IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2011-404-3155
[2014] NZHC 2223

BETWEEN	BELGRAVE FINANCE LIMITED (IN RECEIVERSHIP AND IN LIQUIDATION) Plaintiff
AND	RAYMOND TASMAN SCHOFIELD First Defendant
	SHANE JOSEPH BUCKLEY Second Defendant
	STEPHEN CHARLES WILLIAM SMITH (STAYED) Third Defendant
	DAVIDSON, ARMSTRONG & CAMPBELL (DISCONTINUED) Fourth Defendant
	HAYES KNIGHT (DISCONTINUED) Fifth Defendant

Hearing: 4 September 2014

Counsel: MD Arthur for Plaintiff

Judgment: 12 September 2014

JUDGMENT OF FOGARTY J

This judgment was delivered by me on 12 September at 4.30 p.m., pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date: ……

Solicitors: Chapman Tripp, Auckland
Keegan Alexander, Auckland

Introduction

[1] Belgrave Finance Limited (Belgrave) operated as a finance company, providing mezzanine lending primarily to fund property developments.

[2] At all material times Belgrave was subject to a trust deed, the trustee being the Covenant Trustee Company Limited (Covenant). The trust deed placed restrictions on the use of money paid by the depositors. In particular the debenture trust deed provided that the company would not, without the prior written consent of the trustee:

> enter into any Related Party Transaction … except within the ordinary course of business and where the terms thereof are either evidenced in writing and the consideration therefore is on the basis of an arm's length transaction as between two unrelated parties contracting in an open market, provided however that in any twelve-month period the aggregate value … of Related Party Transactions entered into or remaining outstanding shall not exceed 2 per cent of adjusted total tangible assets. (Emphasis added.)

[3] Belgrave issued an investment statement and prospectus in 2005.

[4] In that debenture, under the heading "related-party lending risk", investors are advised:

> If Belgrave were to lend to related parties, which include directors and shareholders, there would be a risk that returns to investors on that position of funds lent to the related party may not be at a level commensurate with returns resulting from ordinary arm's length lending transactions.
>
> Belgrave has maintained a policy of no related party lending.
>
> The Company has addressed this risk by entering into a covenant with the Trustee (set out above).

[5] Under the heading "mezzanine funding risk", the prospectus advises:

> A portion of Belgrave's loans are secured by way of second mortgages over property … In development situations, as second mortgagee Belgrave is subordinated to the first mortgagee meaning that Belgrave is not entitled to be repaid before the first mortgagee and is prevented from taking enforcement action until the first mortgagee is repaid. There is a risk that in the event of a default on one or all of these securities, Belgrave does not recover all principal, interest, and fees due to most or all of the equity in the security property being realised by the first mortgagee.

[6] Belgrave collapsed at the commencement of the GFC.

[7] Ignoring interest obligations owed to Belgrave by its borrowers, and calculated on a cash-in-cash-out basis, the net unrecovered advances amount to the sum of $8,615,107.74.

[8] The liquidators and receivers of Belgrave commenced these proceedings against four defendants, Messrs Schofield, Buckley, Smith, Davidson Armstrong & Campbell, and Hayes Knight.

[9] Mr Smith was adjudicated bankrupt and the proceedings have been stayed against him. The plaintiff has settled all issues and, with the Court's leave, discontinued proceedings against the fourth defendant known as DAC Legal and the fifth defendant, Hayes Knight. After the hearing, the plaintiff learned that Mr Buckley, the second defendant, has been adjudicated bankrupt. The Official Assignee does not expect any dividend will be paid to creditors. But I grant leave for these proceedings to continue against the estate of Mr Buckley, as empowered by s 74 of the Insolvency Act.

[10] Belgrave seeks to prove its claim against the first and second defendants by way of formal proof. High Court Rule 15.9(4) provides:

> The plaintiff must, before or at the formal proof hearing, file affidavit evidence establishing, to a judge's satisfaction, each cause of action relied on and, if damages are sought, providing sufficient information to enable the judge calculate and fix the damages.

The essence of Belgrave's claim

[11] The plaintiff's case is that the first defendant, Raymond Schofield, initiated the acquisition of Belgrave in 2005. The legal owner of Belgrave was Investment Enterprises Limited (IEL), a corporate entity formed for the purpose. Belgrave was majority owned by a discretionary trust brought into being on the instructions of Mr Schofield and called the Tourist Trust.

[12] Mr Schofield's involvement in that trust was carefully concealed. He was a discretionary beneficiary but not by name. His wife was a discretionary beneficiary,

and he qualified also as a discretionary beneficiary in terms of the deed by his status as husband.

[13] Covenant, the trustee, never knew that Mr Schofield was the organising force behind the acquisition of Belgrave and its subsequent operation.

[14] It is the plaintiff's case that Mr Schofield was a related party in terms of Belgrave's trust deed because of the control and influence he exercised over Belgrave. Its directors, Mr Buckley (also described as the CEO) and Mr Smith, ran the company and were put in that position of control by Mr Schofield and answered to him.

[15] Between August 2005 and May 2008, there were numerous advances made to Mr Schofield and to entities connected to him.

[16] These advances were up to 30 per cent of Belgrave's adjusted total tangible assets. Therefore they breached Belgrave's trust deed restrictions against related party lending (2 per cent) (as we have seen) and advances to a related party other than on normal commercial arm's length terms.

[17] Some of the advances were immediately recycled upon the direction of Mr Schofield as payments of interest accrued on other related loans to Schofield entities. This stratagem gave the impression that some of the older loans were performing by interest being paid, it being disguised that the interest being paid were the proceeds of recent loans.

[18] Belgrave's claim against Mr Schofield is for dishonest assistance and breaches of fiduciary duties by his men, Mr Buckley and Mr Smith as the directors and operators of Belgrave.

The acquisition of Belgrave

[19] Mr Schofield arranged for the acquisition of Belgrave shares by a corporate entity formed for the purpose, Investment Enterprises Limited (IEL). There is email

evidence authored by Mr Schofield indicating that he personally was acquiring the company:

> I want to make sure I'm getting for a cost of 3m a copy worth 1.6m cash for capital or equity to maintain the 15% and pay 1.4 for the goodwill and I control it all first before I work out the best way to spread it around.

[20] At that time Mr Schofield was instructing the fourth defendants, as solicitors, known as DAC Legal. He instructed them to form "a new clean trust with discretionary beneficiaries with no reference to me". The vendors accepted IEL as the purchaser but required Mr Schofield's guarantee. He provided that guarantee. The discretionary Trust was called the Tourist Trust. The directors of IEL were Mr Smith and Mr Buckley, chosen by Mr Schofield. They were his men.

[21] Overall the acquisition and structure set up at the time of the acquisition are a classic case of the true owner, in control of all the benefits of ownership, operating out of sight, "pulling the strings".

[22] Messrs Buckley and Smith began advancing funds directly to Mr Schofield or to borrowers or entities associated directly or indirectly with Mr Schofield. This has been documented by Mr Grant Graham, an insolvency practitioner of Auckland, an accountant and partner in the firm KordaMentha. He is a joint receiver and liquidator of Belgrave. It was his investigations which led to his conclusion that Mr Schofield was behind the acquisition of Belgrave, exercised control over the company, and that he, Mr Schofield, with the directors, Messrs Buckley and Smith, participated in and deliberately concealed a related party lending scheme. It is his judgment that Mr Schofield ultimately controlled Belgrave through his considerable influence and control over IEL and Messrs Buckley and Smith.

[23] The loans to Schofield or Schofield's interests were handled by DAC Legal. Of the 32 matters DAC Legal opened for Belgrave, at least 23 of them involved lending to Mr Schofield directly or indirectly. Many of the loans had unclear or inadequate documentation and, in some cases, were unexecuted and even no documentation. Mr Graham formed the view that Belgrave's directors, Messrs Smith and Buckley, and Mr Schofield deliberately concealed the absence of loan and security documentation in relation to the Schofield loans.

[24] Mr Schofield, Mr Buckley and Mr Smith produced misleading records showing interest repayments by Schofield loan borrowers so as to create the impression the Schofield loans were arm's length transactions. Mr Schofield and Belgrave's directors arranged for Belgrave to advance funds into DAC Legal's trust account only for those funds to be immediately returned to Belgrave as "interest payments" by Schofield loan borrowers. None of these loans had the prior consent of the trustee.

[25] I accept the evidence of Mr Graham. For the purpose of a formal proof judgment, it is not necessary to go into the detail reflected in the three bundles of exhibits supporting Mr Graham's conclusions.

Dishonest assistance by Schofield

[26] Belgrave's claim against Mr Schofield is that he dishonestly assisted the directors, in breach of their fiduciary duties to Belgrave.

[27] The elements of dishonest assistance to a breach of fiduciary duty are:

(a) The existence of a trust or fiduciary duty, which is breached by the fiduciary;

(b) Assistance by the defendant in that breach;

(c) The dishonesty of the defendant in rendering that assistance, namely that:

(i) The defendant's conduct was dishonest by the ordinary standards of reasonable and honest people (an objective test); and

(ii) The defendant himself or herself realised that by these standards his or her conduct was dishonest (objective test).

(d) Loss suffered by the plaintiff as a result of the breach of trust or breach of the duty that the defendant dishonestly assisted.

[28] It is apparent from the documentary evidence that Mr Schofield went to great detail to conceal his role. The fact that he was making attempts to conceal his role shows that he knew that what he was doing was dishonest. I find Mr Schofield knew that the Schofield loans breached the trust deed; that Mr Schofield structured the acquisition of Belgrave's shares so as to avoid detection of the related party lending restrictions applying to him and the entities associated with him. He participated in concealing the related lending scheme.

[29] I am satisfied that the principal reason of Mr Schofield acquiring Belgrave was to access depositors' funds by way of hidden related party loans. The lenders to Belgrave are the victims of his dishonest conduct.

[30] The amount of the unrecovered Schofield loans has been calculated by Mr Graham on a cash-in-cash-out basis without regard to interest obligations. This is a conservative assessment. It amounts to the sum of $8,615,107.74.

[31] Mr Schofield could not have achieved the benefits of the breach of fiduciary duties without the assistance of his directors, Mr Smith and Mr Buckley.

[32] For these reasons, I find the cause of action proved against Mr Schofield. The plaintiff is entitled to judgment in the sum of $8,615,108 (.74 cents rounded up).

The claim against Mr Buckley

[33] The claim against Mr Buckley proceeds on the same reasoning as the claim against Mr Schofield, with the qualification that Mr Buckley was Mr Schofield's man. There is no doubt that Mr Buckley, at all material times, knew of the secret structure controlled by Mr Schofield.

[34] Mr Buckley pleaded guilty to:

(a) 19 charges of theft by a person in a special relationship (ss 220 and 223(A) Crimes Act 1961).

(b) 4 charges of false statements by a promoter (s 242 Crimes Act 1961).

(c) 1 charge of making an untrue statement (s 50 Securities Act 1977).

(d) 1 charge of making a false statement to a trustee (s 377(2) Companies Act 1993).

[35] The charges against Mr Buckley, with the other directors and Mr Schofield, were that they:

> Received or were in possession of, or had control over property, being money secured by [Belgrave's] debenture stock, on terms or in circumstances that [they] knew required [them] to deal with the property, or any proceedings arising out of the property, in accordance with the requirements of [Covenant] as trustee under [the trust deed], and intentionally dealt with the property otherwise than in accordance with those requirements and thereby committed theft.

[36] The charges related to a false statement by a promoter related to the 2006 and 2007 prospectuses.

[37] These charges and the plea of guilty arose out of the same set of events that this civil claim is based on, as can be seen from the reasoning of Faire J in *R v Hamilton.*[1]

[38] Belgrave now claims against Mr Buckley on the basis of breach of his fiduciary duties to Belgrave.

[39] Belgrave pleads that Mr Buckley owed fiduciary duties to Belgrave:

(a) To avoid undisclosed conflicts between his duty as director and the interests of Mr Schofield and/or persons associated with Mr Schofield; and

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1 *R v Hamilton* [2014] NZHC 1024, 16 May 2014.

(b) To exercise his director's powers and Belgrave's best interest by ensuring, inter alia, that Belgrave advanced money to the borrowers in terms of its trust deed.

[40] It needs to be kept in mind that in the foregoing reasoning I made findings of fact that Mr Buckley and Mr Smith effectively controlled the company, Mr Buckley being named in at least one document as the Chief Executive Officer.

[41] I have also found that he was one of Mr Schofield's men. He was put in his position of power in order to serve the interests of Mr Schofield, in breach of the law.

[42] For a director involved in the management of a company's business, the scope and nature of his fiduciary duties are informed by the scope and nature of his management powers and duties. A director of a company, as here, making advances to related parties without security and without any written loan term and particularly in breach of the trust deed, was in clear breach of his fiduciary duty and s 131 duties.

[43] Mr Buckley failed to exercise his management powers and carry out his management duties in Belgrave's best interests. He was disloyal to Belgrave in using his position to advance the interests of Mr Schofield and the various entities associated with him, specifically by:

(a) Entering into the Schofield loans, on terms that were in breach of the trust deed, and designed for the benefit of Schofield-related borrowers rather than Belgrave and, indeed, to the detriment of Belgrave.

(b) Facilitating the related party lending scheme for almost three years, by failing to disclose (indeed, actively concealing) the conduct in advancing the interests of Mr Schofield, despite a director's continuing duty to disclose every trust deed breach to the Covenant.

[44] Indeed, his conduct amounted to a pattern of deliberate and ongoing breaches of fiduciary duties he owed to Belgrave.

[45] Mr Buckley was in a position to prevent any one of the transactions giving rise to the loss. For these reasons, I find he is in breach of fiduciary duties and caused the same loss of $8,615,107.74, which I have rounded up to $8,615,108 in the judgment sum against Mr Schofield. Accordingly, the plaintiff is entitled to judgment against Mr Buckley for the same amount.

[46] In respect of Mr Buckley, the same application was made for compound interest. For the same reason, leave is reserved to the plaintiff to apply for an award of compound interest as contained in paras [39] and [40] above. The plaintiff is also entitled to costs on a 2B basis against Mr Buckley.

Simple interest or compound interest?

[47] This Court has a discretion as to interest in claims for equitable compensation. There is a power to calculate on a compound basis where the defendant's actions amount to fraud.

[48] Mr Arthur submitted that, in this case, justice demands that, against both Messrs Schofield and Buckley, interest be calculated on a compound basis, given that:

(a) Mr Buckley knew that he was acting in breach of fiduciary duties to Belgrave.

(b) Mr Buckley's actions amounted to a fraud against Belgrave.

(c) Mr Schofield knew that the directors were acting in breach of their fiduciary duties to Belgrave.

(d) Mr Schofield's actions in assisting the directors' breach of fiduciary duties were dishonest and amounted to fraud against Belgrave.

(e) It can be reasonably inferred that the funds were used by Schofield for his trading activities.

[49] The principles upon which the compound interest were paid were examined by the High Court in *Equity Corp Industries Group v R (Judgment No 51)*[2] and in *Eden Refuge v Hohepa*.[3] Both judgments rely on Lord Woolf in *Westdeutsche Landesbank Girzentrale v Islington London Borough Council*.[4]

[50] In that passage, Lord Woolf said: (page 695)

> There is one more aspect of Hobhouse J's judgment to which I should refer. In his review of the authorities, Hobhouse J drew attention to two lines of authority, one where simple interest is being awarded and the second where compound interest is being awarded. In the former situation the Court, according to Hobhouse J, is concerned to compensate the party for what he has lost in consequence of not receiving money to which he was entitled. In the later situation the Court is concerned with the benefit which the payee has derived as a result of the payment being made. The distinction is a valid one if what is being considered is the right to interest on the one hand under the statute or common law and on the other in equity. The distinction is not valid if a different position is being considered, namely, whether simple interest or compound interest should be awarded in equity. Equity in the case of both simple and compound interest will look at the benefit which the payee has derived. If it is equitable to do so, the payee will be ordered to pay simple or compound interest depending on the benefit that has resulted from the payment. (Emphasis added.)

[51] In *National Bank of New Zealand Limited v DFC*[5] Somers J, for the Court of Appeal, said:[6]

> [The Court] exercises that power upon the principle that a trustee may not profit from his trust – he is to be charged the interest he has received or that which it is so clearly to be supposed he did receive that he may not deny its receipt ... Such interest will normally be simple interest but if it is established that the money has been used in trade compound interest may be charged: *Burdick v Garrick* (1870) 5 Ch.App.233. (Emphasis added.)

[52] The dictum of Somers J explains why Lord Woolf said the Court is concerned with the benefit that the payee has derived as a result of the payment being made. The course of action against both defendants is a breach of fiduciary duties. The essence of the fiduciary obligation is that one is in control of assets for the benefit of others. If that duty is breached and the others sue, those plaintiffs are entitled to

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2 *Equity Corp Industries Group v R (Judgment No 51)* [1996] 3 NZLR 690 at 695 and 969, Smellie J.

3 *Eden Refuge v Hohepa* [2011] 3 NZLR 273 at [23] [33], Duffy J.

4 *Westdeutsche Landesbank Girzentrale v Islington London Borough Council* [1996] 2 WLR 802, at 852.

5 *National Bank of New Zealand Limited v DFC* [1990] 3 NZLR 257.

6 At 263.

obtain from the fiduciary in breach all the gains that were made from the breach of trust. To my mind, compound interest is only a surrogate for an accounting to recover the profit obtained by breach of trust. However, whether one approaches it as compound interest or recovery of profit from breach of trust, there must be evidence of profits from his trust in excess of the simple interest which is available as of law by way of the Judicature Act.

[53] Should it come to light that Messrs Schofield and Buckley, directly or by entities under their control earned profits in excess of the simple interest to be awarded in this case, then leave is reserved to the plaintiff to apply for an award of compound interest against them, or their entities.

[54] Accordingly, for now the plaintiff is entitled to judgment against the first and second defendants jointly in the sum of $8,615,108 and simple interest at the Judicature Act rate calculated at 7.5 per cent per annum from 2005 to 30 June 2008, 8.4 per cent per annum from 1 July 2008 to 10 July 2011 and 5 per cent per annum from 11 July 2011 to date.

[55] Because the plaintiff was pursuing the compound interest rates, these three simple interest sums have not been calculated. I request a memorandum from counsel of the same. Counsel for the plaintiff can elect to provide evidence justifying compound interest now, or at any later date. The joint liability means that the total recovery cannot exceed the judgment sum and the interest and costs.

[56] The plaintiff is also entitled to costs on a 2B basis. I reserve whether the costs should be calculated on a joint liability basis or severally. I am inclined to the view it is joint, as the same evidence and argument sustained each finding of liability.