#67

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2008-404-7683

BETWEEN	THYLACINE CONSTRUCTION LIMITED Appellant
AND	CAPITAL MERCHANT FINANCE LIMITED (IN RECEIVERSHIP) AND CAPITAL + MERCHANT INVESTMENTS LIMITED (IN RECEIVERSHIP) Respondents

Hearing: 26 March 2009

Appearances: M C Black for Appellant
R J Gordon for Respondents

Judgment: 7 May 2009

JUDGMENT OF KEANE J

This judgment was delivered by Justice Keane on 7 May 2009 at 10am pursuant to Rule 11.5 of the High Court Rules.

Registrar/ Deputy Registrar

Date:

Solicitors:

A Wright, Parnell, Auckland for Appellant
Buddle Findlay, Wellington for Respondents

[1] On this appeal against a summary judgment given in the District Court on 29 October 2008 Thylacine Construction seeks the sum that it was then denied, $97,427, construction costs owed to it by Southern Isles Properties for the first phase of a storage and lock-up facility in Onehunga on which work ceased when Southern became insolvent in December 2007.

[2] In awarding that sum to CM Investments, as first mortgagee, because of its ranking in priority, Thylacine contends, the Judge did not consider a significant aspect of its own case that CM Investments was precluded from relying on its superior interest as a result of an accord in December 2007 on the faith of which Thylacine did not obstruct sale of the property in its incomplete state. That accord, it contends, entitled it to pursue this claim both defensively and affirmatively at trial in contract, under the Fair Trading Act, in estoppel and by way of remedial constructive trust.

[3] To this, CM Investments responds, Thylacine, an unsecured creditor of Southern, seeks to elevate itself in status. CM Investments puts in issue whether Thylacine was ever able to pursue this argument before the Judge. The terms on which the sum in issue was set aside on the sale of Southern's property in May 2008, it says, constitute a bar, as do Thylacine's own pleadings. Thylacine's present argument was not one that the Judge had ever to consider.

[4] If Thylacine is able to rely on its argument, CM Investments says further, it cannot make out the accord it contends for, and if it can that gives it no comfort. The accord was complied with. Thylacine at most will become an unsecured creditor of CM Investments. It will not obtain any beneficial interest in the sum set aside, or any proprietary right. There is, moreover, now no fund. Relying on the judgment under appeal, which was not appealed immediately, the sum set aside was paid out. There is nothing to trace.

[5] These are the issues on this appeal. Thylacine does not seek to challenge the other aspects of the judgment adverse to it; the summary judgment given against it in favour of Lee Salmon Long, Southern's solicitors, in particular.

Context

[6] On 17 July 2007 Thylacine entered into a contract with Southern to construct a two level storage and lock-up facility in Onehunga in two phases. For the first phase it was to be paid $1,294,711 excluding GST. When it ceased work at the end of December 2007, that phase was still incomplete.

[7] Southern, which was reliant on finance from CM Investments, or its allied company CM Finance, became insolvent when they themselves went into receivership on 23 November 2007. At that point Southern owed the one or the other $8.6M.

[8] In July – September 2007 Thylacine had made progress claims for two sums, $22,359.38 and $268,515, which had been met in September – October. It had still outstanding two further claims made for work until the end of November, then totalling $323,739.34. On 21 December CM Investments paid Thylacine the sums approved by the quantity surveyors, Rawlinsons, $309,590.68 in exchange for Thylacine's assurance in a letter that day that it would not interfere with the sale of the property.

[9] On 19 December 2007, two days before, Thylacine had sent its December claim, $112,994.64, to the quantity surveyors, to be invoiced, in terms of the contract, at the end of that month. The greater part, $97,427.64, remains outstanding and is the sum in issue. It is that sum, Thylacine contends, as to which it also had an assurance from CM Finance in December 2007.

[10] On 25 March 2008 Lee Salmon Long, Southern's solicitors, wrote to Thylacine's counsel, Mr Black, responding to a facsimile from him dated 20 March, concerning the proposed sale of the property. They drew his attention to a term in the proposed terms of sale which said this:

> The vendor and the purchaser acknowledge that the property is currently partway through development and that there are outstanding invoices relating to the development in the sum of $97,427.64 which both parties irrevocably instruct Barfoot & Thompson to pay to Thylacine Construction

> Limited out of the deposit immediately following the agreement becoming unconditional.

[11] That sum, Lee Salmon Long explained, represented the balance of the progress claim still outstanding, $112,994.84 after Southern had been refunded by the Inland Revenue Department $15,587.20, which evidently was to go to Thylacine. And so, they said, Thylacine had no ground as it then proposed to seek any interim relief.

[12] Unpersuaded, Thylacine, on 28 March 2008, pursued a more wide ranging claim against Southern, and a shareholder and director, under the Construction Contracts Act 2002. As well as the sum then outstanding for work done it sought damages, in the range $277,746 - $277,746 - $583,714, for loss of the balance of phase one and the whole of phase two. It sought also the Adjudicator's approval for a charging order against the construction site.

[13] On 28 April 2008 the Adjudicator held that Southern owed Thylacine the sum outstanding for work done. That was undisputed. He agreed also that Thylacine was entitled to the charging order. He rejected Thylacine's more wide ranging claim for damages.

[14] In the meantime, the term proposed to be included in the agreement for sale and purchase had not survived. It was rejected by the purchaser, Strowan Investments Limited, which purchased the property for $4.65M on 11 April 2008. But when the receivers obtained the full net proceeds on 9 May 2008 they retained in trust, against Thylacine's claim, $102,450, the sum outstanding and interest accrued, on a basis set out in a letter that day.

[15] The receivers' position then and since is that this sum was set aside, pragmatically and without accepting Thylacine's claim, simply to clear off a caveat that Thylacine had lodged against Southern's title on 30 April 2008, alleging an express trust on Southern's part, entered into on 28 April 2008. Settlement was to occur on 9 May 2008 and it did.

[16] On 21 May 2008 Thylacine brought its claim in the District Court, first as against Southern seeking a review of the Adjudicator's determination, to the extent that he denied Thylacine's claim for damages beyond the sum not in dispute. That was not resolved by the Judge in the decision under appeal and is no longer to be pursued. Southern went into liquidation in June 2008.

[17] Thylacine sought also from Southern's solicitors, Lee Salmon Long, the sum awarded by the Adjudicator, relying on the letter dated 25 March 2008. In that letter, Thylacine said, the solicitors assured it that it would be paid out of the proceeds of the sale the sum the Adjudicator held to be owing. They were in breach of a duty of care, presumably in negligence, and in estoppel and under the Fair Trading Act. The Judge, on Lee Salmon Long's application, gave summary judgment in its favour and that is not pursued on this appeal either.

[18] Finally, Thylacine claimed against CM Finance as stakeholder or on an interpleader, contending that in an exchange of correspondence on 8, 9 May 2008 between Thylacine, Southern and CM Finance, or their advisers, CM Finance undertook to hold in trust as stakeholder, on the sale of the property, $102,450.21, until its claim was determined.

[19] This last cause of action led CM Finance on 8 July 2008 first to say by way of defence that it was not properly a party to the action. It had assigned its interest to CM Investments in December 2006, and the latter held the first mortgage over Southern's property. In a counterclaim CM Finance, or as it was proposed CM Investments, asserted the superiority of that first mortgage interest over the unsecured interest of Thylacine in the sum set aside. It claimed summary judgment.

[20] In opposition, on 14 August 2008, Thylacine contended that the two companies were estopped from asserting their priority as a result of representations made on their behalf in December 2007 by Mark Kwei, a director of Fortress Investment Group (Australia) Pty Ltd, the principal creditor of both, and the appointor of the receivers, to ensure that Thylacine completed phase one and did not disrupt the sale of the property in its incomplete state. Mr Kwei held out that Thylacine would be paid what was outstanding.

[21] Thylacine relied on the same species of remedies as it claimed against Lee Salmon Long and in an amended notice of opposition, dated 2 September 2008, also claimed an equitable proprietary interest in the fund retained. In each instance Thylacine relied on two affidavits, dated 13 August and 1 September 2008, from the Thylacine director to whom Mr Kwei was said to have made the critical representations, Richard Walker.

Decision under appeal

[22] In his decision the Judge elected not to substitute CM Investments for CM Finance as a party to the action. He elected instead, as he said pragmatically, to retain CM Finance as third defendant and to join CM Investments as fourth defendant.

[23] In resolving what then became CM Investments' claim for summary judgment, relying on its priority as first mortgagee, the Judge saw Thylacine's case in response as resting on its statement of claim, principally the Lee Salmon Long letter dated 25 March 2008 on which the claim against the solicitors in its various guises hinged. He understood the December 2007 assurances to serve no other purpose than to buttress that claim.

[24] The Judge took Mr Black to be advancing two propositions:

> There had been a series of exchanges between The Financiers and Mr Walker relating to an apparent endeavour to see the project completed notwithstanding Thylacine's, by then substantial financial problems; and that
>
> Thylacine had then acted to its detriment by carrying on with the project in the expectation of overall payment and in circumstances raising some obligation in its favour on the part of The Financiers.

[25] The Judge took Mr Black to be relying on the doctrine of estoppel, as set out recently in *Krukziener v Hanover Finance Ltd* [2008] NZCA 187, paras [37], [38]. He did not consider that this availed Thylacine. It did not, as he put it, 'impinge on the realities', which he summarised in this way:

> SIPL itself owed The Financiers moneys undoubtedly secured by mortgage rights which for all present purposes (as was agreed at the time of settlement at the sale of the property) remain extant; and
>
> There is no arguably useful evidence to raise (directly or inferentially) the possibility that the LSL letter (written by the solicitors for their then client SIPL rather than The Financiers or either of them) could bear on the merits of the CMIL counter claim.
>
> There is no arguably useful evidence (that I can make out from a veritable jumble of materials) that Thylacine could ever have considered that it could lay claim to $97,427.64.

[26] The exchange of letters on 8, 9 May 2008, between Mr Black and the receivers' solicitors, Buddle Findlay, the Judge said, meant no more than that the fund set aside would be held until agreement or Court order. That could not constitute either CM Finance, or Lee Salmon Long, a stakeholder. The Judge found that 'as the party entitled throughout to the entirety of the proceeds of sale' CM Investments was entitled to summary judgment.

[27] In this the Judge did not advert to the distinct basis on which Thylacine resisted CM Finance's, or CM Investments', claim to priority: the representations said to have been made in December 2007 set out in Thylacine's two notices of opposition and statements of defence and counterclaim, founded on the Walker affidavits.

Terms on which sum set aside

[28] The receivers' first line of defence is their solicitors' letter dated 9 May 2008, in which they spelt out the terms on which the fund would be set aside if the caveat were removed to enable settlement that day. They contend that those terms preclude Thylacine's claim as it may have been and as it is now. That is not so. That letter preserves to each side the most complete ability to pursue their contending claims.

[29] The terms are set out in an email, dated 9 May 2008, from the receivers' solicitors to Mr Black, Thylacine's counsel, in reply to his earlier fax that day. They confirm that the sum had been set aside in their trust account 'pending agreement between the parties or order of the Court' and on this basis:

> Each of the parties will retain and reserve, and can make, each and every claim it believes is available to it in respect of that fund, as if they retained their registered mortgage or caveat; and in the case of Thylacine its judgment against Southern Isle Properties Limited; and that will include (without limitation) on behalf of Thylacine any claims or rights that it believes arise from the matters referred to in subparas (a) and/or (b) and/or (c) of Michael Black's fax to us of 9 May 2008.

[30] In his earlier letter that day Mr Black identified three categories of contentions. Those arising from the Lee Salmon Long letter dated 25 March 2008. Those arising from the charging order made by the Adjudicator on 28 May. Most generally those springing from 'all of Thylacine's rights and remedies', referred to in earlier correspondence.

[31] To resolve this point I see no reason to track back. The three categories of issue identified in Mr Black's letter are no more than instances of the rights of claim that the solicitors identified as reserved, those resting on the mortgage and those shielded by the caveat, and quite generally, 'each and every claim … (each) believes is available … in respect of that fund'.

Claims in equity against CM Investments

[32] As will also already be evident, I do not accept either the receivers' second line of defence, that Thylacine's present claim lies beyond its pleadings. It may be that Thylacine's case evolved as the battle lines shifted. But its position eventually was both specific and relatively clear.

[33] On 14 August 2008 Thylacine, in its statement of defence to CM Finance's counterclaim, pleaded that on and before 21 December 2007 Mr Kwei of Fortress, the principal creditor of the two finance companies that had appointed their receivers, gave an assurance to a Thylacine director, Richard Walker, that the construction costs due to Thylacine would be paid on the receivership. In return Thylacine undertook not to disrupt the sale process.

[34] On 21 December 2007, Thylacine pleaded, Mr Kwei provided the text of a letter to Thylacine to forward to CM Investments confirming that Thylacine would be paid the amount due to the end of November 2007, $309,590.68, and that was

paid that day. But there remained further work to be invoiced in December 2007, $112,994.64, of which Mr Kwei had to be aware.

[35] On that basis Thylacine contended, as it does now, for a representation constituting an agreement, or raising an estoppel, and, supplying a set-off or a basis for counterclaim against CM Finance, relying on two affidavits from Mr Walker.

[36] In the amended notice of opposition dated 2 September 2008 Thylacine maintained that stance. It also asserted a proprietary right in equity to the fund set aside, relying in passing on Lee Salmon Long's role after the receivership, said to be encapsulated in their 'irrevocable letter', and expressed the right in this way:

> By reason of the 'funding representations' it is alleged that there is an equitable interest vested in Thylacine to the fund.
>
> Alternatively, equity imposes a (sic) equitable interest arising out of the parties' dealings, including a constructive trust (or remedial constructive trust) over a property (being the fund) obtained in breach of the representation that a fund would be available to pay the construction costs.

[37] As will appear, therefore, the principal pleadings did not, as assumed in the judgment under appeal, encapsulate all Thylacine's bases for defence and claim. As at the hearing on 3 September 2008, Thylacine had at least raised a further quite distinct footing for the one or the other. To obtain summary judgment CM Investments had at least to exclude that as a source of a defence.

Two bases for claim in equity

[38] Though Thylacine seeks to assert on the basis of any representations made in December 2007 claims in contract and under the Fair Trading Act, principally it relies on the doctrines of promissory and proprietary estoppel as both a shield and a sword.

[39] Thylacine claims that in December 2007 CM Investments and CM Finance agreed to set to one side their priority interest, relying on the first mortgage security, and to pay out what was due. They, and Fortress, had an interest in making the best

of their security. Thylacine's role in completing its work and not disrupting the sale process was crucial.

[40] Thylacine contends that it relied on that assurance, completed whatever work still had to be done in December 2007, and gave its assurance that it would not disrupt the sale process. It did so to its detriment. It was not paid. CM Finance and CM Investments are estopped from relying now on their priority. They are obliged to make good their assurance.

[41] Thylacine seeks more. It seeks the very fund set aside in May 2008 by the receivers' solicitors, on the basis of a remedial constructive trust transcending any priority, relying on *Fortex Group Limited (In Receivership and Liquidation) v MacIntosh* (1998) 3 NZLR 171 (CA), 175, where Tipping J said:

> Equity intervenes to prevent those with rights at law from enforcing those rights when in the eyes of equity it would be unconscionable for them to do so. Equity acts in this respect as a Court of conscience. In order to defeat, pro tanto, the secured creditors' rights at law under their security by the imposition of a remedial constructive trust, the plaintiffs must be able to point to something which can be said to make it unconscionable – contrary to good conscience – for the secured creditors to rely on their rights at law.

[42] To that, in *Regal Castings Ltd v Light Body*, SC 72/2007, 23 October 2008, where a remedial constructive trust was imposed, Tipping J at para 163 did enter a note of caution. He described as 'provisional' the recognition the Court gave in *Fortex* to a constructive trust as a remedy. He said also:

> The Court emphasised the need for caution not to allow the proprietary nature of this form of remedy to undermine or subvert other recognised principles and priorities.

[43] To bring home its claim in equity, Thylacine, as it appears to me, links the December 2007 representations, and the terms on which the fund was set aside in May 2008, by contending for a continuum. Southern, the two finance companies, and Fortex, all had an interest in Thylacine completing phase one and not disrupting sale. The March 2008 solicitors' letter on Southern's behalf assuring Thylacine that what it was owed would be set aside from the proceeds of sale is all of a piece.

[44] In order to resolve this appeal I have then to consider what the nature of the December 2007 representations was, whether they were complied with, how they link if at all to the March assurance and to the terms in May on which the fund was set aside. A continuum is not to be assumed. The receivers say that in December 2007 Thylacine got all that it bargained for.

December 2007 representations

[45] There may well be a basis, as Mr Walker deposes, for the conclusion that by October 2007 CM Investments and CM Finance, the one or the other does not matter, and Fortress, were interested in, and engaged in ensuring, that Thylacine's progress claims then outstanding were met, subject to the fact of the receivership. The question is how far they went.

[46] On 3 December 2007 Southern's Wayne Douglas wrote to Mr Kwei of Fortress asking where, given the receivership, Thylacine was to send its invoices and how Southern was to respond. He asked when the last invoice submitted to CM Finance was to be paid.

[47] Two days later, on 5 December 2007, Mr Walker went directly to Mr Kwei himself in this email, which seems to me to set the scene definitively:

> I have been given a copy of your email to Wayne Douglas, cc Rob Butler, and wish to make the following comments –
>
> 1. Thylacine received its last (late) payment from Buddle Findlay on October 23rd. This was for work completed, and approved by Rawlinsons, up to the end of September.
>
> 2. The invoice for work completed to the end of October, approved by Rawlinsons, and contractually due for payment by 14th November, remains unpaid.
>
> 3. The invoice for work completed to the end of November, approved by Rawlinsons in the last few days, is due for payment by 14th December.
>
> 4. The total amount outstanding is now approximately $300,000 after retentions and GST.

5. Previous payment hold ups have resulted in agreed extensions to the completion date, with the current situation summarised in the latest Rawlinsons report.

6. We urgently need to order materials for the next phase of the project, but are reticent to do so until payments are brought up to date. Every day that passes puts us nearer to the Christmas break and the likelihood of not being able to access the required materials until mid January, resulting in yet more completion delays and increased costs.

7. The construction crew is prepared to work through the Christmas break, (excepting statutory holidays) in order to regain some of the lost time, but this would be pointless without the necessary materials.

Can you please advise us directly of developments that relate to the payments situation so that we can make appropriate decisions and commitments in the interim.

[48] To this Mr Kwei replied that day:

> I appreciate the summary of the current status and understand your position. As a general comment, we are seeking to continue construction progress on a number of the loans within the C + M portfolio, including the Crown Self Storage facility. There are some process issues we need to take care of, and I will try to give you specific clarity on your payments by Monday.

[49] Later that day Mr Walker sent Mr Kwei this email:

> To ensure our work force remains on site, Thylacine requires an undertaking from Fortress in respect of the outstanding October and November, and all subsequent invoices re the Southern Isle contract. Specifically we require a commitment repayment of Invoice 4715 - $139,528.13 forthwith, and Invoice 4716 - $184,211.21 by the 14th of this month, with all subsequent invoices paid by their due dates.

[50] An email on 7 December 2007 from the quantity surveyors concerning a progress valuation, presumably relating to Thylacine's December 2007 invoice, was also sent to Mr Kwei. On that same day he sent this email to Mr Walker:

> I called earlier to give you an update of where we sit in relation to an undertaking/payment of the outstanding bills. We have submitted a plan to the receiver which will allow us to advance funds on projects such as yours. They are assessing them. I anticipate this will be finalised early/mid next week. We may require until the 21st to then make the payments per the details below. I have received all the QS reports from Andrew (including the most recent one this morning). Unfortunately this process does take time and we are moving quickly to meet all stakeholder objectives. I understand this will impact on the timing of completing of the Crown Self Storage project

> and your ability to work through December/January holiday period. We appreciate your patience.

[51] Mr Kwei said that he was to be in Auckland on the ensuing Wednesday, 12 December 2007. He was happy to meet Mr Walker. Then, after further email exchanges, Mr Kwei sent to Mr Walker an email on 19 December that is no less definitive. The receiver, he said, was willing to pay two invoices outstanding, invoices 4715 – 16, but required first an undertaking from a Thylacine director that sale would not be disrupted. He set out the undertaking required.

[52] On 21 December 2009, in a letter to the receivers of CM Investments, Mr Walker gave the exact undertaking stipulated for:

> I have been requested to document the following in consideration for the payment of our outstanding invoices 4715 and 4716 to Southern Isle Properties Limited
>
> - Thylacine acknowledges that payment of an amount of $309,590.68 will be made by Capital + Merchant Investments Limited (in receivership), on request of Southern Isle Properties Limited, in satisfaction of the Thylacine invoices as certified by Rawlinsons, the Quantity Surveyors (valuations 5 and 6).
>
> - In consideration of this payment, Thylacine undertakes to act in good faith, and will not disrupt or interfere or take any action that could be construed as detrimental to any sales process of the Crown Self Storage facility.

[53] Invoices 4715 and 4716 were, as Mr Walker has deposed, those outstanding as at the end of November 2007. The undertaking Thylacine gave, therefore, is not matched by any corresponding undertaking on the receivers' part to pay the further sum owed up until 21 December 2007 that is now in issue. That, I consider, is decisive.

Conclusions

[54] Though in the decision under appeal the Judge gave summary judgment in favour of CM Investments solely on the basis of its ranking in priority over Thylacine as an unsecured creditor, and did not take into account Thylacine's

offsetting claims in equity, the effect of which could have been to render that priority inoperative, he was right to give judgment on the principle of priority.

[55] First, on 5 December 2007 Mr Kwei and Mr Walker had their first exchange of any significance. Mr Walker advised Mr Kwei what Thylacine's predicament was. Mr Kwei undertook to make a review.

[56] Secondly, Mr Kwei did not commit Fortress to any liability to pay on Southern's part. It is no accident that Fortress has never been a party to the action. Nor did he speak on behalf of the receivers. He was clear that any decision lay with them. Again it is no accident that the 21 December 2007 letter was to the receivers.

[57] Thirdly, in that letter Thylacine invited the receivers, in exchange for its undertaking not to disrupt sale, to pay only the sum outstanding as at the end of November 2007. Thylacine made no claim to the December sum soon to be invoiced.

[58] Fourthly, Thylacine undertook only not to disrupt the sale process. It did not undertake to continue with any work then remaining in phase one. That is unsurprising. It had very little to do. A significant part of the December invoice was for retentions. Thylacine cannot and does not claim any related detriment.

[59] Fifthly, and correlatively, there is nothing in the evidence to suggest that after the 21 December 2007 letter Mr Kwei gave to Thylacine any independent assurance, whether on behalf of Fortress or CM Investments, that Thylacine's December invoice would be paid.

[60] Sixthly, it is therefore unsurprising that Thylacine's claim against CM Investments or CM Finance, in the statement of claim does not rely on the 21 December 2007 letter, or any related assurance. It relies instead on Lee Salmon Long's letter dated 25 March 2008, before the agreement for sale and purchase was entered into, and Buddle Findlay's letter dated 9 May 2008 before settlement.