IN THE COURT OF APPEAL OF NEW ZEALAND

CA95/03

BETWEEN	ASB BANK LTD Appellant
AND	KENNETH JAMES MCGREGOR DAVIDSON, ALISON MARY DAVIDSON AND DOUGLAS SEYMOUR ALDERSLADE OF AUCKLAND AS TRUSTEES OF THE AQUATIC TRUST First Respondent
AND	KENNETH JAMES MCGREGOR DAVIDSON Second Respondent
AND	ALISON MARY DAVIDSON Third Respondent

Hearing: 19 April 2004

Coram: Glazebrook J
William Young J
Chambers J

Appearances: Z G Kennedy for Appellant
P J Dale for Respondents

Judgment: 8 October 2004

JUDGMENTS OF THE COURT

Judgments

GLAZEBROOK J

Introduction

[1] The Aquatic Trust banked with the ASB Bank. Purportedly on behalf of that trust, Mr Davidson, without the knowledge of the other trustees, requested the ASB to issue three standby letters of credit which the ASB duly did. This appeal from a judgment of Laurenson J, now reported at (2003) 7 NZBLC 103,927, is concerned with the third of these letters of credit, issued in favour of WestpacTrust. This was called upon and the trustees are refusing to accept liability for the $200,000 paid by the ASB under it.

[2] There are two issues. The first is whether the trustees are liable to the ASB for damages for breach of various representations and warranties in their contract with the ASB. The nub of the argument is that the other trustees were constructively aware of the second letter of credit and were therefore under an obligation to inform the ASB that it was unauthorised. If they had done so, the third letter of credit would not have been issued and the ASB would not have suffered the loss it did.

[3] The second issue is whether Mrs Davidson is required to indemnify the ASB with regard to the amount paid by the ASB under the third letter of credit by virtue of a Deed of Guarantee and Indemnity she had entered into with respect to the Trust's obligations, both existing and future. I note that Mr Davidson was also a guarantor but, as he has no assets, the point is largely academic.

Background facts

[4] The Aquatic Trust was formed in 1987. Its trustees were Mr and Mrs Davidson and Mr Alderslade, the latter a solicitor. The Trust opened an account with the ASB on 1 June 1994 but the account was operated largely by Mr Davidson on behalf of the Trust.

[5] On 6 October 1999, Mr Davidson requested, purportedly on behalf of the Trust, that the ASB provide a standby letter of credit in the sum of $120,000. This

was to be issued to the Bank of New Zealand to secure facilities granted to Leisure Corp Holdings Ltd, a commercial trading entity in which the Trust held a 25% stake and of which Mr Davidson was a director. The ASB manager's contemporaneous file note recorded advice from Mr Davidson to the effect that this letter of credit was to be secured over Mrs Davidson's property and that she was fully aware of the request.

[6] The letter of credit was formally applied for by Mr Davidson on 20 November 1999 after credit approval had been given on 19 October 1999. On 26 October 1999 Mr Davidson, again purportedly on behalf of the Trust, executed an International Trade Services Master Agreement which contained general terms and conditions for the issue by the ASB of, inter alia, import and/or standby letters of credit from time to time. The ASB did not obtain the signatures of the other two trustees. The letter of credit was raised on 23 November 1999.

[7] In the meantime, on 9 November 1999, the trustees executed security documentation which supported a restructure of the Trust's loan facilities. These documents did not mention the standby letter of credit. Mr and Mrs Davidson also executed Deeds of Guarantee and Indemnity which included, among other things, an indemnity for all existing and future indebtedness of the Trust to the ASB, or incurred by the ASB on behalf of the Trust.

[8] In February 2000, Mr Davidson, again purportedly on behalf of the Trust, requested the ASB to issue a second letter of credit in favour of one of Leisure Corp's overseas suppliers. This was issued on 6 March 2000, again without having obtained the signatures of the other two trustees. Confirmation of its establishment was sent in writing to the Trust's Post Office Box, along with a copy of the letter of credit itself. Bank statements sent to the postal address recorded the debit of the ASB's fees for issuing both letters of credit. The second letter of credit was subsequently called upon, and the amount of $116,793.63 debited to the Trust's account on 13 July 2000. This sum was subsequently repaid after the Trust was put in funds for the purpose by Leisure Corp.

[9] Mr Davidson sought a third letter of credit on behalf of the Trust on 31 March 2000. This was to be in favour of WestpacTrust and was to replace the first letter of credit. This reflected the fact Leisure Corp had moved its business from the BNZ to WestpacTrust. Again, establishment fees were debited to the Trust's bank account and recorded in the relevant bank statement sent to the Trust's Post Office Box.

[10] On 10 April 2001 the third letter of credit was called upon by WestpacTrust and Leisure Corp was placed in receivership. Payment of $200,000 was made by the ASB on 11 April 2001 in accordance with its obligations under the letter of credit.

[11] The trustees contended that none of the letters of credit had been authorised by the Trust and refused to accept liability for the sum paid by the ASB. The ASB accordingly issued proceedings to recover this amount, plus interest from 13 April 2001 at 21.75% (its customary unassigned overdraft interest rate) and solicitor/client costs.

The documentation

[12] It is worth setting out at this stage the terms of the relevant documentation relied on by the ASB. The first document is the General Terms and Conditions executed by the trustees on 9 November 1999. The relevant clauses are as follows:

> **[a] Clause 1.1:**
>
> **"Documents"** means these Terms, any Facility Agreement, any Security Document and any other agreement present or future, required by or relating to a Facility;
> **"Facility"** means:
>
> (a) a credit facility; or
>
> (b) any other facility for financial accommodation which expressly incorporates these Terms;
> which the Bank provides or has agreed to provide to the Customer;.
> …
> **"Relevant Party"** means the Customer and each of the other parties to the Documents (other than the Bank);

[b] Clause 3.1:

Representations and Warranties of Customer: The Customer represents and warrants that:

(a) **Obligations Binding:**

(i) each Relevant Party has full power and authority to enter into and comply with its obligations under each Facility or Document to which it is expressed to be a party and has obtained all consents needed to enable it to do so;

(ii) each Document has been (or when executed will have been) duly authorised and entered into by each Relevant Party expressed to be a party to it; and

(iii) the Documents are (or when executed will be) legal, valid, binding and enforceable against each Relevant Party;

(b) **No Cancellation Event:** other than as disclosed to the Bank in writing, no Cancellation Event has occurred;

[c] Clause 3.2:

Representations and Warranties Continuing: Each of the statements in paragraph 3.1 will be deemed to be repeated continuously so long as any Facility is available to the Customer or the Customer is indebted to the Bank, by reference to the facts and circumstances then existing.

[d] Clause 4.1:

General Undertakings: The Customer undertakes to the Bank that it will:

(a) **Cancellation Events:** notify the Bank of the occurrence of any Cancellation Event and any event or circumstance which may have a material adverse effect on any relevant party, immediately upon becoming aware of that Cancellation Event, event or circumstance;

[e] Clause 5:

Cancellation Events

If at any time and for any reason, whether or not within the control of a party:…

(c) **Statements Incorrect:** any statement by the Customer made in, or in connection with, a Facility or a Document is not true, accurate and complied with when made or repeated; or…

(i) **Avoidance or Repudiation:** the enforceability of any Document is contested by any person or it becomes unlawful for the Customer to comply with any of its obligations under any Document; …

then the Bank may, at any time, by notice to the Customer:

(i) cancel each or any Facility; and/or

(ii) declare any or all indebtedness of the Customer to the Bank which is repayable other than on demand to be, and that indebtedness will be due and payable either immediately or at such later date as the Bank may specify, and/or

(iii) require the Customer to pay (and the Customer will pay) to the Bank either immediately or upon demand or at a later date as the Bank may specify an amount equal to the aggregate face values of all bills outstanding under any bill Facility (or any lesser amount which the Bank may specify in writing).

[f] Clause 9.1:

Two or More Customers: If more than one person is named as the Customer, then:

(a) **References to Customer:** unless the context otherwise requires, each reference to the "Customer" will be a reference to each of them separately as well as to all of them together;

(b) **Joint and Several:** each of them is jointly and severally liable for all obligations of the Customer;

[g] Clause 12:

12.1 Addresses and References: Each notice or other communication is to be made in writing and sent by facsimile, personal delivery or by post to the addressee at the facsimile number or address, and marked for the attention of the person (if any), from time to time designated for that purpose.

12.2 Deemed Delivery: No communication will be effective until received. Communications to the Customer, however, will be deemed to be received:

(a) in the case of a letter, on the third business day after posting; and

(b) in the case of a facsimile, on the business day on which it is despatched or, if received after 5.00 p.m. in the place of receipt, on the next business day after the date of despatch.

[13] The next relevant document is the Deed of Guarantee and Indemnity executed by Mr and Mrs Davidson. Clause 2.3 of that document provides as follows:

Unenforceability of Obligations: As a separate and continuing undertaking, the Guarantor unconditionally and irrevocably undertakes to the Bank that, should the Guaranteed Indebtedness not be recoverable from the Guarantor under this Deed for any reason, including a provision of this Deed or an obligation (or purported obligation) of the Customer to pay Guaranteed Indebtedness or to perform or comply with a Guaranteed Obligation being or becoming void, voidable, unenforceable or otherwise invalid, whether or not that reason is or was known to the Bank and whether or not that reason is:

(a) a defect in or lack of powers of the Customer or the Guarantor or the irregular exercise of those powers; or

(b) a defect in or lack of authority by a person purporting to act on behalf of the Customer or the Guarantor; or

(c) a legal or other limitation (whether under the Limitation Act 1950 or otherwise), disability or incapacity of the Customer or the Guarantor; or

(d) a dissolution, amalgamation, change in status, constitution or control, reconstruction or reorganisation of the Customer or the Guarantor (or the commencement of steps to effect the same),

the Guarantor will, as a sole and independent obligation, pay to the Bank on demand the amount which the Bank would otherwise have been able to recover (on a full indemnity basis). In this clause, the expressions "Guaranteed Indebtedness" and "Guaranteed Obligation" include any indebtedness or obligation which would have been included in those expressions but for anything referred to in this clause.

[14] "Guaranteed Indebtedness" is defined in cl 1.1 of the Deed of Guarantee and Indemnity as:

"Guaranteed Indebtedness" means all indebtedness of the Customer to the Bank or incurred by the Bank on behalf of the Customer (including all interest, costs, taxes, stamp or similar duties or taxes, commissions, charges and expenses (including legal fees and expenses) incurred or sustained in any way by the Bank in connection with that indebtedness or the enforcement or attempted enforcement of that indebtedness) and:…

(d) if the Customer is described as the trustee of a trust, the indebtedness incurred on behalf of that trust by any former, present or future trustee;

"Guaranteed Obligations" means all obligations (whether present or future other than obligations to pay money) of the Customer to the Bank;…

[15] There was a separate Guarantor's Acknowledgement attached to the deed. This was not signed by Mr or Mrs Davidson and the acknowledgement was not mentioned in evidence by either Mr or Mrs Davidson. Mrs Davidson did, however, have independent legal advice before signing the Deed of Guarantee and Indemnity. The Acknowledgement read as follows:

I/We refer to the Guarantee and Indemnity to be entered into by me/us and acknowledge that:

(a) I/we have been advised by the Bank to obtain **independent legal advice** before signing the Guarantee and Indemnity;

(b) I/we understand that the Guarantee and Indemnity makes me/us liable for all present and future amounts owing to the Bank by the Customer, including future advances, amounts owing under guarantees given by the Customer, and amounts owing by the Customer together with any other person.

(c) The Bank has no duty to keep me informed of the financial condition of the Customer, and I/we must keep myself/ourselves informed as to all matters relevant to the Guarantee and Indemnity.

(d) Unless a maximum amount is inserted in clause 3.2 of the Guarantee and Indemnity, my/our liability to the Bank will be unlimited.

Laurenson J's judgment

[16] The ASB argued in the High Court that the trustees had effectively delegated the right to operate the Trust's bank account to Mr Davidson and that the creation of the letters of credit were part of the operation of the account. Accordingly, as a matter of contract, the trustees were liable pursuant to the security documents executed by all of the trustees on 9 November 1999 and the Trade Services Master Agreement signed by Mr Davidson on 26 October 1999.

[17] Laurenson J dismissed this cause of action. His Honour said that the general rule is that trustees must act unanimously and cannot delegate their duties or powers, even to a co-trustee, unless such delegation is specifically permitted by the trust deed or by statute. Here it was not. Laurenson J found as a matter of fact that the ASB had knowledge of the need for unanimity. He also found that the remaining two trustees did not authorise the letters of credit.

[18] As an alternative, the ASB submitted that each of the three trustees was under an obligation to advise it if a particular facility was not authorised by all of them. The Judge said that the ASB was relying for this cause of action on an allegation that the trustees had actual knowledge of the letters of credit and that it was no longer relying on an allegation of constructive knowledge. The parties are agreed, however, that this concession was not made.

[19] After a review of the General Terms and Conditions executed by all three trustees on 9 November 1999, the Judge accepted that there was an obligation on the

trustees to inform the ASB of the fact that the letters of credit were unauthorised, but only if they were aware of their existence. He held that they were not. He noted in particular that clause 12.1, regarding notices and communications, did not assist the ASB. He said that all the communications relied on by the ASB and sent to the Trust's Post Office Box were sent to the "Aquatic Trust". None were sent in the name of the trustees and it was they, and not the Trust, who were the customers.

[20] Laurenson J also rejected the unjust enrichment claim, except to the extent of $50,000. The reason he allowed a claim for $50,000 was that the trustees had a separate guarantee to WestpacTrust for 25% of the sum owed by Leisure Corp. The effect of the payment under the letter of credit was to reduce the overall shortfall by $200,000, thus decreasing by $50,000 the amount the trustees were called upon to pay under the guarantee to WestpacTrust. This finding is not now challenged by the trustees.

[21] The ASB also sought to enforce separate Deeds of Guarantee and Indemnity signed by Mr and Mrs Davidson at the time the ASB was restructuring the advances to the Trust. In addition to these securities, Mrs Davidson had also executed a first mortgage over her house in favour of the ASB. The ASB submitted that the terms of the documents were such that the obligations in each case extended to protect the ASB in respect of the payment made by it to WestpacTrust, ostensibly on behalf of the Trust.

[22] Laurenson J rejected the argument that Mr and Mrs Davidson were liable under the guarantee. This was because there was never a guaranteed indebtedness of the customer (the three individually named trustees) with regard to the third letter of credit. No liability could be incurred by the Trust unless all trustees concurred: *Niak v MacDonald* [2001] 3 NZLR 334.

[23] Laurenson J accepted the ASB's submission that the terms of clause 2.3 of the deed clearly extended the guarantors' obligations to those of indemnifiers. The Judge, however, rejected the contention that Mr and Mrs Davidson were liable under the indemnity in this instance. He accepted the submission that this case was comparable to that of *Citicorp Australia Ltd v Hendry* (1985) 4 NSWLR 1, even

though in that case at issue was an indemnity to enforce something prohibited by law. In both cases in his view there was never an obligation which the plaintiff was legally able to enhance.

[24] The Judge considered the ASB's submission that clause 2.3(b) meant that the indemnity continued to apply notwithstanding that Mr Davidson lacked authority to act on behalf of the Trust. He concluded, however, that it did not help the Bank. He said:

> [84] For this submission to be correct it involves an acceptance that an indemnifier incurs a liability arising on the failure of a bank customer to repay a sum of money which it never agreed to, and of which it was not aware, for which it obtained no consideration and in respect of which it had no legal obligation at all. When stated in these terms I consider the plaintiff's submission becomes quite untenable. In my view the words in cl. 2.3(b) "a defect in or lack of authority by a person purporting to act on behalf of the Customer…" do not extend to providing a *carte blanche* indemnity to a bank in every case where it incurs a debt having accepted the purported authority of an agent of a customer to do so. There must be a pre-existing authority by the customer authorising the bank to accept the authority of the agent.

[25] In this case the Judge held that, although there was a pre-existing authority for Mr Davidson to operate the bank account, it did not go beyond this and allow Mr Davidson to incur liabilities on behalf of the Trust. In his view, this situation therefore was not covered by clause 2.3(b).

[26] The Judge said that to find otherwise would mean that a bank could accept the authority of any single trustee without inquiry and with knowledge that the approval of three trustees was required and could still rely on the indemnity. That in his view could not be the law. The submission that the ASB had been led to believe, on the basis of Mr Davidson's previous dealings, that he did in fact have power to commit his co-trustees was also rejected. Not only was the ASB not entitled to make this assumption, but the making of such an assumption did not accord with normal banking practice. Had the ASB adopted normal banking practice in this case, the matter at hand would never have arisen. Indeed, the Judge pointed out that a further express guarantee had been envisaged (but not pursued) with regard to the first letter of credit.

[27] Laurenson J concluded that Mr and Mrs Davidson were not liable to the ASB as indemnifiers for the simple reason that the Trust was never liable to the ASB. He considered that his conclusion in relation to this cause of action was supported by clause (b) of the Guarantor's Acknowledgement. That paragraph is expressly directed to liabilities incurred by the customer (the Trust) and there were none.

[28] Laurenson J did, however, accept the ASB's submission that it was nevertheless entitled to recover the amount of its loss from Mr Davidson. This was on the basis that it was entitled to rely on Mr Davidson's warranty in the General Terms and Conditions (executed by him on 9 November 1999) that each trustee customer had the power to enter into each document to which it is expressed to be party. Alternatively, Laurenson J found that the ASB was entitled to relief against Mr Davidson under the Fair Trading Act cause of action. These findings against Mr Davidson are not under appeal.

Appellant's submissions

[29] The ASB appeals on two grounds. The first is that the trustees were liable to the ASB under the ongoing representations, undertakings and warranties made by them. Mr Kennedy, for the ASB, submitted that clause 12.2 of the General Terms and Conditions deemed communications to the customer (the Trust) to be received on the third day after a letter is posted to the Trust's designated address. On this basis, Mr Kennedy submitted that correspondence concerning the establishing of the second letter of credit sent to the Trust's Post Office Box was deemed to have been received by the Trust prior to the issue of the third letter of credit.

[30] Mr Kennedy submitted that the clear intent of the deeming provision was to ensure that the ASB could rely upon correspondence sent to the Trust's address as effective communication to all three of the trustees. Even though the trustees did not have actual knowledge of the second letter of credit they had therefore, in his submission, constructive knowledge of it. Any decision by the other trustees to leave trust matters and correspondence to Mr Davidson was taken at their own risk.

[31] Mr Kennedy submitted further that, by virtue of clauses 3.1(a) and 3.2 of the General Terms and Conditions, the trustees were deemed to have represented and warranted to the ASB on a continuing basis that the second letter of credit and corresponding credit facility had been duly authorised by and entered into by the Trust and that it was legal, valid, binding and enforceable against the trustees. It was also submitted that, pursuant to clause 3.1(b), the trustees warranted and represented to the ASB that no Cancellation Event had occurred. Pursuant to clause 4.1, the trustees had undertaken to notify the ASB of the occurrence of any Cancellation Event or other event which may have an adverse effect on any relevant party.

[32] He submitted that the general purpose of these provisions was to require the trustees to advise the ASB in the event they became aware, or were deemed to have become aware, of the unauthorised operation of the Trust's account by Mr Davidson. If they did not do so, the ASB was entitled to conclude that Mr Davidson was indeed authorised by the Trust as he claimed he was. In this way, the risk of unauthorised operation of the account was transferred from the ASB to the trustees themselves who were obviously more familiar with the Trust's activities.

[33] In the written submissions filed, the ASB attempted to back this up with an assertion that the trustees conducted themselves so as to confer ostensible authority on Mr Davidson to procure the issue of the letters of credit. This was not pursued orally, rightly, in my view, given Laurenson J's findings and this Court's decision in *Niak v MacDonald* [2001] 3 NZLR 334.

[34] As to the second ground of appeal (which in practical terms only applies to Mrs Davidson) it was submitted that clause 2.3 of the Deed of Guarantee and Indemnity squarely applies to the present case as a matter of construction of the ordinary meaning of the words used. With regard to the High Court's rejection of this argument on the basis that there was "never any debt", Mr Kennedy submitted that the very nature of an indemnity means that it does not relate or refer to a principal obligation. In Mr Kennedy's submission, the High Court's interpretation of the clause ignores the clear stipulation that it will apply whether or not the reason for the failure to recover from the customer is lack of authority and whether or not that was known to the ASB.

[35] Mr Kennedy submitted that the clause amounts to an undertaking to pay to the ASB the amount of the guaranteed indebtedness where for any reason that indebtedness cannot be recovered from the customer itself. That reason can include a purported obligation of the customer being unenforceable by reason of the lack of authority of a person purporting to act on behalf of the customer. Mr Kennedy submitted that it is difficult to see how the clause could be drafted more clearly. Mr Kennedy, however, conceded that the clause could not be taken so literally that it would cover transactions entered into purportedly on behalf of a Trust by a complete stranger to the Trust.

Respondents' submissions

[36] With regard to the first ground of appeal, Mr Dale, for the trustees, supported Laurenson J's reasons for rejecting the contention that all the trustees had knowledge of the second letter of credit by reason of documents having been forwarded to a designated address. Mr Dale submitted that in any event the ASB had failed to prove that the designated address of the Trust was the Post Office Box rather than the Davidsons' residential address of 9 Pencarrow Avenue. While the bank statements were sent to the Post Office Box, he pointed to numerous examples of documents being sent to Pencarrow Avenue. He noted that the space for address for notices in the General Terms and Conditions signed on 9 November 1999 was blank, and that the only prior acknowledgement as to the Trust's Post Office Box being its postal address came from Mr Davidson in his private capacity.

[37] Mr Dale also submitted that constructive knowledge does not suffice to trigger the requirement to give notice. Only actual knowledge can do so. Further, Mr Dale noted that the ASB had express knowledge that unanimity of the trustees was required. Accordingly he submitted that the ASB cannot show reliance on the warranty in clause 3.1.

[38] With regard to the second ground of appeal, Mr Dale accepted the Judge's finding that clause 2.3 is an indemnity. However, relying on *Citicorp* Mr Dale submitted that, unless there was at some stage guaranteed indebtedness, the indemnity clause could have no application. In *Citicorp*, a lessor sought to recover a

sum allegedly owing under the lease. The relevant clauses of the lease were held to be unenforceable as a penalty and the lessor sought alternatively to recover the sum under an indemnity provision in the lease. It was held that it could not. This was because the indemnity clause could only operate in circumstances where the sum had been at some stage recoverable but had been affected by some supervening irrecoverability (per Priestley JA at 41).

[39] The result in *Citicorp,* in Mr Dale's submission, accords with common sense. It is inconceivable that the phrase "for all obligations of the customer to the bank from time to time" could be read as rendering an indemnifier liable for a completely unauthorised loan advance. If the ASB's argument were correct, then any person purporting to act on behalf of the customer could bind the indemnifier. This cannot, in his submission, be correct.

First ground of appeal

[40] With regard to the first ground of appeal, as a general comment I do not consider that the purpose of the clauses relied on by the ASB was to enable the ASB to recover amounts from the Trust by the back door in circumstances where no direct recovery was possible because two of the trustees were unaware of the transactions. This is especially so where the ASB knew of the need for unanimity.

[41] Turning now to the clauses relied on by the ASB, the first page of the General Terms and Conditions provided that the customer was Kenneth James McGregor Davidson, Alison Mary Davidson, Douglas Seymour Alderslade as trustees for the Aquatic Trust. Clause 9.1 provides that "unless the context otherwise requires", a reference to a customer will be a reference to each customer named separately as well as to all of them together. Where, as here, the customers are recognised as customers in their capacity as trustees and the ASB knows that those trustees are to act unanimously for most purposes, I consider that the context will usually require them to be treated together rather than separately. It is effectively the trustees acting unanimously who are the "customer" in this case. As Mrs Davidson and Mr Alderslade had nothing to do with the letters of credit, the customer (being

all three trustees acting unanimously) cannot have represented anything in relation to them and can have no duties regarding them.

[42] Even if each trustee is treated separately, I do not consider that clause 3.1 helps the ASB. The transactions were not entered into on behalf of the Trust or by Mrs Davidson or Mr Alderslade in their capacity as trustees or in any other capacity. Mrs Davidson and Mr Alderslade did not know of the letter of credit transactions and cannot logically therefore have represented anything about them.

[43] Mr Kennedy suggested Mrs Davidson and Mr Alderslade could be deemed to have made the representations and warranties in clause 3.1(a), even if they were not a party to a transaction, as long as a person with some authority on behalf of the Trust had purported to enter into the transaction and all the trustees were constructively aware of the obligation. This would require reading this concept into the clause and I see no reason to do so.

[44] Neither, in my view, does clause 4.1 help the ASB, assuming there had been a Cancellation Event or that the clause had been otherwise triggered. The obligation to notify is only triggered upon a customer becoming aware of a Cancellation Event or other event or circumstances. If "customer" is taken, as I consider it has to be, as meaning all three trustees acting unanimously, then the customer in this case cannot have known of the Cancellation Event as Mr Alderslade and Mrs Davidson were unaware of it.

[45] Even if Mr Alderslade and Mrs Davidson are treated separately, neither was aware of the letters of credit. I am not able to read the word "aware" in other than its plain meaning and thus requiring actual knowledge. Constructive knowledge does not suffice. They can therefore have had no obligation to notify the Bank.

[46] In addition, I accept Mr Dale's submission that constructive knowledge could not, in any event, be shown as it is uncertain that the Post Office Box was the Trust's designated address under clause 12.1. In the only document I was pointed to that all three trustees signed, the Pencarrow Avenue address was given and that address had been used by the ASB for sending a number of significant documents to the Trust.

[47] The issue of constructive knowledge by reason of a designated address was not pleaded, although it was referred to in the High Court without objection in the opening and closing submissions of the ASB. The case as a whole was not, however, presented in a manner that concentrated on the point. It was never directly put to the trustees, for example, that the Post Office Box was the address designated for the purpose of clause 12.1.

[48] Because of the view I take as to the meaning of the term "customer" in this context, I differ from the tentative view expressed in Chambers J's judgment that Mr Davidson's obligation to notify arose from his description as a customer and, therefore, that Mrs Davidson and Mr Alderslade are jointly liable, under clause 9.1(b), for the breach of his obligation to notify the Bank of a Cancellation Event. In any event, as pointed out by Chambers J, this has never been the basis on which the Bank has put its case, either in relation to liability on the letter of credit or on the notification obligation.

[49] Finally on this point, there was no direct proof that the loss would not have been suffered if the ASB had been notified of the unauthorised nature of the second letter of credit. The obligation under the second letter of credit would still have existed (and that letter of credit was called upon). Mr Kennedy asked us to infer from what actually happened that there would have been no loss on the second letter of credit. I do not in the event need to decide if he is correct in this submission but it may be thought less than satisfactory that this was a matter of inference rather than direct evidence.

The indemnity

[50] I turn to the second ground of appeal. Mr and Mrs Davidson did not challenge Laurenson J's finding that the terms of cl 2.3 of the Deed of Guarantee and Indemnity executed by them extended their obligations to those of indemnifiers. This means that the obligation is an independent primary obligation and not one that is dependent on the continuing obligation of the trustees. Further, most of the defences available to guarantors are not available to indemnifiers – see the discussion in

O'Donovan and Phillips, *The Modern Contract of Guarantee* (London 2003) at 37-38.

[51] As indicated above, Mr Dale submitted that the liability of an indemnifier can arise only if there was at one time a primary obligation of the customer. In this case, there was never any primary obligation as the trustees never had any liability at all with regard to the letters of credit. He relied for that proposition on the case of *Citicorp*.

[52] *Citicorp* concerned an indemnity with regard to a lease of chattels. The New South Wales Court of Appeal held, after analysing the provisions of the indemnity, that the indemnifier was not liable to indemnify the lessor for non-payment under an unenforceable penalty clause. The main judgment was given by Priestley JA. He noted that the indemnity in that case was defined by reference to the term "the Moneys Hereby Secured". As a matter of construction of the definition of that term, he held that liability did not extend to moneys that had at no stage been recoverable. The penalty had never had any legal effect and at no stage could it have been enforced. The indemnity therefore did not cover it. At first instance, Clarke J had suggested that, in any event, even if the wording had covered it, public policy would have prevented recovery of such a penalty. Priestley JA, having found for the indemnifier on the construction of the indemnity, did not find it necessary to deal with that point. It is clear then that the Court of Appeal decision depended on the construction of the clause. It was not setting down any general principles as to recoverability under indemnities.

[53] Unlike in *Citicorp*, in this case, clause 2.3 clearly applies, on its plain wording, to a situation where there was never any obligation on the part of the customer (the trustees). The clause provides that the indemnifiers, where the indebtedness was not recoverable from the guarantors for any reason, would pay to the ASB on demand, and on a full indemnity basis, the amount that the ASB would otherwise have been able to recover from the guarantors. The clause goes on to make it clear that this covers a situation where any obligation of the customer (the trustees) to pay the guaranteed indebtedness is or becomes void, unenforceable or otherwise invalid and explicitly provides that this covers the situation where the reason for that

is a lack of authority by a person purporting to act on behalf of the trustees and whether or not this is known to the ASB. It is also made clear that the terms "guaranteed indebtedness" and "guaranteed obligation" cover any indebtedness or obligation that would have been included in those expressions but for the lack of authority or any of the other reasons for invalidity or unenforceability referred to in the clause. This indemnity is very widely drafted and is clearly designed to shift to the indemnifier any risks associated with the guaranteed indebtedness or guaranteed obligations not being recoverable for any reason whatsoever.

[54] What occurred is within clause 2.3. Mr Davidson was purporting to act on behalf of the customer, the trustees, in the letter of credit transactions. The guaranteed indebtedness was not recoverable from the trustees because of the lack of unanimity. Had it not been for the lack of authority on the part of Mr Davidson the amounts would have been recoverable. The amounts are not recoverable from the guarantors (given that their liability as guarantors depends on the primary obligation being valid and enforceable). On the plain wording of the clause, however, there is clear liability on the part of Mr and Mrs Davidson in relation to the indemnity.

[55] Although not an argument relied on by Mr and Mrs Davidson, I have considered whether the actions of the Bank could mean that the indemnity was nevertheless unenforceable against Mr and Mrs Davidson. In this case, the Bank knew of the requirement for trustee unanimity. There was no reason for Mr Cooper, the bank officer dealing with Mr Davidson at the relevant time, to assume that there had been unanimity given that he had never been told that the third trustee, Mr Alderslade, had agreed to the letters of credit.

[56] If this could be construed as negligence (and I make no finding on that), there is authority to suggest that clear words are needed to extend an indemnity to cover the negligence of the party indemnified – see *Smith v South Wales Switchgear Ltd* [1978] 1 All ER 18 (HL). In this case, clause 2.3 applies whether or not the reason for invalidity or unenforceability is or was known to the Bank. I accept Mr Kennedy's submission that this, by necessary implication, would cover negligence on the part of the ASB. If, as the clause says, it covers a situation where

the Bank knows that there is a lack of authority it is difficult to see that it would not cover a situation where the Bank negligently fails to discover that lack of authority.

[57] I have noted Mr Dale's submission that the indemnity must be read down as it is worded in such a way that, taken literally, it would mean that the indemnifiers could be called upon even if a fraudster, with no connection at all to the Trust, purported to act on behalf of the trustees and it was known to the ASB that he or she had no authority to do so. Mr Kennedy, rightly in my view, conceded that the clause did not go so far. The fact that it does not cover that extreme case, however, is no justification in my view for holding that the clause does not apply to a situation where the person purporting to act is a trustee was known to the bank as a trustee and who had some authority to act on behalf of the trustees in the operation of the Trust's bank account. That the clause was intended to apply to such a situation can be seen from the plain words of the clause and, in my view, also finds some support from para (d) of the definition of "guaranteed indebtedness" set out above.

[58] I have also considered whether there are public policy reasons that the indemnity should not be enforced. In this case, it may be that the contract of indemnity was entered into by Mr and Mrs Davidson at the request of the trustees. This would give Mr and Davidson the right to recoup from the Trust the amounts paid pursuant to the indemnity – see O'Donovan and Phillips at 666-667. This could be seen as a back door means for the Bank to enforce an obligation that would not otherwise be enforceable against the Trust. If there is an ability for the courts to hold indemnities unenforceable for public policy reasons (and O'Donovan and Phillips consider that there is not, at least in relation to penalties – see at 309) I do not consider that it would apply here. The trustees, if indeed they did request Mr and Mrs Davidson to enter into the indemnity, must have done so unanimously and therefore must take the consequences if that indemnity is called upon and the terms of the indemnity cover the situation that has arisen.

[59] Finally, I have taken into account the acknowledgement attached to the Deed of Guarantee and Indemnity and in particular para (b) of that acknowledgement. This refers, among other things, to the guarantee and indemnity making Mr and Mrs Davidson liable for all present and future amounts owing to the bank by the customer

including future advances. There is no mention here of the indemnity applying to amounts that were not owing by the customer but that would be owed under the indemnity. In my view, the acknowledgement does not purport to be other than a brief description of the document. I do not consider that, as a matter of construction, the acknowledgement, particularly as it was not signed by Mr and Mrs Davidson, can affect the interpretation of clause 2.3 or limit its application.

[60] For completeness, I note that undue influence was not pleaded by Mrs Davidson. Nor was the Fair Trading Act or the Contractual Remedies Act relied on. I have therefore not considered these matters. This is not, however, to suggest that there was any factual basis for those matters to be pleaded or that, if the pleadings had covered these items, the result would necessarily have been different.

Result and costs

[61] The appeal is dismissed insofar as it relates to the First Respondents.

[62] The appeal is allowed insofar as it relates to Mr and Mrs Davidson's liability under the Deeds of Guarantee and Indemnity. Mr and Mrs Davidson are jointly and severally liable, under the Deeds, to indemnify the ASB with regard to its loss under the letter of credit.

[63] The parties have leave to file memoranda on the calculation (including interest calculations) of the amount owing under the indemnity and on costs, if these matters cannot be agreed between the parties.

[64] The Bank must file and serve its memorandum on or before 29 October 2004. Mr and Mrs Davidson should file and serve their memorandum on or before 12 November 2004. Any reply memorandum by the Bank should be filed and served on or before 19 November 2004.

WILLIAM YOUNG J

[65] I am in agreement with the judgment of Glazebrook J but will add a few words in relation to the first cause of action.

[66] In all respects, the arguments on behalf of the bank rest on the definition of "Customer" in the General Terms and Conditions:

> If more than one person is named as the Customer, then:
>
> (a) **References to Customer**: unless the context otherwise requires, each reference to the "Customer" will be a reference to each of them separately as well as to all of them together;
>
> (b) **Joint and Several**: each of them is jointly and severally liable for all obligations of the Customer;

The argument of the Bank (and the rather different approach suggested by Chambers J) depend on the assumption that conduct or knowledge on the part of one of the trustees (ie Mr Davidson) can be attributed to all of the trustees.

[67] The definition of "Customer" relied on does not apply if the "context otherwise requires". There are a number of respects in which the context plainly does "otherwise require". For instance, entirely separate credit facilities made available to individual trustees in capacities unrelated to their roles as trustees or conduct of individual trustees in relation to such facilities could not be attributed to the trustees collectively. This encourages me to think that in the core provisions of those General Terms and Conditions, "Customer" applies to the trustees collectively. On that basis I am inclined to construe the General Terms and Conditions contra proferentem especially as the particular problem the bank is seeking to address (ie lack of authority on the part of the trustee dealing with the bank) is specifically addressed in the Deed of Guarantee and Indemnity.

[68] On the arguments of the Bank and the slightly different approach suggested by Chambers J, there remains a significant question as to the relief to which the Bank is entitled. If the warranties and representations are worked through, the consequence may be that the trustees collectively warranted the authority of Mr Davidson to

commit them to the third letter of credit. This, however, was not the argument which was advanced on behalf of the Bank

[69] The argument that was advanced was that the bank was entitled to damages on the basis that that it issued the third letter of credit by reason of the breach of warranty/misrepresentation. Damages were sought on a detriment basis. Had Mr Davidson's conduct been discovered earlier, the third letter of credit would not have been issued. But the impact of the discovery is likely to have resulted in a break-down in the relationship with the Bank. This in turn is likely to have precipitated the collapse of Leisure Corp Holdings Ltd. In this context, it is not obvious that the bank would have been cleared of its exposures which, ex-hypothesi, would have been current at the time. Detriment damages in this context require an assessment of the situation as it panned out as compared to the hypothetical situation which would have resulted in the absence of the breach of warranty/misrepresentation. There was, on my appreciation, insufficient evidence of the hypothetical situation to enable damages to be assessed, at least on the basis contended for by the Bank.

[70] If I thought that the trustees were liable to the Bank for breach of warranty/misrepresentation, I probably would have been prepared to assess damages on a broad-brush basis. Given that I am against the Bank on the construction question, however, there is no point going into this issue in any further detail.

CHAMBERS J

[71] I concur in the outcome of the appeal, but desire to add a few thoughts, particularly on the first ground of appeal.

The contract cause of action

[72] ASB Bank Limited originally brought five causes of action against the Aquatic Trust. At the hearing before Laurenson J, ASB advised that it did not pursue two of those causes of action: 7 NZBLC 103,927 at [5]. That left three

causes of action. ASB lost on two of those, but won on the third – unjust enrichment. In respect of that cause of action, the trust was held liable to ASB for $50,000. The trust's cross-appeal against that judgment has now been abandoned. According to Mr Dale, that judgment sum has been paid.

[73] ASB did not appeal with respect to the first cause of action against the trust on which it lost. I express no view as to whether ASB's loss on that cause of action was justified. This is not a matter before us. ASB appealed only against its loss on the second cause of action. This was a cause of action for breach of contract. ASB alleged that the trustees failed to advise it "that the issue of the initial standby letter of credit was not authorised by [them]": see second amended statement of claim ("Claim"), para 28. The "initial standby letter of credit" there being referred to was the initial standby letter of credit in favour of the Bank of New Zealand for $120,000: see Claim, para 27, particular A.

[74] The obligation so to advise the ASB was said to arise from:

> (a) clauses 3.1 and 3.2 of the General Terms and Conditions (set out in Glazebrook J's judgment at para [12][b] and [c]); and
>
> (b) an implied term to the effect "that the [trustees] would advise [ASB] in the event they became aware of circumstances indicating the facilities held by or in the name of the Trust with [ASB] were being operated in an unauthorised manner".

[75] I am not quite sure why ASB relied on this alleged implied term when there was an express term requiring such notification, which express term had in fact been pleaded earlier in the Claim: para 8(e) and (f). The express term was clause 4.1(a) of the General Terms (again set out in Glazebrook J's judgment at para [12][d]). Laurenson J appears to have treated this pleading of the implied term as if it were the pleading of clause 4.1 and I shall do likewise.

[76] ASB pleaded that, as a result of the trustees' failure to notify the bank of the unauthorised nature of the initial standby letter of credit, it had proceeded to issue the third letter of credit, in respect of which it had not been reimbursed.

[77] Laurenson J found against ASB on this cause of action because he found as a matter of fact that neither Mrs Davidson nor Mr Alderslade was aware of Mr Davidson's unauthorised application for the initial standby letter of credit or of its subsequent issue. His Honour accordingly considered that the trust could not be liable in view of the fact that two of the trustees were not aware of the wrongful conduct of the third.

[78] I think it distinctly arguable that it did not matter that Mrs Davidson and Mr Alderslade were not aware of what Mr Davidson was doing. There is an argument that the contract with ASB was breached when Mr Davidson, one of "the Customers", failed to "notify the Bank of the occurrence of [a] Cancellation Event". The Cancellation Event pleaded was clause 5(c), as set out in Glazebrook J's judgment at para [5][e]. Mr Davidson made a statement in connection with a facility which he knew not to be true and accurate: that was the statement that the trust sought the initial standby letter of credit, when he knew that the other trustees knew nothing of it. He had the obligation to notify the bank of that untrue statement; that obligation was breached; the trust's contract with the bank was thereby breached; because of joint and several liability, the trust is liable for loss flowing from his breach.

[79] Such an argument appears to be open on the original pleadings (with one amendment, inserting the express term, clause 4.1(a), for the pleaded implied term to very similar effect). But, despite the pleadings, the argument does not appear to have been put that way to Laurenson J, and it certainly was not advanced in that way to us. Although I think there is considerable merit in the argument, it would not be appropriate to allow ASB's appeal on a basis which was not argued.

[80] Mr Kennedy advanced his argument on the basis that the obligation to notify ASB of a Cancellation Event arose only if all three trustees were aware of it. Mr Kennedy was compelled to accept that there was no proof that Mrs Davidson and

Mr Alderslade were in fact aware of the Cancellation Event. His argument had to be that Mrs Davidson and Mr Alderslade were deemed to have become aware of the Cancellation Event by virtue of certain bank statements sent to the trust. I agree with Glazebrook J that constructive knowledge of Mr Davidson's wrongdoing does not suffice to trigger the obligation to notify.

[81] I reject Mr Kennedy's argument on this first ground as formulated before us. ASB's claim under this cause of action must therefore fail.

The guarantee cause of action

[82] ASB sued Mr and Mrs Davidson on the guarantee they had given: see Claim, paras 45-47. ASB failed on this cause of action because Laurenson J found that the trust was not indebted to ASB: 7 NZBLC 103,925 at [70]-[72]. Laurenson J also found that Mr and Mrs Davidson were not liable under the "indemnity" clause, clause 2.3. Glazebrook and William Young JJ have held that his conclusion in that respect was in error.

[83] Had the trustees been found jointly and severally liable on the contract cause of action, as I have tentatively suggested they might have been, then it would be clear that Mr and Mrs Davidson would also have been jointly and severally liable under their guarantees. That liability would have stemmed from the obligations they severally undertook under clauses 2.1 and 2.2 of their respective Deeds of Guarantee and Indemnity, clauses in fact pleaded by ASB.

[84] But we have found that the trustees were not liable on the contract cause of action. The only relevant clause can be clause 2.3. On that topic I agree with the reasoning of Glazebrook J.

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