

# INSIGHT



**ISSUE 007:** March 2009 **Philippa Fee**

## Professional Liability

### “Fiduciary Agents” and the “Narrow Escape Route” – The Supreme Court *Premium Real Estate* Decision

The series of decisions, from the High Court to Supreme Court, in this long running dispute has received considerable media publicity, and will doubtless be subject to much academic debate. This article focuses on one of the many issues thrown up by the decision, namely proof and quantum of loss when a fiduciary breaches a duty of loyalty.

#### Facts

Mr and Mrs Stevens owned a property in Beach Road, Torbay. The property was listed with Premium Real Estate in February 2004. The neighbouring property, which was on a larger section, had a tennis court and was not a unit title, sold in September 2003 for \$3.2m. Premium appraised the property as having a value of mid to high \$2m.

The Stevens initially wanted \$3m for the property. In April 2004, Mr and Mrs Stevens signed a conditional agreement to purchase a property in Parnell which was subject to a condition which allowed the Stevens to back out of the agreement if they did not sell their property in Beach Road for \$3m, or such other lesser sum as they may agree to.

By early March, the Stevens reduced their expectations to \$2.8m. After a substantial marketing campaign, the only offer received was for \$2.2m. The Stevens counter-offered at \$2.8m.

At this point, the Stevens put the property up for sale by tender and the only tender received was from a Mr Larsen. The tender price was \$2.52m and the Stevens counter-offered at \$2.57m. A deal was struck and the property was sold in July 2004.

Immediately Mr Larsen carried out renovations to the property and placed it on the market. He conducted an extensive marketing campaign overseas and in

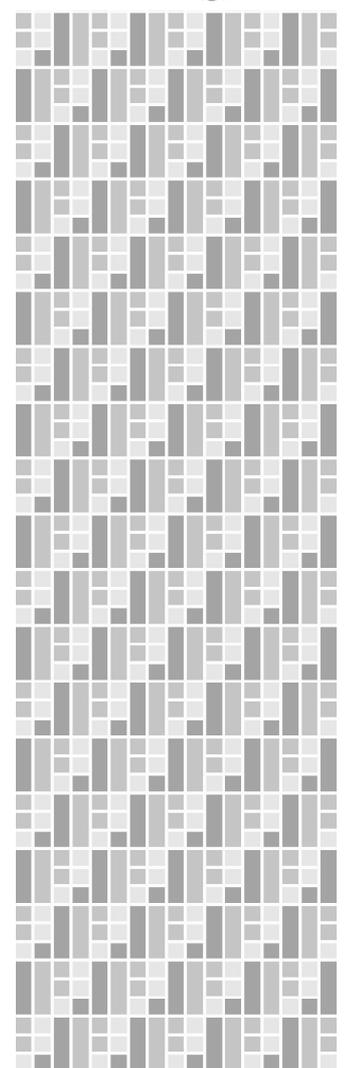
November 2004 he sold the property to an overseas buyer for \$3.55m, netting him a handsome profit of close to \$1m.

Had it not been for several crucial facts, this transaction would be unremarkable. After Mr Larsen on-sold the property the Stevens discovered that the real estate agent at Premium who brokered the sale had acted for Mr Larsen a number of times, had a personal connection with him, and that Mr Larsen bought and sold properties to make a profit. His *modus operandi* was to pretend that he was going to live in the property to the vendor, but having bought the property he would then upgrade it, market it extensively and make a considerable profit on the sale. The agent's mistake was not only in failing to tell the Stevens that Mr Larsen was a speculator but, more importantly, by aiding Mr Larsen's duplicity by telling the Stevens' that Mr Larsen and his wife wanted to buy the property to live in it so that they could be closer to Mr Larsen's place of business on the North Shore.

There was one thing on which all the judges in all of the courts agreed. They found a breach of the duty of good faith on Premium's part in failing to disclose material information to the Stevens. None of the Courts found Premium's appraisal or method of marketing to be a breach of the Fair Trading Act, negligence or a breach of contract.

#### Loss

One of the intriguing aspects of the case is the widely divergent views the judges reached on the question of what is the loss resulting from the breach of fiduciary duty, both as to its characterisation and quantum. It was this issue which divided the Court of Appeal from the other courts, and divided the Supreme Court itself.



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## High Court Approach

Courtney J asked first-off, before determining any other issue (such as whether there had been a breach), what was the value of the property in April 2004?

At the trial, as you would expect, there was evidence from a number of valuers as to what the property was worth. The range of values was between \$2.7m and \$3.6m. The Judge examined these valuations and favoured the valuation of one valuer over the others. She determined that the market value was \$3.25m. However, she found that it was not negligent of the real estate agent, and not a breach of the Fair Trading Act, to form the view on value that he did, namely that the value was in the mid to high \$2m.

Courtney J ordered damages to be paid by Premium in respect of the Fair Trading Act cause of action in a different sum to that under the fiduciary duty cause of action. Because the Court is able to assess Fair Trading Act damages on a broadly discretionary basis, she deducted 50% to reflect that Premium's non-negligent appraisal had an actual causative effect on the Stevens' conduct. While no one would object to a deduction from FTA damages for the plaintiff's contributory negligence, it is hard to see why a plaintiff should get less than full compensation for loss simply because there were other factors (not its own conduct) which lead to the loss occurring.

Be that as it may, the court said that had the Stevens been told that Mr Larsen was a speculator this would have led to "nervous consideration" of the proposed sale [para 106]. It was information which would have "affected their view of the offer". But instead of assessing damages on the basis of the affect on the sale price, the court ordered Premium to pay damages calculated on the difference between the property's "market value" and the sale price, namely \$675,000. This was a surprising result, given that the Stevens intended to sell the property and the information that Mr Larsen was a speculator would have been relevant (at most) to the price. Knowing that a purchaser is a speculator would lead most people to conclude that the price offered is likely to be lower than someone else, who is not a speculator, would offer. But it would not ordinarily result in the sale being put off.

The court ordered Premium to pay damages based on a value far in excess of the price offered by anyone during the lengthy sale process.

## Court of Appeal

The Court of Appeal described Justice Courtney's findings on the crucial question of what would the Stevens have done had they known the full facts as "unclear". Unlike Courtney J, the Court of Appeal was not drawn to conclude that the Stevens would have kept the property and abandoned their idea of buying in Parnell. The Court of Appeal noted that there was ample evidence that the Stevens were more likely to have held out for a higher price and ultimately sold the property for \$2.8m.

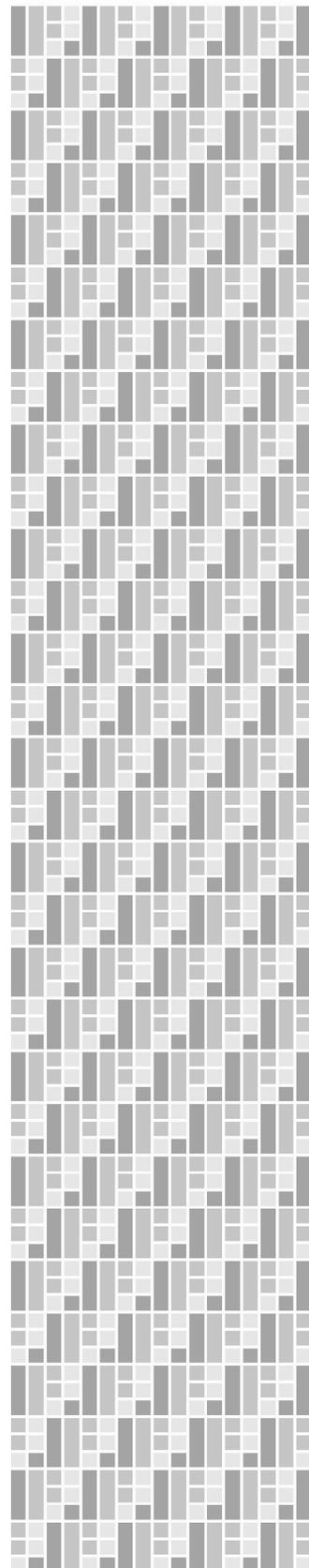
The decision includes no reference to the onus of proof being on either the plaintiff or defendant. Which of the two possible outcomes, namely whether the Stevens would have retained the property or sold it for \$2.8m, are weighed to determine which is more likely. The Court of Appeal concluded that there was no evidence establishing that the Stevens would have refused to sell at all. Instead, the Court was persuaded to limit the damages to the price at which the Stevens were going to sell the property, untainted by the impugned conduct. That meant that the damages ordered reduced to a more modest \$225,000.

## Supreme Court

The final stage for all parties was of course the Supreme Court. While the outcome was broadly similar to that of the High Court, the method of getting there was different.

The Supreme Court was more strident in its criticism of Premium's conduct. On this point the Supreme Court was united. Instead of characterising the conduct as a failure to disclose material information, it was described as positively misleading and assisting Mr Larsen in his duplicity by lying to the Stevens.

While the Supreme Court agreed with the Court of Appeal that the evidence did not establish that the Stevens would have kept the property, the majority found that the Court of Appeal "approached the quantum of loss arising from a fiduciary breach in the wrong way and arrived at the wrong figure" [para 84].



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The majority said:

*“Policy dictates that fiduciaries be allowed only a narrow escape route from liability based on proof that the loss or damage would have occurred even if there had been no breach”*

This exacting test applied to both causation and quantum.

*“The onus is on the fiduciary to demonstrate that the Plaintiffs’ loss was actually less (or nonexistent). If there is any doubt about that the doubt should be resolved against the fiduciary.”*

The majority found that the Court of Appeal’s reference to “likelihood” made it clear that the Court of Appeal was seeing proof as established on the balance of probabilities. It was not applying “the reverse onus” which Premium had to “discharge with rigour”. To my knowledge this is the first time that the court in New Zealand has described the onus in such a way. The decision of the Court of Appeal in *Gilbert v Shanahan* [1983] 3 NZLR 528 did not find that there was any such onus of proof. Rather, the court said that there must be “a proper evidential foundation for the conclusion” which “should be cogent and ....not lightly reached”. The Supreme Court was also prepared to take into account the part that Premium had played in reinforcing the Stevens intention to sell at \$2.8m by its incorrect (although not negligent) appraisal.

The minority decision of Elias CJ is refreshingly pragmatic in a number of respects. Firstly she makes the point that when assessing the property’s value, Courtney J seems to have seen her task as to prefer one valuer over another.

*“I do not think such an approach, which starts and ends with the opinion evidence, is adequate here. Opinion evidence of market value is a proxy for the market. Very often it is the only evidence available. Such opinions, particularly those reconstructed after the event, inevitably turn on judgments and impressions which legitimately vary...Often such opinions cannot be tested. But here, the opinions can be tested against the experience with the market”. (Para 20).*

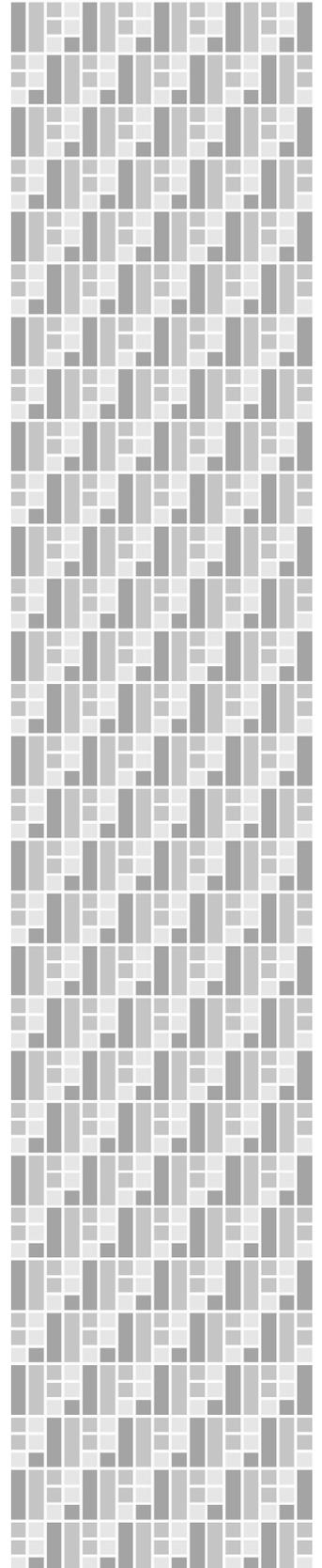
As the courts have commented on in the past, there will never be only one value, but only a range of values which a willing buyer and willing seller will pay and accept. In the Premium decision, there was actual evidence of what the market was prepared to pay for the property (no more than \$2.57m). The market evidence did not substantiate a value of \$3.25m.

Elias CJ’s approach to the onus of proof is also starkly different to the majority. She found that the burden on the defendant was an “evidential rule which arises when the plaintiff has demonstrated loss caused by the breach but the defendant seeks to attribute the loss in whole or in part to another cause in circumstances where proof is difficult and shifting the onus meets the justice of the case”. She rejected the “narrow escape route” to be “policed with vigour” test expounded by the majority, but like any civil case, said the onus must be discharged on the balance of probabilities.

Elias CJ formulated the Stevens’ loss not as a loss of the property (which the approach taken by the High Court and the majority of the Supreme Court) but a loss of an opportunity to obtain a higher price. The Judge considered what shaped the Stevens’ attitude as vendors and said there was ample evidence to establish that they would have sold the property for \$2.8m even if properly informed.

## Comment

The approach taken by Elias CJ, and the Court of Appeal, seems to be both more logical and more appropriate given the facts. There is no doubt that the Stevens wished to sell, and did voluntarily sell. The loss caused by Premium’s failure to tell the Stevens that Mr Larsen was a speculator was the extent to which a higher price could have been obtained had this information been known. What this higher price would have been can never be known with certainty, but the court has to do its best to determine what is likely to have occurred. In this case the court’s job was made easier by the fact that the evidence established the price the Stevens were happy to sell the property for in an earlier untainted transaction.



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But of course the Supreme Court is the final word on this question. There is now a high onus of proof set for fiduciaries that breach the duty of loyalty to prove that the loss would have occurred in any event. The Stevens achieved damages calculated on a “sale” price in excess of any market offer and in excess of what they themselves were prepared to sell the property for.

This is a sobering outcome for all professionals bound by fiduciary duties. Where a fiduciary actively misleads by telling lies to its client, then perhaps such a harsh outcome is justified. But had the Court wanted to punish Premium it should have used punitive, not compensatory, damages to do so. Most allegations of breach of fiduciary duty involve innocent (albeit negligent) mistakes or errors of judgment. It is frequently difficult for professionals to balance competing clients’ interests and to do what the law requires. The majority decision in the Supreme Court in Premium may just make a professional’s life a little bit harder.

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