IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2016-404-1018
[2016] NZHC 2754

UNDER	the Companies Act 1993
IN THE MATTER	of the liquidation of Intext Coatings Limited (In Liquidation)
BETWEEN	INTEXT COATINGS LIMITED (IN LIQUIDATION) Plaintiff
AND	ROSHNI DEO First Defendant
	ALFRED DEO Second Defendant

Hearing: 9 September 2016

Counsel: KM Wakelin and GA Campbell for the plaintiff

No appearance by or on behalf of the defendants

Judgment: 17 November 2016

JUDGMENT OF FITZGERALD J

This judgment was delivered by me on 17November 2016 at 12:30 pm,
pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date.....

Solicitors: Meredith Connell, Auckland

To: R & A Deo, Auckland

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Introduction

[1] Intext Coatings Limited (in liquidation) ("Company") was put into liquidation by Court order on 19 February 2016. Vivienne Judith Madsen-Ries and Henry David Levin were appointed liquidators. Prior to its liquidation, the Company provided painting, water blasting and minor maintenance services. The first and second defendants, Mrs and Mr Deo, were at all relevant times directors and/or shareholders of the Company.

[2] By its first cause of action, the Company seeks to recover from Mr and Mrs Deo drawings said to have been made by them from the Company over two periods: the first being to 31 March 2014 ("FYE 2014"); the second from 1 April 2014 until the Company's liquidation. The reason for the two periods is that financial statements for the Company were only available up to FYE 2014. The Company's bank statements are the primary record available for the period after FYE 2014. Across the two periods, the total sum claimed is $575,418.

[3] The second cause of action relates to the sum of $80,461.86. The Company's case is that, in breach of her fiduciary duties as a director of the Company, Mrs Deo allowed or caused payments in this amount to be made by the Company in repayment of mortgages over a residential property owned by Mrs Deo ("Property"). The Company says it is entitled as a matter of equity to trace these payments into, and claim an equitable proprietary interest in, the Property (to the extent of $80,461.86).

Factual background

[4] Mr Levin swore an affidavit in support of the Company's application for formal proof. My summary of the factual background is drawn from Mr Levin's uncontested evidence.

[5] The Companies Office records for the Company show the following information:

(a) Mr and Mrs Deo were the directors and shareholders of the Company on incorporation;

(b) Mrs Deo transferred her shareholding to Mr Deo on 27 May 2014; and

(c) Mr Deo was removed as a director on 16 January 2015.

[6] Creditor claims in the liquidation total $116,455.69, largely comprising claims by the Commissioner of Inland Revenue ("Inland Revenue"), and approximately $10,000 claimed by the Accident Compensation Corporation.

[7] Mr Levin deposes that that the Company has no realisable assets apart from legal claims and a nominal bank account balance of $176.

[8] Mr Levin gives evidence as to the financial position of the Company over the relevant periods. Of primary relevance to the current claim, he points to the Company's financial statements for FYE 2014, which record a shareholder current account with a closing balance of $233,194.

[9] The financial statements record that the current account is allocated to "Shareholder 1". At FYE 2014, both Mr and Mrs Deo were shareholders of the Company. They were not designated as "Shareholder 1" or "Shareholder 2" anywhere in the Company's records. On this basis, Mr Levin concludes that the current account was held by both Mr and Mrs Deo jointly. Further support for this conclusion is drawn from the Company's statement of financial position as at FYE 2014, which records the following entry: "Shareholders' overdrawn current accounts" of $233,194 (my emphasis).

[10] On the basis of the information before me, I am satisfied that the shareholders' current account shown in the FYE 2014 financial statements was held jointly by Mr and Mrs Deo.

[11] Mr Levin also gives evidence of the Company's increasing debt to Inland Revenue over the period 2012 to its liquidation. Mr Levin notes that the Company did not pay any GST for all but one of the periods ending between 31 July 2012 and 31 March 2014, despite numerous reminders by Inland Revenue. The Company eventually deregistered for GST with effect from 4 April 2014.

[12] The Company's tax issues were not, however, confined to payment of GST. The Company also failed to pay income tax for the periods ending 31 March 2012, 31 March 2013 and 31 March 2014. As a result of these issues, the Company

accrued non/late payment/filing penalties totalling some $24,734.71 and interest totalling $17,895.51.

[13] Despite the significantly increasing tax debts, Mr Levin deposes that at no stage prior to liquidation did the Company take any steps to collect the current account debt said to be owing from Mr and Mrs Deo. He deposes that as a result, his view is that the current account "asset" effectively had zero value, as it was unrecoverable and was not immediately realisable. Mr Levin concludes that on this basis, it should not have been recorded as an asset of the Company. Backing that "asset" out of the Company's accounts, the Company's liabilities for the period to FYE 2014 exceeded its net assets by $61,637. Mr Levin notes that, but for the drawings taken from the Company by Mr and Mrs Deo, the Company would have had a positive net asset and net working capital position.

[14] As a result of the overall financial position of the Company and the debts due to Inland Revenue, Mr Levin concludes that the Company was insolvent from at least 31 July 2012.

First cause of action: claim for recovery of current account

Current account to FYE 2014 - approach

[15] As noted at [8] above, the financial statements to FYE 2014 record a closing balance of the shareholder current account of $233,194.

[16] Ms Wakelin submits that the Company is entitled to rely on the accounts of the Company, prepared at the direction of the directors at the time, and that Mr and Mrs Deo, as the directors, are responsible for the accuracy of those accounts. Ms Wakelin refers to *Chesterton Holdings Ltd (in liq) v Durney*),[1] *New Zealand Game Meat Exports Ltd (in liq) v Lau*[2] and *Thom Contractors Ltd (in liq) v Thom*[3] in support of these propositions. I accept that these authorities support the propositions advanced on behalf of the Company. Particularly in circumstances where no evidence has been offered by the directors/shareholders to contradict the position set

1 *Chesterton Holdings Ltd (in liq) v Durney* HC Napier CIV-2011-441-007, 19 May 2011.
2 *New Zealand Game Meat Exports Ltd (in liq) v Lau* HC Whangarei CP34/98, 19 March 1999.
3 *Thom Contractors Ltd (in liq) v Thom* HC Auckland CIV-2008-404-6829, 28 April 2009.

out in the Company's financial accounts, and in light of directors' duties under s 194 of the Companies Act 1993,[4] the liquidators, on behalf of the Company, ought to be able to rely on the financial statements at face value.

[17] I also accept that advances made on a shareholders' current account are a debt due, owed by the shareholder to the company, repayable on demand.[5]

Demand made regarding current account balance

[18] By letters dated 26 February 2016, the Company made demand on each of Mr and Mrs Deo for repayment of the current account debt of $233,194. There is no evidence that this amount, or any part of it, has been paid by Mr or Mrs Deo.

[19] On this basis, I am satisfied that Mr and Mrs Deo remain liable for the current account debt to FYE 2014.

Current account from 1 April 2014 to liquidation

[20] As noted earlier, financial statements after FYE 2014 were not available. Accordingly, the liquidators have relied primarily on the Company's bank statements to consider further drawings made by Mr and Mrs Deo.

[21] On the materials before me, it is apparent that the liquidators have carefully and thoroughly considered the Company's bank statements and identified a range of payments that they consider to be further drawings from the Company made by Mr and Mrs Deo. These total $342,224.

[22] The liquidators have categorised these payments as follows:

(a) Personal in nature;

(b) Loan payments;

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4 Including a duty to keep accounting records that correctly record the transactions of the company; see s 194(1).

5 See for example *Thom Contractors Ltd (in liq) v Thom* above n 3, at [16]*: Re Samarang Development Ltd (in liq)* HC Christchurch CIV-2003-409-2094, 30 September 2004 at [55]*; Chesterton Holdings Ltd (in liq) v Durney*, above n 1, at [27]; *Mizeen Painters Ltd (in liq) v Tapusoa* [2015] NZHC 826 at [24] and [25].

(c) Bank transfers;

(d) Payments narrated as "personal";

(e) Insurance; and

(f) Payments in relation to the mortgage.

[23] Ms Wakelin took me through each of these categories and the basis for concluding that they represent continued drawings by Mr and Mrs Deo for their personal use, rather than payments for the benefit of the Company.

Personal in nature

[24] Attached to Mr Levin's affidavit is a lengthy schedule summarising the various payments identified in the Company's bank accounts which are considered "personal in nature". I have reviewed the entries in the schedule and am satisfied that they reflect general expenditure of a day-to-day and personal nature by Mr and Mrs Deo. For example, a large number of the entries are payments to various supermarkets, clothing stores, jewellers, shoe stores, fast food/takeaway outlets, post shops, hardware stores, dairies, liquor stores, butchers and so on. Absent any explanation from Mr and Mrs Deo, these payments do not appear to be associated with Company business or otherwise for the benefit of the Company.

[25] In similar circumstances, Muir J observed in *Mizeen Painters Ltd (in liq) v Tapusoa* that:[6]

> It is clear from the schedules that [the liquidator] annexes [to his affidavit] that the defendants simply regarded the company's account as their personal account, using it for almost every conceivable type of personal expenditure.

[26] Such an observation applies here.

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6 *Mizeen Painters Ltd (in liq) v Tapusoa* above n 5, at [23].

Loan payments

[27] This category is broken down into payments to Marac Finance, Instant Finance, Aotea Finance and Consumer Finance.

[28] The bank statements record weekly payments to Marac Finance of $100. File notes of interviews by the liquidators' staff of Mr and Mrs Deo record that they had obtained finance from Marac Finance to purchase a car. Mr Levin says that there is no evidence that this was for the benefit of the Company. On the basis of the Deos' interview and Mr Levin's evidence, I accept the submission on behalf of the Company that these loan payments were for the personal benefit of Mr and Mrs Deo.

[29] In relation to Instant Finance, Mr Levin states that there is no evidence as to what this loan related to, other than Mr Deo's advice to the liquidators (recorded in file notes annexed to Mr Levin's affidavit) that Mr and Mrs Deo had borrowed money from Instant Finance. Ms Wakelin submits that, on that basis, and absent any further evidence from Mr or Mrs Deo, it is appropriate to conclude that the payments were not for the benefit of the Company and were for the benefit of the Deos personally. On the basis of the materials before me, I accept Ms Wakelin's submission to that effect.

[30] A similar position exists in relation to Aotea Finance. When questioned about these payments by the liquidators, Mr and Mrs Deo were unable to advise what they were for. As directors of the Company, if these payments were proper Company expenses, they ought to have been recorded as such and explained by Mr and Mrs Deo on that basis. In the absence of any evidence or explanation that these payments were for the benefit of the Company, I accept that on the balance of probabilities, they were also payments for the benefit of Mr and Mrs Deo personally.

[31] Regular payments made to Consumer Finance up to FYE 2014 were classified as shareholder drawings in the financial accounts for that year. On that basis, and there being no evidence of any change in status of these payments in the subsequent time period, Ms Wakelin invited me to infer that the continuing payments to Consumer Finance were of the same nature, namely drawings for the personal benefit of Mr and Mrs Deo. I accept that submission.

Bank transfers

[32] The next category is of payments from the Company bank accounts to bank accounts which, in interviews with the liquidators' staff, Mr and Mrs Deo confirmed are their personal bank accounts. Mr Levin gives evidence that test tracing payments of this nature demonstrates that the payments were classified as drawings in the general ledger for FYE 2014. On that basis, Ms Wakelin again invited me to draw an inference that the continuing payments to the same bank accounts were of the same nature, i.e. drawings for the personal benefit of Mr and Mrs Deo. I accept that submission and conclude that these payments were also for the personal benefit of Mr and Mrs Deo.

[33] There is also a collection of payments narrated "WBC trust account". These total $5,260. Mr Levin does not expressly address these payments in his evidence. Ms Wakelin was similarly not able to offer any insight into these payments. On that basis, I am not satisfied that the Company has demonstrated that these particular payments, although relatively nominal in amount, were personal drawings by Mr and Mrs Deo (or either of them). I will accordingly exclude them from the total of alleged drawings for the period 1 April 2014 to liquidation.

Payments narrated as personal

[34] This is a collection of payments where the narrations in the Company's bank accounts refer to Mr or Mrs Deo personally. I have reviewed the relevant extracts from the schedule to Mr Levin's affidavit and, absent any explanation from Mr or Mrs Deo as to the nature of these payments, accept that they appear to be personal payments for the benefit of the Deos. A large number of them are narrated "Roshni Deo Visa", or simply referenced as repayments to Mr Deo. For some of the payments, there are further narrations of "groceries", "mortgage", "Trade Me" and "shopping".

[35] Also within this category are payments totalling $3,900 and narrated "Watercare Services" (with the description "Water Bill") or "Watercare Service Ltd" (with a further narration "AA Deo"). Test tracing carried out by the liquidators' staff indicates that similar payments narrated to Watercare were classified in the FYE

2014 financial accounts as rates and cash drawings (for each $50 payment, rates $10 and cash drawings $40). Absent an explanation from Mr or Mrs Deo as to how these payments properly relate to Company business rather than being payment of the Deos' personal water bills, I conclude that these were also payments for the personal benefit of the Deos, rather than for the Company itself.

Insurance

[36] Over the period 16 April 2014 to 16 February 2016, there is a total of $6,363.95 in payments to insurers. These were narrated as "ANZ F & G Insurance", "Sovereign", "Atherton Life Ltd" and "PREMASB ACB".

[37] In relation to the Sovereign and Atherton Life payments, the liquidators contacted each of Sovereign and Atherton Life and each of those entities confirmed that it did not hold any policies in the name of the Company. Mr Levin deposes that, on this basis, and absent any other evidence that the payments were for the benefit of the Company, the payments were for the benefit of the Deos personally. I accept that evidence.

[38] In relation to the ANZ insurance payments, by letter dated 16 March 2016, the liquidators wrote to ANZ asking it to provide to the liquidators a schedule of all policies ANZ currently or had previously held in the name of the Company. No response was received from ANZ. Mr Levin deposes that this is usually a good indicator that there is no policy in the Company's name (and I note that the letter did not expressly require a "nil" response). On the basis of this evidence, and in the absence of any explanation of these payments by the Deos, I accept that they are more likely than not to be payments for the personal benefit of the Deos rather than the Company.

[39] In relation to those payments categorised as "PREMASB", there is limited information. Mr Levin states that "We found no evidence that these were business related payments". However, unlike the other payments discussed, there is no evidence of what these payments actually relate to, nor is there any evidence that they were more likely than not to be payments for the Deos personally. In the absence of *any* information about these payments, and again whilst nominal in

amount (being $1,766.95), I am not prepared to conclude that these must have been for the benefit of the Deos rather than the Company. I will therefore also exclude these from the total alleged drawings for the post-FYE 2014 period.

Payments in relation to the mortgage

[40] The final category is payments made in relation to various mortgages over the Property. The earlier payments are to the Bank of New Zealand Ltd ("BNZ") over the period 9 April 2013 to 12 February 2014. These total $26,600.00. The payments are narrated "Roshni BNZ" with a description of "mortgage payment". Mr Levin deposes that in April 2016, his staff called BNZ who confirmed that the Company had no accounts with that bank, but that a housing loan in Mrs Deo's name had closed in January 2015. On the basis of this evidence, I am satisfied that these payments were for the personal benefit of Mrs Deo, being the repayment of the mortgage in her name over the Property. Mr Levin clarifies that these amounts are not included in the schedule of post-FYE 2014 amounts, as they all pre-date 31 March 2014.

[41] From 2015, payments began to be made by the Company to Plus Finance and Avanti Finance. These totalled $2,092.86 and $49,169.33 respectively. In their interviews upon liquidation, Mr and Mrs Deo advised that the payments to Avanti Finance were mortgage repayments for the Property. Mr Levin also exhibits a copy of the loan agreement, which is in Mrs Deo's name and is secured over the Property. The Company is recorded as a guarantor of the loan, but there is no evidence of the Company having been called on that guarantee.

[42] Mr Levin further deposes that, in his view, the Company was not in a position to provide a guarantee at that time in any event, given his conclusion that the Company was insolvent from 31 July 2012. Putting aside the precise point at which the Company might have been insolvent, I am satisfied that the directors would certainly need to explain why, when the Company was clearly experiencing significant financial difficulties, it was appropriate to guarantee a residential mortgage. I therefore accept that it is more likely than not that the payments to

Avanti Finance were for the personal benefit of Mrs Deo rather than the Company itself.

[43] In relation to Plus Finance, information sourced by the liquidators from Plus Finance confirmed that Mrs Deo had a personal loan with that entity and that the Company had no loans with Plus Finance. Again, I am satisfied on the balance of probabilities that these payments were for the benefit of Mrs Deo, rather than for the Company itself.

[44] Given these loans were all in the name of Mrs Deo only, these are not amounts which I consider Mr Deo should also be liable for (on a joint and several basis).

[45] There is also $2,600.00 claimed by the Company in respect of six payments caused to be made by it to "ABC Landscaping". There is no information concerning these payments, other than one of the payments is narrated with the address of the Property and reference to "Alfred Deo". I am satisfied that, on the balance of probabilities, these payments were not for the purpose and benefit of the Company, but were for the benefit of the Deos.

Summary in relation to post-FYE 2014 payments

[46] On the basis of the facts and circumstances referred to in the preceding paragraphs, and save for those relatively minor items referred to at paragraphs [33] and [39], I am satisfied that the payments referred to were also drawings by Mrs and/or Mr Deo for their personal benefit.

[47] The Company seeks an order that Mr and Mrs Deo are jointly and severally liable for these post-FYE 2014 payments. I accept that the Deos appear to have continued to draw funds from the Company for personal living expenditure over this later period in much the same way they did prior to FYE 2014. However, the basis for their joint liability for drawings to FYE 2014 is that those drawings were classified in the FYE 2014 accounts as drawings in the joint shareholders' current account. Ms Wakelin invited me to infer from that fact that the post FYE 2014 payments ought to be categorised in the same way.

[48] However, Mrs Deo ceased to be a shareholder on 27 May 2014, i.e. relatively soon after the end of the 2014 financial year. She continued to be a director. I accept Ms Wakelin's submission that there can be director's drawing accounts. She also took me to the Company profile form completed by Mr and Mrs Deo where, in response to the query "Did you or any other past or present directors/shareholder take drawings on your respective current accounts (including if this was in addition to taking a salary/wage)?", the Deos had marked "Yes", and noted both their names and the narration "to paying mortgage and food, bills".

[49] I am satisfied that Mr and Mrs Deo ought to be jointly and severally liable for the drawings after FYE 2014 in the same way they are jointly and severally liable for the drawings to FYE 2014. The nature of the drawings continue across both periods, and at all relevant times, each of Mr and Mrs Deo was a director or shareholder of the company. The nature of the drawings does not alter across the two periods.

[50] However, excluded from Mr and Mrs Deo's joint and several liability are the amounts referable to the mortgage repayments, given those loans are in the name of Mrs Deo only.

Second cause of action – equitable tracing

[51] By its second cause of action, the Company seeks a declaration that it is entitled to trace the payments made to BNZ, Avanti Finance and Plus Finance ("Mortgage Payments") into an equitable proprietary interest in the Property.

[52] The basis upon which this remedy is sought is four-fold:

(a) First, at the time the Mortgage Payments were made, and as a result of her role as director of the Company, Mrs Deo owed fiduciary duties to the Company, and by allowing or causing the payments to be made, she breached those duties;

(b) Second, as a director of the Company, Mrs Deo was a trustee of the Company's assets and property that were in her possession or control,

and in causing or allowing the Mortgage Payments to be made, Mrs Deo acted in breach of trust;

(c) Third, as a result of either or both of the above propositions, the Mortgage Payments were subject to an institutional constructive trust in favour of the Company (i.e. they were trust property); and

(d) Fourth, the Company is entitled to trace that trust property into its proceeds and claim an equitable proprietary interest in Mrs Deo's equity in the Property.

[53] I do not have any difficulty with the first three of the above propositions. In *Shannon Agricultural Consulting Ltd (in liq) v Shannon*, Woolford J summarised the position as follows:[7]

> [25] It is well established that a company director, in consequence of the fiduciary nature of the duties which he or she owes to the company, is treated as if he or she was a trustee of the company's property under his or her control.[8] Therefore a breach of a director's fiduciary duty is considered to be the equivalent to a breach of trust. Mr Shannon and Ms Moorhouse, as fiduciaries of the company, had obligations not to profit personally from their position as directors; not to allow a conflict of interest to arise between their duties as directors and their self interest; and were required to exercise their powers in good faith for the best interests of the company.
>
> [26] In so far as the company's funds were under the control of Mr Shannon and Ms Moorhouse, they had an obligation to ensure that those funds were not misapplied. In causing or allowing the mortgage payments to be paid by the company and applied for their personal benefit when the company was itself insolvent, Mr Shannon and Ms Moorhouse misapplied company funds.
>
> [27] A fiduciary is accountable for any benefit or gain acquired through breach of his or her duty, but also, in most cases, it will be appropriate for the Court to declare that the ill-gotten gains are held subject to an institutional constructive trust for the principal. The institutional constructive trust is recognition by the Court that an event occurred in the past that generated a trust over the property acquired by the constructive trustee. Such a trust comes in to being before any order of the Court, which simply confirms the trust.

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7 *Shannon Agricultural Consulting Ltd (in liq) v Shannon* [2015] NZHC 1133.

8 John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd edition, Brookers, Wellington, 2013) at 536.

> [28] Examples of a constructive trust flowing from a breach of fiduciary obligations are found in *Dickie v Torbay Pharmacy (1986) Ltd*[9] and *Attorney-General (Hong Kong) v Reid.*[10]

[54] Similarly, in *Selangor United Rubber Estates Ltd v Craddock*, having surveyed the authorities, Ungoed-Thomas J concluded that: [11]

> So, in my view, in general as in this case, a credit in a company's bank account which the directors are authorised to operate are moneys of the company under the control of those directors and are held by them on trust for the company in accordance with its purpose.

[55] A similar approach was adopted by Peters J in *Sion Consultants Ltd (in liq) v Bason*[12] and Brown J in *Taj Construction Ltd (in liq) v Singh*.[13] Finally, in *The Fish Man Ltd (in liq) v Hadfield*,[14] Fogarty J summarised the relevant authorities which support the first three of Ms Wakelin's propositions.

[56] I therefore accept that, by allowing or causing the Company's funds to be misapplied in repayment of the mortgages over the Property from time to time, Mrs Deo breached her fiduciary duties to the Company and must account as trustee to the Company for those payments.

[57] However, and as I explored with Ms Wakelin at the hearing, I have some difficulty with proposition (d) (namely that the Company is able to trace the Mortgage Payments into the Property itself). Equitable tracing generally permits the tracing of trust property into its identifiable proceeds. As Lord Millett explained in *Foskett v McKeown*:[15]

> The simplest case [of tracing] is where a trustee **wrongfully misappropriates trust property and uses it exclusively to acquire other property for his own benefit. In such a case the beneficiary is entitled at its option either to assert his beneficial ownership of the proceeds** or to bring a personal claim against the trustee for breach of trust and enforcing equitable lien or charge **on the proceeds** to secure restoration of the trust fund.
> (Emphasis added)

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9 *Dickie v Torbay Pharmacy (1986) Ltd* [1995] 3 NZLR 429 (HC).
10 *Attorney-General (Hong Kong) v Reid* [1994] 1 NZLR 1, [1994] 1 AC 324 (PC).
11 *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555, (Ch D) at 1577.
12 *Sion Consultants Ltd (in liq) v Bason* [2015] NZHC 645.
13 *Taj Construction Ltd (in liq) v Singh* [2016] NZHC 584, (2016) 4 NZTR 26-015.
14 *The Fish Man Ltd (in liq) v Hadfield* [2016] NZHC 1750, [2016] NZAR 1198.
15 *Foskett v McKeown* [2000] UKHL 29, [2001] 1 AC 102 (HL).

[58] The difficulty I have with this aspect of the Company's claim is whether payments made in repayment of a mortgage can be traced into the relevant property as the "proceeds" of those payments, or whether such repayments simply discharge a debt owed to the mortgagee. This requires consideration of the nature of a mortgage and payments made in relation to it, and how equitable tracing can apply, if at all, to such transactions.

Nature of a mortgage and repayments under it

[59] The starting point is to consider the nature of a mortgage and repayments made in relation to it. In the New Zealand text *Campbell on Mortgages,*[16] the author describes a mortgage as follows:

> [a] Conveyance of, or a charge over, property created by contract to secure the future payment of money or money's worth, the rights of the mortgagee against the mortgaged property being extinguished on performance of the obligation secured, or enforceable against the property by appropriate means in case of default.

[60] The author refers to most mortgages of estates or interests in land as having the following characteristics:[17]

> (1) the mortgagor is liable under the covenants in the mortgage to pay a debt or perform an obligation;
>
> (2) the mortgagee has the right to have the mortgaged property made available for the satisfaction of the debt or for the performance of the obligation;
>
> (3) the mortgagor has the right to redeem the mortgaged property when the debt has been paid or the obligation performed; and
>
> (4) the mortgagee is liable to release the mortgage when the debt has been paid or the obligation performed.

[61] The author goes on to confirm that, unlike the position at common law,[18] pursuant to s 100 of the Land Transfer Act 1952, a mortgage has the effect as a security but does not operate as a transfer of the estate or interest charged. The same

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16 Neil Campbell *Campbell on Mortgages* (LexisNexis, Wellington, 2014) at [15.003]; citing PT Young *Law of Mortgages of Land in New Zealand* (Butterworths, New Zealand, 1995) at [1.2].

17 At [15.003].

18 Under the common law, a first mortgage was effected by an actual conveyance to the mortgagee of the mortgagor's legal estate in the land as security for the repayment of the money lent.

position now also applies to non-Land Transfer system land, by virtue of s 79(1) of the Property Law Act 2007, which contains a similar provision as to the effect of a mortgage.

[62] Accordingly, a mortgage operates as a security for the underlying debt, in that it gives the mortgagee a charge on the estate or interest in the land with a power of sale in the event of default.

[63] Conversely, the mortgagor has the right to redeem the mortgaged property once the debt is fully repaid. The right to redeem only comes about when the debt is fully repaid; in other words, it is not an "increasing" right during the term of the mortgage itself.

[64] In this context, there is no concept of "increasing equity" in a mortgaged property as the underlying debt secured by the mortgage is repaid. Rather, repayments of principal and interest will reduce the amount of sale proceeds that would accrue to the mortgagee in the case of an enforced sale, in satisfaction of the outstanding debt.

[65] Accordingly, while in common parlance a mortgagor's "equity" in a property increases as the mortgage is repaid, that "equity" is really a function of two matters: first, how much of the debt has been repaid to the mortgagee at any given point in time, and second, the market value of the property at that point in time. So for example, in an extreme (but certainly not unknown situation following the recent global financial crisis), if there has been a significant drop in the market value of the property, the mortgagor's "equity" in the property may actually *decrease* despite making repayments towards a mortgage. Such circumstances can also lead to "negative equity".

[66] When looked at in this way, repayments of a mortgage are not a contribution to the *acquisition* of a property or to the *purchase price* of a property. Rather, in the case of a traditional mortgage, the original amount loaned by the mortgagee to the mortgagor will have funded the acquisition of the property itself. The subsequent repayment of that loan over time is just that, the repayment of a debt, culminating in

the mortgagor's right to redeem the property (through a release of the mortgagee's charge over the property) once the debt has been repaid in full.

[67] The High Court of Australia drew a clear distinction between the acquisition of a property (or a contribution to the purchase price of a property) and repayments of a mortgage in *Calverley v Green* (when determining whether a partner in a relationship had contributed to the purchase price of a property).[19] The High Court said:[20]

> It is understandable but erroneous to regard the payment of mortgage instalments as payment of the purchase price of a home. The purchase price is what is paid in order to acquire the property; the mortgage instalments are paid to the lender from whom the money to pay some or all of the purchase price is borrowed. …
>
> [The couple] mortgaged that property to secure the performance of their joint and several obligation to repay the principal and to pay interest. The payment of instalments under the mortgage was not a payment of the purchase price but a payment toward securing the release of the charge which the parties created over the property purchased.

[68] Citing this decision, the authors of *Snell's Equity* also observes that: [21]

> The original purchase of the asset and the discharge of the charge are often analytically distinct transactions.

[69] Similar observations are made by Professor Robert Chambers in "Tracing and Unjust Enrichment" in the text "Understanding Unjust Enrichment". There, the learned author observes that:[22]

> …[W]hen the purchase price is borrowed from a third party, payment of that debt becomes a separate transaction. For example, when an asset is purchased by using a credit card, payment of the ensuing credit card debt is not part of the purchase transaction. Similarly, when a home is purchased with the aid of a mortgage to the bank, payment of the purchase price to the vendor and payment of that mortgage to the bank are different transactions. A claimant who pays these debts on behalf of a defendant is not contributing to the purchase price.

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19 *Calverley v Green* (1984) 155 CLR 242.

20 At 257.

21 John McGhee (ed) *Snell's Equity* (33rd edition, Thomson Reuters, London, 2015) at 792.

22 Robert Chambers "Tracing and Unjust Enrichment" in Jason W. Neyers, Mitchell McInnes and Stephen G.A. Pitel (eds) *Understanding Unjust Enrichment* (Hart Publishing, Oxford and Portland, Oregon, 2004) 263 at 298-299.

Equitable tracing (traditionally) ends at repayment of debt

[70] Equitable tracing has traditionally been viewed as coming to an end when a claimant's money is traced into the repayment of a debt.[23]

[71] The fact that repayments made under a mortgage are repayment of a debt rather than the acquisition of property (or a contribution to the purchase price of property) gives rise to the concept of "backward tracing". This is tracing from repayment of the debt into the asset that was acquired (at some earlier point in time) with the original loan.

[72] Whether there can ever be such "backward tracing", and if so in what circumstances, has been the subject of consideration by academics. For example, Professor Chambers in "Tracing Unjust Enrichment" observes as follows:[24]

> If it is also possible to trace value back through the payment of debts over much longer periods of time, then the payment of a mortgage could be traced into the purchase of the mortgage asset. However, established law does not permit this. In *Calverley v Green* the High Court of Australia said that it was 'understandable but erroneous to regard the payment of mortgage instalments as payment of the purchase price of the home'.

[73] The Privy Council's recent decision in *Federal Republic of Brazil v Durant International Corporation* has softened the earlier position that there can never be such backward tracing.[25] This decision has been relied on in some earlier High Court decisions which have permitted the tracing exercise that the plaintiff seeks to carry out in this case. However, for the reasons that follow, I do not consider that the Privy Council's decision in *Federal Republic of Brazil v Durant International Corporation* permits such backward tracing in this case.

Federal Republic of Brazil v Durant International Corporation

[74] *Federal Republic of Brazil v Durant International Corporation* concerned the tracing of bribes that had been received by the former Mayor of Sao Paolo and his

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23 *Re Diplock* [1948] Ch 465 (CA); *Re Registered Securities (in liq)* [1991] 1 NZLR 545; (1991) 5 NZCLC 66,874 (CA).

24 Robert Chambers "Tracing and Unjust Enrichment", above n 22, at 297.

25 *Federal Republic of Brazil v Durant International Corporation* [2015] UKPC 35 [2016] AC 297.

son during the Mayor's time in office. The plaintiff sought to trace the moneys through a number of bank accounts and finally into an account (in credit) in the name of the first defendant at a bank in Jersey. Issues arose in respect of such tracing, given, inter alia, some of the bribes were paid into the first bank account *after* the last transfer into the Jersey bank account. Given there was no established basis for "backward tracing", it was argued by the defendants that those subsequent bribes could not be traced into the "end" account.

[75] The Privy Council described the issue as follows:[26]

> The doctrine of tracing involves rules by which to determine whether one form of property interest is properly to be regarded as substituted for another. It is therefore necessary to begin with the original property interest and study what has become of it. If it has ceased to exist, it cannot metamorphose into a later property interest.

[76] Having reviewed academic debate on the issue of backward tracing, the Privy Council observed:[27]

> More particularly the plaintiffs submit, as Professor Smith argues, **that money used to pay a debt can in principle be traced into whatever was acquired in return for the debt**. That is a very broad proposition and it would take the doctrine of tracing far beyond its limits in the case law to date. **As a statement of general application, the Board would reject it**. The courts should be very cautious before expanding equitable proprietary remedies in a way which may have an adverse effect on other innocent parties. If a trustee on the verge of bankruptcy uses trust funds to pay off an unsecured creditor to whom he is personally indebted, in the absence of special circumstances it is hard to see why the beneficiaries' claim should take precedence over those of the general body of unsecured creditors.
>
> (Emphasis added)

[77] However, the Privy Council was prepared to recognise "backward tracing" in certain circumstances. It stated that "there may be cases where there is a close causal and transactional link between the incurring of a debt and the use of trust funds to discharge it".[28]

[78] In this context, the Privy Council referred to a Canadian decision of the Saskatchewan Court of Appeal in *Agricultural Credit Corporation of Saskatchewan*

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26 At [17].
27 At [33].
28 At [34].

v Pettyjohn.[29] In that case, the defendants had applied to the plaintiff for a loan in order to purchase cattle. The defendants were notified that the loan had been approved. As a result, they used a credit line with their existing bank as their immediate source of funding for the purchase of the cattle. At about that time or very shortly thereafter, the loan documentation between the plaintiff and the defendants was executed, the plaintiff was given security over the cattle and the loan funds were advanced. The funds were used by the defendants to repay the credit line that had been used to purchase the cattle.

[79] The defendants later became insolvent and the plaintiff claimed to have a purchase money security interest in the cattle under the Canadian Personal Property Security Act. Under that Act, the plaintiff was required to show that it gave value to the debtor defendants for the purpose of enabling them to acquire rights in personal property *and* that the value was in fact applied to acquire those rights.

[80] In addressing the second requirement, the Court said as follows:[30]

> The … requirement, that the value has been used to acquire such rights, presents greater difficulties. How can it be said that the moneys advanced were used to acquire rights when the purchase had already taken place and the rights already acquired? It is, however, commercially unreasonable to divide the transactions so minutely. The Pettyjohns used the value given to them to pay off interim financing, **but the interim financing had not been obtained as a separate transaction, but always with the view that it would be repaid through the moneys advanced by ACCS**. The Pettyjohns used the value given as part of a larger, commercially reasonable transaction to acquire rights in the 1981 and 1984 cattle. The fact that the use of the value given was, due to the nature of the transaction, after the acquisition of rights does not alter the conclusion that the value given was used to acquire those rights.
>
> (Emphasis added)

[81] The Privy Council in *Federal Republic of Brazil v Durant International Corporation* referred to the above extract from *Agricultural Credit Corporation of Saskatchewan* and stated as follows:[31]

> On those facts the court was right in the view of the Board not to divide minutely the connected steps by which, on any sensible commercial view,

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29 *Agricultural Credit Corpn of Saskatchewan v Pettyjohn* (1991) 79 DLR (4th) 22 (Sask CA).
30 At 38.
31 *Federal Republic of Brazil v Durant International Corporation* above n 25, at [37].

> the purchase of the cattle was financed by the credit corporation, but to look at the transaction overall. The interposition of the bank was purely to provide bridging finance to cover the gap in time between the purchase and the credit corporation's funds coming through as previously arranged.

[82] On this basis, the Privy Council concluded that backward tracing is possible in certain circumstances:[32]

> The development of increasingly sophisticated and elaborate methods of money laundering, often involve a web of credits and debits between intermediaries, makes it particularly important that a court should not allow a camouflage of interconnected transactions to obscure its vision of their true overall purpose and effect. If the court is satisfied that the various steps are part of a coordinated scheme, it should not matter that, either as a deliberate part of the choreography or possibly because of the incidents of the banking system, a debit appears in the bank account of an intermediary before a reciprocal credit entry. The Board agrees with Sir Richard Scott V-C's observation in *Foskett v McKeown* that the availability of equitable remedies ought to depend on the substance of the transaction in question and not upon the strict order in which associated events occur.
>
> Similarly, in a case such as *Agricultural Credit Corpn of Saskatchewan v Pettyjohn*, the Board does not consider that it should matter whether the account used for the purpose of providing bridging finance was in credit or in overdraft at the time. An account may be used as a conduit for the transfer of funds, whether the account holder is operating the account in credit or within an overdraft facility.
>
> The Board therefore rejects the argument that there can never be backward tracing, or that the court can never trace the value of an asset whose proceeds are paid into an overdrawn account. **But the claimant has to establish a coordination between the depletion of the trust fund and the acquisition of the asset which is the subject of the tracing claim, looking at the whole transaction, such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund.** This is likely to depend on inference from the proved facts, particularly since in many cases the testimony of the trustee, if available, will be of little value.
>
> (Emphasis added)

[83] Applying those principles to the facts before it, the Privy Council concluded that:[33]

> In the present case the Royal Court and the Court of Appeal were justified in concluding that the necessary connection between the bribes itemised in schedule 3 and the receipts itemised in schedule 5 was proved, having regard in particular to the admission in the pleadings as to the link between the sums received by the defendants and the Chanani account. …

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32 At [38]-[40].
33 At [42].

[84] Accordingly, the Privy Council did recognise backward tracing, but in reasonably limited circumstances. In particular, this reflected the sophistication of money laundering and the modern banking system in camouflaging transactions. Similarly, the Court in *Agricultural Credit Corporation of Saskatchewan v Pettyjohn* permitted a concept similar to backward tracing, but only in circumstances where the transactions allowing purchase of the asset and the repayment of the loan were closely interlinked. In both cases, all of the relevant steps were, in substance, one and the same transaction.

[85] In my view, these decisions do not sanction backward tracing in the simpler case of trust moneys being utilised to repay a debt secured by a mortgage. In the present case for example, there is no suggestion that Mrs Deo obtained the original loans to acquire the Property as a result of the Company's funds being available to repay those loans over time. Nor is there evidence it was always intended that the Company's funds would be used to repay the loan, such that the incurring of the debts and the use of trust moneys to discharge them are one and the same transaction. Nor is there the complex use of bank accounts through which misappropriated funds have travelled, potentially through the conduit of an overdrawn account as a result of an incidence of the banking system. In short, there is not the necessary "co-ordination" between the depletion of the trust fund and the acquisition of the Property itself. Rather, in my view, these facts are closer to the much starker proposition put to the Privy Council in *Federal Republic of Brazil v Durant International Corporation,* namely that money used to repay a debt can be traced into whatever was acquired in return for that debt. As noted above, the Privy Council rejected that as a broad statement of principle.[34]

Earlier High Court decisions

[86] As flagged earlier, Ms Wakelin has referred me to a number of High Court decisions that have permitted a plaintiff to trace misappropriated funds through mortgage repayments and into the underlying property:

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[34] See [76].

a) In *Sion Consultants Ltd (in liq) v Bason*, a decision of Peters J of April 2015, mortgage repayments totalling approximately $5,000 were traced into the underlying property itself and a declaration made that the property, to the extent of those repayments, was held on trust for the plaintiff.[35] I note however, that that was a formal proof hearing and it does not appear that the Court had received submissions as to the nature of payments made under a mortgage as I have discussed at paragraphs [59] - [69] above.

b) In *Shannon Agricultural Consulting Ltd (in liq) v Shannon,* a decision of Woolford J of May 2015, a similar approach was adopted.[36] There, Woolford J found that company funds had been used by the company's directors to make mortgage repayments. His Honour stated that the company's funds had thereby been used to "make an investment in the property, giving the company an interest in that property to the extent of the company's funds used".[37] Again, that was a formal proof hearing and there does not appear to have been consideration of the nature of payments made under a mortgage in the context of equitable tracing.

c) Subsequently in *Torbay Holdings Ltd v Napier*, a 2016 decision, Woolford J considered the ability to trace mortgage repayments into underlying property, with reference to the Privy Council's decision in *Federal Republic of Brazil*.[38] I address Woolford J's decision in *Torbay Holdings Ltd* in further detail below.

d) Finally, in *Taj Construction Ltd (in liq) v Singh*,[39] also a 2016 decision, Brown J allowed a constructive trust over a property via equitable tracing through mortgage repayments, by reference to

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35 *Sion Consultants Ltd (in liq) v Bason*, above n 12, at [15].
36 *Shannon Agricultural Consulting Ltd (in liq) v Shannon*, above n 7.
37 At [29].
38 *Torbay Holdings Ltd v Napier* [2015] NZHC 2477, [2015] NZAR 1839.
39 *Taj Construction Ltd (in liq) v Singh*, above n 13.

> Woolford J's judgment in *Torbay Holdings Ltd v Napier*. Again, the matter proceeded by way of formal proof.

[87] The facts in *Torbay Holdings Ltd v Napier* centred on alleged misappropriation of company funds by Mr and Mrs Napier (the first defendants), who were directors of the plaintiff companies at various times. Mr Napier represented himself during the hearing, and Mrs Napier took no part in the proceedings. Woolford J found that company funds had been used by the Napiers for their personal use.

[88] It was alleged that the Napiers caused or allowed company funds to be used to fund both the construction and mortgage repayments in relation to a property. In relation to both uses to which the company's funds had been put, the plaintiff sought to trace those payments into the property itself, and sought a declaration that the property was held on constructive trust for the plaintiff (to the extent of those payments).

[89] Complex tracing issues arose, as company funds had been paid into bank accounts containing Mr and Mrs Napier's legitimately sourced funds, and in "mixed payments" in which the exact proportions of misappropriated company money was not clearly determinable. As observed by Woolford J at [211] of his judgment, this aspect of the claim squarely raised the question of accounting and tracing for mixed funds.

[90] The various "tracing rules" that apply when a plaintiff's property has been mixed with other funds were considered in some detail by Woolford J. At [216] of his judgment, he referred to the following extract from the leading decision in *Foskett v McKeown*:[40]

> The simplest case is where a trustee wrongfully misappropriates trust property and uses it exclusively to acquire other property for his own benefit. In such a case the beneficiary is entitled *at his option either to assert his beneficial ownership of the proceeds or to bring a personal claim against the trustee for breach of trust and enforce an equitable lien or charge on the proceeds to secure restoration of the trust fund*. He will normally exercise the option in the way most advantageous to himself. If the traceable proceeds

[40] *Foskett v McKeown*, above n 15, at 130 - 132..

> have increased in value and are worth more than the original asset, he will assert his beneficial ownership and obtain the profit for himself. There is nothing unfair in this. The trustee cannot be permitted to keep any profit resulting from his misappropriation for himself, and his donees cannot obtain a better title than their donor. If the traceable proceeds are worth less than the original asset, it does not usually matter how the beneficiary exercises his option. He will take the whole of the proceeds on either basis. This is why it is not possible to identify the basis on which the claim succeeded in some of the cases.
>
> Both remedies are proprietary and depend on successfully tracing the trust property into its proceeds. A beneficiary's claim against a trustee for breach of trust is a personal claim. It does not entitle him to priority over the trustee's general creditors unless he can trace the trust property into its product and establish a proprietary interest in the proceeds. …
>
> …
>
> Where a trustee wrongfully uses trust money to provide *part of the cost of acquiring an asset*, the beneficiary is entitled *at his option* either to claim a proportionate share of the asset or to enforce a lien upon it to secure his personal claim against the trustee for the amount of the misapplied money. It *does not matter whether the trustee mixed the trust money with his own in a single fund before using it to acquire the asset, or made separate payments (whether simultaneously or sequentially) out of the differently owned funds to acquire a single asset*.
>
> …
>
> There is a mixed substitution (with the results already described) whenever the claimant's property has contributed in part only towards the acquisition of the new asset. It is not necessary for the claimant to show in addition that his property has contributed to any increase in the *value* of the new asset. This is because, as I have already pointed out, this branch of the law is concerned with vindicating rights of property and not with reversing unjust enrichment.
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> …
>
> Common to both [the equitable rules and the common law rules] is the principle *that the interests of the wrongdoer who was responsible for the mixing and those that derive title under him otherwise than for value are subordinated to those of innocent contributors*. As against the wrongdoer and his successors, the beneficiary is entitled to locate his contribution in any part of the mixture and to subordinate their claims to share in the mixture until his own contribution has been satisfied.
>
> (emphasis original)

[91] I have set out the above extract in full, as it can be seen that the tracing rules were considered by Lord Millett in the context of mixed funds being used to contribute to the *acquisition* of an asset.

[92] With reference to the Privy Council's decision in *Federal Republic of Brazil v Durant International Corporation*, Woolford J concluded as follows:[41]

> The loans in this case were also clearly acquired before the money necessary to make principal and interest payments was acquired, and even once it was acquired (gradually, over a period of years) the series of transactions across the accounts of Mr and Mrs Napier and the Napier Family Trust make it difficult to consistently track which deposits were used toward which payments, and whether at times the deposits into the accounts which were used to make principal and interest payments were legitimate or not. I am, however, of the view, based in part on my analysis of the principal and interest payments made on 15 December 2011 and 29 December 2011 in [112] and [113], that there is sufficient evidence of Mr Napier's misappropriation of funds throughout the accounts to "establish a coordination between the depletion of the trust fund and the acquisition of the asset which is the subject of the tracing claim, looking at the whole transaction, such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund." *Republic of Brazil v Durant* clearly endorses the ability to claim property rights in the property obtained using loans which were financed by misappropriated money, as occurred here. This is supported by New Zealand case law. This reflects that **paying down the loan allowed the defendants to acquire a significant, valuable asset with less debt encumbrance. This is an increase in the value of the house to the Napiers**.
>
> (Emphasis added)

[93] I agree that the Napiers were enriched by the mortgage repayments. But where I respectfully disagree with Woolford J is that the mortgage repayments involved the acquisition of an asset or an increase in the value of the house to the Napiers. The paying down of the loan did not enable the defendants to *acquire* a significant valuable asset, given that asset had already been acquired with the original loan proceeds. Rather, the Napiers' enrichment resulted from the reduction in their debt secured by the mortgage.

[94] The issue of equitable tracing when misappropriated funds have been used to make mortgage repayments was considered most recently by Fogarty J in *The Fish Man Ltd (in liq) v Hadfield.*[42] That case involved a similar tracing claim to that being made in this case and Fogarty J considered a number of the authorities to which I have already referred.

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41 *Torbay Holdings Ltd v Napier*, above n 38, at [230] (footnotes omitted).

42 *The Fish Man Ltd (in liq) v Hadfield*, above n 14.

[95] Although doubting the breadth of the ability to trace repayments of mortgages from misappropriated funds into proprietary rights in the underlying properties. Fogarty J stated that he agreed with Woolford J's reasoning in *Torbay Holdings Ltd v Napier*, Fogarty J saw the material facts in that case as justifying a finding that misappropriated funds were *in fact* used to acquire an asset. These comments appear to be based on the fact that approximately $107,000 of trust funds had been used to make repayments of a $475,000 mortgage.[43] However, I do not consider that the amount or level of mortgage repayments funded by misappropriated funds will, absent anything further, provide a "tipping point" as to when an asset will be "acquired" through repaying the debt:

a) As discussed earlier, the repayment of a mortgage debt is a conceptually separate transaction from the original acquisition of the property itself. Even if the entirety of a mortgage is repaid using a claimant's funds (which would ordinarily occur over very many years), the asset will have been acquired at the outset by the payment of the purchase price to the vendor. All that will have happened in the intervening years is the repayment of a debt and the consequent right of the mortgagor to redeem the mortgagee's charge against the property.

b) Further, such an approach could create real uncertainty as to where the dividing line is between repaying a debt and acquiring an asset in the case of mortgage repayments. For example, in relation to a property purchased for $500,000, with $450,000 of that purchase price being funded by a bank loan secured by a mortgage, would later mortgage repayments totalling $100,000 be sufficient to trigger equitable tracing into the property itself? If not, would repayments totalling $200,000, or $300,000 be sufficient, and so on?

[96] Rather, on the basis of *Federal Republic of Brazil v Durant International Corporation*, the ability to trace "backward" from the repayment of a debt into the asset it funded ought to depend on whether, in light of the facts in any given case,

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[43] At [69].

there is a close causal and transactional connection between the incurring of the debt and the use of trust funds to discharge it. I do not agree that is the case in the context of partial, or even full, repayment of mortgages using misappropriated moneys, in the absence of any other factors.[44]

[97] In *The Fish Man Ltd (n liq) v Hadfield*, Fogarty J also considered the Privy Council's decision in *Federal Republic of Brazil v Durant International Corporation* and stated the following:[45]

> I distinguish *Shannon* and *Singh* on their material facts, and because I do not think that *Durant* is authority for tracing any small payment made off a mortgage into an interest in property.
>
> I do not believe that *Durant* or any of the House of Lords and Privy Council decisions are authority for the proposition that any misappropriated payment used to pay current mortgage liabilities can be traced into a proprietary interest in the property. I do not think that the authorities go that far.
>
> However, it has to be acknowledged that in *Shannon* and *Singh* there is judicial support for the proposition that the use of funds obtained in breach of fiduciary duty to make mortgage payments can give rise to a proprietary claim.
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> I agree with this submission of Mr Barker:
>
> > I have not found any significant discussion of this in (other) authorities. It is an approach, however, that I think gives rise to a range of problems. If the Court were to accept payment of a debt that is giving rise to a constructive trust over the asset purchased with the debt, then I submit that the extent of that interest could only extend to the amount of the principal repaid. It could not extend to interest.
>
> Tracing is a practical remedy of following money where it is converted into property. It is not some principle of converting money to a property right. There has to be a direct and substantial link between acquiring the property and the use of the misappropriated money. Reflecting on *Shannon* and *Singh,* I think it is a question of degree as to the point at which one can find money has been used to acquire or retain an asset.
>
> Repayment of a debt is properly not usually treated as the use of money to purchase an asset. In support of this proposition of law, Mr Barker relied on the decision of Abbott AJ in *Fletcher Steel Ltd v Nahal Contractors Ltd* and the United Kingdom authority *In Re Gorman (a Bankrupt).* He also argued it is consistent with the analysis in *Foskett v McKeown,* which requires a focus of what the payment actually achieves and whether it acquires ownership of an asset.

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44 See the alternate scenarios posed above at [85].

45 At [86]-[93] (footnotes omitted).

> I think that trying to turn mortgage payments into a proprietary interest in the equity of a home, at least on this set of facts, is pushing tracing out of its natural confined scope.
>
> All of the authorities to which I rely upon establish that tracing is available where money, wrongfully obtained, is used to acquire an asset. But tracing is not, however, available where that money is used to pay a debt unless it also materially acquires an asset. It is for the Court to determine whether on the particular facts of each case the money has been used to acquire an asset or to pay a debt.

[98] I agree with Fogarty J's conclusion set out above.

Other authorities relied upon by the plaintiff

[99] In support of the plaintiff's claim for equitable tracing, Ms Wakelin also referred to Wild J's decision of in *Barnett v Wilkie,* a relationship property case.[46] The issue in that case was whether the plaintiff had an interest in the defendant's house property, and if so, in what sum. The parties had agreed that the test for determining that issue was as laid down by the Court of Appeal *Lankow v Rose*, namely whether the claimant could prove: [47]

a) contributions, direct or indirect, to the property in question;

b) the expectation of an interest in the property;

c) that such an expectation was a reasonable one; and

d) that the defendant should reasonably expect to yield the claimant an interest.

[100] In the context of the first element set out at (a) above, there was evidence that the plaintiff had made cash contributions of $46,000 to the couple's joint account from which mortgage payments relating to the property were made. Over the period in question, the mortgage principal was reduced by $17,767. There was also evidence that the plaintiff had carried out gardening work at the property, and had contributed a gas-fired hotwater, space heating system and PV spouting to the

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46 *Barnett v Wilkie* HC Wellington CP 42-01, 19 March 2002.
47 *Lankow v Rose* [1995] 1 NZLR 277 (CA).

property. Wild J held that all three items in combination were significant contributions to the property in question. In the context of the mortgage repayments, Wild J observed that:[48]

> The defendant argued that [a] was a contribution to the mortgage, not to the property. The relevance of the distinction escapes me, since a reduction in the mortgage principal increased the equity in the property.

[101] This supports the proposition being advanced by for the plaintiff. However, there does not appear to have been any detailed submissions put to Wild J or discussion of the nature of mortgage repayments in that case. I also observe that that was a decision in the context of relationship property matters, which are different to the concepts in question here. I therefore distinguish *Barnett v Wilkie* on that basis.

Conclusion on equitable tracing

[102] For all of the above reasons, I do not consider that it is possible in this case to trace the Company's money that was used to repay mortgage debts into a proprietary interest in the Property itself. There is also no evidence before me as to whether the repayments did reduce the principal amount owing on the mortgage, or whether, for instance, this was a table mortgage where all of the repayments were interest only.[49]

Equitable lien

[103] In her supplementary submissions, Ms Wakelin submits that if I was not satisfied that the mortgage repayments could be traced into the Property, a constructive trust can be founded on the alternative basis that the Company has an equitable lien over the Property. This is on the basis that the mortgage repayments have improved the Property. Ms Wakelin also submits that the remedy of equitable lien can be used to "vindicate property rights of an innocent contributor to a wrongdoer's assets". In support of this submission, Ms Wakelin refers to extracts

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48 *Barnett v Wilkie* above n 46, at [32].

49 In Robert Chambers, "Tracing and Unjust Enrichment", above n 22, at 298, the Professor notes that even if backward tracing were possible in the case of mortgages, such tracing could not be into payments of interest: "Since the asset was purchased with the principal amount borrowed, the only portion of a mortgage repayment that can be traced into the purchase is the reduction of principal."

from *Foskett v McKeown, Ashton Group Ltd (in rec and in liq) v Ambrosia Holdings Ltd* and *Boscawen v Bajwa.*[50]

[104] As a preliminary point, it seems to me that the submission that a remedy of constructive trust can be founded on the Company having an equitable lien over the Property confuses two concepts. This is evident from the extract from *Foskett v McKeown* that Ms Wakelin relies on:[51]

> Where a trustee wrongfully uses trust money to provide part of the cost of acquiring an asset, the beneficiary is entitled at his option **either** to claim a proportionate share of the asset **or** to enforce a lien upon it to secure his personal claim against the trustee for the amount of the misapplied money.
>
> (Emphasis added)

[105] The two options being described by Lord Millett are, first, a beneficial interest in the underlying asset itself, enforced by a declaration of constructive trust; *or* enforcing an equitable lien upon the asset to secure the personal claim against the trustee for the wrongful use of the beneficiary's money in acquiring that asset.

[106] Moreover, the two alternatives available to a claimant are predicated on the trustee wrongfully using trust money to "provide part of the cost of acquiring an asset", as noted in the opening words of the extract from *Foskett v McKeown* set out above.

[107] The extract from *Ashton Group Ltd (in rec and liq) v Ambrosia Holdings Ltd* relied upon simply describes, in broad terms, the nature of an equitable lien.

[108] Ms Wakelin also refers to the following extract from the discussion in *Boscawen v Bajwa* of the range of proprietary remedies available to a court of equity, where Millett LJ (as he was then) said:[52]

> If the plaintiff's money has been applied by the defendant, for example, **not in the acquisition of a landed property but in its improvement**, then the court may treat the land as charged with the payment to the plaintiff of a sum

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50 *Foskett v McKeown,* above n 15; *Ashton Group Ltd (in rec and in liq) v Ambrosia Holdings Ltd* HC Auckland CP198/SW01, 26 June 2001; *Boscawen v Bajwa* [1996] 1 WLR 328 (CA).

51 *Foskett v McKeown,* above n 15, at 130.

52 *Boscawen v Bajwa*, above n 50, at 335.

> representing the amount by which the value of the defendant's land has been enhanced by the use of the plaintiff's money.
>
> (Emphasis added)

[109] For the reasons I have already discussed, I do not consider that the repayment of a mortgage debt itself amounts to an improvement in the defendant's land or the property secured by the mortgage, or its value, in the sense referred to by Millett LJ.

[110] Immediately following that observation in *Boscawen v Bajwa*, Millett LJ went on to state the following (which is not referenced in Ms Wakelin's submissions):[53]

> And if the plaintiff's money has been used to discharge a mortgage on the defendant's land, then the court may achieve a similar result by treating the land as subject to a charge by way of subrogation in favour of the plaintiff.

[111] In light of this, I turn to consider whether subrogation is an appropriate remedy in this case.

Subrogation

[112] The term "subrogation" encompasses both contractual subrogation and the broader equitable subrogation. In its equitable sense, subrogation has been described as follows:[54]

> [W]here A's money is used to pay off the claim of B, who is a secured creditor, A is entitled to be regarded in equity as having had an assignment to him of B's rights as a secured creditor …. It finds **one of its chief uses** in the situation where one person advances money on the understanding that he is to have certain security for the money he has advanced, and for one reason or another, he does not receive the promised security. In such a case he is nevertheless to be subrogated to the rights of any other person who at the relevant time had any security over the same property and whose debts have been discharged in whole or in part by the money so provided by him.
>
> (Emphasis added)

[113] Relevantly for current purposes, in *Boscawen v Bajwa,* Millett LJ held that there was no requirement for a mutual intention on the part of the creditor and the

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53 At 335.

54 *Burston Finance Ltd v Speirway Ltd* [1974] 1 WLR 1648 (Ch D) at 1652.

party seeking subrogation that the latter party's funds would be used to discharge the security and that they would receive the benefit of the security in return.[55]

[114] The subrogation remedy was subsequently considered by the House of Lords in *Banque Financiere de la Cite v Parc (Battersea) Ltd*.[56] In that case, the appellant bank had (mistakenly) believed it had an arrangement that, as "security" for money it advanced to repay a first ranking charge over Parc's assets, the bank would have priority over a second ranking charge (though not priority as against any other parties, as the arrangement was not to result in a formal registered first charge). In the event, that arrangement as to the priority was invalid, as the holder of the second ranking charge (referred to as "OOL") had no knowledge of the proposed arrangement and had therefore not agreed to it.

[115] The bank sought to be subrogated to the first ranking charge that had been discharged with its money. Lord Hoffman made clear that the remedy of subrogation was based in restitution and was an "equitable remedy to reverse or prevent unjust enrichment which is not based upon any agreement or common intention of the party enriched and the party deprived".[57] And instead of any such intention being a pre-requisite to the remedy, Lord Hoffman stated:[58]

> … I think it should be recognised that one is here concerned with a restitutionary remedy and that the appropriate questions are therefore, first, whether the defendant would be enriched at the plaintiff's expense; secondly, whether such enrichment would be unjust; and thirdly, whether there are nevertheless reasons of policy for denying a remedy.

[116] Like Millet LJ in *Boscawen v Bajwa*, Lord Hoffmann nevertheless observed that that intention may be highly relevant to whether or not any enrichment was unjust.

[117] Lord Hoffman also emphasised the flexibility of the remedy and went on to say:[59]

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55 *Boscawen v Bajwa* above n 50, at 339.
56 *Banque Financière de la Cité v Parc (Battersea) Ltd* [1999] 1 AC 221 (HL).
57 At 231.
58 At 234.
59 At 236.

> [Subrogation] is a means by which the court regulates the legal relationships between a plaintiff and a defendant or defendants in order to prevent unjust enrichment. When judges say that the charge is "kept alive" for the benefit of the plaintiff, what they mean is that his legal relations with a defendant who would otherwise be unjustly enriched are regulated *as if* the benefit of the charge had been assigned to him. It does not by any means follow that the plaintiff must for all purposes be treated as an actual assignee of the benefit of the charge and, in particular, that he would be so treated in relation to someone who would not be unjustly enriched.

[118] In that case, the bank's (mistaken) understanding of the priority it would achieve through the proposed arrangement was central to its willingness to advance the funds to Parc. This mistaken assumption led to a finding that it would be unjust for OOL, the second ranking charge holder, to rank ahead of the bank and be enriched as a result. However, given the bank had never intended to have a registered first ranking charge (only the more informal "arrangement" of priority as between it and OOL), the remedy was fashioned such that it was available as against OOL only.

[119] It is also important to note that the charge to which a claimant is subrogated is not the earlier charge itself (which has been discharged with the claimant's funds), and consequently the language of the earlier charge being "kept alive" for the benefit of the plaintiff is misleading. Rather, as explained by Lord Hoffman, the legal relations between the plaintiff and defendant are regulated "as if" the benefit of the earlier charge had been assigned to the plaintiff.[60]

[120] Subsequently, in *Cheltenham & Gloucester PLC v Appleyard*, Neuberger LJ for the Court of Appeal summarised the principles of subrogation, and in particular emphasised its flexibility as a remedy in preventing unjust enrichment.[61] Neuberger LJ noted that while a "classic case" of subrogation involves a lender who expects to receive security (in the proprietary sense, for example, a mortgage) claiming security to another security, it can also apply to personal rights.[62]

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60 *Banque Financiere de la Cite v Parc (Battersea) Ltd*, above n 56, at 236 and 237.

61 *Cheltenham & Gloucester PLC v Appleyard* [2004] EWCA Civ 291, [2004] All ER (D) 280 (Mar) at [30] and [48].

62 At [36].

[121] Most recently, subrogation was considered by the United Kingdom Supreme Court in *Menelaou v Bank of Cyprus UK Ltd.*[63] In that case, the plaintiff's parents were indebted to the defendant bank in the sum of £2.2 million, which was secured by two charges on the family home owned by the parents. To enable them to sell that property for £1.9 million, so as to repay part of the indebtedness and purchase a house for their daughter, the defendant bank agreed to release those charges, on the condition that once the sale had completed, it would receive a charge over the property purchased for the daughter. That charge would secure the remainder of the parents' indebtedness to the defendant bank. The daughter (plaintiff), Ms Menelaou, was unaware of the proposal regarding the charge on her property. Subsequent to taking possession and ownership of the property and becoming aware of the charge, she sought to have it removed from the relevant register on the basis it was invalid.

[122] The defendant bank accepted that the charge was invalid. It counterclaimed for unjust enrichment on the grounds Ms Menelaou had been unjustly enriched at its expense, as she had ultimately received a property free of any encumbrance at all (contrary to the overarching arrangement between the bank and her parents). The remedy sought by the bank for such unjust enrichment was subrogation, namely subrogation to an unpaid vendor's lien. This was the lien the vendor of the property had as a matter of law, pending payment of the purchase price by Ms Menelaou. Ultimately, the Supreme Court, having discussed and endorsed the decisions referred to above, found for the bank on both issues: namely that Ms Menelaou had been unjustly enriched at the bank's expense and that subrogation to the unpaid vendor's lien was the appropriate remedy.

[123] In the course of argument before the Supreme Court, Ms Menelaou's counsel submitted that the decided cases to date which establish a right to be subrogated to a charge or debt all involved the money coming from the person who establishes subrogation being used to pay off the chargee or creditor respectively.[64] Lord Neuberger noted that the funds used to pay off the secured creditor (ie the unpaid

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63 *Menelaou v Bank of Cyprus UK Ltd* [2015] UKSC 66, [2016] AC 176.

64 At [84].

vendor) in that case did not emanate from the bank itself. Lord Neuberger went on to state:[65]

> However, that does not seem to me to present the Bank with a problem in relation to its claim for subrogation. For the reasons given in paras 66-68 above, the Bank has established that Melissa's [Ms Menelaou's] enrichment was at its expense even though the money did not emanate from the Bank directly, so that its unjust enrichment is made out against her. I do not see why the Bank need establish anything more in this case in order to make good its case to be subrogated to the Lien.

[124] The decision can perhaps be seen as pushing the remedy of subrogation further than the earlier decisions, in that the bank could not trace its funds into the payment to the vendor. This is a point discussed by Associate Professor Jessica Palmer in a recent article.[66] Ms Palmer notes that Millett LJ in *Boscawen v Bajwa* had previously explained the remedy of subrogation, and the role of tracing in locating the property to which the plaintiff claims rights, as being based on the vindication of a pre-existing property right.

[125] It is correct that in *Boscawen v Bajwa*, Millett LJ had described the processes adopted as follows:[67]

> Tracing was the process by which the Abbey National sought to establish its money was applied in the discharge of the Halifax's charge: subrogation was the remedy which it sought in order to deprive Mr Bajwa (through whom the appellants claim) of the unjust enrichment which he would thereby otherwise obtain at the Abbey National's expense.

[126] Accordingly, the tracing exercise contemplated by Millett LJ in *Boscawen v Bajwa* was tracing the Abbey National's money into the repayments to the mortgagee, i.e. rather than tracing its money into the underlying property itself.

[127] For present purposes, I do not need to decide whether the approach adopted in *Menelaou v Bank of Cyprus UK Ltd* ought to be followed in this case. That is because, in the present case, the Company did retain a beneficial interest in the funds in question (in that they were held on trust for the Company by Ms Deo in her role as

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65 At [92].
66 Jessica Palmer "Restitution" [2016] 2 NZ L Rev 435 at 452-455.
67 *Boscawen v Bajwa,* above n 50, at 335.

director), and those funds are able to be traced by the Company into the repayments made from time to time to mortgagees of the Property.

[128] However, the facts in this case are perhaps different to the facts in the authorities discussed above, in that it is not a case where the party seeking subrogation (i.e. the Company) had intended to advance money to the defendant (Mrs Deo) for her to repay a secured creditor, or that the Company intended to have a charge over the Property as a result.

Can subrogation apply outside the "classic case"?

[129] The majority of the English cases involving claims for subrogation have involved the claimant intending to make a loan, sometimes with the purpose extinguishing a secured debt, and sometimes with an intention to take a form of security as a result – which fails for various reasons. This is distinct from the remedy being used where money has been misappropriated or utilised in breach of fiduciary duties or trust.

[130] Nevertheless, the courts in all of the cases discussed above emphasis the flexibility of the remedy. For example, in *Boscawen v Bajwa*, Millett LJ observed:[68]

> It is perilous to extrapolate from one set of circumstances where the court has required a particular precondition to be satisfied before the remedy of subrogation can be granted a general rule which makes that requirement a precondition which must be satisfied in other and different circumstances.

[131] More recently, in *Filby v Mortgage Express (No 2) Ltd*, the English Court of Appeal summarised the cases in relation to subrogating to mortgages.[69] The Court described the remedy, identifying the conflict between its possible origins as either equitable or restitutionary, and said that the remedy was to reverse unjust enrichment. The Court stated:

> [62] … The remedy is not limited to cases where either or both the claimant and defendant intended that the money advanced should be used to effect the improvement. **It is sufficient that it was in fact in reality so used**. The remedy is flexible and adaptable to produce a just result. Within this framework, the remedy is discretionary in the

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68 *Boscawen v Bajwa,* above n 50, at 339.

69 *Filby v Mortgage Express (No 2) Ltd* [2004] EWCA Civ 759, [2004] All ER (D) 198 (Jun).

> sense that at each stage it is a matter of judgment whether on the facts the necessary elements are fulfilled.
>
> [63] The label "subrogation" is unhelpful, as has been frequently recognised … The essence of the remedy is that the court declares the claimant to have a right having characteristics and content identical to that enjoyed, in this instance, by Midland Bank subject to any modification (for example as to rates of interest) necessary to ensure that the claimant does not get more than he bargained for.
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> (Citations omitted, emphasis added)

[132] Leading texts also do not refer to the "classic case" as being the only circumstance in which subrogation will arise. Rather, it is described in broader terms. For example, in Hudson's *Equity and Trusts*, the author describes the subrogation remedy as allowing a charge over a property wherever it can be shown that the claimant's money was used to pay off a secured debt to another person.[70] The author specifically says that the remedy "is useful in tracing claims when the original property has been dissipated or cannot be traced: what the claimant can do is to demand that any obligation which was discharged with the original property is henceforth owed to the claimant instead".[71] However, it is to be acknowledged that, when later listing the situations in which subrogation has been recognised, the listed examples are where a payment has been deliberately made, or mistakenly paid in confusion as to the security on offer.[72]

[133] In *Snell's Equity,* the author states that:[73]

> If the claimant's money is paid to discharge a debt, the creditor will typically take free of his interest since he will generally be bona fide purchaser for value of the legal interest in the money. The claimant may nonetheless be entitled to enforce a proprietary remedy if the debt was secured by a charge over property. He may elect to be subrogated to the creditor's charge over the debtor's property to the extent his money was applied towards repaying it. It is unnecessary for the claimant to show that he intended to keep the charge alive for his own benefit, since the remedy of subrogation depends on a principle of preventing unjust enrichment at the claimant's expense.

[134] In New Zealand, Dr Andrew Butler in *Equity and Trusts in New Zealand* writes that subrogation can be seen as an analogue of tracing, in which the "remedy"

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70 See the summary of authorities in Alastair Hudson *Equity and Trusts* (8th ed, Routledge, Oxon, New York, 2015) at 931.

71 At 931.

72 At 1283 – 1284.

73 John McGhee (ed) *Snell's Equity*, above n 21, at 791-792.

is an equitable lien or constructive trust.[74] Dr Butler also endorses the view that subrogation is based on unjust enrichment, and that either proprietary or personal remedies may be used. He notes that Australian commentators support the flexibility of the remedy outside the traditional cases.[75]

[135] Perhaps most relevantly for current purposes, the authors of the text *Subrogation – Law and Practice* address this particular question.[76] The authors endorse the remedy of subrogation in circumstances not dissimilar to this case.

[136] The authors refer to "ignorance" as one of the recognised grounds for an enrichment to be found to be unjust, justifying the remedy of subrogation. In this context the authors state as follows:[77]

> 'Ignorance' is the ground for restitution that explains a claimant's right to restitution where the defendant has been enriched at the claimant's expense without the claimant's knowledge and consent. It is the core manifestation of a broader ground of no consent or no authority.

[137] Expanding on the "broader ground of no consent or no authority" comment, the authors go on to say:[78]

> Recognition of the existence of a broader ground of that type makes it possible to avoid the difficulties which might otherwise arise in cases where the claimant's assets are misappropriated by a person whose knowledge is or may be attributed to the claimant (e.g. where directors of a company transfer a company's property in breach of fiduciary duty).

[138] The authors refer to a number of authorities where the remedy has been granted in those or similar circumstances. Indeed, the authors state:[79]

> A substantial body of authority indicates that the remedy of subrogation is prima facie available wherever a claimant's asset is taken without his knowledge and consent, and either the original asset or its traceable substitute is used to discharge a defendant's debt.

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74 Andrew Butler "Subrogation" in Andrew Butler (ed) *Equity and Trusts in New Zealand* (2nd edition, Thomson Reuters, Wellington, 2009) 979 at [34.3.2].

75 At [34.3.6(3)] and [34.4.1].

76 Charles Mitchell and Stephen Watterson *Subrogation: Law and Practice* (Oxford University Press, Oxford, 2007).

77 At [6.38] (footnotes omitted).

78 At fn 48.

79 At [6.42].

[139] Three of the authorities referred to are particularly relevant:

(a) In *Gertsch v Atsas*, the (innocent) recipient of a legacy under a forged will had used part of the legacy to discharge a mortgage over her home.[80] The will had been forged by the deceased's solicitor in breach of his fiduciary duty. The New South Wales Supreme Court stated it was uncontroversial that the plaintiff would have a subrogation claim in such circumstances, subject only to the question of whether any equitable defences arose. On the facts in that case, the Court found the change of position defence did not arise in relation to a portion of the legacy received. As a result the Court was prepared to make an order charging the relevant amount on the defendant's home. However, the Court deferred making the order to permit the defendant time to make repayment.

(b) In *Scotlife Home Loans (No 2) Ltd v Melinek*, a solicitor, in breach of trust, used client funds to pay off a mortgage on his family home.[81] As a matter of principle, Scott VC for the English Court of Appeal stated that any clients who could trace their money into the funds used to redeem the mortgage would be able to claim by subrogation the benefit of that charge.

(c) In *Primlake Ltd (in liq) v Matthews Associates*, a shadow company director was held to have breached his fiduciary duties to the company by misappropriating company funds for his own benefit.[82] Some of those funds had been applied to discharge a secured debt owed by him and his wife to a third party. The plaintiff company sought subrogation to the security that had been discharged. The defendants submitted that subrogation was not available, given the company had not intended that its funds should be applied in that manner, and had no intention that the mortgage would be "kept alive" for its benefit.

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80 *Gertsch v Atsas* [1999] NSWSC 898, (1999) 10 BPR 18,431.
81 *Scotlife Home Loans (No 2) Ltd v Melinek* (1997) 78 P & CR 389.
82 *Primlake Ltd (in liq) v Matthews Associates* [2006] EWHC 1227 (Ch), [2007] 1 BCLC 666.

Collins J referred to *Banque Financiere de la Cite v Parc (Battersea) Ltd* and concluded as follows:[83]

> I have no doubt that Primlake is entitled to be subrogated to the security. The question is whether the enrichment of Mr and Mrs Matthews was unjust, and the use of Primlake's money to pay off a secured debt and the intention whether it should succeed to the security are "only materials on which a court may decided that the defendant's enrichment would be unjust" … As a de facto director Mr Matthews intended to discharge the debt and the security. Mr and Mrs Matthews were unjustly enriched by the unlawful use of Primlake's funds to repay their loan and redeem the charge, and the restitutionary remedy of subrogation is appropriate.

[140] The remedy of subrogation has also been deployed in a New Zealand case concerning misappropriated moneys, namely *Trustees Executors Ltd v Steve G Ltd*.[84] The case was an application to sustain caveats on various properties, where mortgages against the properties had been partially repaid using funds that the defendant had held on trust for the plaintiff, reducing the defendant's overall indebtedness.

[141] Associate Judge Bell addressed the concept of subrogation and concluded that if trust funds could be traced into the discharge of debts secured on caveated properties, the discharge of the registered proprietor's liabilities accordingly enriches them.[85] In order for that enrichment to be at the expense of the plaintiff, the funds had to be able to be traced into the mortgagees' hands. In order to demonstrate the unjustness of the enrichment, Associate Judge Bell referred to cases where subrogation claims had been permitted when misappropriated funds had been used to pay off secured debts, including those I have addressed at [139] and onwards. The remedy of subrogation was held to be applicable. The Judge acknowledged that the effect of subrogation was not acquiring the creditor's interest in the property, but obtaining a new and independent equitable charge which replicates the creditor's old interest. It arises immediately on paying off the debt as a matter of equity.[86]

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83 At [340].
84 *Trustees Executors Ltd v Steve G Ltd* [2013] NZHC 16.
85 At [110].
86 At [113] – [115].

[142] Finally, in *F M Custodians Ltd v McKenzie*, Hugh Williams J considered the remedy of subrogation where the claimant's money had been used to pay off part of a mortgage.[87] The Judge highlighted that tracing was the mechanism for identifying the movement of funds and subrogation the means adopted to prevent the recipient of those funds being unjustly enriched: and it was to be fashioned to the circumstances and flexible.[88] On the facts of that case, however, the Court concluded there was no breach of trust and no unjust enrichment.

Conclusion on subrogation

[143] In light of the authorities and commentaries referred to above, I consider subrogation is a sufficiently broad remedy to encompass the concept of using misappropriated money, or money used in breach of a fiduciary duty, to discharge a secured debt. The leading authorities recognise the flexibility of the remedy. They emphasise its breadth and discretionary nature, and the fact there need not be any intention as to how the money is to be used. While there are certainly "classic cases" of subrogation, I do not read any of the authorities as standing for the proposition that the remedy can *only* be deployed in such cases. What is required, however, is close consideration of whether the defendant has been enriched at the plaintiff's expense, and if so, whether that is unjust. And that is not to be considered in a moral or overarching "fairness" sense. Rather, a principled approach must be taken.

[144] In this case, the Company's funds have been used in breach of a fiduciary duty to discharge a secured debt. Those funds were held on trust for the Company by Mrs Deo, given her role as a director. The Company's funds are able to be traced directly into the mortgage repayments. Absent Mrs Deo's breach of fiduciary duty and trust, the funds would not have been so used. As a result, Mrs Deo has been unjustly enriched, given part of a secured debt owed by her to third parties has been discharged.

[145] I consider other unsecured creditors of Mrs Deo would, in the case of Mrs Deo's bankruptcy, also be unjustly enriched, such that it is not necessary to limit the effect of the subrogation remedy in terms of the ranking of the charge. Had

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87 *F M Custodians Ltd v McKenzie* HC Auckland CIV-2009-404-3285, 26 July 2010.
88 At [47] – [48].

Mrs Deo not breached her fiduciary duty and wrongfully used the Company's funds to repay her mortgage, less funds would be available to unsecured creditors in the event of Mrs Deo's bankruptcy and the sale of the Property. I note that the second ranking creditor (OOL) in *Banque Financiere de la Cite v Parc (Battersea) Ltd* was held to be unjustly enriched, despite not having any awareness of or involvement in the facts which were said to give rise to that unjustness. In that case, the enrichment was unjust because of a mistaken assumption on the part of the plaintiff bank as to priority arrangements between it and OOL. Arguably, a breach of fiduciary duty and a director's misuse of moneys held on trust for the company present a stronger case for unjust enrichment than a mistaken assumption. The facts in this case are also consistent with the recognised category of "ignorance" as a basis for finding an enrichment being "unjust", as discussed above.

[146] Accordingly, I am prepared to order an equitable charge over the Property in favour of the Company as a result of subrogation, up to the amount of Company money used to discharge Mrs Deo's mortgage debts (namely $77,862.19). This is the sum claimed by the Company in respect of the Property related payments, less the amounts claimed for the landscaping payments. However, given the Company's funds were used to discharge only part of the secured debts, that charge does not affect or take priority over Avanti or Plus Finance's rights under their pre-existing mortgages over the Property.

Result

[147] Judgment is accordingly entered for the plaintiff as follows:

a) Judgment on the first cause of action against Mr and Mrs Deo, on a joint and several basis, in the sum of $490,528.86;

b) Judgment on the first cause of action against Mrs Deo in the sum of $77,862.19 (being the mortgage repayments);

c) Interest at the prescribed rate under the Judicature Act 1908 on both sums from 20 May 2016 (being the date by which the Company demanded repayment of the sums) to judgment;

d) A declaration on the second cause of action that the Company has an equitable charge over the Property in the sum of $77,862.19, such charge to rank behind the mortgages of Avanti and Plus Finance; and

e) Costs on a 2B basis.

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Fitzgerald J