construction* [1974] 2 NZLR 107 at 112.)

Counsel for the defendants argued that the first plaintiff, the Korean manufacturer, could not claim the benefit of protection under s 10 of the Act. She referred to s 49 of the Act, which empowered the Governor-General to direct, by Order in Council, that the provisions of the Act should apply in the case of another country; but which directed that the Governor-General should not, in principle, make such an Order regarding a country not party to a copyright convention to which New Zealand is also a party (s 49(1) and (3)). In terms of the Copyright (International Conventions) Order 1964 (as amended by SR 1979/64), Korea is not listed amongst the countries of the Berne Copyright Union or the Universal Copyright Convention. Counsel for the defendant argued that it would be contrary to the policy and purpose of the copyright legislation and its convention arrangements to grant to a non-convention country such as Korea the benefit of s 10 of the Act. She claimed that "any such action would run directly across the purpose of the international conventions, namely encouraging reciprocal recognition of copyright between consenting jurisdictions" (at 5).

Thorp J noted that he had been referred to several cases which dealt with the importation of goods in which a foreign copyright had been claimed, but, "in each case the country of origin was a 'convention country', and accordingly none offer much assistance on the principal point I have to consider" (at 4-5). He declared his "present inclination . . . to accept the argument of [defence counsel] that the application of s 10 to protect copyright originating in non-convention countries would create a situation so foreign to the obvious intention of s 49, and particularly the direction of s 49(3) that orders in council under that section shall not be granted unless the Governor-General is satisfied that mutual protection will be available, that the more limited interpretation she proposes should be preferred" (at 5). However, Thorp J noted that he did not have to reach a firm decision on this point, as the plaintiffs' application for an interim injunction failed on account of insufficiency of evidence of the exclusive distributorship arrangement between the plaintiffs (at 6).

Conclusion

Analysis of the above three judgments has indicated that they have extended the scope and understanding of New Zealand copyright law in new directions. Out of them have come new interpretations of works which fall within the term "artistic work", illustrations of the operation of the Act in situations concerning the originality of the work in question and the domicile of the authors, clarification of the notion of joint authorship, demarcation of the overlap between copyright and registered design by reproduction, and suggestions regarding the protection of foreign copyright. No doubt these judgments will prove to be useful to future Courts required to deliberate upon questions of copyright law. But, many of the difficulties facing Judges in copyright cases will remain, as much will continue to depend on their subjective impressions (particularly of potentially infringing artistic works) and their assessment of the competing interests involved. As Somers J noted in *UPL Group Limited*, the Court's decision on whether copyright has been infringed is a "value judgment" and in that judgment "there lies the balance between the private right to exploit the expression of the author's ingenuity, skill, labour or imagination and the public interest in obtaining the benefit of creative work and thought" (at 19).

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"Totally inadequate advice" given by witnessing solicitor — Matrimonial Property Act 1976, s 21(6)

In *Odlum v Odlum* [1989] BCL 700, the Family Court had held a pre-nuptial agreement to be void under s 21(8)(a) of the Matrimonial Property Act 1976 for non-compliance with s 21(6) and not to have been saved by s 21(9). The husband appealed and the matter came before Doogue J. The respondent wife was a Fijian national of Indian descent. She had not been in New Zealand very long. The appellant husband was a New Zealander. The parties were married at Paeroa in December 1981. They had entered into a s 21(1) contracting out agreement on the very day before the marriage. The wife had no significant assets. The husband owned a small farm and some chattels. He was employed in local government work until his retirement in 1986. The farm was not, therefore, the spouses' main source of income. The marriage proved to be not a very successful one; indeed, there had been a number of separations. The final separation occurred in July 1987. At the time of the Family Court hearing, the husband was 59 and the wife 41. The Family Court found that (a) the wife had not been consulted about the agreement at all; (b) she had not even known of its existence until actually confronted with it; (c) she had had no chance to read and consider it, and (d) she knew nothing of New Zealand matrimonial property law. It was also observed that the agreement was a highly detailed and complex one. The Family Court Judge went on to note that the solicitor who attended the wife on the execution of the agreement had had no information about her other than what she had told him. He had, so it would appear, not made any file notes and had expressed the view to the wife that the matter was a simple one and that the document set out all the information. He had advised her of the total effect of it by working out an overall picture and then explaining that the whole point of the agreement was "to shut her out". He had not explained what entitlements she might have under the 1976 Act. Accordingly, she would not have had any advice as to her rights in the matrimonial home. Indeed, it seems that the solicitor had frankly stated that he had advised the wife to sign because had formed the view that the marriage was a marriage of convenience.

As Doogue J observed in addition, the evidence did not disclose that the wife had read through the agreement or that it had been read through to her, or that the witnessing solicitor had entered into any discussion with her as to the parties' respective properties. Nor was there any evidence from the solicitor that he had advised the wife on any of the requirements of the Act in respect of family chattels, the matrimonial home, the effect of the separate property provisions in the 1976 Act or the effect of s 13 concerning marriages of short duration.

Counsel for the husband submitted that, in a compromise situation governed by s 21(2) of the 1976 Act, a witnessing solicitor would have available the facts enabling him or her to make an assessment of the Court's likely approach, whereas with a s 21(1) agreement there would be no circumstances of relevance to which the solicitor could direct himself. In the present case, he submitted, the solicitor was right in advising on the effect of the agreement, viz, that the wife would have no rights. *C v C* (1985) 5 NZFLR 1 was, in his view, distinguishable.

Doogue J upheld the decision of the Family Court Judge. He concurred with the view that the agreement could not be "rescued" under s 21(9). It is, doubtless, not to be wondered at that Doogue J should have described the advice of the witnessing solicitor as "totally inadequate" in these circumstances.

The Family Court Judge had also dealt with the question of the unjustness of giving effect to the agreement under s 21(8)(b) and (10) and had concluded that the contract was not a fair one. Doogue J upheld this conclusion also.

It is worth setting out in full what Doogue J said concerning the non-compliance with s 21(6):

> With all respect to Mr Hudson's careful submissions on this topic, I prefer the finding of the Judge under appeal. In my view of the matter, without putting a particular onus on any particular solicitor in any particular case, a solicitor advising under the provisions of Section 21(6) of the Act in respect of a contracting out agreement, is necessarily obligated to ascertain, at least in a general way, the property of the parties, so that he or she can advise the person who is being advised of the consequences for that party of the provisions of the Act in respect of that property and in respect of other property which would come within the Act and of the consequences of the agreement, both in respect of that property and in respect of the provisions of the Act. In my view the present case is an admirable example of the need for a solicitor to address himself to the property of the parties and the provisions of the Act and to ensure that the party being advised is aware of not only the simple consequences of the agreement but the consequences of the Act which the agreement relates to. Unless the party is aware of the consequences of the Act for the property which the parties have at the time of marriage or may acquire thereafter, how can the party be aware of the true consequences of the agreement being entered into? In particular, how can it be said that the party has a real understanding of the significance of the agreement when, as in this case, the Respondent was totally unaware of her rights under the Act which she was forfeiting by entering into the agreement?
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> In my view it is insufficient for the Appellant to say that the Respondent was aware of the nature of the agreement and that she would take nothing thereafter, when she was unaware that she had rights under the Act which she was forfeiting by virtue of the agreement. How could it be said that she had the matter properly explained to her for the purposes of Section 21(6) of the Act?

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Lender liability for negligent "in-house" real estate appraisals (II)

By Stuart D Walker, a Dunedin practitioner

This is the second of two articles on the topic of the duty of care of a lender when a property is a appraised by an "in-house" valuer. In this article the author considers the question of whether a Court can, in particular circumstances, infer an undertaking by the lender to protect the interests of the borrower.

Since the article was written the House of Lords has decided the two cases Smith v Eric S Bush *and* Harris v Wyre Forest District Council *(House of Lords, 20 April 1989). The cases are discussed in an article by Howel Lewis in the* New Law Journal *for 5 May 1989 at p 615.*

Hedley Byrne — the principle

In *Harris v Wyre Forest Council* [1988] 2 WLR 1173 (CA) Nourse L J (at 1180) said that whether or not a lender is under a duty of care "must be answered by an application of established principles relating to negligent misstatement". One needs to view this limitation with caution for it can sometimes be inappropriate to completely divorce the principles of negligent misstatement from the general principles of negligence. In *Meates v Attorney-General* [1983] NZLR 308 (CA), Cooke J (dissenting) in considering whether a duty of the *Hedley Byrne* type could be extended beyond the giving of information, opinion or advice, to requests or assurances of future action or promises, noted (at 379):

> I think that there can be occasions when a reasonable person, on receiving such a request, promise or assurance . . . is entitled to assume that the speaker has taken and will take reasonable care to safeguard the interests of the person he has sought to influence, if that person acts as suggested. And if the speaker in authority has indicated that certain assistance or other benefits will follow, he will be bound to do what is reasonably within his power . . . to bring about that result. This is not an absolute duty or a guarantee, which belongs to the realm of contract. It depends simply on what a reasonable man would regard as his duty to his neighbour.

He further noted (at 379):

> Perhaps not unnaturally in the light of the state of the authorities [counsel for the appellants] concentrated on trying to bring the case within the *Hedley Byrne* category, focusing on the question of negligent statements. It can be artificial, however, to distinguish between statements and other actions.

A most important observation; and an observation which has particular relevance in the area of "in-house" real estate appraisals. For if, prior to agreeing to make a mortgage advance, a lender negligently appraises a property, it is often somewhat difficult for a borrower to prove the existence of a duty of care on the conventional principles of negligent misstatement. (See generally J A Smillie, "Negligence and Economic Loss" (1982) 32 *Univ Toronto LJ* 231.) Particularly where the results of the valuation are not reported to the borrower, a rather artificial process has to be gone through to show that there is, in fact, a *misstatement.*

Whether a lender, in conducting a real estate appraisal, has undertaken to "safeguard the interests" of an intending borrower may be determined by express agreement between the parties, but most often, will involve a determination as to whether such an undertaking can properly be inferred from the circumstances which exist between the parties. The task then becomes one of identifying whether and to what extent, the lender, in conducting a particular in-house appraisal, has undertaken to safegurd the claimed interests of the intending borrower. And whilst in making that identification the Court must consider "all the circumstances of the case" (Lord Keith in *Peabody*, p 534), the very factors which formed the basis of the decisions in *Bruce* and *Miller* viz, the role the lender is performing, the lenders' assumption of responsibility and "knowledge" of reliance by intending borrowers on the undertakings of the lender, will guide the Court in determining whether there exists a relationship of proximity sufficient to establish the requisite duty of care; and this, regardless of the particular "category" of real-estate appraisal in respect of which liability is claimed.

Where a lender conducts an "in-house" appraisal before agreeing to finance the purchase of real estate, there exist a number of factors which provide a *general* jurisprudential basis to allow a Court to infer an undertaking by the lender to safeguard the interests of the intending borrower, and thus establish a recognition by the lender as to its own answerability to the intending borrower in conducting such appraisal.

1 In most instances intending borrowers will know that lenders will appraise the real estate
Intending borrowers probably know this as a matter of general knowledge, but in any event most will be told by the lender that an appraisal will be made: of survey participants who conduct "in-house" appraisals 88% will always inform the intending borrower that an appraisal will be conducted.

2 Most lenders will tell intending borrowers that the reason the appraisal is being conducted is to ensure the suitability of the real estate for mortgage purposes
Many of the survey participants who conduct "in-house" appraisals will also tell intending borrowers of the nature and extent of the appraisals and the means by which the appraisals will be made.

3 Most intending borrowers will be required to pay for the "in-house" appraisal
Of the survey participants who conduct "in-house" appraisal, 77% charge specific appraisal fees. If there is no duty, intending borrowers might well ask just what the fee is for.

4 Many intending borrowers do not fully understand the differences between a full structural survey, a registered valuation and a mortgage valuation[1]
Intending borrowers who are told by a lender that an appraisal is to be made may justifiably think that the additional expense of a second appraisal is not warranted. Park J noted in *Yianni v Edwin Evans & Sons* (at 597) that

> the intending mortgagor feels that the building society, whom he trusts, must employ for the valuation and survey competent qualified surveyors; and, if the building society acts on its surveyor's report, then there can be no good reason why he should not also himself act on it.

5 Intending borrowers do in fact rely on lenders' real estate appraisals
Intending borrowers will often think: "The lender won't lend to me unless the appraisal is satisfactory"; they have a legitimate expectation that their interests are protected.[2] In *Yianni* expert evidence was given that over 90% of those borrowing money from building societies rely on the societies' surveys. Whilst no research has been undertaken to assess the situation in New Zealand, from the writer's experience there are a significant number of intending borrowers (particularly those purchasing houses at the lower value end of the market) who do rely on lenders' appraisals as affording them protection: not only in respect of their decision to proceed with the purchase of the real estate, but also in their decision to mortgage it to the lender. Whilst the evidence given in *Yianni* that valuers who conduct appraisals for building societies in the United Kingdom know of the *widespread* reliance on their appraisals *may* not reflect the situation in New Zealand, such knowledge in reliance is, of course, only one of the factors to be taken into account in determining whether the requisite relationship of proximity is established. Certainly it would be wrong to think that lenders could evade liability by refusing to acknowledge that there are borrowers who do rely on "in-house" appraisals as affording them some protection.

6 Banking institutions in particular encourage and invite their customers to rely on the wider banking services which they offer
This invitation of trust permeates many bank advertisements. Rightly or wrongly, customers do regard banks as institutions which will look after their interests. In many ways the banker-customer relationship is starting to exhibit characteristics more akin to the professional-client relationship than to the traditional creditor-debtor relationship.

The "inherent jurisprudential weakness"
But of course before an undertaking, sufficient to support the imposition of a duty of care, can be established, it is necessary to examine all the circumstances of a particular case. Broad generalisations must be avoided, yet it was a generalisation which was used by Kerr L J in *Harris* (at 1187) to illustrate his view that there is an "inherent jurisprudential weakness" in the application of *Yianni* to any "ordinary situation". He gave the following example:

> Suppose that A approaches B with a request for a loan to be secured on a property or chattel – such as a painting – which A is proposing to acquire. A knows that for the purpose of considering whether or not to make the requested loan, and of its amount, B is bound to make some assessment of the value of the security which is offered, possibly on the basis of some expert inspection and formal valuation. Then assume that B knows that in all probability A will not have had any independent advice or valuation and is also unlikely to commission anything of the kind as a check on B's valuation. B also knows, of course, that any figure which he may then put forward to A by way of a proposed loan on the basis of the offered security will necessarily be seen to reflect B's estimate of the minimum value of the offered security. Suppose that A then accepts B's offer and acquires the property or chattel with the assistance of B's loan and in reliance – at least in part – on B's willingness to advance the amount of the loan as an indication of the value of the property or chattel. Given those facts and no more, I do not think that B can properly be regarded as having assumed, or as being subjected to, any duty of care towards A in his valuation of the security. Even in the absence of any disclaimer of responsibility I do not think that the principles stated in *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 support the contrary conclusion. B has not been asked for advice or information but merely for a loan. His valuation was carried out for his own commercial purposes. If it was done carelessly, with the result that the valuation and loan were excessive, I do not think that A can have any ground for complaint. And if B made a small service charge for investigating A's request for a loan, I doubt whether the position would be different; certainly not if he were also to add a disclaimer of responsibility and a warning that A should carry out his own valuation.

But one needs to view this example with caution:

1 It merely describes an "ordinary situation", and it should not be thought that just because a particular set of facts contains the ingredients listed by Kerr L J then no duty of care could arise. In the end, *all* the circumstances of the case have to be taken into account.
2 It is accepted that just because it can be shown that B knows that in all probability A will not have an independent valuation and will treat B's willingness to advance the loan as an indication of the value of the property, it does not automatically follow that the necessary "undertaking" or "assumption of responsibility" has been established. It may show "foreseeability", but no more. Thus whilst liability for negligent appraisals may have a jurisprudential weakness in an ordinary situation, the factual bases of cases such as *Harris* can hardly be described as "ordinary".
3 Kerr L J makes no reference to the "status" of A, yet this aspect is vitally important. It is not without significance that the three New Zealand cases discussed in this article all involved the Housing Corporation as the lender. Judge Willy noted in *Miller v S R Smith Ltd* that "the Housing Corporation lends widely to property owners at the lower end of the scale of value." (See also, *Bruce v Housing Corporation of New Zealand.*) In *Yianni* it was noted that a person buying at the lower end of the market is less likely to obtain an independent valuation. Thus status will have an important bearing on whether a lender ought reasonably to know of an intending borrower's reliance and on its own answerability. A duty of care will be more easily established in a situation involving a home-purchasing borrower, as opposed to one involving a commercial borrower where it might be quite difficult to show (either expressly or by implication) knowledge by the lender that a commercial borrower might be relying on the appraisal for the protection of its interests. Similarly, a duty of care will find greater expression in situations involving purchasers of lower, rather than higher, valued real estate.
4 Whilst Kerr L J bases his example on "a property or chattel – such as a painting", there is a very real difference between property in the form of real estate and property in the form of a chattel. In *Yianni* there was the evidence that 90% of applicants for a building society housing loan rely on the lenders' appraisals as affording them some protection and that the valuers knew of this reliance. It is thought that a survey of borrowers who would be buying say a painting of such value as to require a lender to make a valuation prior to agreeing to advance a loan against it, would produce a quite different result from that expressed in *Yianni*, and would, due primarily to the "status" of the typical borrower in this category, show minimal reliance by borrowers on lenders with regard to the appraisal results. The aspect of foreseeability, let alone an assumption of responsibility, would not be easily established.
5 Whether a fee in respect of the appraisal is charged to an intending borrower *will* be an important factor, and although Kerr L J talks of "a small service charge for investigating A's request for a loan", the fee is, in many instances, not small, and is charged not for investigating the intending borrower's request for a loan, but specifically to cover an appraisal of the real estate.
6 It is of course quite obvious that the adding of "a disclaimer of responsibility and a warning that A should carry out his own valuation" would be relevant (see later discussion on this point).
Establishing whether any set of facts warrants the implication that a lender has assumed a duty of care towards an intending borrower will depend on the circumstances of each case. Whilst a doctrine which imposes liability in Kerr L J's "ordinary situation" may well suffer from a "jurisprudential weakness", the very nature of the relationship which commonly exists between lender and intending borrower can be such as to take that relationship out of the "ordinary situation" and into one which requires a lender to carry out an "in-house" appraisal with due care. In *Curran v Northern Ireland Co-ownership Housing Association Limited* (an unreported decision of the Court of Appeal in Northern Ireland on 9 May, 1986) Gibson L J refused to recognise a cause of action where a lender arranged for a firm of surveyors to survey a house and where the house was subsequently found to be structurally defective. Gibson L J, distinguishing *Yianni*, noted that in the present case no fee for the survey was charged to the plaintiffs, the results were not reported to them and the surveying firm could not have contemplated that their report would be relied on by the plaintiffs. On these facts the Court held that the surveyor had not assumed any responsibility towards the plaintiffs. On the respective fact situations both *Yianni* and *Curran* can be accommodated within a principle allowing liability to be imposed where a lender has undertaken to safeguard the claimed interests of an intending borrower. There must always be a close examination of the lender's undertakings (and of the circumstances surrounding them) in regard to the lender's requirement of an "in-house" appraisal and of the particular relationship which exists between the lender and the intending borrower. Judge Willy's decision in *Miller* shows how, on this basis, lender liability can, in an "ordinary mortgagor/mortgagee" relationship, arise where a new building is being financed. That exact same approach applies where a lender, prior to advancing funds to an intending purchaser of real estate, undertakes to complete an "in-house" appraisal to ensure that the real estate provides suitable security: a lender can place itself in a position of "responsibility" towards an intending borrower so as to bring about a close and direct relationship of proximity such as to render it incumbent on the lender to perform the appraisal with due care.

Disclaimers

In *Harris v Wyre Forest Council* (supra) the mortgagee included the following disclaimer in its standard mortgage application form.

> TO BE READ CAREFULLY AND SIGNED BY ALL APPLICANTS
>
> I/We enclose herewith the valuation fee & administration fee £22. I/We understand that this fee is not returnable even if the council do not eventually make an advance and that the valuation is confidential and is intended solely for the information of Wyre Forest

> District Council in determining what advance, if any, may be made on the security and that no responsibility whatsoever is implied or accepted by the council for the value or condition of the property by reason of such inspection and report.
>
> (You are advised for your own protection to instruct your own surveyor/architect to inspect the property). I/We agree that the valuation report is the property of the Council and that I/We cannot require its production.

Nourse L J held that by the terms of the application form the council had made it clear that it was not undertaking any duty, citing Lord Devlin's comments in *Hedley Byrne & Co Ltd v Heller & Partners Ltd* (at 533) that "[a] man cannot be said voluntarily to be undertaking a responsibility if at the very moment when he is said to be accepting it he declares that he is not." Nourse L J specifically rejected plaintiff counsel's argument that a duty of care was inescapable and not able to be avoided by the use of a disclaimer. Interestingly, his reasoning is based on the premise that a disclaimer prevents a duty of care from in fact arising, which is in contrast to the approach evidenced in *Smith v Eric S Bush (a firm)* [1987] 3 WLR 889 (CA) (Appeal Pending) that a Court should first determine (without taking into account the disclaimer) if negligence is established on the facts, and only when that question is answered affirmatively, determine whether the disclaimer is effective to exclude liability. These differing approaches have raised particular concern in England where the Unfair Contract Terms Act 1977 specifies that a disclaimer is not effective unless it satisfies the requirement of "reasonableness". In *Harris* the English Court of Appeal held that the Act had no application since the disclaimer had prevented a tortious duty of care arising, whereas in *Smith* it held that the Act did apply and thus *was* required to determine the question of reasonableness. Not unexpectedly, both decisions are the subject of appeals to the House of Lords.

Two matters do however have to be remembered when drafting a clause to limit or exclude liability.

1 Bringing the disclaimer to the notice of the intending borrower

The test has been stated as being whether those wishing to exclude liability "did what was reasonably sufficient to bring to the [intending borrower's] notice the existence of the condition."[3]

The disclaimer must be given at the correct time. The obvious place is in a loan application form[4] (which is the formal request by the intending borrower for loan funds) signed by the intending borrower. Some institutions put the disclaimer in the formal loan offer: this may be too late as many institutions will first indicate orally that the loan application has been approved and that the formal written offer will follow. Purchasers often confirm finance on receipt of that oral advice due to the delay which can invariably occur before the formal offer is received. It is suspected that most lending institutions are aware of this practice; the risks are obvious.

To ensure its effectiveness, the disclaimer needs to be notified to the intending borrower. Its inclusion in a loan application form signed by the intending borrower would comply with this requirement, but difficulties could well arise if it is included, as it was in *Yianni*, in the lender's "Explanatory Booklet" about its lending procedures. Purporting to disclaim in this way runs the very real risk that a borrower will be able to successfully argue that proper notification of the disclaimer has not been made.

2 Ensuring the wording of the disclaimer is effective to exclude or negate tortious liability

The wording needs to be clear and unequivocal, and must be more than a mere caution against relying on the lender's appraisal.[5] Consider the wording used by the Housing Corporation in *Miller v S R Smith Ltd.* The relevant parts of form J 3/4 read:

> Special note: As the Corporation is not a party to either your contract for the purchase of the section or the erection of the house, any subsequent claims which you may have in respect of either contract must be taken up, preferably through your solicitor, with the person concerned.
>
> Your attention is drawn to the fact that the contract for the erection of the house is between you and the builder and that the purpose of the inspection is to ensure that the Corporation's requirements in regard to the building as security for the loan are satisfied.

On the first part Judge Willy noted:

> In my view this is no more than a caution to the plaintiffs that if they wish to claim against their vendor, or builder, then [sic - they?] cannot expect the Housing Corporation to prosecute such claim. Viewed in that way the caution illustrates the extent to which the Housing Corporation has come to expect its borrower to rely upon it. It would otherwise be a most curious warning for a mortgagee to feel necessary to give to its mortgagor.

And of the second part:

> As I have said earlier far from negating liability this statement evidences the basis upon which the plaintiffs were entitled to assume and expect that the house as designed and built would comply with the Housing Corporation's requirements including the requirements relating to the foundations. In my view there is no evidence before the Court upon which I could conclude that the parties ever turned their minds to the question of exclusion or limitation of their tortious obligations to each other . . .

VI Policy

What policy factors in the lender-borrower relationship affect the imposition on lenders of a duty to protect intending borrowers from loss arising from negligent "in-house" real estate appraisals?

1 The ability of lenders to avoid liability if they so wish

A lender which presently conducts "in-house" appraisals is faced with an unfettered choice to adopt one of three courses of action. (See generally *Hedley Byrne & Co Ltd v Heller & Partners Ltd*, supra.) First, it can continue to conduct appraisals and accept the duty of

care which those appraisals might attract. Second, it can continue with appraisals and disclaim liability; this is the course adopted by the Housing Corporation. Third, it can stop conducting in-house appraisals; this appears to be the decision taken by an increasing number of lending institutions. (Forty-one percent of survey participants do not conduct "in-house" appraisals.) Certainly no great hardship would be caused to lenders forced to elect which of the three options they wish to follow. To impose lender liability in this area is not to back lenders into a corner; in the final analysis they do have a choice as to the procedure they adopt with regard to real estate appraisal.

2 Protection of the borrower

As lending institutions continue to invite reliance on their services, so too borrowers need to be "protected" – "protected" in the sense of being aware of the exact role the lender is performing with regard to the appraisal, and the duty, if any, the lender is purporting to assume in respect of that appraisal. The borrowers' informed choice becomes the desired aim: being informed as to the differences between the various methods of appraisals and valuations, and being informed of the merits of obtaining an additional independent registered valuation. At the moment intending borrowers can receive the worst of both worlds – paying an appraisal fee and yet often not receiving the benefit of a report from a "professional" appraiser. The informed choice is fundamental in this consumer-oriented age.

3 Ability to bear and spread loss: the role of insurance

Lenders are generally in a much better position to spread loss than are borrowers. In this area, lender liability will tend to arise most often with residential home buyers for whom a house is often their largest single investment and for whom any loss can result in a serious economic burden. On the other hand commercial borrowers are often well placed to bear and spread loss or avoid loss, through retaining their own professional advisers. Lenders are in a similar position to local authorities of whom Lord Denning in *Dutton v Bognor Regis* [1972] QB 373 once said (at 398): ". . . their shoulders are broad enough to bear the loss."

When faced with increasing liability, lenders who continue to conduct "in-house" appraisals are likely to repeat the past reactions of professional groups: contracting-out of liability has not been the traditional response; it has been to accept the possibility of liability and to insure against it. Disclaiming liability does not lie well with the present marketing thrust of banks in encouraging customers to rely more and more on their services. The cost of insurance is low, with lenders being able to effectively self-insure.

4 Will an insurmountable burden be cast on lenders?

The ability to disclaim liability, the low cost of insurance and the ability to self-insure dictate against the burden being too great. And it must be remembered that most lenders now charge intending borrowers for the in-house appraisal.

5 The likelihood of preventing losses in the future by imposing a duty of care, and the ease of implementation

The imposition of an extended duty of care would have little or no effect on the New Zealand housing market; recognition of that duty simply imposes on lenders the obligation of electing which of the three options, detailed above, they wish to adopt with regard to "in-house" appraisals. There is unlikely to be any significant increase in loan fees due to the ability of lenders to self-insure. Also, there is the very real advantage that would accrue to intending borrowers in being fully informed as to the appraisal process. Should lenders who presently conduct "in-house" appraisals decide to require loan applicants to supply registered valuations, the increase in the amount of appraisal fees would be negligible given the level of "in-house" appraisal charges currently imposed by some financial institutions. Again, if lenders *do* adopt that course, at least intending borrowers will receive the benefits of registered valuations and have access to a professional defendant who can be expected to carry liability insurance cover.

6 The extended role of lenders

As lending institutions invite trust and confidence from their customers, the duties of care which they owe to those customers will increase accordingly. It is not thought that Courts will now allow banks and other lending institutions to define their activities narrowly, such as was permitted in *Mutual Life Ltd v Evatt* [1971] AC 793, so as to avoid or restrict their duties of care.[6]

VII Lender Liability: The Future

Whilst it seems that in New Zealand some lenders discount the possibility that a duty of care is owed to intending borrowers in respect of "in-house" real estate appraisals, it is submitted the law is such as to subject a lender to potential liability where it negligently conducts an appraisal. Appraisals form a key element in the lending process, yet lenders adopt a variety of methods to assess the value of real estate. Given the importance of real estate appraisals to both the lender and the borrower, the arguably limited nature of some "in-house" appraisals, and the competition which now exists in the New Zealand financial market, it is hoped that lenders will be far-sighted enough to adopt real estate appraisal procedures which will help to safeguard the interests of their real estate purchasing customers. □

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1 The survey disclosed that "in-house" appraisers have a wide variety of backgrounds and qualifications, however as a general rule most appraisers employed by the survey participants have little or no formal appraisal qualifications.

2 In the context of estoppel Lord Herschel once said: "The very person who makes a statement of that sort has put the other party off making further inquiry. He has produced on his mind an impression as a result of which further inquiry is thought to be unnecessary or useless": *Bloomenthal v Ford* [1897] AC 156, 168.

3 *Hood v Anchor Line* [1918] SC 143, 149 per Lord Dunedin. This test was also accepted in *Grayston Plant Ltd v Plean Precast Ltd* [1976] SC 206, 217-218 per Clerk L J.

4 This is where the Housing Corporation includes the disclaimer in Form J1/2.

5 In *Yianni* Park J noted: "No doubt if the paragraph had been in stronger terms, and had included a warning that it would be dangerous to rely on the valuer's report, then I think that the plaintiffs might well have been held to be negligent."

6 *Mutual Life Ltd v Evatt* has been criticised in *Esso Petroleum Co Ltd v Marden* [1976] QB 801, *Shaddock & Associates Pty Ltd v Parramatta City Council* (1981) 36 ALR 385 and *Meates v Attorney-General* supra.

Law firms and economies of scale

By M J Ross, Department of Commercial Law, University of Auckland

Over the last few years there has been a marked increase in the size of many legal firms in New Zealand. This has been particularly true because of amalgamations of firms. Another development has been the establishment of the Lawlink group of firms. In this article the author considers the advantages and disadvantages of the economies of scale in the practice of the law. The author conducted a survey of one particular type of activity relating to companies and the statutory procedure for a scheme of arrangement under s 205 of the Companies Act 1955. On the basis of the research he concludes that there is clear indication of benefits for larger firms because of the degree of specialisation that can be achieved.

One of the advantages touted by larger law firms is economies of scale – greater specialisation can be provided within the firm and hence a better service for clients.

Evidence to support this view surfaced in a study of schemes of arrangement entered into by companies in Auckland over the four year period, 1980-1983.

A search of the High Court registers at Auckland indicated that during this period a total of 73 companies commenced the statutory procedure for a scheme of arrangement under s 205 of the Companies Act 1955.

A total of 45 companies (62%) completed the requisite procedure with registration of the confirmed scheme with the Registrar of Companies.

There were several possible reasons why companies failed to complete the statutory procedure, including: a change of mind by the company's management; intervention by creditors either disputing the procedure followed or having the applicant company wound up as insolvent; financial cost and time delays. It typically took two-three months for each proposed scheme to complete the statutory procedure.

A further possible reason for failure to complete was a lack of competence or expertise evinced by the firm acting for the applicant company. This was tested by matching the data gathered against the size of the law firm acting.

Classification of firms

The firms were classified by size as follows: small firms (1-5 principals per firm), medium (7-12), and large (14 principals and upwards.) These classifications may seem inappropriate when compared with the size of major law firms in the late 1980s, but it provides a reasonable cross-section of the Auckland legal profession during the period of the survey, 1980-83.

A total of 29 law firms acted for the applicant companies surveyed. On the classification used there were 15 "small" firms, 10 "medium" firms and 4 "large" firms.

1 **Small firms** (1-5 principals per firm)

Small firms initiated a total of 16 different schemes, giving an average of 1.06 schemes per firm. A total of 8 schemes (50%) completed the statutory procedure to get final Court approval but of those which did get Court approval 3 schemes (37%) were not registered with the Registrar of Companies.

A scheme is of no effect until a sealed copy of the Court order confirming the scheme is registered (s 205(3) Companies Act 1955). The blame for failing to register must be laid at the feet of the solicitors acting for the applicant company.

2 **Medium firms** (7-12 principals per firm)

Each firm represented in this category initiated an average of 4.2 schemes. Medium size firms were more likely to have their client companies complete the procedure when compared with small size firms. In this category, 33 schemes (79%) completed the procedure through to Court confirmation, but an embarrassing 6 schemes (18%) did not have a copy of the Court order registered.

3 **Large firms** (14 principals and upwards)

An average of 3.75 schemes were dealt with by each firm in this category. Only 2 schemes failed to complete the statutory procedure. This means 87% of schemes entrusted to larger firms obtained final Court confirmation and all (100%) of these confirmed schemes were registered.

In addition, large firms completed the statutory procedure for s 205 schemes in the quickest average time – 8 weeks.

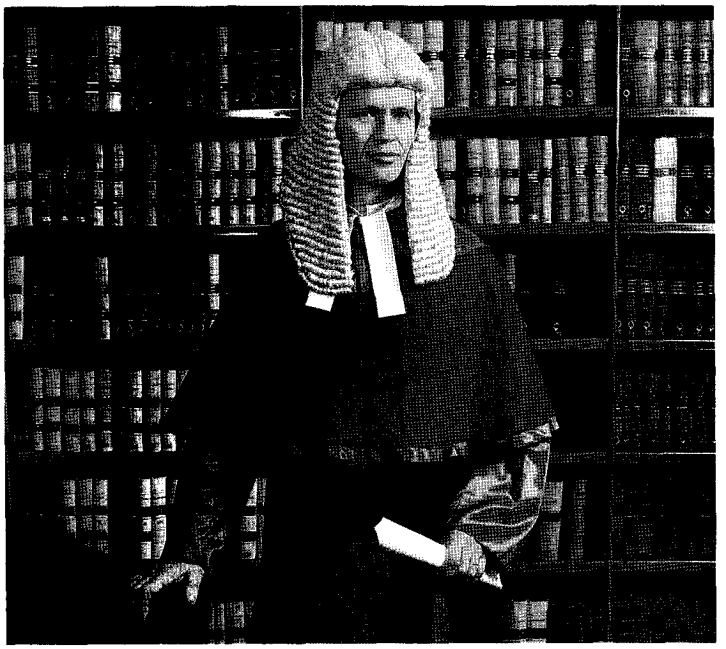
Survey conclusions

The survey indicates that the larger the law firm acting the greater the likelihood both of completing the statutory procedure to the stage of Court confirmation, and on confirmation of having the scheme registered with the Registrar of Companies.

The benefits of specialisation by larger firms are clear. □

Judicial Appointments

Mr Justice Fisher



Mr Justice Fisher was sworn in recently and has taken up his duties as a Judge of the High Court stationed at Auckland.

Judge Fisher is a graduate of Victoria University of Wellington. During his studies he was awarded the R A McGechan Memorial Prize in 1964. He graduated LL M (Hons) in 1966. After being admitted to the Bar in 1955, he was in Wellington for a short time and then joined a firm in Hamilton. In 1970 he started practice as a Barrister on his own in Hamilton.

Judge Fisher wrote a major textbook on matrimonial property that was published in 1977. He did research for this book at Southampton and London Universities, and was later awarded the degree of Doctor of Laws.

While in Hamilton he was a member of the Hamilton District Law Society Council and was active in the Hamilton Citizens Advisory Bureau.

In 1977 he moved to Auckland, continuing in practice as a Barrister. He was active in professional groups and was on various committees of the Auckland District Law Society and the New Zealand Law Society. He has had a particular interest in the question of continuing education for the legal profession.

In Auckland he also served as a Police Disciplinary Tribunal.

The new Judge has lectured and written widely on a variety of legal subjects. These have included family law, intellectual property, evidence and Court procedure. He wrote on the subject of Patents for the *New Zealand Commentary on Halsbury.*

Mr Justice Fraser

On 2 May 1989 the Attorney-General announced the first appointment of a High Court Judge on promotion from the District Court bench.

Mr Justice Fraser was sworn in as a High Court Judge on 12 May and took up his duties in Christchurch. Prior to that he had been a District Court Judge in Christchurch since 1980.

In making the appointment the Attorney-General said that it was unusual, although not unprecedented, to appoint a person who was already a Judge to be a member of another Court in New Zealand. Two former Magistrates had served as temporary Judges of the High Court during the 1970s but this was the first time that a District Court Judge had been appointed to the High Court on the basis that he would be a permanent Judge of that Court.

Mr Palmer said that he did not expect appointments from the District Court to the High Court to become a frequent occurrence. He stated however, that a person who accepted office as a Judge of the District Court should not be debarred from later appointment to the High Court if he or she was suited to that task. In the opinion of the Attorney-General, Judge Fraser would bring different experience to the High Court and would add to its strength.

The new Judge was admitted to the Bar in 1955. He practised in Invercargill where he was a senior partner in the legal firm of Hanan, Harper and Company. From 1971 to 1973 he was President of the Southland District Law Society. The new Judge is married and has two children.

Future agreements and uncertainty of contract:

Money v Ven-Lu-Ree Ltd (Playle v Money) and the effects of *Sudbrook Trading Estates Ltd v Eggleton*

By Jeremy Finn, Senior Lecturer in Law, University of Canterbury

Uncertainty of contracts is a basic problem in the world of commerce. This article considers the problem that existed in those contractual situations where the parties had left aspects of the agreement to be settled later. The issue of some objective means of filling out the contract has been considered by the House of Lords in the Sudbrook Trading Estates *[1983] 1 AC 444 and the question has been taken further by the New Zealand Court of Appeal in* Playle v Money *(reported in NZLR under the name* Money v Ven-Lu-Ree Ltd *[1988] 2 NZLR 414.)The author concludes that this latter case should ensure that the legitimate expectations of the parties (or perhaps only of the plaintiff!) will be better protected.*

Introduction

Practitioners and students of contract alike have long been familiar with the problems of agreements which were challenged as being insufficiently certain. The recent decision of the Court of Appeal in *Playle v Money* (reported in NZLR under the name *Money v Ven-Lu-Ree Ltd* [1988] 2 NZLR 414) on appeal from *Money v Ven-Lu-Ree Ltd* [1988] 1 NZLR 685 demonstrates the some of the problems encountered in previous cases may now be resolved by the Courts, and that there may be fewer cases where the Courts will have to conclude that no enforceable agreement exists.

Although the New Zealand Courts have generally been prepared to give contractual effect to incomplete agreements if sufficient certainty could be established by the use of arbitration clauses (as in *Attorney-General v Barker Bros* [1976] 2 NZLR 495 or implication of terms (eg in *Devonport Borough Council v Robbins* [1979] 1 NZLR 1), difficulties remained in those cases where the parties had left some aspect of the transaction to be resolved at a future time. In such cases the Courts have had to attempt to keep faith with two different and firmly established lines of authority. It was generally accepted that where the parties had reserved a matter such as price to be agreed at a later date *by agreement between themselves* the apparent agreement is invalid and ineffective (see eg *May & Butcher v the King* [1934] 2 KB 17n, *Willetts v Ryan* [1968] NZLR 863); but if the parties had provided in some way for the fixing of the matter left unresolved by the application of some external standard, the Courts would hold there was no uncertainty – certum est quod certum reddi potest (see as examples *Hillas & Co Ltd v Arcos Ltd* (1932) 38 Com Cas 23 and *Foley v Classique Coaches* [1934] 2 KB 1).

Much depended in the "external standard" cases on the machinery provisions which embodied the way in which the matters originally left undetermined were to be settled. If the Courts could spell out adequate machinery, they would do so, whether by the use of arbitration clauses or otherwise (*Hillas & Co Ltd v Arcos Ltd*; *Attorney-General v Barker Bros* [1976] 2 NZLR 495). However, until the landmark case of *Sudbrook Trading Estates Ltd v Eggleton* [1983] 1 AC 444 it was generally held that the Courts could not give contractual force to an agreement where the machinery provisions were defective in that they did not provide an assured method of settling undetermined matters. In *Sudbrook*, the House of Lords held that if the machinery provision could be classed as a subsidiary or minor element of the entire bargain, and that the parties had clearly intended to provide machinery to determine a contractual obligation *objectively*, the Courts were at liberty to substitute new machinery so that the parties' intentions could be achieved.

The significance of *Playle v Money* lies in its extension of the *Sudbrook* principle to cover some cases where the parties have provided no *explicit* machinery to resolve a major term left unsettled in their negotiations other than a provision for the parties to agree in the future as to that term. The Court of Appeal decision indicates that a provision for future mutual agreement will not necessarily result in insufficient certainty, *if the parties intended that the settlement of the matter still to be agreed reflect some objective standard.* Such a provision would appear now to be capable of being a machinery provision to which the Courts can

have regard, and one which allows the Courts to create, if necessary, an alternative method of ascertaining the value or nature of that objective element if the parties fail to reach agreement themselves. This development of the *Sudbrook* principle may well allow the Courts to find enforceable agreements in cases where previously they could not.

The background to the decision in *Playle v Money*

The case originated in an application for relief under s 209 of the Companies Act 1955 by Money, one of the major shareholders in Ven-Lu-Ree Ltd. Those proceedings were adjourned following an agreement that the other shareholders would purchase Money's shares, and after a failure by the respective parties' accountants to agree a price, under the terms of the consent order the matter was submitted to an umpire. The primary issue for the umpire was the date at which the shares were to be valued. Playle and the other shareholders claimed that the relevant date was 30 June, 1986 on the basis of an oral agreement made prior to the commencement of the s 209 action for the purchase of Money's shares by the other shareholders. The agreement provided for various minor matters and for the parties each to seek a valuation of the shares as at the 30 June, 1986 but did *not* provide for a formula for the valuation of the shares.

The umpire made two findings of fact which were to be of great importance later in the litigation. He found that the parties had intended the price of the shares to be a "market" price and that both parties had the possibility of arbitration procedures in mind if there was no eventual mutual agreement as to price. The umpire determined that the September 1986 agreement was binding on the parties, holding that although there was no explcit provision to cover the position of a failure to reach an agreed price, there was to be implied a term that the parties agreed to seek and accept arbitration procedures to determine the price if need be. Thus he held that the September oral agreement was a binding contract, and the valuation date was 30 June, 1986 (the valuation date appears, impliedly, to have been a matter of great importance in determining the amount to be paid for the shares).

Money applied to the High Court to have the determination of the umpire set aside, on the grounds that the finding that there was a binding oral agreement amounted to an error of law. That contention was upheld by Chilwell J (*Money v Ven-Lu-Ree Ltd* [1988] 1 NZLR 685 and the matter was ordered to be remitted to the umpire for consideration of other matters raised by the would-be purchasers. Chilwell J took the view that the implication of the term that the umpire had found should be implied transgressed the principle stated in *Aotearoa International Ltd v Scancarriers A/S* [1985] 1 NZLR 513 and amounted to making for the parties an agreement they had failed to make for themselves.

The Court of Appeal decision

Playle and the other would-be purchasers appealed from this decision, and their appeal was allowed by the Court of Appeal (Cooke P, Richardson and Bisson JJ). The reasoning of the judgments is not entirely the same but the approach taken by all of the Judges indicates that the Courts may be even more ready to find sufficient certainty in an agreement than in prior years. As the judgments were given on the day of hearing, the differences of expression among the Judges may be of less significance than in some cases, but it is perhaps worth considering the essential parts of the reasoning of the various judgments.

Cooke P began by referring to certain established principles – that the Courts cannot add implied terms to an indefinite agreement so as to make a contract for the parties but that if the conduct of the parties indicates an intention to be bound and is sufficiently definite in its terms, the Courts may imply terms to clarify the exact nature of the contractual obligations established by the agreement. He continued:

> Into which category a given case falls can be a difficult question. It may be seen as resolving into whether there is sufficient certainty in what has been expressly agreed to warrant the Court in proceeding to the further stage of considering implications. . . . In modern times the Courts have tended in the main to seek to give business efficacy to agreements apparently reached, provided that some standard or machinery can properly be found for supplying what is lacking in the express terms. . . . Another important consideration is that reasons given by an arbitrator or umpire should be read fairly and as a whole. Awards should not be vitiated by fine points; the modern approach is in favour of sustaining awards where that can fairly be done, rather than destroying them.
>
> Approaching the present case in the light of those various principles or considerations, I think that normally an agreement to buy and sell at valuation implies the objective test of a fair valuation and is sufficiently certain. If necessary the Court can arrive at the figure on evidence, even though the evidence on the two sides may very well be conflicting. . . .
>
> . . . The *Sudbrook* case brings out that, if arbitration machinery cannot be resorted to or breaks down, the Court may arrive at the valuation on evidence directed at an objective standard. Once such a standard has been agreed, the binding force of the contract is not affected by the presence or absence of an arbitration clause.

Cooke P's judgment therefore appears to proceed on the basis that if the Court is satisfied in any contract that the parties intended an objectively assessed or "fair" or "valuation" price, the Court can and should hold the agreement binding. At different points in his judgment he seems to fluctuate between two rather different, but allied, lines of reasoning. The first is that deficiencies in the original agreement can be cured by the Court supplying machinery to fix the price (with the Court acting in default of success in such machinery) for itself; the second that the Court may resolve any uncertainty by supplying fresh machinery to replace defective and inessential machinery provisions which the parties had themselves provided to determine the

quantification of the "objective" or "fair" price.

The importance of the different lines of reasoning is that the first assumes that the Court is *creating* machinery, not merely rectifying problems with defective machinery. This would go very much further than *Sudbrook* did, and certainly appears to be going much further toward the Court creating a contract than would the other Judges. On this view the umpire did not need to imply a term as to arbitration. Cooke P did make reference to implied terms, and this may mean he was really assenting to the second view — that the implication of the term was valid as a method of remedying a defect in the machinery the parties had themselves provided.

The reasoning of Richardson J straddles both the line of approach taken by Cooke P and the rather narrower approach taken by Bisson J. Richardson J stated:

> The crucial question is whether the parties had expressed themselves with sufficient certainty as to the terms of their agreement. As to that, it is well settled that, if the Court is satisfied that the real intention of the parties was to enter into an immediate and binding agreement, the Court will do its best to give effect to that intention and that is as true where it is suggested there is apparent uncertainty as to price as in relation to other material terms. . . . So where the price is not specifically fixed in money, it is a matter of determining whether some means or standard by which that term can be fixed is to be found in the agreement. *If the price is still subject to the agreement of both parties, then that necessary certainty is lacking. It is a different matter if there is a manifest intention on the part of the parties that the property be sold and that the price be fixed on an objectively ascertained basis.* (emphasis added)
>
> . . . I do not see any error of law on the part of the umpire in implying such a term. Where the machinery the parties have provided for the ascertainment of the objectively ascertainable price will not work, it then becomes a matter for the Court to determine the price according to that standard, unless of course the machinery provided constitutes an essential term of the contract. (*Sudbrook* per Lord Fraser at 483-4). It was not suggested that this was such a case or that that point had been reached. . .

As the emphasised passage above shows, Richardson J would appear to agree with the contention advanced by Cooke P that a provision for some term of the contract to be mutually agreed at a future date *on an objective or market basis* does not mean that the contract lacks certainty.

By contrast, Bisson J while apparently not questioning the "objective agreement" standard, placed greater emphasis in his judgment on the umpire's finding of fact that the parties had the possibility of arbitration in mind should there be a failure to agree on a price to complete the September 1986 transaction. His primary concern was the validity of the implication of the term as to arbitration which the umpire had found was to be implied. A vital part of his judgment was as follows

> . . . In my view the parties to the share sale had agreed on a price to be fixed by valuation. That was their formula for the determination of a fair price. All that was necessary was to imply an added term to overcome a stalemate in a transaction they wished to complete. I have already set out a finding of fact, "that each had in mind that arbitration procedures could be used". This finding is essential to the decision of the umpire to imply that term. The introduction of that implied term is in line with the approach of the Courts in a number of cases to give effect to the intention of the parties. . . . All that has been done by the introduction by the umpire of the implied term is to cure a lack of certainty in so far as the two valuations may differ. All that is needed is some machinery or formula to resolve that difference — namely, the appointment by the two accountants of a third party to settle the issue. It is by such a machinery provision that business efficacy is given and a reasonable price determined, based on a valuation on professional standards, of the shares as at 30 June 1986. (See *Sudbrook Trading Estate Ltd v Eggleton & Ors*) [1983] AC 444).

Richardson and Bisson JJ both appear, to varying extents, to have regard to the issues of principle involved in implying terms into agreements such as this — a matter which Cooke P would apparently find it unnecessary to consider in detail. On Bisson J's view, the finding that there was intended to be an objective or "fair" price becomes only the setting from which the Courts are prepared to hold that an implied term as to arbitration was necessary to give business efficacy to the argument, with the implied term then providing the necessary certainty for the agreement. Cooke P and Richardson J, it would appear, would take the view that an agreement for a future determination of a "fair" or objectively assessed price in itself may provide sufficient certainty — the implication of a term is then only done to rectify any otherwise defective machinery.

The possible effects of the decision

However, although there are differences in the reasoning and the emphasis placed on different factors, the decision in *Playle v Money* appears to establish a new approach to determining questions of certainty in agreements which leave some matter to be determined at a future time. The judgments may support either, or both, of two approaches to determining contractual certainty in those cases *where the parties have intended the matter left for future agreement is to be determined on an objective standard.* In either case, the Courts can, and should, find a means of rendering the contract certain. The first approach, which appears more strongly in the judgments of Cooke P and Richardson J than in that of Bisson J, is in effect to consider that a failure by the parties to agree on the objectively assessed term in the future would be no more than the failure of a machinery term, and

therefore only as to a minor matter which can be replaced by the Courts under *Sudbrook*. The second line of approach is to take the view that where the parties have intended an objective determination of a matter left undecided, the Courts can, and should, imply a term for some machinery provision which would be necessary to ensure that the parties common intention is achieved.

The objective agreement and machinery argument

This approach requires that the Courts accept that where an agreement leaves some matter unresolved but expressly or impliedly provides for it to be determined by valuation or by some other "objective" procedure, the provision as to the future can be regarded as a mere machinery provision. This argument is, in many ways, appealing both conceptually and practically, and would allow the Courts to enforce agreements in appropriate cases, while leaving businessmen free to adopt more flexible forms of business practice.

It is interesting to note that in *Didymi Corporation v Atlantic Lines and Navigation Co Ltd. The Didymi* [1988] 2 Lloyd's LR 108 (a case decided in October 1987, but only recently reported and therefore not before the Court in *Playle v Money*, the English Court of Appeal took a similar view of the *Sudbrook* principle. *The Didymi* concerned the enforceability of a provision in a charterparty which stated that the hire to be paid to the ship's owners should be increased or decreased, according to the ship's performance, by an "equitable" amount to be mutually agreed between the parties. The Court of Appeal upheld the judgment of Hobhouse J that the clause created a binding contractual obligation, even though in appearance it related to a future agreement by the parties. Bingham LJ ([1988] 2 Lloyd's LR 108 at 115) and Nourse LJ (ibid at 118) held that *Sudbrook* applied – the intention of the parties was to use an *objective* standard in the negotiations between themselves – and as such, the Courts could replace the contractual machinery if this was necessary to allow an *objective* or *fair* price to be fixed. The critical point of the decision was that the Court took the view that *future agreement of the parties on some objective or fair reduction* was *in itself* the machinery provision to resolve any alleged uncertainty. This approach accords well with the reasoning of Cooke P in *Playle v Money.*

Recognition by the Courts that a provision for mutual agreement on an objective standard is a machinery provision only would allow the question of certainty to be approached on a footing more consistent with commercial practice. If the Court is satisfied that the parties to a contract had a common intention, be it express or tacit, that a matter left to be mutually agreed at some future time *on an objective not a subjective basis* intention, the Court should hold that there is machinery capable of resolving any element of uncertainty originally apparent in the agreement – because there is then the requisite "machinery" to resolve the uncertainty. The provision for future agreement on a "fair" or "objective" standard is in itself the contractual machinery needed to prevent the agreement being void for uncertainty. If that machinery is defective (in that the parties fail to agree) the *Sudbrook* principle can operate, and allow the Courts to provide a substitute machinery to settle the disputed matter on the "objective" basis.

Naturally, in such cases the Courts may have to order various steps to be taken by the parties to implement the agreement – the parties themselves might have to try to reach agreement, but failing that the Court could step in.

There will of course also be cases where the Courts are not able to adopt this approach – because the provisions of the agreement do not reflect an intention for the matter which is to be determined in the future to be ascertained on an objective basis. The Courts could not, for instance, have remedied the defect on the agreement in *Willetts v Ryan* [1968] NZLR 863 – if the parties have expressed a desire for the matter to be settled "by mutual arrangement", there is surely no possibility of substituting for such arrangement the determination of any other person. There are a number of English decisions which indicate constraints on the application of the *Sudbrook* principle, and these may provide some guide to the applicability of *Playle v Money.* It is clear that machinery provisions cannot be replaced under *Sudbrook*, even if they are defective in some way, if the parties are to be taken as having regarded the machinery as essential (see eg *McLeod Russel (Property Holding) Ltd v Emerson* [1985] 1 Estates Gazette LR 258, 51 P & CR 176, and *Metrolands Investments Ltd, v J H Dewhurst Ltd* [1985] 3 All ER 206, 49 P & C R 334, [1985] 1 EGLR 105). It is also clear that the Court cannot use *Sudbrook* to authorise the replacement of an effective machinery provision with another, even if it would be more efficient to use a substitute provision – *Northern Regional Health Authority v Derek Crouch Construction Co Ltd* [1984] 1 QB 644, [1984] 2 All ER 175).

It is also relevant to note that *Sudbrook* may be more easily invoked in cases where the alleged agreement has been partially or completely executed by the party seeking the Court's assistance. The Courts have always been readier to find a means of rendering the contract certain enough to be enforced against the non-performing party in such cases, as in *Foley v Classique Coaches* [1934] 2 KB 1 – and this has already been shown in at least one English case. The decision in *Trustees of National Deposit Friendly Society v Beatties of London Ltd* [1985] 2 EGLR 105 – a case in which Goulding J held that the Court could import terms to render enforceable a lease allegedly arising from an exchange of letters, where the missing elements included the date of the commencement of the lease, the rental payable and the conditions of the lease – is obviously affected to a large extent by the fact that the contract had been performed in good faith by one party.

The implied term approach

This approach depends on implying some term into an agreement which provides for a matter to be determined in the future by the parties which will cover the position if the parties cannot later agree. The conceptual difficulty here is that implying a term as to arbitration or any other *particular* machinery for resolving a dispute is difficult to square with the traditional approach

to the implication of terms in fact.

The first, and perhaps lesser, difficulty in implying terms to complete any agreement is to ensure that the Courts do not make a contract for the parties which they had not made for themselves. As the decision in *Aotearoa International Ltd v Scancarriers A/S* [1985] 1 NZLR 513 shows, there are limits on the powers of the Courts to give substance to the unexpressed contractual intentions of one or other party. However, it is submitted that the *Playle v Money* approach to implication of machinery terms does not conflict with the decision in *Scancarriers*. In that case, the implied term accepted by the Court of Appeal and rejected by the Privy Council, was, in essence, a fresh and substantial obligation to be borne by one party – the duty to make shipping space available as it was required by the other party. The implication of such a major obligation is not, in principle, correct on any view of the standard tests for implied terms, and therefore it had to be rejected.

There is, however, a very substantial difference between implying what is essentially a *primary* obligation outside those agreed by the parties into the contract, as in *Scancarriers*, and implying a term which clarifies or defines the way in which a primary obligation under the contract is to be carried out. Such implied terms have long been used to ensure that an apparent agreement which the parties consider themselves to have made does not fail for lack of certainty (see as examples such well-known cases as *Hillas & Co Ltd v Arcos Ltd* (1932) 38 Com Cas 23 and *Foley v Classique Coaches* [1934] 2 KB 1.)

The greater difficulty, perhaps, lies in reconciling the implication of machinery terms with the accepted principles governing the implication of terms "implied in fact". The leading recent statement of the conditions under which such a term may be implied by the Courts is that of the Privy Council in *BP Refinery (Westernport) Ltd v Shire of Hastings* (1977) 16 ALR 363 at 376 (adopted in New Zealand in *Devonport Borough Council v Robbins* [1979] 1 NZLR 1 and *Prudential Assurance Co Ltd v Rodrigues* [1982] 2 NZLR 54.) In the *BP Refinery (Westernport)* case, it was held that a term could only be implied into a contract if:
(1) it was reasonable and equitable;
(2) it was necessary to give business efficacy to the contract, so that no term would be implied if the contract was effective without it;
(3) it was obvious (ie one which "goes without saying");
(4) it was capable of clear expression;
(5) it did not contradict any express term of the contract.

The implication of a term to provide for a mechanism for resolving the problems that may arise out of any failure by the parties to reach agreement as to a matter left for later determination on an objective basis which clearly fulfils most of the criteria in the *BP Refinery (Westernport)* case – it would be reasonable and equitable; it is necessary to give business efficacy to the agreement, it does not contradict the express terms of the contract; it is capable of clear expression. The difficulty is with the third criterion – that it be "obvious". If there are a number of different possibilities as to the terms to be implied, then it may well be that no single one of them is *obvious* and therefore none can be implied as a term of the contract (*Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board* [1973] 1 WLR 601; [1973] 2 All ER 260).

This element of principle seems to have received little consideration by the Court in *Playle v Money*. Bisson J, who examined the matter more closely than the other Judges, appears to have held that since the umpire had found as a fact that both parties had the possibility of arbitration procedures in mind, an implied term that resort could be had, if need be, to arbitration was both necessary and obvious. Where it is possible to determine from the factual matrix surrounding the transaction that there was such a common intention, there would appear to be no objection to using this common intention as a basis for implying a particular term (compare *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337; 41 ALR 367 and Deane J's judgment in *Hawkins v Clayton* (1988) 78 ALR 69).

Even though many cases could be dealt with in this way, there may still be difficulties in cases where the parties have reserved some matter for future agreement, even on an objective basis, with each being of the view that some procedure be used in the event of a failure to reach agreement. If there is no implicit consensus as to the external machinery to be used if the occasion requires it, the implication of any term is difficult to justify. The Court would be implying into the agreement a matter which is neither obvious nor one that can be said to be one that the parties would undoubtedly have agreed to.

The problem is not insoluble, however. There can be little objection, in those few cases where no other implied term is "obvious", to the Courts determining that the appropriate method for the resolution of the failure to agree is to imply a tacit agreement by the parties that any dispute be settled by reference to the Court or by such procedures as the Court should provide. To say that the parties may be taken to have agreed that, "if all else fails, the Courts can sort it out" may be implying a most inelegant term; but it is hardly one that would not accord with most commercial expectations. This approach does ensure that business efficacy is given to the agreement (a matter stressed as important in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41; 55 ALR 417 and the *Codelfa* case) and, especially in cases where the contract has been partially executed, the Courts would surely be achieving a result in line with the parties' original expectation. There is some little authority for such an approach – the Australian Courts do seem to indicate that where a contract has been partially executed, the Courts need not adhere rigidly to the probanda in the *BP Refinery (Westernport)* case. (eg see the views of Deane J in *Hawkins v Clayton* (1988) 78 ALR 69 at 91-93.)

An alternative approach, which may be simpler, is to treat the implication of terms by the Court in *Sudbrook*-type cases as being in a class distinct from "terms implied in fact", and more akin to terms implied by operation of law (as to which see *Liverpool City Council v Irwin* [1977] AC 239). This would require the Courts to hold that in the class of contracts where the

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Motor Vehicle Securities: The quagmire deepens

By D W McLauchlan, Professor of Law, Victoria University of Wellington

In this article Professor McLauchlan introduces and evaluates the Motor Vehicle Securities Act 1989. He concludes that, while the Act is a worthwhile consumer protection measure, the need for comprehensive reform of the law of chattel securities is now more pressing than ever.

Introduction

The passing of the Motor Vehicle Securities Act by Parliament in April this year is likely to receive a mixed reaction from the legal profession and the commercial community, at least if the submissions to the Commerce and Marketing Select Committee are a reliable guide. (The legislation was supported, for example, by the Motor Vehicle Dealers' Institute, the Financial Services Association and the Automobile Association, but it was opposed by the Law Society, Bankers' Association and Society of Accountants.) There are undoubtedly many who will greet the legislation as a welcome attempt by Parliament to solve the long-standing problem of "cheating at cars" whereby unsuspecting and innocent purchasers buy motor vehicles (whether from a dealer or privately) only to have them repossessed by finance companies claiming prior security interests. Others, however, will bemoan the fact that the legislation deals with security interests in motor vehicles only and does not effect the much needed comprehensive reform of the law of chattel securities.

The present writer has some sympathy for the former view. The pragmatic and political considerations which persuaded the Government to proceed with piecemeal reform are readily understandable. It is in relation to motor vehicle transactions that the deficiencies of our chattel securities law have had the most visible and serious impact on the public at large. The calls for reform from various pressure groups, which the Government began to take seriously only after a series of "Fair Go" television programmes in 1986, have focused almost exclusively on the motor vehicle security. Nevertheless, it must be said that, regardless of the improvements to the law as it affects motor vehicle securities, the overall effect of the Motor Vehicle Securities Act is to compound the infuriating complexity and irrationality of the law of chattel securities. This is particularly regrettable when it is appreciated that, at the same time as the legislation was being prepared by the law reform division of the Justice Department, the Law Commission as part of its company law reference had taken the initiative and commenced investigating wider reforms. It had retained Professor John Farrar and Mr Mark O'Regan to study the workings of Article 9 of the Uniform Commercial Code and the Canadian legislation modelled on Article 9. It is also regrettable that for some time neither law reform agency knew that the other was working on the same subject. This is one of a number of recent examples of inefficiency in our law reform arrangements which have resulted in unfortunate duplication of effort and waste of resources.

Interestingly, a mere nine days after the Motor Vehicle Securities Act was given the Royal Assent, on 26 April 1989 the Law Commission presented its Report No 8 to the Minister of Justice which recommends a new Personal Property Securities Act for New Zealand. The proposed legislation will, the Commission hopes, eventually supersede the Motor Vehicle Securities Act, perhaps even before the latter comes into full force on 1 April 1990. The present writer, as a member of the Commission's advisory committee, is similarly hopeful that

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parties have stipulated for a future mutual agreement on some objective or market basis, a term for settlement of the matter by such procedure as the Courts might decide is implicitly required by the agreement if the expectations of the parties are to be satisfied. Such a term is, again, admittedly inelegant, but it would not be seriously out of line with principle or commercial expectations.

Conclusion

Although *Playle v Money* does not leave the issue of future agreements entirely free of questions of reconciling varying lines of relevant authority, it certainly indicates a far greater willingness by the Courts to enforce agreements, and renders it possible for the parties to agreements to be bound by promises of future negotiation and agreement. It would now appear that there will be fewer cases where the Courts will have to decide that an agreement had been left incomplete, and the legitimate expectations of the parties to such an agreement may be better protected. Only those cases where the parties have stipulated for subjective considerations to govern the final determination of a matter left unresolved can now be classed as too uncertain to be enforced. Such an approach is surely to be welcomed by businessmen and practitioners of law alike. □

comprehensive reform of the law of chattel securities is just around the corner, but there appears to be little chance that the Motor Vehicle Securities Act will not proceed on schedule. Indeed, while the current Minister of Justice remains in office and adheres to his present view that the new personal property security law contemplated by the Law Commission would not be in the interests of harmonisation of New Zealand and Australian business law, the Commission's report will not be implemented at all.

The Act in outline

According to its title, the object of the Motor Vehicle Securities Act is

> to provide for the registration of security interests in, and other information relating to, motor vehicles and to amend, in certain respects, the law relating to the disposition of and the creation of interests in motor vehicles subject to security interests.

The main features of the Act are as follows:

- The establishment of a central registry of security interests in motor vehicles to be administered by the Department of Justice. This registry, which commences full operation on 1 April 1990, will be independent of the High Court and Companies Office registries provided for under the Chattels Transfer Act 1924 and the Companies Act 1955.

- The creation of a new set of priority and title rules in relation to competing dispositions of motor vehicles.

- The Chattels Transfer Act 1924 will cease to apply to motor vehicle securities as from 1 April 1990. Thus a mortgage of a motor vehicle will no longer be an instrument affected by the registration and avoidance provisions of the Chattels Transfer Act. Motor vehicles are excluded from the definition of chattels in that Act. Since the Motor Vehicle Securities Act contains no equivalent of s 18 of the Chattels Transfer Act, one consequence is that a mortgage of a motor vehicle granted by an individual can no longer be avoided for non-registration on the insolvency of the grantor. On the other hand, a hire purchase agreement in relation to a motor vehicle can no longer enjoy the status of being "customary", ie valid for all purposes without registration even against a bona fide purchaser.

- The registration provisions of Part IV of the Companies Act 1955 remain in full force. Mortgages and fixed charges in respect of motor vehicles granted by a company will require registration under both the Companies Act and the Motor Vehicle Securities Act. Furthermore, in one important respect, the ambit of Part IV has been increased. Assignments by way of mortgage of hire purchase agreements relating to motor vehicles will no longer be exempt from registration (see s 2(8) of the Chattels Transfer Amendment Act 1931) since, as mentioned above, such hire purchase agreements are no longer customary.

- Where a consumer (any person other than a finance company and a motor vehicle manufacturer, wholesaler or dealer) buys, or acquires under a hire purchase agreement or lease, from a licensed motor vehicle dealer a motor vehicle which is subject to a security interest, the security interest is extinguished irrespective of whether that interest is registered under the Act. In the case of other sales, hire purchase agreements or leases, the security interest will be extinguished only if the buyer, hire purchaser or lessee takes without notice. The latter will be deemed to have notice where the security interest is registered under the Act.

- In the case of competing security interests in motor vehicles priority is conferred according to the time of registration.

- Provision is made for the entry in the register of particulars of stolen vehicles upon receipt of such information from the Police.

Application of Act

The key definitions in s 2 of the Act are those of "motor vehicle" and "security interest". The term "motor vehicle" or "vehicle":

(a) Means a vehicle, including a trailer, that –
  (i) Is equipped with wheels, tracks, or revolving runners upon which it moves or is moved; and
  (ii) Is drawn or propelled by mechanical power; and
  (iii) Has a registration number or chassis number, or both of those numbers.

(b) Includes any other vehicle that is declared in regulations made under this Act to be a motor vehicle for the purposes of this Act; but

(c) Does not include–
  (i) A vehicle running on rails; or
  (ii) An aircraft; or
  (iii) A trailer (not being a trailer designed solely for the carriage of goods) that is designed and used exclusively as part of the armament of any of Her Majesty's Forces; or
  (iv) A trailer running on 1 wheel and designed exclusively as a speed measuring device or for testing the wear of vehicle tyres; or
  (v) A vehicle designed for amusement purposes and used exclusively within a place of recreation, amusement, or entertainment to which the public does not have access with motor vehicles; or
  (vi) A pedestrian-controlled machine designed to perform some mechanical operation and not designed for the carriage of persons or goods; or
  (vii) A pedestrian-controlled forklift.

Two significant features of this definition should be noted. First, it includes trailers and caravans, but excludes boats. Secondly, the vehicle must have a registration number or a chassis number, or both of these numbers. Accordingly, vehicles

which have not been registered but which have a chassis number are included. An important consequence of this is that wholesale financing arrangements which hitherto have escaped registration requirements are subject to the Act. The finance company or motor vehicle manufacturer who supplies vehicles to a dealer pursuant to floor plan or other retention of title terms will, no doubt much to their dismay, need to register in order to preserve their priority in the event of the dealer subsequently granting a security interest to a third party (say, a mortgage or charge to its bank) or selling to non-consumers.

The implications of the Act for the wholesale finance industry are not, however, as serious as they would have been if the legislation had proceeded in the form in which it was introduced to Parliament. The Motor Vehicle Securities Bill defined "motor vehicle" as "a motor vehicle that is registered under Part I of the Transport (Vehicle and Driver Registration and Licensing) Act 1986 . . . ." Thus, the legislation did not apply to new vehicles supplied to a dealer since such vehicles were not normally registered until the point of sale to the consumer. The industry's fear was that a financially distressed dealer could defeat the wholesaler's security interest by first registering the new vehicles and then either selling them at a forced sale or obtaining further credit on the security of the vehicles. Thus, to protect its position the careful wholesaler would have been obliged to insist on cash on delivery or incur the expense and inconvenience involved in both registering new vehicles under the Transport Act and registering its security. The Act as finally passed is a compromise. The wholesaler can register its security by reference to chassis numbers without having to register the vehicles. Furthermore, the Act also provides that even an unregistered security interest will not be defeated in the event of a forced sale if the purchaser knows that the sale is not in the ordinary course of the seller's business; s 31.

"Security interest" is exhaustively defined and catches "any interest in or power over a motor vehicle . . . which secures the payment of a debt or other pecuniary obligation or the performance of any other obligation" other than the possessory securities – the possessory lien and pledge. Expressly included are leases, hire purchase and conditional sale agreements, fixed charges and (for the purposes of Part II of the Act) floating charges that have become fixed in relation to a motor vehicle.

The primary concern of this definition is to ensure that, in every situation where a person obtains or is in possession of a motor vehicle with the consent of the owner or someone claiming a proprietary interest in the vehicle, third parties dealing with the person in possession should be able to ascertain the true situation by consulting the register. It is questionable, however, whether this objective has been achieved. Consider the following not uncommon situation:

> O sells her car to B, a rogue, who gives a cheque for the price which is drawn on insufficient funds. O contacts the police, thereby effecting a rescission of the contract which revests title in O. B then sells to T who takes in good faith.

There is some authority for the view that T obtains good title under the *nemo dat* exception in s 27(2) of the Sale of Goods Act 1908; see *Newtons of Wembley Ltd v Williams* [1965] 1 QB 560. But there is a strong argument that s 27(2) does not apply. Since the effect of a rescision is to avoid the contract *ab initio*, the rogue cannot be a person "having bought or agreed to buy" within the meaning of the opening words of s 27(2). If this is the case (so that prima facie the *nemo dat* rule applies) there is nothing in the Motor Vehicle Securities Act to assist T. O's ownership interest arising from the rescission does not fall within any of the categories of security interest. Accordingly, neither T nor any subsequent purchaser (including a purchaser from a dealer) will acquire good title. The position will be no different than if B had stolen the car from O.

Another, albeit less common, situation not involving a security interest so that there is nothing in the Act to assist the bona fide purchaser, is the well-known "mistake of identity" scenario where the basic facts are as follows:

> O parts with possession of her car pursuant to an apparent contract of sale with B, a rogue, in reliance on B's fraudulent misrepresentation that he is a reputable third person, X. B then purports to sell the car to T who takes for value and without notice of B's fraud.

The law relating to this kind of situation is confused and complex, particularly in New Zealand since the enactment of the Contractual Mistakes Act 1977; see generally McLauchlan (1983) 10 NZULR 199. For present purposes, however, it suffices to say that *if* a Court were to follow the analysis in *Ingram v Little* [1961] 1 QB 31 in preference to the analysis in *Lewis v Averay* [1972] 1 QB 198 T would be liable in conversion to O. The "contract" between O and B would be void for mistake, legal title to the car would remain in O, and therefore (regardless of whether there was a rescission before the sale to T) B would simply not have title to pass to T.

The Registration System

Section 4 of the Act establishes the position of Registrar of Motor Vehicle Securities to be appointed by the Secretary for Justice under the State Sector Act 1988. The duty of the Registrar is to establish and maintain a register of security interests in motor vehiccles; s 5. Every holder of a security interest in a motor vehicle may apply to the Registrar for registration of that security interest by filing an application containing the details prescribed in s 6(2). Where the application is in due form the security interest must be entered in the register before 9 am on the next registering day and is deemed to be registered at 9 am on that day; s 8. Under s 10 any person may enquire of the Registrar whether or not a security interest is registered in respect of a specified motor vehicle and the Registrar is required to respond to that enquiry. Provision is also made for application for a certificate in respect of a specified motor vehicle; s 11. On receipt of such application the Registrar must issue a certificate which states, inter alia, whether or not a security

interest is registered in respect of the motor vehicle and, if one is so registered, the registered particulars. Disclosure of the amount of the debt or the details of the other obligation secured is expressly prohibited; s 13. A certificate issued expires at 9 am on the day after the date of issue; s 12. Sections 14-21 of the Act contain detailed machinery provisions relating to the cancellation of registration and amendment of the register.

At the time of writing the precise day-to-day workings of the register had not been settled but the writer's inquiries reveal the following general features. There will be a central computerised register, probably located in Auckland, run by the Department of Justice Courts Division which will be completely independent of the motor vehicle register under the Transport (Vehicle and Driver Registration and Licensing) Act 1986. An application for registration will be on a standard form which may either be filed at a District Court (which will in turn transmit the form by facsimile to the central registry) or submitted direct by facsimile or courier delivery to the central registry. No form will be accepted for registration until it reaches the central registry. Two types of search will be available. First, freephone inquiries to the central registry which will give a yes, no, or no match response. There will be no charge for this service which will initially be available on seven days a week and on Thursday, Friday and Saturday evenings. Secondly, application for the certificate provided for in s 11 may be made direct to the central registry or at a District Court office. Telephone requests from users with credit facilities may be accepted. Applications for certificates made at the District Court will be submitted to the central registry by facsimile and the certificate returned in the same way, hopefully while the applicant waits. The certificate will provide the registration and chassis numbers, the names of the creditor and the debtor, the date of registration and the date and time of issue of the certificate. It is envisaged that the certificate could be a copy of the registration application but with confidential information electronically blanked. Fees are likely to be in the region of $10-15 for registration and $8-10 for search certificates.

Ordinary members of the public searching the register before completing a purchase should rarely need to incur the latter expense especially if, as seems to be envisaged, all telephone inquiries are recorded on tape and hence can be verified subsequently. A simple "no registered security" response should be adequate protection provided, of course, that the purchase is completed before 9 am on the following day. The advantage of having a certificate will be that it provides ready proof of the state of the register at the time of the search in the event of a later dispute. Subject to this qualification, the comment of the Minister of Justice, Geoffrey Palmer, in the course of the first reading debate on the Bill, that "People can't rely on oral inquiries" (*Hansard*, 3 May 1988, p 3863) appears to be wrong.

Part II — Dispositions of Motor Vehicles subject to Security Interests

(a) Dispositions by dealers to consumers

Registration of a security interest under the Act constitutes notice (s 29) but does not necessarily preserve the validity of the security interest. Section 24 provides that where a "consumer" purchases from a licensed motor vehicle dealer a motor vehicle that is subject to a security interest the security interest is extinguished and, if title to the vehicle was vested in the holder of the security interest, that title passes to the consumer. A consumer is any person other than a motor vehicle manufacturer, a motor vehicle wholesaler, a licensed motor vehicle dealer, or a finance company (as defined in s 2 of the Motor Vehicle Dealers Act 1975). The consumer takes free of the security interest regardless of (a) whether it was registered under the Act and hence notice given and (b) whether the dealer was the debtor in relation to the security interest, except in the limited situations mentioned in s 26. It should also be noted that, where the actual seller to the consumer happens to be a finance company which previously bought the vehicle from a dealer with a view to selling it to that consumer, the dealer is deemed to be the seller to the consumer; s 2(5).

A similar protection applies where consumers take a motor vehicle on hire purchase or lease from a dealer; s 25. Any security interest in the vehicle is extinguished and, if title to the vehicle is vested in the holder of the security interest, that title passes to the dealer.

In the event that a security interest is extinguished pursuant to the above provisions, the secured party is not necessarily relegated to a personal claim against the defaulting debtor. Where the dealer had notice of the security interest (usually because it was registered under the Act), the dealer is obliged to pay to the secured party the amount outstanding in respect of the debt or other obligation secured by the security interest; ss 34 and 38(1). When payment is made to the secured party, the dealer becomes subrogated to the latter's rights against the debtor; ss 37(1) and 38(4). If the dealer defaults the secured party has the limited right of recourse to the Motor Vehicle Dealers Fidelity Fund specified in ss 35 and 38 provided that the vehicle disposed of by the dealer is a motor vehicle as defined in s 2 of the Motor Vehicle Dealers Act 1975. (The latter restriction means that there will be no right to reimbursement from the Fund where the vehicle is a caravan or trailer.) In the event that reimbursement is made by the Fund, the latter is subrogated to both the secured party's rights against the dealer (ss 37(2) and 38(4)) and the secured party's rights against its debtor (ss 37(1) and 38(4)).

(b) Other dispositions

In the case of dispositions other than by dealers to consumers the validity of a security interest against purchasers, hire purchasers and lessees is dependent on whether the latter take with notice of the security interest. For the purposes of the Act, a person has notice if the security interest is registered or there is actual knowledge of the interest; s 29. Registration will not, however, constitute notice in respect of the engine of the vehicle in question if that engine is later transferred to another vehicle; s 33. Where a purchaser takes without notice of a security interest, that interest is extinguished and, if title to the vehicle was vested in the holder of the security interest, title passes to the purchaser; s 27. Similarly, where

a hire purchaser or lessee takes without notice the secured party is bound by the terms of the hire purchase agreement or lease (s 28) and (under s 32) steps into the shoes of the person who disposed of the vehicle.

The above rules do not apply, however, unless the vehicle is acquired from the debtor or a person having a superior interest vis-a-vis the debtor in terms of s 30(b).

Illustrations

1 B's motor vehicle is subject to an unregistered security interest in favour of O. B wrongfully sells the vehicle to T who has actual knowledge of O's security interest. T later sells to T2 who does not know of O's security interest. That interest is defeated under s 27.

2 B's motor vehicle is subject to an unregistered security interest in favour of O. T steals the vehicle from B and sells it to T2 who is unaware of the theft and the security interest. The proprietary rights of both B and O are unaffected.

A further limitation on ss 27 and 28 is enacted by s 31. Where a person who is not a consumer (eg a motor vehicle dealer) purchases or acquires a vehicle from any other person who is not a consumer (eg another motor vehicle dealer) the security interest is not extinguished if the former knows that the sale or other disposition is not in the ordinary course of business of the latter.

(c) Miscellaneous provisions

A security interest may be extinguished under the above rules notwithstanding that it is a charge registered under the Companies Act 1955 or the Industrial and Provident Societies Act 1908; s 39. However, the extinguishment of a security interest does not affect a security interest which may exist in respect of the proceeds of sale of the vehicle; s 40. Furthermore, provision is made for the revival of a security interest in the event of cancellation of the sale, hire purchase or lease which extinguished the security interest; ss 41 and 42. In the case of a credit sale which extinguishes a security interest under ss 24 or 27 the secured party is subrogated, to the extent of the amount outstanding under the security, to the rights of the seller against the purchaser in respect of the balance of the purchase price; s 43.

Priority of Security Interests

Part III of the Act, which is subject to the provisions of ss 25 and 28 relating to the extinguishment of security interests in the case of consumer and other hire purchase agreements or leases (see s 52), regulates the priority of security interests in motor vehicles. An immediately noticeable feature of these provisions is the absence of any sanction for non-registration in the event of insolvency or intervention by creditor representatives. In other words, the Act contains no equivalent of s 18 of the Chattels Transfer Act 1924 which, subject to certain conditions, avoids unregistered instruments against, amongst others, the assignee in bankruptcy of the grantor. This has some curious results.

Illustration

B is adjudicated bankrupt. The sole asset of any value in her possession is a motor car which is the subject of an unregistered chattel mortgage in favour of O. The validity of O's security is unaffected by non-registration as, it will be recalled, a motor vehicle is no longer a chattel for the purposes of the Chattels Transfer Act. If, however, the subject matter were a *boat* O's security would be prima facie void on B's bankruptcy.

The position becomes even more anomalous when the situation in relation to motor vehicle securities involving a company debtor is considered. A mortgage or charge granted by a company in respect of motor vehicles continues to be registrable under Part IV of the Companies Act 1955. If it is not so registered then, regardless of whether it is registered under the Motor Vehicle Securities Act, it is void pursuant to s 103 of the Companies Act against "the liquidator and any creditor of the company". So, whilst an unregistered company mortgage of a motor vehicle is void on the insolvency of the debtor, precisely the same security is unaffected when the debtor happens to be a firm or private individual.

The basic priority rules in relation to competing security interests in a motor vehicle, which should be read subject to s 50 (security for further advances) and s 51 (postponement of priority), are as follows. First, a registered security interest has priority over an unregistered security interest; s 46. Secondly, in the case of two or more registered security interests priority is determined according to the time at which the applications for registration were presented and not according to the time of creation; s 47. Both of these rules apply irrespective of whether the holder of the registered security interest (or, as the case may be, the first registered security interest) had notice of an earlier created security interest at the time when the application for registration was presented; s 48. Thirdly, where there are two or more unregistered security interests priority is according to the order of the time of creation; s 49. Fourthly, as an exception to the above rules, priority as between competing charges created by a company registered under the Companies Act (or a society registered under the Industrial and Provident Societies Act 1908) is to be determined as if Part III of the Act had not been passed; s 45.

The anomalous consequences of the above rules are almost endless and quite mind-boggling. First, whereas in the case of unregistered security interests governed by the Motor Vehicle Securities Act the first in time of creation has priority, this will not necessarily be the case in relation to competing mortgages and charges granted by a company in respect of motor vehicles *or* competing security interests in relation to chattels other than motor vehicles. In the latter situations the outcome may be affected by one or more of the following: (i) the *nemo dat* rule and its exceptions, especially s 27(1) and (2) of the Sale of Goods Act 1908; (ii) the "BFP" rule whereby the holder of an equitable interest is subordinated to one who subsequently takes the legal interest in good faith for value and without notice; (iii) resolution of the "uneasy co-existence"

between ss 19 and 22 of the Chattels Transfer Act 1924 (see Riesenfeld, *The Quagmire of Chattels Security in New Zealand* (1970) 23-24); (iv) resolution of the vexed question as to the effect of s 103 of the Companies Act 1955 on priorities between competing unregistered charges (compare Pennington, *Company Law* (5 ed 1985) 536-537, Gough, *Company Charges* (1978) 336 and Goode, *Commercial Law* (1982) 777).

Secondly, a registered security interest in respect of a motor vehicle has priority over any unregistered security interest *regardless of notice*. This is consistent with the position under the Companies Act but quite different from the position under the Chattels Transfer Act. Under s 22 of the latter Act, which will continue to apply to non-motor vehicle chattel securities, priority of the first registered is subject to lack of notice of earlier created instruments.

Thirdly, priority of registered security interests is according to the time of registration which (leaving aside the question of notice) is consistent with s 22 of the Chattels Transfer Act but quite different from the position under the Companies Act where registration is not a priority point. Bearing in mind that the Motor Vehicle Securities Act rules do not apply to competing company charges, some strange results follow. Let us take one illustration.

> B Ltd acquires a car from O pursuant to a hire purchase agreement and then purports to grant a mortgage of the car to T. T registers under the Companies Act and the Motor Vehicle Securities Act. O registers under the Motor Vehicle Securities Act but not under the Companies Act (quite rightly because the hire purchase agreement is not a charge). If T registers under the Motor Vehicle Securities Act prior to O, T will have priority. (T has a security interest notwithstanding B Ltd's lack of title because the mortgage will operate as an assignment of B Ltd's interest under the hire purchase agreement and thus confers on T "an interest in or power over a motor vehicle" within the opening words of the definition of security interest in s 2 of the Act.) The position will be otherwise and T will not have priority if O's security consisted of a legal chattel mortgage duly registered under the Companies Act. O will have priority regardless of whether T registered first. (Of course, if O's mortgage were *equitable*, T might win under the BFP rule!)

Miscellaneous Provisions

Part IV of the Act contains several miscellaneous provisions of which the following are the most important. First, ss 54-57 provide for the payment of compensation to persons who suffer loss arising from certain defined acts or omissions of the Registrar. Secondly, s 59 prohibits contracting out of the Act subject to the limited exception in subs (2) which was inserted at the select committee stage to enable wholesalers and dealers to agree on their own terms concerning reimbursement of the wholesaler in the event of dispositions by the dealer. Thirdly, s 61 substantially re-enacts, in relation to motor vehicles, s 4(2) of the Chattels Transfer Act 1924. Section 61, which was necessitated by the deletion of motor vehicles from the definition of chattels in the Chattels Transfer Act, ensures that, except for the purposes of the Motor Vehicle Securities Act, registration under the Companies Act of a security given wholly or partly in respect of motor vehicles will constitute constructive notice of the security and of its contents so far as it relates to motor vehicles. The major practical consequence of this is that registration of a floating charge under the Companies Act will continue to give notice, at least in so far as the charge affects chattels, of a clause which prohibits the creation of subsequent charges ranking in priority to or *pari passu* with the floating charge. Hence the main ground for the decision in *Re Manurewa Transport Ltd* [1971] NZLR 909, which gave priority to the holder of a floating charge over a later mortgagee of a motor vehicle, is preserved.

Fourthly, s 67 amends, in large measure consequentially, the enactments specified in the Second Schedule in the manner indicated in that schedule. Amendments to s 27(2) of the Sale of Goods Act 1908 and s 3 of the Mercantile Law Act 1908 limit the application of these *nemo dat* exceptions upon registration of a security interest under the Motor Vehicle Securities Act. A new s 94A of the Summary Proceedings Act 1957 obliges a Court registrar to search the motor vehicle securities register and to notify a secured party in the event of seizure of a motor vehicle for non-payment of Court fines under s 94 of that Act. Surprisingly, no comparable amendment is made to the provisions of the Criminal Justice Act 1985 (ss 84-88) governing the confiscation of offenders' motor vehicles. This may have been an oversight.

Commencement

The Motor Vehicle Securities Act comes into full operation on 1 April 1990. There is a six month transitional period from 1 October 1989 to 31 March 1990 during which the holders of existing or newly created security interests may apply for registration under the Act; s 70. Every security interest in respect of which an application for registration is presented during the transitional period is deemed to be registered at 9 am on 1 April 1990; s 71. Such security interests have priority according to the time at which they were created (s 72) unless a different priority is provided for by virtue of registration under the Chattels Transfer Act 1924 (s 73). Security interests registrable during the transitional period include those registrable under the Chattels Transfer Act and the Companies Act but not registered within the time permitted for registration; s 74. The registration of any instrument affecting a motor vehicle under the Chattels Transfer Act ceases to be of any effect as from the end of the transitional period; s 75.

Conclusion

Prior to the Motor Vehicle Securities Act there was no way that a purchaser of a second hand motor vehicle could, even leaving aside the possibility that the vehicle was stolen, guarantee that the seller was in a position to pass good legal title. (Dealers often did their utmost to convince the public that buyers from them were safe but, of course, they really gave only the *promise* of clear title, admittedly backed by their

Fidelity Fund, contained in s 89 of the Motor Vehicle Dealers Act 1975.) If, for example, the seller was in possession under a hire purchase agreement, that agreement was more than likely a "customary" hire purchase agreement and hence the owner's title was protected without the need for registration under s 57(5) of the Chattels Transfer Act 1924. Or, if the seller had granted a chattel mortgage which was registrable under the Chattels Transfer Act, searching in the High Court was a hit-and-miss exercise in the absence of a central registry.

Assuming that the new registration system will be well publicised and will operate efficiently, has the problem been solved? Clearly, consumers who buy from dealers will now be adequately protected against outstanding security interests. (Of course, in the case of stolen vehicles, they may have to rely on their personal remedies against the dealer and the Fidelity Fund.) However, much of the fraud which the Act is designed to prevent occurs in private sales. No doubt its incidence will be reduced, but probably not as significantly as the legislature would hope. Frauds will continue to be perpetrated because large numbers of the very people in our society who need the protection, particularly those from lower socio-economic groups, will not know of the need to search and, to the extent that they do seek to verify title, will continue to treat certificates of registration as ownership papers. Perhaps this view is unduly pessimistic. We can only wait and see.

Partly because of the above doubts the writer suggests that it would have been much preferable if the Motor Vehicle Securities Act had been deferred in favour of comprehensive reform of the law of chattel securities, especially considering the major progress that the Law Commission had made on this task. There can be no denying the need for comprehensive reform. The case for it has been documentated on numerous occasions over recent years; see Farrar and O'Regan, *Reform of Personal Property Security Law* (1988, NZLC PP6), Goode, "The Modernisation of Personal Property Security Law" (1984) 100 LQR 234, and McLauchlan, "Contract and Commercial Law Reform in New Zealand" (1984) 11 NZULR 36. The central object of such reform will be to achieve a fair and rational system for the regulation of all security interests in personal property which will rid the law of artificial distinctions based on the legal personality of the debtor, the form of the security and its classification (ie whether legal or equitable), and the type of personal property secured. Particular objectives will be

(a) to integrate the existing registers,

(b) to simplify and rationalise registration requirements by, for example, introducing a system of notice filing and removing arbitrary distinctions between registrable and non-registrable securities, and

(c) to subject security agreements to a common set of rules concerning attachment, perfection, enforcement and priority except to the extent that distinctions can be justified on functional or policy grounds.

By contrast, the overall effect of the Motor Vehicle Securities Act is, as mentioned earlier in this paper, to compound the complexity and irrationality of the law of chattel securities. If the law were a "quagmire" when Professor Riesenfeld wrote his well-known paper back in 1970 it is more so today. One now says "*a fortiori*" when reminded of Riesenfeld's statement that

> . . . the present body of law is the product of a slow process of statutory sedimentation and of *ad hoc* patchwork . . . . The law as presently existing bristles with inconsistencies, contradictory or outmoded policies, and haunting obscurities. (p 15)

It really does seem incredible that, when Riesenfeld posed as one of the main policy questions to be resolved

> the wisdom and expediency of the two-track system: one for companies and one for individual traders

we should opt for what could be described as *three-track* system. We now have three main registration systems affecting chattel securities – the Companies Act, the Chattels Transfer Act and the Motor Vehicle Securities Act. Furthermore, resolution of conflicting claims to chattels will require one to pick a path through the following maze:

(a) the priority rules of common law and equity;

(b) the *nemo dat* rule and its various exceptions in the Sale of Goods Act 1908 and the Mercantile Law Act 1908;

(c) the modifications of the common law and equity rules in the Chattels Transfer Act which, however, no longer apply to motor vehicle securities;

(d) the modifications of the common law and equity rules in the Companies Act which continue to govern motor vehicle securities; and

(e) the title and priority rules in the Motor Vehicle Securities Act.

Such intricacies may delight the law teacher seeking to stretch the intellects of his or her students, but they are hardly the sensible product of a commercial law reform exercise □

Legal Conference

Preliminary advice has been received of a proposed second Greek/Australian International Medical and Legal conference which is to be held in Rhodes from 25 May to 1 June 1990.

Advance notice of this conference is being given, but details are yet to be determined. The Organising Committee is hopeful that New Zealand practitioners, as well as Australian practitioners, will take an interest in the conference. Further information about the conference can be obtained from the Secretariat, ICMS, PO Box 29, Parkville, Victoria 3052, Australia.

The practice of law in inter-war Auckland 1914-45

By Professor Russell Stone, University of Auckland

Professor Russell Stone is currently engaged in writing a history of the Auckland-based law firm Russell McVeagh McKenzie Bartleet & Co. The work is expected to be published in 1990.

This article contains the substance of the talk given by Professor Stone in Auckland on 3 May 1989 during Law Week. Professor Stone has explained that the talk was based mainly on the archives of the inter-war firms of Russell McVeagh & Co and McKenzie & Bartleet. He also used the minutes of the general meetings of the Auckland District Law Society and of its council, and the statistical records of the Society — all dependent he acknowledges, on the patient co-operation of Miss J B Bowring. He acknowledges too the great usefulness of Jackson Russell: A scrapbook History *by J H Rose, a partner of that firm whom he also interviewed at length. Information was orally supplied by about thirty people, almost all in their seventies or older: lawyers, accountants, female clerical staff and two prominent merchants of the time, the late Lawrence D Nathan and Sir Kenneth B Myers.*

By the late nineteenth century, lawyers in New Zealand were considerable men of affairs. Their position was cemented by the long upswing of prosperity arising out of pastoral exports, largely refrigeration-based, beginning 1896-7, a date we can speak of as marking a kind of economic takeoff. Auckland, province and city, was a great beneficiary of these good times. The city and port — in geographer's terminology New Zealand's main interface between the national and international economies — consolidated its position as entrepot, dominant trading centre, and commercial capital. And Auckland lawyers rose with the tide.

The legal profession, like the Dominion as a whole, was not set back by the Great War. True, the initial reaction of the New Zealand business community to the outbreak of hostilities had been one of uncertainty. But that mood soon passed. A confident economic outlook was fully restored during 1915-6 when the British government, shut off by the German blockade from alternative supplies of food and wool, initiated the "Commandeer" policy by which it guaranteed to take until the end of the war, and at an agreed price, all New Zealand's pastoral exports. Thus was the long upward curve of prosperity which began in 1897 sustained until 1920. During the war farmers enjoyed good times. But benefits were diffused through the rest of the community as well. Many city businessmen, including those members of Auckland's 104 law practices who were too old to serve, prospered.

It seems that for most law firms during the 1914-18 War it was a matter of (in the slogan of the hour) "business as usual". With one exception. This certainly was the time when women began to make up a significant proportion of the support staff. The phenomenon was Dominion-wide, and characterised all clerical work.

During the 1914-18 War the call-up of men so quickly stripped banks, offices and legal firms of their clerical staff that the entry of women either began then (in the case of banks) or was accelerated. It is known that by 1918 Buddle Richmond & Buddle had four women upon its staff of a dozen; two typists, and two clerks (one a book-keeper and the other in charge of petty cash) helping the male accountant.

In the firm I am currently studying there is ample oral testimony to women having become a fixture by the early 1920s as typists, telephonists, assistant book-keepers and trust ledger clerks. We can assume that, as with Buddle Richmond & Buddle, the breakthrough took place in Russell Campbell & McVeagh during the war.

The Spanish influenza epidemic which ravaged the country late in 1918, in a melancholy way, was reflected into legal business. The loss of over 1,100 lives in the space of a few weeks caused great grief in a city where many still mourned boys killed overseas. A young law clerk who joined Buddle Richmond in 1918 recalled that he became so involved in winding up deceased estates he imagined for a while, that this was the major work of a solicitor.

Nevertheless, anyone who reads the newspaper advertisements for November 1918, cannot fail to recognise that for businessmen at least, war had ended on a deliriously optimistic note. It was generally felt there was a boom at hand which would have its beginnings in the 80,000 farm holdings which, intensively farmed, had doubled the Dominion's export earnings in the space of a decade. Running parallel to this boom in pastoral exports was widespread trafficking in farm land in New Zealand itself. The rapid turnover of country real estate was

quickly reflected in a rush of conveyance work for solicitors. A speculative boom in imported goods also took place in the cities at much the same time. In 1920, £19,000,000 worth of imports passed through the Port of Auckland, treble the 1913 figure, and far beyond the capacity of the urban or provincial market (moving into recession by the time the goods had reached retailers) to absorb.

By late 1921 the boom was at an end. Imported goods glutted the country. More seriously the bottom had fallen out of the British market for pastoral exports. This exposed farmers, many of whom carried heavy mortgages because they had bought during the post-war land boom at inflated prices often with the intention of later speculative resale. Farmers, some of them returned soldier settlers, began walking off their farms.

A sharp check to New Zealand's export earnings in 1926 was a forewarning of the disastrous slide in prices for farm produce between 1929 and 1934. A fall of 37% in export receipts, 1929-1931, produced a drastic decline in farmers' incomes. The consequences of this fall in overseas earnings spread far and wide. Real income fell, unemployment reached 80,000 and construction dwindled — reflecting the failure of nerve of investors and entrepreneurs. Not until 1934 was there a recovery of export earnings.

Suburban residential housing

How these changes in the national economy affected the role of Auckland lawyers can be understood only in the setting of developments taking place over the same years within the Auckland metropolitan area. And there, during the 1920s no regional development was more important than suburban residential housing growth, which took shape upon and about extensions of the highways leading out of the city, and which also enlarged satellite townships like New Lynn and Otahuhu linked to the inner city by railway routes to the north and south. While the suburban spread was general, the part of the Tamaki Isthmus which was most dramatically opened up was the area lying to the west of Mt Eden Road including Sandringham, Balmoral, Mt Albert, Avondale, Point Chevalier, and Westmere. It is noteworthy that during the 1920s Mt Albert virtually doubled its population and was the fastest growing borough in the Dominion: between 1923 and 1926 on average almost 80 building permits were issued there every week. By 1931 Mt Albert had become New Zealand's largest non-city borough. But by then the country had been plunged into the Slump. Many of the "spec" builders who had erected Californian bungalows throughout the borough were bankrupted. In one year 400 Mt Albert ratepayers were summonsed for their failure to pay rates. In Mt Albert, Point Chevalier, Westmere and elsewhere many residents lost their homes and values collapsed completely.

This great residential expansion was an expression of important demographic changes within the Auckland urban area which grew between 1921 and 1926 by 22%, in contrast to the Dominion figure of 15.5%. Even more remarkable over those five years was the growth of the Auckland suburbs by 38%. Such population pressure would clearly have sought its release in closer settlement of the inner city had it not been a fact that so much capital investment in the 1920s, public and private, was clearly devoted to the creation of social assets. The sealing of lesser streets by bitumen and of main streets by the then much venerated concrete has led an urban historian to speak of the 1920s as Auckland's "concreting decade". The city and the inner boroughs saw a more general provision of basic services: sewerage, water reticulation, electric lighting in streets, and above all transport — the Auckland City Council had 185 tramcars in service by 1924.

However, whereas in one district improved transport could be the "creator" of the suburb, in another it might be no more than its "camp follower". More accurately it is the impersonal force of population growth in response to Auckland's emerging commercial role and not the pastoral wealth of its hinterland which is to be seen as the chief maker of the suburbs of the 1920s.

Mortgage money

But crucial to the growth of dormitory suburbs was the availability of mortgage money to finance home-owners. The sources at that time were:

(1) The government. By 1929, 12,045 discharged soldiers in New Zealand had taken up advances to "purchase and erect dwellings and discharge mortgages thereon". Similar in its effect was the provision made by the 1922 State Advances Amendment Act to extend state loans through the State Advances Department to workers making a house purchase.

(2) Incorporated building societies, chiefly the Auckland Co-operative Terminating Building Society and (after 1923) the Northern Building Society.

(3) Financial institutions — most notably the Auckland Savings Bank and the Public Trust Office and Trustee Companies.

(4) Private sector finance, usually funds entrusted to lawyers for that purpose by clients and executors of estates. A knowledgeable observer recalls that in the inter-war years a home-buyer who did not have a state or building society loan would, as a matter of course, approach a lawyer to arrange a mortgage. And if you were a sound borrower the lawyer usually provided the secured loan out of the trust funds he had at his disposal: moneys provided for investment by the well-to-do, women living on capital, administrators of estates, and retired capitalists of means.

The profession in the 1920s

One need not apologise for stressing the real-estate market and its financing in any account of the history of the profession in the inter-war era. Speak to any elderly lawyer with experience of those years and he is at pains to tell you how much the average law firm then relied on conveyancing. The astonishing surge in the land market up to 1924 during which (according to one estimate) almost one-half of the total occupied area in the Dominion changed hands in about eight years affected the profession in Auckland

directly; though conveyance work there was concerned mainly with urban property. On 4 August 1920, 60 members of the Auckland District Law Society crammed into the Magistrates' Court Library for a Special General Meeting to protest at the "dangerous congestion of work at the Auckland Deeds Registry Office and the Land Transfer Office" (where there was a log-jam of 8,000 unprocessed documents), complaining that the "lack of accommodation and consequent disorganisation" had become "highly dangerous to [the] public . . . interest".

But this "disorganisation" though inconvenient for solicitors was also profitable for them. The abundance of land transfer work and the initiation and rolling over of mortgages in the 1920s were an enormous stimulus to the profession. Between December 1918 and December 1928 the number of lawyers in the Auckland district doubled. In 1928, the year the suburban land market began to collapse, 534 practitioners' certificates were issued by the Auckland District Law Society. Not until 1948 was this figure attained again.

As a long-established, large practice with four partners, Russell Campbell & McVeagh was not a typical 1920s Auckland law firm. In 1921 there were only five practices with four partners or more. Your characteristic Auckland legal firm was small then. (Accountancy practices were even smaller.) In the 1920s half of the practices were solo; in 1928, 122 out of the city's law firms were run by one lawyer from a small, often dingy office. At that time over 80% of the practices had just one or two principals. J H Rose has pointed out how much of the legal work on offer during the decade could be carried out by just such small firms. "In the early post-war period there was much business to be picked up arising out of the discharge and rehabilitation of ex-servicemen. I mean the buying of houses, farms or businesses. There was a lot of conveyancing."

Depression of land market

For any recently qualified lawyer who saw no prospect of a partnership in an existing practice of which he was a salaried employee, the temptation to strike out on one's own must have been irresistible. The depression of the land market in time changed things. A young lawyer (later a Judge) recalls that as a qualified clerk by 1928 he could comfortably accomplish the conveyancing work that three years before had occupied him and two other clerks. Little wonder that though there was no chance of a partnership he elected to stay on during the depression of the 1930s as a salaried clerk of the firm for three pounds a week.

Before we move to the Depression, however, I should look briefly at McKenzie & Bartleet in the 1920s, for its early years are so well documented one is able to reconstruct this practice which, because smaller (two solicitors and two women clerks) could be regarded almost as a paradigm of the Auckland law firms which functioned in the inter-war period. The two partners were essentially (in Bartleet's phrase) "all-rounders", with the bulk of their work bound up in conveyance (country and town), investment of trust money, debt collecting — in the early days a prop of the practice — and (much less important) winding-up of estates and forming of companies. As for clients, apart from a few investors providing mortgage moneys, they were mainly people of moderate means: in the country, cow cockies leavened by the odd storekeeper or Dalmatian orchardist-winemaker; in the city, commercial-agents and land-agents, shopkeepers and the like.

House-building firms

The main work of this practice in the 1920s was conveyancing based on suburban home-building, curiously enough almost entirely confined to a limited region more or less along the boundary of the Mt Eden and Mt Albert boroughs, the new bungalow suburb opened up on the right hand side of Dominion Road after the completion of the tram extension to Balmoral in 1920.

During the 1920s, which might be appropriately described as "Auckland's bungalow decade", most suburban home-building was in the hands of "spec builders", a term which for people then, unlike now, held few critical overtones. House construction was a small-scale industry in the hands of builders whose entire risk capital was sunk at most in two houses that would sell for £700 to £800 each; perhaps one house just built and awaiting sale, the other about one-third of the way towards completion. The characteristic building firm on McKenzie & Bartleet's books was made up of a builder assisted by a journeyman carpenter; or two partners; in either case employing a labourer, or maybe two. Though these men operated on limited capital and with primitive equipment, their performance is not to be disparaged. They were highly efficient. Your 1920s spec builder, assisted by one or two men, using traditional handtools and operating on small profit margins, could put up a 1000 square feet weatherboard bungalow with limited prefabricated elements in about ten weeks.

McKenzie & Bartleet acted mainly for small builders who were putting up homes for buyers without direct or assured access either to building-society, trust-bank, or State Advances mortgages. Consequently, in servicing the legal and financial needs of its clients, the practice earned its fees in two ways. There was transfer work related either to the early subdivision, or to the later sale of individual properties. Then there was the arrangement of mortgages on which a procuration charge of one percent could be levied.

The sequence is best conveyed in Edgar Bartleet's own words:

> Builders who didn't have much money at all would approach us to arrange the sale finance by raising mortgages. Say the house cost £700; we would raise £450 by way of mortgage through one of the rich old clients we had on our Trust Account, people who (like my father) preferred to lend on landed security. The buyer would put in perhaps £100 of his cash. Then we would provide £200 as second mortgage. Or at least the spec builder would provide a second mortgage of £200. He would then sell it to us for £150.

The cycle would be completed when McKenzie & Bartleet in turn would sell this second mortgage to one of the local capitalists, some of them retired farmers, who made a practice of going from lawyer to lawyer buying up mortgages at discount prices.

This method of financing home-building, however well adapted to the economic environment of the 1920s, was a fair-weather system. The slump laid waste the home-building industry.

The Great Depression

The Depression of the early 1930s was the worst in New Zealand's history. Between 1929 and 1933 the Dominion's export earnings declined by 45% producing a collapse in the income of farmers which had a profoundly depressing effect upon the whole economy.

In an attempt to bring internal costs into line with export prices, the government of the day pursued a policy of retrenchment and wage-cutting, which, however justified in terms of the prevailing economic orthodoxy, was savagely deflationary in its consequences. In the building industry, so often an indicator of the mood of investors, the number of permits taken out over the whole country between 1930 and 1933 fell by 74%. In Auckland, as elsewhere, there was a paralysis of nerve and initiative among private investors. Business reamined stagnant.

A recovery in export earnings set in in 1934. This trend continued under the Labour government which came to power at the end of the following year. But during 1938 a balance of payments crisis asserted itself. The Labour government responded by introducing sweeping import licensing and exchange control procedures. This attempt to shield the domestic economy from external market pressures was to persist for about half a century; shaping not just the economy but the facilitating role of lawyers within it.

A strictly-regulated economy

The 1939-45 war restored the exchange situation. But if it resulted in the building up of New Zealand's reserves abroad to an unprecedented level, it also continued the trend towards a much more strictly regulated or interventionist economy. Manpower direction, to be sure, did not outlast the war. Many regulations did. Stabilisation controls of prices, land sales and rents; a complex system of graduated taxation rising to high levels; and the proliferation of tribunals and commissions set up during the war; all had a profound and enduring influence on the activities of lawyers.

The slump of the early 1930s gave a serious setback to the legal profession no less than to the community at large. Older and bigger firms, particularly those with a family practice base, survived rather better than the smaller. Rose explained why:

> No matter what happens in a community, people with money and property must look after their investments, have houses to live in, make wills and die. Commercial transactions can be more profitable, but businesses rise and fall, and the profits are more uncertain.

And so it proved in the 1930s Depression. But no law firms came through unscathed, even the solid old ones. How could they, with the opportunities for mortgage investment of trust funds traditionally generated by family and estates work, reduced more than ever before? The firms which tended to go under, however, were the small ones launched during the land and property booms of the previous decade. Profits for all practices, it seems, went down. A partner of Jackson Russell, a large and sound practice, recalled:

> By November 1930 the firm's gross income was down to about two-thirds of the previous year and profit was down to less than half. In the following two years profits were minimal. The half year to May 1931 actually showed a small loss .... In the years 1931-33 the partners earned less than the senior staff members.

Senior partners of some established law firms lived off capital, making no appropriation for themselves from the Profit and Loss Account, rather than put off staff. Large firms could do this. Small could not. Some new practices went under. Lawyers left the profession never to return.

Need for legal advice

Ironically, during a slump, clients stand in greater need of their lawyers than at almost any other time for legal advice: on how to get relief from debt or how to recover debts, where to invest, and how to improve liquidity. The trouble then was: "few could afford to pay for it". Edgar Bartleet recalled as a sign of the times, small rural clients arriving at his office carrying eggs or other farm produce, as part payment of accounts.

The President of the District Law Society in 1934 G P Finlay (later Sir George Finlay, J) lamented that it was his "misfortune" to hold office "when everything seems disjointed". First cut-throat competition threatened its monopoly of certain traditional legal business. Second, at a time when conveyance was still the lifeblood of so many practices, the government regulated what lawyers could charge in cases of mortgage adjustment which had become a veritable flood.

The first threat became pressing when the urban property market collapsed at the end of the 1920s. Thereafter, an old lawyer recollects, "there were very few property transactions and these were for very low prices."

Mortgage relief

The bane of lawyers was to be, however, the new mortgage relief legislation. Between 1931 and 1936 about a dozen measures were put on the statute books with the aim of keeping efficient, though debt-burdened farmers on the land by reducing mortgage debt and interest levels through a variety of adjustment procedures. In time this remission of obligation was extended to urban residential mortgages as well.

From today's perspective this legislation is probably to be seen as enlightened and humane. Such detachment was not granted to lawyers of the 1930s. As trustees of investment funds they too were aware that mortgagees were suffering hardship. But although lawyers of conservative bent jibbed at the dangerous precedent involved in what they regarded as an attack on the sanctity of contract, the profession as a whole seemed to accept the justification provided by the Prime Minister of the day that he could do no other: "The prosperity of every section of the community is wrapped up in the welfare of the farming community." Here George Forbes was simply enunciating a national article of faith that lawyers like most other

New Zealanders believed it would be impious to dispute.

They were less willing to accept however, the government's further argument that for debt adjustment effectively to benefit the mortgagor, legal costs must be cut to the bone. One lawyer who was responsible for applying the provisions of Mortgagors Relief Acts within a large Auckland practice possessing a huge raft of rural clients complained many years later that the fees he was permitted to charge for his services in many cases had a ceiling of six guineas "though you might have to spend hour after hour upon the case". A resolution of the Council of the Auckland District Law Society in 1932 that "the fees now fixed by Regulations [under the Mortgagors and Tenants Relief Act, 1932] be increased so that they may be reasonably commensurate with the work done in each case". It was to be repeated in one form or another over the next four years. The New Zealand Law Society, understandably enough, regarded these regulations as a wedge by which the existing conveyancing scale could be disrupted.

Through the depression the Auckland District Law Society was vigilant about the need to "generally maintain" its fees for procuration of mortgages, deeds registration transactions and conveyancing charges. Hard bargaining continued with the advent of the Labour government. The annual report of the District president stated that "Representatives of the [New Zealand] Council interviewed the Ministry of Justice before the issuing of the Mortgagors and Lessees Rehabilitation Costs Regulations, 1936, and secured as satisfactory a scale of costs as was under the circumstances available". An important facet of the Depression which, surprisingly, has not entered into the collective memory of the profession is how deeply lawyers were disturbed by threats to the traditional rights of mortgagees and landlords through changes in the statutes and regulations of that time. One wonders whether a long-term consequence of this was an accelerated diversion of the interest of capitalists away from their traditional investment in real estate towards equity investment.

The Depression and pessimism

A depression which lowered the profits of law and led to an encroachment on what the profession had regarded as the sacred preserve of contract induced a mood of pessimism among lawyers. The annual report of the Auckland District Law Society in 1930 noted that "for the first time for many years there was a decrease in the number of practitioners in the district". Worse was to come. The District president, A M Goulding, in March 1933, drew attention to the fact that at a time when the Society's finances had been straitened by the reduced earnings of its securities, the revenue from admissions was the lowest for twenty years.

What was perceived as the reduced prospects of the profession was also expressed in the low numbers taking up legal studies, even when the economy had clearly improved. An older student who embarked upon an LLB in 1936 was surprised to find that the first-year intake was a mere half-dozen. The number of law students graduating in law at the college in that year was also six: granted, an abnormally low figure, but the annual average figure of nine for graduates in the quinquennium 1936-40, is nonetheless, significantly small.

Second World War

On the outbreak of the War in 1939, the local Law Society was wholehearted in its opposition to Nazi Germany. It accepted as its patriotic responsibility the need to provide routine legal services free of charge to all who had enlisted. Staff visited men in camp before embarkation to give legal advice, or to prepare wills or documents conferring power of attorney. Nine thousand wills were thus prepared in camps around Auckland (half of the wills were left in the safe custody of the Society). The practice was discontinued in 1942 when the armed services set up special legal sections of their own for just this purpose.

The war led to acute staff shortages in some practices. I have the impression lawyers were disproportionately prominent in the Territorial movement in the 1930s. Out of one Auckland practice came two World War II brigadiers and one major-general.

The rush of lawyers and their clerks to join up in 1939 (44 practitioners and a lesser number of clerks enlisted in the first year of war) produced difficulties in many offices. But the problems of shortages of staff, exacerbated by the fall-off in numbers of those entering courses at the Law School of the University, grew beyond any makeshift solutions of the Law Society, such as maintaining a register of persons seeking employment.

Active service

At the height of the country's mobilisation of its manpower in 1942, 174 solicitors and clerks with the Auckland Law District were on active service. In the case of some small practices previously run by young men, closure proved inevitable. Others, with a high proportion of staff serving, carried on only under great difficulties. The number of practitioners on the Auckland District Law Society roll fell from 517 in 1938 to 408 in 1943, then recovered to 480 by 1945. Things would probably have been worse had staff deficiencies not been partly met by elderly lawyers delaying retirement. Nevertheless there were occasions when legal and accountancy practices were entirely run by partially-qualified staff. Professional people from elsewhere would drop in and provide a necessary signature; or alternatively, papers would await the scrutiny of the principal when he came home on leave.

What made the absence of qualified staff so particularly inconvenient was the increase in tribunals of one sort or another, and the speedy growth of a thicket of wartime regulations through which clients needed to be guided by a lawyer. J H Rose of Jackson Russell has maintained that during 1940 about 300 sets of regulations were issued by Orders-in-Council under the Emergency Regulations Acts. Further, as rehabilitation of ex-servicemen got under way during the later stages of the war, clients needed guidance upon procedures to be followed under such measures as the Servicemen's Settlement and Land Sales Act 1943. This particular Act setting up the Land Sales Court was regarded by the District Society as "a measure vitally affecting the profession". It continued to cause lawyers much concern until its repeal in 1950.

An environment of work-pressures and understaffing induced some law firms to resort to body-snatching. This came to a peak in the few months following Japan's entry into the War when every available man had been put in uniform. The president of the Society, W H Cocker, in March 1942 "deplored the discourteous competition for clerks that had arisen between firms". His pious protests had little effect.

Dearth of law graduates

By the end of the war the legal profession in Auckland was over-age, overworked and understaffed. The demobilisation of lawyers and clerks in uniform eased the situation a little. But the profession had been impoverished by a continuing dearth of law graduates. Over the six war years, the average annual output of graduates in Auckland was under five per annum. Quantitatively the situation had some remedy with the crop of "grandfather" post-war concession passes to those who had been pre-war clerks in training, and with the provision of pressure-cooker degree courses for ex-servicemen who after demobilisation took up the study of law for the first time. Accelerating admission into the profession in this way seems to replicate the 1914-1918 War Repatriation Scheme. In the Annual Report of the Auckland District Law Society at the end of 1946 attention was drawn to the fact that the Land Transfer Office had become overloaded with documents to process, once again, apparently, a repetition of the land-boom situation of 1919-20.

It would be mistaken, however, to see in all this a simple case of history repeating itself. After 1945 a whole cluster of regulations concerned with distribution of supplies of scarce materials, detailed price controls, cost-plus pricing procedures for manufacturers, and an unprecedented higher level of direct taxation, were to make the work of lawyers considerably more complex than had been the case in the years following the First World War.

The general opinion among old lawyers is that at the beginning of the post-war years six or seven large firms dominated the legal scene in Auckland. Big practices mentioned usually include:

> Earl, Kent, Massey, North & Palmer;
> Meredith, Meredith, Kerr & Cleal;
> Buddle, Richmond & Buddle;
> Nicholson, Gribbin, Rogerson & Nicholson;
> Jackson, Russell, Tunks & West;
> Hesketh, Richmond, Adams & Cocker;
> Russell McVeagh & Co.;
> Thorne, Thorne, White & Clark-Walker.

Some of these firms were confident they were secure, felt they had no urgent need to compete, or go out and get clients. Yet this belief that a practice could continue to prosper while living on past achievements threatened to be the undoing of the handful of these large well-established law firms of which Russell McVeagh was so prominent a member. Twenty years on, in the midst of a period of exceptional commercial growth in Auckland in the 1960s, some of these big old firms had wasted away; largely the consequence of sitting back, of too little readiness to adapt to change. A major inter-war client of Russell McVeagh regards the apparent stability represented by "large legal firms of good standing" in the 1930s and 1940s working for "old-fashioned family firms", as being no more than an illusion.

> On the surface Auckland city businessmen were still involved in "traditional" business, with the big fish being what you might call the warehouse people [general and liquor merchants]. But now I see the 1930s as a transition period with the warehouse people dying away. The import licensing and exchange control of the Labour government boosted local manufacture and speeded up the process I've been referring to.

The sense of permanence was on the surface only. Beneath all, the economic centre of gravity was shifting. The ability of larger law firms to maintain their position and take advantage of post-war growth would depend on their sensitivity to the awakening commercialism of the country's largest and most rapidly-growing city, and on their having the ability to cater for the emerging demands for finance of the new manufacturing and service sectors.

Academic standards

Between 1945 and 1985 the number of lawyers practising in Auckland quadrupled. 1945 was at the threshold of unusual growth. So great was the post-war demand for lawyers that within five years the Auckland Law Society President deplored the paucity of secondary school students taking up law: "Many city firms have been unable to obtain junior clerks", he complained. He wound up by suggesting that perhaps the time had come to drop Latin as a compulsory subject for entry into the Law Faculty. In the following year the Council held conferences with secondary school principals, and secondary school vocational guidance officers, urging them to tout for entrants into the School of Law. Today only an average of A- or better over seven subjects can guarantee a place in the University of Auckland Law School. Which simply emphasises how the inter-war world in yet another way has become a world we have lost. □

Law Congress

Union Internationale des Avocats

The International Union of Lawyers has advised that the 33rd Congress of the Union will be held at Interlaken, Switzerland from August 27-31 1989. The main topics to be discussed include New Trends in Tort, Recent Developments in Transnational Banking and Securities Laws and Legal Protection of the Right to be Different. The brochure from the organising committee also indicates that there wil be excursions to the Swiss Alps that will take place on August 31, 1989 which some New Zealanders might find an added attraction.

Further information about the Congress can be obtained from

> 33rd UIA-Congress 1989
> c/o AKM Congress Service
> PO Box CH-4500 *Basel*
> Switzerland

Legal imperialism and debt subordination

By R B Grantham, LLM, Tutor, Faculty of Law, University of Auckland

Debt subordination occurs when an unnamed creditor forgoes his or her right to repayment until after some other unsecured creditor is paid in full. It has been held by the House of Lords that on bankruptcy the statutory ordering of payments is mandatory. In this article the author suggests that because of statutory differences that now exist debt subordination may be affected in New Zealand.

In an address at Auckland University, on 5 August 1988, delivered on his recent visit to New Zealand, Professor Goode spoke on various issues in the field of the law of securities. One such issue was debt subordination,[1] and the possibility, or impossibility, of such agreements surviving the onset of winding up. Professor Goode, as one would expect of an English lawyer, was of the view that in light of the pronouncements of the House of Lords it was not possible by private agreement to vary the statutory order of distribution of an insolvent company's assets. While the Professor's conclusions received the assent of those present, the readiness of legal advisers in New Zealand to accept the House of Lords' opinion as conclusive of the state of affairs in New Zealand is surprising, for reasons it is suggested beyond even recent Australian developments.[2]

It is the purpose of this paper to canvass briefly two grounds upon which the conclusiveness of the English position might be called into question. Before proceeding however it is useful to make a number of points by way of background.

Debt subordination it will be recalled is

> the ranking of unsecured debt of a company, which occurs when an unsecured creditor agrees not to be repaid until another unsecured creditor is repaid in full. (Johnston (1987) 15 ABLR 80)

However despite its simplicity subordination in the Commonwealth[3] has been plagued with doubts as to the impact of statutory provisions which provide for specific order of distribution upon winding up. This order is generally that after the payment of preferential debts the remaining assets are to be applied pari passu amongst all general creditors.

The question that has therefore come before the Courts is whether these provisions, which it seems have existed in one form or another since the earliest English bankruptcy Acts (Holdsworth, *History of English Law*, 1926 vol 8 p 236) and which are said to represent a fundamental principle,[4] may be replaced by the order of distribution contained in the subordination agreement. The House of Lords in *National Westminster Bank v Halesowen Presswork* ([1972] AC 785), and more particularly *British Eagle International Airlines Ltd v Compagnie Nationale Air France* ([1975] 2 All ER 390), have held that these provisions may not be waived and thus the liquidator must distribute according to the statutory order, irrespective it seems of even the unanimous wish of all creditors to the contrary.[5] This conclusion was reached by Lord Cross in *British Eagle* because

> such a contracting out must, to my mind be contrary to public policy. . . I cannot doubt that on principle the rules of general liquidation should prevail. (supra, p 411)

This conclusion can however be contrasted with the view taken by F B Adams J in *In Re Walker Construction Ltd* ([1960] NZLR 523) where His Honour concluded

> the statutory requirement of pari passu payment does not rest on considerations of public policy, but is a matter of private right to which the maxim *Quilibet potest renunciare juri pro se introducto* may properly be applied. . . In my opinion, the statutory right of a creditor who is entitled to prove, or who has proved, in a winding up is within the rule, and may be qualified or renounced as the creditor thinks fit; and, to the extent to which he may have chosen to waive or qualify his right to pari passu payment, the liquidator's duty to him will be affected accordingly. (at p 536)

While this view has found favour in Australia, Mahon J in *Re Orion Sound* ([1979] 2 NZLR 574) felt the decision in *Walker* could not stand

in the face of the decisions of the House of Lords, because

> the reasoning of FB Adams J . . . is rendered nugatory once it is accepted that the moratorium arrangement in the *Walker* case was against public policy. (at p 585)

While Mahon J's decision was described at the time as the "death knell" for debt subordination in New Zealand (J Farrar [1980] NZLJ 100, 103) it is suggested that there are at least two grounds upon which the application of the English authorities can be called into question. The first such ground relates to their Lordship's conclusion that the statutory provision for pari passu payment may not be contracted out of or waived. This ground has two aspects.

Set-off

The first concerns the decision in *National Westminster Bank v Halesowen Presswork Ltd*, which while dealing with the set-off provisions of the Bankruptcy Act has been held to establish a principle, applicable by analogy, to the pari passu provisions (*British Eagle v Air France* supra, p 403 per Lord Simon of Glaisdale.) In this case the House of Lords held that

> the terms of s 31 are mandatory in the sense that not only do they lay down statutory directives for the administration of claims in bankruptcy, but they also make it impossible for a person effectively to contract. . . with a view to the bankruptcy being administered otherwise than in accordance with the statutory directives. (at p 824)

This finding was in their Lordship's opinion supported by the majority of the authorities, particularly the decision of the Court of Appeal in *Rolls Razor v Cox* ([1967] QB 552), where Lord Denning MR applied the dictum of Lord Selborne LC in *Ex Parte Barnett* ((1874) 9 Ch App 293). Lord Selborne LC, reaffirming this dictum in *Mersey Steel & Iron Co v Naylor, Benzon Co* ((1884) 9 App Cas 434), viewed the use of "shall" rather than "may" in the section as confirmation[6] that the rule of set-off was

> a positive absolute rule for the purpose of proof in bankruptcy. . . (at p 438)

What is apparent, in this comment and in the comments of the majority in *Halesowen*, is an assumption that the conclusion a provision is mandatory (ie a positive absolute rule), rather than merely directory, is also conclusive of the waiver issue.[7]

Waiver

This assumption however is open to challenge, for it has been demonstrated by a number of commentators that even mandatory rules can, in appropriate circumstances, be waived. For example, J Evans in (1981) 1 *Legal Studies* 227, notes this assumption, while common, "is wrong" and the answer to the justification often given for the assumption,

> that if waiver is possible the rule must be directory, for otherwise waiver would create substantive legal effects. . . (p 248)

is simply that waiver, as the authorities demonstrate, does on occasion create substantive legal effects, thus

> the doctrine of waiver can apply not only to some directory rules, but also to some mandatory rules. (supra p 248)

It follows therefore that the possibility of waiver

> does not depend on the logical status of a rule, but on its purpose. (supra p 249)

A view shared by DC Pearce in, *Statutory Interpretation in Australia* (2 ed, 1981) who notes:

> A mandatory provision . . . will impose an obligation on a person or body for the benefit either of a particular person or of the public at large. If the benefit is clearly for a particular person, it seems only reasonable that the person should be able to elect not to require strict compliance with the section. . . (p 177)

It is submitted the confusion by the majority in *Halesowen* of two distinct issues severely undermines the persuasiveness of the decision, for in effect their Lordships have not addressed the waiver question, and as such their judgments can hardly be taken as authority for a negative answer to that question.

Public policy elements

The second aspect, under this general head, concerns the decision in *British Eagle v Air France*, where Lord Cross, avoiding a confusion of the mandatory/directory and waiver issues, held, according to orthodox view[8] that the English equivalent of s 293 Companies Act 1955 could not be waived as it involved elements of public policy. The concern here is, assuming the correctness of this finding, whether having regard to the state of the authorities on the waiver of statutory provisions the opinion of the House of Lords as to the nature of an English statute should be treated as conclusive of the nature of a New Zealand statute.

The authorities on the waiver of statutory provisions form a considerable body, and one marked by apparent confusion and certainly a lack of consistent principle. For while in the various authorities two principles can be deduced, the first expressed in the maxim *Quilibet potest renunciare juri pro se introducto*,[9] and the second, that a statute may not be waived if it involves elements of public policy (F Bennion, *Statutory Interpretation*, 1984 p 30; *Halsbury's Laws of England* 4 ed, vol 44, para 950), the authorities do not provide any indication of which factors are relevant to the establishment of one or other of these principles. Thus in the absence of any conceptual criteria each case turns upon its own facts and the particular provision under consideration. Indeed the leading texts (Craies, *On Statute Law*, 7 ed, 1971 p 269; Maxwell, *Interpretation of Statutes*, 12 ed, 1969 p 328; F Bennion supra, p 28) do not attempt to place the decisions in conceptual framework but instead deal with them on a case by case basis.

The use of this body of authority as precedent is further hindered in two respects. First, few if any of the authorities indicate the actual factors which led them to their conclusions, and more often than not the conclusion is merely

asserted. (Paterson, fn 9 below; at p 211) A feature well illustrated in *British Eagle* where the full extent of the discussion as to the possibility of contracting out of the Act is contained in the sentence

> Such a contracting out must to my mind be contrary to public policy . . . [and] the rules of the general liquidation should prevail. (supra, p 411)

Secondly, while these two principles appear to be merely opposite sides of the same coin

> a brief consideration of these principles is sufficient to indicate that they are applicable to the same facts and do not always lead to the same effect. (Paterson, fn 9 below, note 16 p 221)

Thus it seems the factors relevant to the waiver issue are dependent as much on the question posed as on the provision being considered. The problems associated with the use of these decisions as precedents can be illustrated by a comparison of the two Privy Council decisions, which at first glance would seem to deal with provisions both aimed at protecting specific individuals. In *Corporation of Toronto v Russell* ([1908] AC 493) their Lordships considered that a statute requiring notice to be given to the owner of land being compulsorily sold, for unpaid taxes, could only serve purposes beneficial to the owner, thus

> These things being entirely for his own benefit he can waive the notice. (at p 500)

This decision can be compared with that in *Equitable Life Assurance Society of the US v Reed* ([1914] AC 587). This case concerned a provision of the New Zealand Life Insurance Act 1908 which limited the right of the insurer to forfeit policies for non-payment of premiums. Their Lordships held that the section, while appearing in a part of the Act entitled "Protection of Policies" and being, in fact, of benefit to policy holders, was nevertheless

> intended to lay down a rule of public policy. (at p 595)

The notable feature of this comparison is that while their Lordships again fail to specify the factors that led them to their decision, the most obvious factors, the statute's purpose or effect (Evans supra p 249), which as I suggested were similar, nevertheless resulted in different conclusions. The point for our purposes is that because the authorities have failed to elaborate on the application of these principles, and because the result of any case would seem to turn as much on the question posed, and hence factors seen as relevant, as it does on the provision being considered, these authorities were of use as precedent only if it can be established, with sufficient certainty, that the factors which led to the decision are also present in the case under consideration. However as we have seen such specification is rare, and thus as the example above illustrates, it is most unwise to treat a decision on the nature of one provision as conclusive of the nature of another, even similar, provision.

Appropriateness for New Zealand?

It is submitted therefore that while the decision in *British Eagle* is no doubt persuasive, as there are no standard criteria, and the actual factors that led Lord Cross to his decision are unspecified, it is not appropriate for a New Zealand Court to simply adopt, as Mahon J did, the conclusions of the House of Lords without an independent consideration of the provision in its peculiar New Zealand context.

The second area of doubt I wish to consider concerns the legislative provisions currently in force in New Zealand, and their similarity to the corresponding English legislation. The requirement of a pari passu distribution on winding up is, in New Zealand, contained in s 293 and s 307 Companies Act 1955. Section 293, which applies to voluntary windings up, provides that

> the property of a company shall, on its winding up, be applied in satisfaction of its liabilities pari passu. . .

Section 307, which deals with all insolvent windings up, provides that the

> same rules shall prevail and be observed with regard to the rights of secured and unsecured creditors and to debts provable. . . as are in force for the time under the law of bankruptcy. . .

The effect of s 307, in this context was, considered in *Walker* where it was said

> the application of the bankruptcy rules incorporates in the Companies Act the provision for pari passu payment in s 120(e) of the Bankruptcy Act 1908. (supra p 532)

The combined effect of these two provisions, as *Walker* and *Orion Sound* demonstrate, is to provide for a pari passu payment in all cases. This state of affairs is one also existing in Australia, by virtue of s 440 Companies Act 1981 (CTH), (McPherson, fn 7 below, at p 392 et seq) and is identical, in material respects, to the position that existed in England at the time of the decision in *British Eagle*, and despite recommendations to the contrary[10] it is still the position. It is from this similarity of legislation, and hence issues, that the decisions of the House of Lords are said to derive relevancy for New Zealand.

Legislative scheme changes

However while the legislative scheme has not changed in England the same cannot be said of New Zealand, and it is this to which I wish to draw attention. For while s 293 and s 307 retain the same form the Bankruptcy Act 1908, which in s 120(e) provided that after payment of preferential debts the assets should be distributed

> in payment, pari passu, of all debts provable and proved in the bankruptcy,

has been repealed and replaced by the Insolvency Act 1967. This Act, incorporated by s 307, brings with it a significant change of wording for s 104(1)(f), the successor of s 120(e),[11] provides after payment of preferential debts, for

> payment of all debts admitted in the bankruptcy. . .

The striking feature of this comparison is the omission (Farrar and Russell, *Company Law in New*

Zealand, 1985 p 442 note 88) from s 104 of any reference to a "pari passu" distribution. An omission made all the more significant by the retention of references to a rateable distribution in the other paragraphs of s 104. It has however been suggested, in *Sutherland v North Shore Marine & Industrial Ltd* ((1988) 1 NZCLC 98167), that the pari passu principle (as distinct from its statutory manifestation) survives these changes. This decision however is subject to a number of doubts. First, while Hardie Boys J cited as authority for this proposition the decision in *Walker*, this case in fact supports the contrary view, for in an earlier part of his judgment F B Adams J made it clear that the pari passu rule was of statutory origin.[12] Secondly, in the face of the deliberate omission of references to "pari passu" in the section, it is not open to a Court to reimpose a requirement that Parliament has chosen to dispense with. (Craies, supra, p 142)

However even accepting that the pari passu rule remains as a judicial doctrine, the real significance of this change lies in its impact on the issues upon which the previous authorities have turned. In cases such as *Walker*, *British Eagle*, and the Australian authorities, the issue facing the Court was, supposing the existence of a binding agreement, could it be given effect to in the face of an Act of Parliament providing for a specific, and different, mode of distribution. The answer, as we have seen, has in the main been in the negative on the basis that the statutory provision could not be contracted out of or waived. However with the change in legislation and the removal of the pari passu requirement what had formerly been the major issue must now cease to be so, for there is no longer a statutory direction out of which the parties must contract if the agreement is to be effective. Furthermore while this legislative change does not provide a positive authorisation of subordination, and while there still may be other obstacles, the decision in *British Eagle*, turning as it does on the existence of a pari passu provision, and being authority only for the proposition that such agreements are ineffective because contracting out is impermissible, must now be largely irrelevant for New Zealand.

Statutory conflict

These changes, brought about by the Insolvency Act 1967, however create a conflict with the overlapping operation of s 293, which retains references to pari passu payment. While little assistance is to be gained from the Act, the solution, adopted in *Re Mutual Traders Ltd* ([1943] NZLR 254, 255), has been to recognise that while s 293 is general in its terms, s 307 is specifically directed at the winding up of insolvent companies. Thus s 293 is effectively limited to the voluntary winding up of solvent companies. It follows therefore that s 293 is no real impediment to debt subordination, for even if the decision in *Orion Sound* is still to be considered, in the light of my earlier comments, as authoritative of the nature of s 293, as the section applies only to solvent companies where presumably all creditors will be paid in full, the ineffectiveness of the subordination agreement will be of little practical concern.

Thus it is submitted the similarity in legislation which would formerly have made a decision of the House of Lords, at the very least, highly persuasive, is no longer present in the crucial area of insolvent companies and the proposition for which *British Eagle* is authority is one no longer relevant to New Zealand.

Conclusion

In conclusion it may be said that it has been the purpose of this paper to demonstrate that the unquestioning and whole-hearted adoption of the views of the House of Lords with regard to the major legal impediment to debt subordination in the Commonwealth may not be a satisfactory means of resolving these issues in New Zealand. It has been suggested here, that whether or not their Lordships' conclusions as to the possibility of contracting out of the pari passu provisions are correct, it is not a conclusion that can be adopted for New Zealand without it first being ascertained that all of the circumstances, including the policy considerations, are identical. As the factors upon which their Lordships' conclusions were based are unspecified it must be at least open to a New Zealand Court to reach a contrary conclusion. Secondly, and perhaps more importantly, the changes that have taken place in the New Zealand legislative scheme have disposed of the issue for which *British Eagle* is authority.

Finally it can be said that while the doubts raised here do not establish, nor were they intended to establish, the efficacy of subordination, if subordination is to be ineffective it must be so for reasons apart from those given by the House of Lords. □

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1 See generally, B Johnston (1987) 15 ABLR 80; P R Wood, *Law and Practice of International Finance* 1980; P R Wood (1985) International Financial Review 11; M Fitzgerald (1983) International Financial Review 17; D G Carlson (1985) 38 Vanderbilt LR 975; D H Calligar (1961) 70 Yale LJ 376.

2 *In Re Walker Hare Ltd* [1968] VR 447; *Re Marlborough Construction Ltd* [1977] QdR 37; *Re Industrial Welding Ltd* (1978) 3 ACLR 754; *Re NBT Builders Ltd* (1983) 8 ACLR 724; Price Mitchell Ltd (1984) 2 ACLC 524; *Horne v Chester Fein Property Developments Ltd* (1987) 5 ACLC 245.

3 Owing to different legislation this problem has not arisen in the United States of America.

4 Australian Law Reform Commission, *Discussion Paper No 32*, 1987 p 178; New Zealand Law Commission, *Preliminary Paper No 5* p 98.

5 There is a suggestion in New Zealand that unanimous consent may be sufficient; *In Re Stephens* [1929] NZLR 254; *Smith & Smith v Basten* [1934] FLR 340; *In Re Campbell* [1937] NZLR 1.

6 The significance of this was lost on Chilwell J in *Rendell v Doors & Doors* [1975] 2 NZLR 191, 197.

7 This assumption is also apparent in the comments of Mahon J in *Re Orion Sound* supra, J Farrar [1979] NZLJ 71, 73, and McPherson, *The Law of Company Liquidations*, 3 ed 1987 p 394.

8 A different view was taken by Southwell J in *Horne v Chester* supra note 3.

9 "Anyone may at his pleasure renounce the benefit of a stipulation or other right introduced entirely in his own favour." *Broom's Legal Maxims* 10 ed, 1929, p 477. For a useful summary of the New Zealand authorities applying these two principles see D E Paterson, *The Effect of s 5(k) Acts Interpretation Act 1924*, LL M thesis 1961.

10 The *United Kingdom Committee on Insolvency Law and Practice* (1982) recommended changes to allow subordination. For a summary of the report see J Farrar [1983] JBL 200. These changes were however not implemented: s 328 Insolvency Act 1986.

11 Spratt and McKenzie, *Law of Insolvency*, 1972 p 254; Sutton, *Creditor's Remedies in New Zealand*, 1981 p 206-207.

12 supra p 531; "one has to seek elsewhere [than s 293] for statutory authority for pari passu payment in a winding up by the Court."

Contract conundrum

By Jeffrey Miller

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Bright strikes a bargain with his Contracts tutor, Professor Bart Vader. Bright will pay Vader for his instruction once Bright wins his first case. Their studies go on. One day, Vader declares that he has taught Bright all he knows and Bright now owes him his fee. As Bright has not yet won his first case at Bar, he refuses to pay.

Seeking to teach his pupil a graduation lesson, Vader files suit. Bright answers with a motion for nonsuit, claiming that because he is still willing to perform his part of the bargain, Vader cannot demonstrate a cause of action. There has been no breach of contract: Bright has not argued, let alone won, his first case.

Feeling his trap spring, Vader replies that, even so, he cannot lose: If Bright wins *this* case, he must pay Vader under the terms of the contract. If Bright loses the case, he must pay Vader because the Court tells him to.

Bright, no dimwit, is prepared for this argument, and counters that it is he who cannot lose. If the Court finds against him, the contract says he doesn't have to pay. He will not yet have won his first case. If the Court finds in his favour, he can postpone payment because the Judge will have freed him of that obligation.

In celebration of the new year, fresh approaches and new resolves, I though it might be fun to invite readers to solve this 2,500-year-old conundrum attributed to the Greek sophist Protagoras.

An Athenian jurist of wealth and standing, Protagoras boasted several firsts, including first sophist in the original sense of "professional teacher" and first person to have his books burnt: In 415 BC, he was expelled from Athens as an agnostic.

He believed only in what he could discover with his senses. Thus his motto, "Man is the measure of all things," is generally taken to mean that human experience is irreducibly subjective or relative. Plato attacked him for his materialism (which earned him as much as 100 minae – about $1,000 – per student), accusing the sophist of dereliction of philosophical duties: Protagoras didn't want to find truth, he just wanted to win arguments, by any means – which pretty well brings us back to *Vader v Bright*.

It seems to me that if you attempt to reduce the problem to a legal syllogism, you get only as far as a contradiction.

> If A wins the case, he must pay B (because the contract says so).
> If A wins the case, he need not pay B (because the Court says so).

That contradiction would seem to support a finding of nonsuit. In so far as there can be no actual breach of contract until the Court has rendered judgment (and then only if Bright succeeds: There is no breach unless Bright "wins his first case"), there is none at the time of argument. Ergo, there is no cause of action.

But must Bright then pay Vader anyway, under the terms of the contract? Bright might fall back on those terms and say that getting the Court to declare "no suit" is not "winning" a case. The case was never argued. *Black's*, in fact, gives "nonsuit" as "a variety of termination of an action which does not adjudicate the issues on the merits."

In a declaration of nonsuit, judgment is rendered *against* the plaintiff, not in favour of the defendant. A nonsuit is not a victory but a draw. The defendant has parried but not counter-thrusted. Of course, the professor will reply that the contract says nothing about a decision on the merits of the case. A motion by itself is a separate trial of an issue, with a winner and a loser. If the Court declares a nonsuit, Bright has won on that separate issue.

And what if Bright never becomes a lawyer or argues another case? Perhaps Vader should have foreseen such eventualities, but unless the Court awards him his fee, he may well have given valuable consideration for no return. Bright will be unjustly enriched by Vader's tutoring.

Again, suppose the Court decides to enter into the spirit of the dispute and decide the case on the merits, on the question of whether or not there was a breach of contract. There is no so-called "anticipatory breach" because Bright never refused to honour the contract on its terms. Technically, even on Vader's view there can be no breach until *after* the Court has given judgment.

But in so far as Bright has said in his pleadings that he can't lose no matter whether the Court finds for or against him (an admission that he can win?), might the Court find a prospective breach, even as it tries that very issue?!

Even analogy doesn't help much. Farmer delivers wheat flour to Baker. Baker agrees to pay for the flour in bagels he bakes out of the flour. Farmer sues for payment while the bagels are in the oven. Although it is impossible for Baker to pay yet (just as Bright has not paid), it is not impossible for Farmer to sue (just as Vader has sued).

Of course, the Court can simply hold that Baker must pay once the bagels are crisp and brown. If he turns off the oven, we're back to unjust enrichment. (He gets wheat without paying for it.)

All discussion ends, I suppose, if we assume that whatever the *Vader* Court says, its authority supersedes the terms of the contract. (You could say that by submitting their dispute to adjudication, Vader and Bright admit that fact.) If the Court told Vader he'd have to wait for payment, he'd have to wait – never mind the semantics of whether Bright "won" or not.

If I were the Judge, I suppose I'd tell Vader to give Bright the chance to perform – allow him three years to finish his law course, and then, if necessary, sue him for *quantum meruit*. Can you come up with something more interesting or convincing or entertaining? □