Privy Council Appeal No. 50 of 1992

Ryde Holdings Limited *Appellant*

v.

Rainbow Corporation Limited *Respondent*

(and Cross-appeal)

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 15TH NOVEMBER 1993

Present at the hearing:-

LORD KEITH OF KINKEL
LORD GRIFFITHS
LORD GOFF OF CHIEVELEY
LORD JAUNCEY OF TULLICHETTLE
LORD MUSTILL

*[Delivered by **Lord Mustill**]*

This appeal from three judgments of the Court of Appeal of New Zealand shows how a court, required by prior decision to apply a strict rule of law or equity to an artificial transaction far removed from those in relation to which the rule was developed, can be compelled to results which are capricious and in some cases absurd. This is no criticism of the tribunals from which the present appeal is brought. Throughout nine lengthy hearings following upon a deceptively simple order for the taking of an account of profits an arbitrator, the High Court, the Court of Appeal and finally this Board have struggled to apply logic and arithmetic to a series of transactions whose only logic was that of tax avoidance and market flotation, and whose conception and execution had little to do with arithmetic. The result has been that in addition to two issues of law and another of procedure there are before the Board six questions relating to the method by which the amount which the plaintiffs are entitled to recover should be computed. These are peculiar to the present case, and are of no general interest, but they have to be solved before the appeal can be determined. Permuting the suggested answers has led to a multiplicity of solutions - the Board has seen at least 20 figures, and no doubt

others have been put forward along the way - occupying almost the whole of the range between zero and NZ$5,000,000.

The transactions in question were complex and informal. Even now, after five years of litigation, some important aspects remain hidden from view. The rest are comprehensively described in the first of the judgments delivered in the present case, and since this is reported (*Ryde Holdings v. Sorensen* [1988] 2 NZLR 158) there is no need to set out here more than the barest outlines of what took place.

I. THE TRANSACTIONS.

Rainbow's End Limited ("Rainbow's End") was the wholly owned subsidiary of Rainbow Corporation Limited ("Rainbow"). Rainbow's End owned and operated a leisure park near Manaku City. Amongst the attractions was an arcade of video games machines which made good profits. A group of financiers had the disposal of large tax losses which they wished to marry with equivalent taxable gains. The video machines at Rainbow's End were selected as a convenient source, and a plan was made which called for a new company wholly owned by the financiers and subsequently re-named Ryde Holdings ("Ryde"), as a vehicle for bringing the losses and gains together. The plan as executed had the following features:-

1. Ryde purchased the video machines from Rainbow's End for a price of $460,850. It is not known how this price was fixed. It was more than twice the true value of the machines.

2. Rainbow's End allowed the machines to remain at the amusement park and operated them on Ryde's behalf. For this service they charged Ryde 5 per cent of the takings plus $200-250 per month on account of "salaries". These sums, (hereafter "the nominal expenses") were much less than would have been charged in an arms-length transaction. The evidence does not disclose how they were arrived at.

3. Ewoch Three Limited ("Ewoch") was a "shelf" company. Rainbow held 87.35 per cent of its share capital.

4. Rainbow lent $460,850 to Ewoch which lent it on to Ryde to enable it to purchase the machines from Rainbow's End.

5. The loan by Ewoch to Ryde was on the terms of a "floating rate debenture" the interest on which was 85 per cent of Ryde's revenue from the machine, net of the nominal expenses.

6. The debenture provided that whilst Ewoch could call for repayment of the advance on 31st [sic] April in any year on seven days notice Ryde had no right to repay before 31st April 1991.

The reason for the provisions for terminating the loan is clear enough. The entire purpose of the venture was to save tax by a device which could not be guaranteed to succeed. If it worked, the initiators of the scheme would be able to keep it in existence for long enough to write off the tax losses against the anticipated profits of the machines now taken through Ryde; whereas if the tax advantage did not materialise the scheme would have lost its purpose and should be brought to an end by the calling in of the loan. Meanwhile 82.35 per cent of the 85 per cent payments (i.e. just short of 70 per cent of the whole) would find their way back to Rainbow via its interest in Ewoch.

In the event this composite transaction, which made no commercial sense except as a tax avoidance scheme, was successful to the extent that for the part year ended 31st July 1985 the Inland Revenue Department accepted that the tax losses could be set against the assessable income of Ryde. Whilst the Revenue could not be guaranteed to take the same stance in future years there must have seemed a reasonable chance that the Ewoch/Ryde relationship would be kept in being until the tax losses had been used up, or the machines had become obsolete or defunct.

It was not long however before events took a new turn. First, the depreciation on an expensive new attraction, together with heavy interest charges, gave Rainbow sufficient expenses of its own to set against the profits from the machines, without the need to offset the external losses under the tax avoidance scheme. Secondly, the management of Rainbow had conceived an ambitious proposal to bring together the leisure interests of Rainbow and KTUW in a company later named Questar. For this purpose it was necessary to bring the substantial earning capacity of the video machines back into hand. Accordingly, Mr. Sorensen, who was a director of Ryde, was instructed by an executive director of Rainbow to "unwind" (as it was put) the tax avoidance scheme. This he did, in a manner which cannot be precisely reconstructed. What is clear however is that the "unwinding" operation involved a sale of the video machines back to Rainbow's End at book value, and a repayment of the Ewoch loan. This repayment was made, contrary to the terms of the debenture, part-way through the year and without the necessary notice. The resale of the machines to Rainbow's End took place without the authority or even the knowledge of the directors of Ryde.

Meanwhile, negotiations had been taking place for the sale to Questar of Rainbow's undertaking, which by now included or was due to include the video machines. The consideration for the sale was stated to be $20.3 million. The two major components of this figure were some $14 million in respect of "fixed assets at cost", and $5 million for "goodwill". Their Lordships must return to the

figure of $5 million. For the moment it is enough to say that it was based on an estimate of future profits. The transaction duly went ahead in this form. Questar was nominated as purchaser of the video machines under the re-sale agreement and thereafter the video machines were operated as one of the elements of Questar's amusement enterprise. The formal agreement for the sale to Questar was dated 6th June 1986.

When the shareholders of Ryde discovered what had happened they brought an action against Mr. Sorensen and Rainbow, alleging that the former, as a director of Ryde, had acted in breach of trust in re-selling the machines without authority, and that Rainbow was liable for bringing about this breach. The action was tried by Hillyer J. who found in favour of Ryde,and made the order for an account on which all the numerous subsequent hearings were founded.

It is important at this point to emphasise the nature of the wrongful act alleged by Ryde and of the relief granted in respect of it. In purely commercial terms the conduct of Rainbow could be seen as a ground for complaint in two different respects.

First, there might be a complaint by Ryde that its property in, and constructive possession of, the machines had been wrongfully taken away by the sale to Rainbow's End. This would found a proprietary claim in tort, and the remedy would be damages equal to the financial loss suffered by Ryde. The resulting recovery would be small. True, Ryde had lost the capital value of the machines, but it had received in return their book value which was more than the machines were worth. It had also lost the opportunity to retain 15 per cent of the revenue for as long as the promoters decided to keep the scheme in existence. Whilst it lasted this was a valuable right, since the cost of earning the revenue was only the artificially low nominal expenses. But the scheme was vulnerable to the right of Ewoch to call in the loan at the year-end. Since Ryde had insufficient assets from which to satisfy the demand this would have meant the end of the scheme, and of Ryde's 15 per cent participation in the inflated profit, unless it could obtain capital elsewhere. Thus, the effect of the "unwinding" was to deprive Ryde of no more than one year's certain participation in the profits. Moreover the unwinding also had the effect of relieving Ryde of the overhanging debt to Ewoch which it had no present means to repay. It is hard to see how in these circumstances Ryde had suffered more than a comparatively small loss, if indeed any loss at all.

There was however a much more realistic ground for complaint, not by the puppet company Ryde, but by the promoters of the tax avoidance scheme which used Ryde as its instrument and which had been cancelled without their consent. At the trial Hillyer J. held that the scheme had been in the nature of a joint venture, and rejected a

contention that it was subject to an express or implied term that it could be dissolved at any time at the option of any participant. On this view it would appear that the remaining participants in the joint venture would have a strong, and indeed perhaps unanswerable, claim against Rainbow for breach of contract, or perhaps for inducing a breach of contract. The damages would reflect the real loss resulting from the wrongful "unwinding", namely the loss to the other participants of the opportunity to share in the tax advantage throughout the intended lifetime of the scheme. It is unnecessary to consider precisely how the recovery would have been computed since, so far as the Board is aware, no claim on this basis was advanced in these proceedings. Instead, there was the claim for breach of trust, which the trial judge accepted, and which led him to make the following order:-

> "THIS COURT
>
> a) Declares that when the undertaking of the plaintiff was transferred to Rainbow's End Ltd. then to the second defendant or its nominee the first and second defendants held such undertaking as trustees of the plaintiff, and are liable to account to the plaintiffs for the profits which they or either of them have or will have made by disposing of such undertaking.
>
> b) Orders that the amount of such profits be determined by enquiry."

Later a consent order provided that:-

> "3. G P Barton Esq, of Wellington Barrister be appointed arbitrator under section 15 of the Arbitration Act 1908.
>
> 4. That Dr. Barton determine by way of enquiry under section 15 of the Arbitration act 1908 the following questions as between the parties:
>
> (a) What profit (if any) did either defendant make from the transactions involved in the sale of the assets included in the agreement for sale and purchase dated 6th June 1986 between Rainbow's End Limited and Rainbow Corporation Limited, and if there was a separate sale to Questar Limited by either, the sale to Questar Limited.
>
> (b) What proportion of such profit (if any) should either defendant account to the plaintiff for.
>
> (c) Having regard to the answers in questions (a) and (b) what sum (if any) including interest (if any) should either defendant pay to the plaintiff."

There was no appeal against the decision of the trial judge. If there had been, it might have led to close scrutiny of the nature of the trust property, and of the

declaration that the defendants had wrongfully made away with the "undertaking" of Ryde. This might in turn have prompted an explicit statement of what exactly Dr. Barton was required to investigate. In the event however the arbitrator set about performing the very difficult mandate entrusted to him with no more guidance than the orders just quoted.

Before their Lordships describe how the arbitrator, and subsequently the courts, set about this task two preliminary observations may be in order. First, if Rainbow had kept the misappropriated machines for itself the profit for which it had to account would have been measured either by the value of the machines less the amount paid for them (namely a net profit of nil) or alternatively the capitalised value of the future profitability of the machines, again less the price paid for them. Ryde could not have held Rainbow liable for both measures of recovery and would no doubt have chosen the latter. This choice would require the arbitrator to arrive at - (a) an estimate of the future earnings of the machines throughout their useful lifetime, and (b) an estimate of the true costs (not the nominal expenses) of operating the machines in the Rainbow's End park. The arbitrator would subtract one figure from the other and capitalise the profits, making an allowance for advancement. The exercise might be difficult, especially in view of the apparent paucity of the records, but would be of a perfectly familiar nature and would yield a result which made real commercial sense. In the event however Rainbow realised the profit from its wrongful act, not by selling the machines for their true value, or by operating them for its own account, but by selling them on to Questar as part of a package, the price of which was more or less directly related to the projected profitability of the entire leisure enterprise including the machines. It has been assumed throughout these proceedings that the account must be taken on the basis that the duty of the arbitrator was to discover how much of the price, and in particular how much of the "goodwill" element of $5 million, was attributable to the profitability of the machines. This required the arbitrator to perform on behalf of Ryde an appropriation of the price agreed between Rainbow and Questar between the various elements of the goodwill figure which those two parties had never performed at the time. It is now far too late to question whether this assumption was correct, but the conscientious attempts of all concerned to carry through its implications have meant that disputes were bound to arise, not only on questions of fact and computation, but also as to the methods by which the arbitrator was to arrive at his award. These disputes duly materialised, and after many hearings have arrived unabated before the Board.

Secondly, it is essential to appreciate that all the figures which form the bedrock of the account were - (a) negotiated or voluntarily fixed, and not computed, and (b) either much too high or much too low. The machines were sold to Ryde for more than they were worth, and resold again for

more than they were worth. The profit divided between Ryde and Ewoch in the proportions of 15 to 85 was artificially inflated by the fact that the nominal expenses charged against the earnings were lower than the true overheads. Furthermore, the profitability attributed to the machines during the negotiations with Questar can in retrospect be seen to have been over-optimistic. Thus although an order that an errant trustee shall account for the profits from his wrongful act may often yield to the beneficiary a recovery disproportionate to his actual loss, this disproportion is greatly exaggerated in the present case by the fact that in the original transactions the worth of a useful but modest capital asset was artificially multiplied and multiplied again. It is this fact which accounts for the breath-taking size of the figures claimed by Ryde. For example, its expert witness Mr. Chisholm advanced with some appearance of plausibility a calculation which yielded a recovery of $3,342,500, and at a later stage there were numerous other figures in the range between $1 million and $3 million. For reasons to be stated their Lordships reject these as unsound, but even the altogether more realistic sum of about $460,000 preferred by the Court of Appeal still appears, once allowance is made for the fact that Rainbow paid Ryde for the machines on their wrongful re-sale, surprisingly out of proportion to their true worth. The fact remains however that once the arbitrator and the court set out on the task prescribed by the unchallenged order for an account the principles must be observed, however out of tune with common sense the result may appear.

II. THE ISSUES OF APPORTIONMENT

The artificial nature of the accounting exercise on which the arbitrator and the courts have been engaged during the past five years has inevitably given rise to controversy about every aspect of the computation. Disputes have arisen concerning the propriety of making any apportionment of the $5 million goodwill; the choice of the general method for making whatever apportionment is attempted; the choice of the numerator of the fraction which is applied to the $5 million goodwill; the choice of the denominator of that fraction. With two exceptions these questions are of no interest to anyone but the parties themselves, who have come to understand them only too well. Nevertheless, since the Board is called upon to resolve the dispute and to give reasons for its conclusions, some brief account must be given to enable the reader to understand both the unhappy course of the litigation and the bewildering array of figures which at one stage or another have been put in contention. For this purpose the Board will adopt the informal labels given to various issues in the course of the proceedings and add one or two of their own.

A. The feasibility of apportionment.

1. The "Full Recovery point".

Given the paucity of evidence and contemporary documentation adduced by Rainbow before the arbitrator, is the right course to conclude that an apportionment of profits is impossible and, by applying a presumption against the defaulting trustee, award to Ryde the entire $5 million attributable to the projected profits of the whole leisure park enterprise?

B. The principles of recovery.

1. The "Ewoch Dividend point".

(a) Is the correct approach to value the profits of the misappropriated undertaking of Ryde without reference to the identity of the defaulting trustee? Or should the calculation reflect the betterment of Rainbow's financial position consequent on the breach of trust?

(b) If the latter, should the award reflect the fact that before the breach of trust Rainbow was already receiving (or at least was entitled to receive), by virtue of its shareholding in Ewoch, dividends equivalent to 70 per cent of the revenue from the machines (net of the artificially low nominal expenses)?

2. The "Turnover point".

(a) Given that the budget projection which founded the goodwill figure of $5 million did not distinguish between the costs attributable to the various attractions, and hence assumed a profitability net-for-gross at the same rate for the video machines as for all the other attractions, should the apportioned fraction compare the respective turnover of the machines and the entire enterprise, or should an attempt be made to estimate what profitability would have been attributed to the machines if the parties had chosen to negotiate in this way?

(b) Was it open to Rainbow to contend that the comparison should be based on turnover?

2. The "Rough Compromise" point.

Was it open to the arbitrator to arrive at a solution by making a compromise between various plausibly derived figures so as to arrive at a just approximation; and, if so, did the arbitrator's original award achieve a just approximation?

C. The choice of numerator

Many questions arose on the choice of numerator for the fraction which must be applied to the total "goodwill" of $5 million to arrive at the portion representing the anticipated profitability of the video machines. Of these the following were the more important:-

1. The "15 per cent point".

Given that before Rainbow's wrongful act Ryde had retained only 15 per cent of the earnings (after deduction of the nominal expenses) should the fraction be based on the entire projected earnings for future years or only on 15 per cent thereof?

2. The "Foreign videos" point.

This odd expression has been used to denote a contention by Rainbow that some of the videos at Rainbows End had not formed part of the sale to Ryde, and that accordingly the earnings from them should be left out of account when computing the part of the $5 million attributable to the machines wrongfully taken by Rainbow.

3. The "Nominal Expenses" point.

When carrying out a computation which involved the use of net profits rather than revenue should the profits in the numerator of the fraction be calculated by reference to the nominal expenses charged to Ryde, or on some other basis?

D. The choice of denominator.

"The March/August point".

Should the estimate for the forecast profits be based on a budget prepared in March 1987 or a budget prepared in August 1987?

There were, in addition, numerous subordinate questions, both of method and accounting, relating to both the numerator and the denominator of the fraction. To resolve them would require rehearing, on the basis of documents, written evidence and transcripts of the entire proceedings before the arbitrator and probably also of some aspects of the full hearing before Hillyer J. This task would not be appropriate to a final appeal, and the parties did not invite the Board to perform it. The Board will therefore consider only the questions summarised above, and will use as raw materials only the figures and evidence specifically drawn to its attention, without further burdening a long judgment by detailed explanation.

Before addressing these questions their Lordships must first summarise the long, and in some ways strange, procedural history of this unhappy dispute, and then consider whether the court had the power to interfere, as it did on three successive occasions, with the award of the arbitrator.

III. THE PROCEEDINGS

The arbitrator heard evidence and submissions for nine days. Shortly put, his resulting award ("the First Award") was to the following effect. After considering various reported cases he rejected the argument of Rainbow (on the Full Recovery point) that a rational apportionment was impossible and went on to hold (on the Rough Compromise point) that "the conclusion, supported by the authorities ... is that one should aim for the nearest approximation which [one] can make to justice". When arriving at the figures which appear to have been the basis of his approximation the arbitrator dealt with the question of method as follows. Whilst not discussing the Turnover point, the arbitrator assumed that the apportionment should be made on the basis of the relative profits from the machines and from the leisure business as a whole, and thereby assumed that it was proper and feasible to project backwards to the date of the sale an assessment of the relative rates of profitability of the different elements of Rainbow's business.

As regards the 15 per cent point the award touches only obliquely on the argument of Rainbow that since Ryde was retaining only 15 per cent of the income from the machines before they were wrongfully resold to Rainbow, this limited income should form the numerator in the apportionment factor, but the award at which the arbitrator ultimately arrived is consistent only with his having rejected it.

The Foreign Videos point is not discussed in the award, but most of the figures cited contain no allowance for the possibility that some of the machines at Rainbow's End were not the subject of the original sale to Ryde.

The arbitrator did not discuss the Nominal Expenses point, but in an important paragraph of the award he employs a figure of $691,000 as a starting point for alternative apportionments of $1,091,306 and $1,532,237. This figure charged against the gross income only the nominal expenses. Given the size of the figure which the arbitrator ultimately awarded it seems that he must have accepted Ryde's submissions on this point.

Turning to the denominator for the apportionment fraction, an important choice (the March/August point) was to be made between figures drawn from two sources. The first was a "Negotiation Budget" for the year to 31st March 1987. This set out the projected income and expenses for Rainbow's activities as a whole, in three columns representing Rainbows End, Puttersland Holdings Limited

and Investment Division. Puttersland Holdings was the operator of some of the minor attractions and the Investment Division represented income flows which had not at the time been separately identified. This document yielded a figure of $1,174,000 as the anticipated net profit before tax of Rainbow's End.

The second important document was a forecast budget for the year to 31st July 1987, said to have been presented to the Board of directors of Questar on 26th August 1986. This showed a profit for the year of $512,000. According to the evidence of Mr. Chisholm (one of Ryde's expert witnesses) he had been able to deduce that the parties had been working on an estimated net profit after tax of $538,000, which compared well enough with the August 1986 figure of $512,000. As their Lordships understand his First Award, the arbitrator reasoned that, since the task is to assess the proportionate contribution of the Ryde assets to the total "goodwill" of $5 million it is right to take the profitability of the Ryde assets as it was forecast to be at the time when the deal was done. The general tenor of the award shows that the arbitrator must have chosen the March budget for this purpose.

Thus far it is possible to deduce the reasons of the arbitrator, but what cannot be made out is the final step which led him to his decision on the account of profits, of which the only explanation given is as follows:-

> "79. Consideration and reconsideration of the detailed evidence and argumentation of the various expert witnesses lead to the conclusion that the nearest approximation which this arbitrator can make to justice is to award the sum of $1,750,000 as the amount for which Rainbow should account to Ryde in accordance with the judgment of the High Court."

Rainbow were dissatisfied with this award and moved to set it aside. Hillyer J. granted the application and remitted the case to the arbitrator. The learned judge added a direction, which it is unnecessary to describe in the light of the subsequent history of the matter, as to the way in which the arbitrator should deal with the 15 per cent point. Both sides appealed. The judgment of the court on this appeal ("the First Appeal") made the following points:-

1. The first award contained two clerical errors. First, on one of the occasions when the arbitrator stated the figure of $691,670 (see above) he had written $591,670. Second, he had written for one of the alternative results of computation the figure of $1,910,306 instead of $1,091,306. These must be put right.

2. The clerical errors might, for the following reason, have had an important effect on the train of thought

which led the arbitrator to a figure of $1.75 million. One of the calculations deployed in the award involved the application to the total $5 million of a fraction which had as its numerator the estimated video sales profit (allowing for deductions of the nominal expenses) taken from the March 1987 budget: this figure was $691,670. It seems to have commanded fairly general acceptance: see the First Award, paragraph 71. The denominator of the fraction was $2,257,000, being the total net profit before tax of the Rainbow's End business, taken from the document 97F (the March negotiation budget for the year ending 1987). The outcome of this calculation was to attribute $1,532,277 as the video machines' contribution to the full $5 million of goodwill. If one compares this with $1,910,306, the figure which the arbitrator had mistakenly written down for $1,091,306, it can be seen that $1,750,000 was about halfway between the two. It seemed possible that this was how the arbitrator had arrived at his assessment of $1.75 million, and if so his clerical error had led to an award which was much too high. The case should be sent back to the arbitrator, so that he could clear up this doubt.

3. The court considered and rejected the appeal of Rainbow on the 15 per cent point, in effect directing the arbitrator to ignore it.

The matter then went back to the arbitrator who published a Second Award on 6th December 1990. This was to the following effect:-

1. The two criticised figures were the result of transcription errors.

2. The errors played no part in his choice of $1.75 million for the award.

3. In particular, that figure did not result from striking an average between $1,532,277 and $1,910,306.

4. As regards the Foreign Videos point, it was true that some of the video machines in the arcade did not belong to Ryde, but it was impossible to tell how many these were. The arbitrator therefore assumed against Rainbow that the whole of the potential revenue flow had been misappropriated.

5. Similarly, as regards the Nominal Expenses point, there was insufficient evidence to make any allowance for the fact that the charge for operating the machines on the premises of Rainbow's End had been unrealistically low.

6. The nature of the case made it impossible for the arbitrator to give any more reasons for his figure of $1.75 million than were already contained in the First Award.

7. Rainbow sought to rely on the Turnover point. This substitution of income for profit in the calculation was, in the opinion of the arbitrator, a departure from the way in which the case had hitherto been presented, and he declined to take account of it.

8. In the result the arbitrator repeated his former award of 1.75 million.

Rainbow appealed again. The careful judgment of the Court of Appeal on this occasion ("the Second Appeal") is the most important of the three now before the Board. It is too long and complex to set out in detail. Briefly, what it decided was this. The court began by discussing the principles and the authorities relating to the way in which an account of profits should be taken where the subject-matter of the misappropriated trust property was, as a result of the breach of trust, made part of an undifferentiated whole. On this the court did not disagree with what had been said in the previous awards and judgments. The court then proceeded to close analysis of paragraphs 68-71 of the award, and made several criticisms. In summary -

1. The arbitrator had done no more than rehearse some parts of the evidence, notably that given by Mr. Chisholm at a late stage of the hearing.

2. In important respects the evidence quoted by the arbitrator was mutually inconsistent.

3. The arbitrator had adopted a method of apportionment which involved the computation of differential rates of profits across the elements of Rainbow's End's business, whereas no such method had been used when the $5 million goodwill figure had been negotiated.

4. If an apportionment in terms of profitability was to be made, it should use real profitability and not a rate of profit derived from the artificially low nominal expenses made by Rainbow's End to Ryde under the tax avoidance scheme. By giving credence to Mr. Chisholm's calculation of $1.53m on this artificial basis the arbitrator had been led into error. The arbitrator had proceeded directly to his figure of $1.75 million without giving any explanation of how he got there. This figure was greater than any of those which the arbitrator had evidently regarded as plausible, and in particular was greater even than the figure of $1.53m given by Mr. Chisholm. This cast doubt on its credibility.

After these criticisms their Honours developed the Turnover point, making four assumptions:

1. That the negotiated goodwill figure was based on the figures in the March budget.

2. The whole of the goodwill figure was based on the revenue of the business as a whole.

3. Mr. Chisholm was close enough to being right in his reconstruction of the estimated revenue flow from the machines made available in the March budget that his figure of $731,230 could safely be adopted. (This was equivalent to $691,670 before netting down for the nominal expenses).

4. The total budgeted revenue from the Rainbow's End leisure park was $6,500,000.

On this basis the apportionment would be:

$$\frac{731230}{6500000} \times \$5 \text{ million}$$

The court went on to discuss the Foreign Videos point and concluded that a deduction of 20 per cent should be made from the revenue from the machines to account for this factor. Allowing for this in the proportional calculation just mentioned the court arrived at a figure of "some $460,000".

Having reached this point, their Honours concluded that the court had no power to decide for themselves the questions referred to the arbitrator on the evidence which he had heard, and that the award should therefore be set aside and remitted to the arbitrator for further consideration.

So the matter returned to the arbitrator once again. In a brief award ("the Third Award") he recorded that over the space of three days the parties had advanced arguments on three issues mentioned by the Court of Appeal for further reconsideration, and went on to state that on consideration of these submissions in the light of the judgment there appeared to be no justifiable basis for departing from the court's view that the correct basis for apportionment was to apply to the $5 million the proportion of the estimated revenue from the machines less 20 per cent to the total budgeted revenue of $6.5 million. The arbitrator added that he respectfully adhered to the views expressed in the First Award, but since they had been adjudged to be wrong adherence to them would be pointless. Accordingly, he awarded Ryde the sum of $461,538.46.

Ryde then brought the matter before the Court of Appeal for the third time asking that - (a) the court should recall and reverse its decision in the second judgment, and (b) the Third Award should be set aside. (The latter application, having been commenced before Hillyer J. was removed into the Court of Appeal and dealt with directly).

Their Lordships need not describe the first application. Essentially it was an attempt to appeal to the court against its own second judgment, and was rightly rejected as incompetent. The second ground sought to re-agitate, by

way of an attack on the Third Award, the issues canvassed in the Second Judgment, and to say that the arbitrator had not exercised any independent judgment upon them. This argument was also rejected.

Rainbow then appealed to the Board against the First Judgment, and Ryde appealed against the Second and Third Judgments.

IV. INTERVENTION BY THE COURT

The next step is to consider whether, on each of the three occasions, the Court of Appeal had power to interfere with the awards of the arbitrator in the way in which it did. It is convenient to begin with the appeals against the First and the Third Judgments. As to the First Award, their Lordships have no doubt that the award was properly remitted to the arbitrator. The clerical errors were, it is true, trifling in themselves and easily detected. But the absence of any explanation of how he had arrived at his award of $1.75 million lent plausibility to the argument that the arbitrator had simply struck a rough average between the figures of $1,532,277 and $1,910,306 which appeared in consecutive sentences of his award, and that the mistranscription of the latter figure had led him to an average which was much too high. No authority need be cited to show that the court has power to intervene in such a case, and their Lordships have no doubt that the award was rightly remitted.

If events had taken a different course the position as regards the Third Judgment would have been less clear. The Board has no doubt that the Court of Appeal rightly rejected the attempt by Ryde to re-argue a question which had already been determined against it by the Second Judgment, namely whether it had been open to Rainbow to raise the Turnover point. But there remains the part of the Judgment in which the court considered whether the arbitrator had in his Third Award failed to perform the mandate entrusted to him by the Second Judgment to "reconsider his award in the light of this judgment and any further submissions the parties may care to make", and had simply given up what he saw as an unequal struggle and confined himself to working out the arithmetical consequences of the Second Judgment, without any further investigation of the issues on his own account. Here, there was real force in the argument of Ryde that the award should have been sent back yet again, at least for further investigation of the facts relating to the Foreign Videos point. A decision on this argument would have called for close consideration of what the Second Judgment had instructed the arbitrator to do, and what in his Third Award he had actually done.

In the event however the parties were able to agree, at the end of the hearing before the Board, that so far as practicable the Board should take the dispute into its own

hands to avoid any further remissions. Since as will appear it proves possible to resolve the outstanding issues on the merits, the question whether the arbitrator should have been directed to make a fourth award has become academic, and the Board will not enter upon it.

Their Lordships turn to the Second Judgment. At first sight this goes surprisingly far. With the exception of the one question of principle concerning the apportionment of an undivided profit the arbitrator was concerned solely with establishing primary facts and applying to them a chosen method of calculation. By substituting its own choice, and working out the financial implications of its choice the court might be said to have usurped a function which was for the chosen fact-finder alone.

Powerful as this objection might have been in another context it is out of place here, for the reference was not what was called in the past a "voluntary reference out of court", the subject of sections 3 to 14 of the Arbitration Act 1908 (New Zealand), but was a "reference by order of the court", pursuant to sections 15 and 16. So far as material these are as follows:-

"15. In any cause or matter ...

(a) If all the parties interested who are not under disability consent; or

(b) If the question in dispute consists wholly or partly of matters of account; or

(c) If the cause or matter requires any prolonged examination of documents ... which cannot in the opinion of a court or a Judge conveniently be made before a jury or conducted by the court through its ordinary officers, -

the court may at any time order the whole cause or matter, or any question or issue of fact arising therein, to be tried before an arbitrator agreed on by the parties or by an officer of the court.

16. (1) In all cases of reference to an arbitrator under an order of the Court ... the arbitrator shall be deemed to be an officer of the Court, ... and shall conduct the reference in such manner, as is prescribed by rules of Court, and, subject thereto, as the Court directs.

(2) The report or award of any arbitrator on any such reference shall, unless set aside by the Court, be equivalent to the verdict of a jury."

The long history of the English legislation, now repealed, from which these provisions were drawn was expounded with great learning by Stephen and Jacobs JJ. in *Buckley v. Bennell Design & Constructions Pty.* (1978) 140 CLR 1

in relation to the corresponding provisions of the Arbitration Act 1902 of New South Wales. It would be pointless to go over the same ground again. For present purposes it is enough to summarise the principles, which apply equally to the New Zealand legislation (cf. *Davidson v. Wayman* [1984] 2NZLR 115) as follows. There is a fundamental difference between an arbitration by agreement out of court and a reference by order of the court. In the former case the arbitration takes place pursuant to a contract between the parties, in whose making the court plays no part. If the court interferes at all it does so *ab extra*. By contrast, the statutory provisions for a reference under order of the court establish a mechanism for the trial of an entire action or of issues arising in an action. The proceedings before the arbitrator where an issue is referred is simply an episode in the trial of the action as a whole. Where the court intervenes in the arbitration it does so, not as a stranger to a contractual mode of resolving the dispute but as the prime mover in relation to the proceedings which the arbitrator has conducted as its delegate. One would therefore expect to find that the powers of the court to intervene in the reference and the award are wider than in the cases of a voluntary arbitration, and this is what one does find. In particular, there is power to set aside the award on the same grounds as the verdict of a jury may be set aside, namely if the verdict is against the evidence or the weight of the evidence, or wrong in law.

Applying this view of the law to the instant case it is in the opinion of the Board quite clear that the court had power to remit the award. Even the Second Award contains no explanation of how the arbitrator arrived at his figure. True, his discussion of the law suggests that he had adopted a method of rough approximation, but although this might well have been legitimate it is plain, for reasons which their Lordships will give at a later stage, that the way in which he performed it cannot have been right. Whether one says that by reiterating his first award the arbitrator had failed to perform the directions given in the First Judgment or that the decision was against the evidence, or simply that (to adopt the expression of Stephen J. in *Davidson v. Wayman (supra)*, at page 117) the arbitration had "miscarried", the conclusion is the same; the award could not be allowed to stand.

There remains the question whether the court was also correct to go beyond a simple remission and enter into the merits of the dispute. It may perhaps be said that the court adopted an uneasy compromise between, on the one hand, annulling the entire reference and resuming the conduct of the dispute and, on the other, maintaining the reference and allowing the arbitrator to continue as he thought best. This criticism is, in the opinion of the Board, unfounded, so far as it relates to the Turnover and 15 per cent questions. Once the court had concluded

that there was only one correct answer to each of these questions it would have been pointless to abstain from expressing it, for otherwise the arbitrator would have had to receive further argument on matters of method and make a further award which would be at risk of being set aside yet again. Their Lordships are less confident about the Court's treatment of the Foreign Videos point, which depended on ascertainment of primary facts and not on choice of method. As will later appear, however, the agreement that the Board will so far as possible deal with the dispute in a manner which avoids further remission has made this purely procedural point academic, and their Lordships do not explore it further.

Against this background their Lordships turn to the various issues of principle and method summarised above.

V. THE ISSUES DISCUSSED

A. A full recovery.

Throughout these proceedings successive tribunals have been pressed by Ryde to award the entire $5 million and all have refused: in their Lordships' opinion rightly so. Even allowing for the multiplication caused by the artificiality of the transactions such a result would be so extravagant that no court would accept it unless compelled to do so by firmly established law. Ryde contends that the law is indeed established to this effect by a line of authority founded on *Lupton v. White* (1808) 15 Ves-Jun 432. In that case a mine-owner had obtained an injunction against adjacent owners to prevent them from taking over a mine called The Little Ing which the plaintiff claimed was his own. The injunction was discharged on an undertaking by the defendants to keep separate accounts of the ore from The Little Ing. Subsequently the plaintiff made good his title and obtained an order for an account. In his report the Master found that the ores from The Little Ing and the defendant's mine had been deliberately mixed to prevent a true discovery of the amount owing to the plaintiff, and that the accounts had failed to distinguish between the two sources. The Master therefore stated that it was in the circumstances impossible to take an account with any accuracy. Lord Eldon, Chancellor, ordered that the defendants be charged with the whole net produce, except what they should prove to have been taken from their own mine. The heart of the judgment reads as follows:-

> "If a man by his own tortious act makes it impossible for another to ascertain the value of his property, and that in a transaction, in which the former was, not merely under an implied moral obligation, but pledged by a solemn undertaking in a Court of Justice, that such should not be the state of things between them, by those means preventing the guard, which the Court would have effectually interposed, is the argument to be endured, that, as the party, so injured, cannot distinguish his property, therefore he shall be having

> nothing? That is not the law of this country; as administered in Courts either of Law or Equity. The case of the diamond ring, found by a poor boy, proves the contrary. He had not the means of shewing the value. The person who took it from him, by wrong, prevented the jury from ascertaining the value by production of the ring, or other evidence. Therefore, as it was proved, that the Plaintiff's evidence had been destroyed by the act of that person, who ought to have refrained from placing the transaction in that state, the Lord Chief Justice directed the jury to find, that the stone was of the utmost value they could find; upon this principle, that it was the Defendant's own fault, by his own dishonest act, that the jury could not find the real value.
>
> The case of *Panton v. Panton* in the Court of Exchequer applies to this. A clerk in a banking-house at Chester remitted his own money, with that of his employer, to an agent in London, to be laid out upon security; and by management the securities were so changed, that the property could not be distinguished."

In later cases this conception was translated into other spheres including "commixtio". One such situation existed where a trustee mixed the trust moneys with his own: see *Cook v. Addison* (1869) L.R. 7 Eq. 466, 470 and *Re Tilley's Will Trusts* [1967] Ch. 1179, 1183. There there was a theoretical difference from the present case, in that Ryde's machines were never "confused" with the property of Rainbow's End (except perhaps as regards the "Foreign Videos": see post). It was only the future revenue stream which was in confluence with that of the other interests. This distinction would not in itself be sufficient to disapply the strict equitable rule. Nevertheless, although the existence of the rule cannot now be doubted, it is essential to regard its practical foundation, which is simply that as a measure of discipline trustees should not be allowed to profit from a breach of their duties of fidelity. If the profit can be ascertained the trustee is made to yield it up. If, through the trustee's own act, it is completely incapable of ascertainment, even to the extent of a rational approximation, so that the choice lies between holding a trustee liable for nothing and holding him liable for all, the latter course must be chosen. This is rough justice, applied for want of a better solution. But the doctrine cannot be pressed so far as to demand that in every case where precise arithmetical computation is impossible the whole of the mingled profits must be awarded to the beneficiary, for this would be, not rough justice but no justice at all. It would not only deprive the trustee of his unwarranted gains but would impose a fine as well: a fine which in the present case would amount to millions of dollars. No reported case has gone to this length. When the words "separated with perfect accuracy" employed by

Stuart V-C. in *Cook v. Addison, supra,* are read in context they can be seen as no more than a brief summary of the much less extreme doctrine propounded in *Lupton v. White, supra.* In their Lordships' opinion the solution to a case where the extent of the profits cannot be precisely ascertained is to be found in a judgment of Staughton J. in *Indian Oil Corporation v. Greenstone Shipping (Panama)* [1988] 1 Q.B. 345. This was a case on admixture, where the law does not have the special disciplinary overtones applicable to profits made by a trustee. Nevertheless the careful analysis of the authorities contained in the judgment demonstrates that if it is possible to tell with tolerable certainty that, whatever may be the amount of the trustee's profits, it cannot have exceeded a particular figure, then that figure and no more should be awarded: and indeed that was the direction to the jury in *Armorie v. Delamine* the case of the "poor boy" to which Lord Eldon adverted. In the present case, the wide spread of the figures put in issue was due not so much to the deficiencies in the documentary and oral evidence produced by Rainbow before the arbitrator (although that was certainly an important factor) but the difficulty of choosing the right method for making an apportionment which Rainbow and Questar had never made for themselves. Once these difficulties are overcome, there is a sufficient substratum of primary fact to enable a maximum to be fixed. Thus, although in arriving at this maximum nothing should be assumed in favour of Rainbow, and although as will appear the general principle exemplified by *Lupton v. White* has an important bearing on the Foreign Videos point, the Board in company with all the tribunals which have discussed the matter consider that an award of $5 million should not be entertained.

B. A Rough Compromise.

The general nature of this question has already been stated. The artificial inflation of the net profits of the machines in the hands of Ryde combined with the absence of any specific appropriation of the contribution which the anticipated profits of the video machines made to the inflated goodwill element entailed that there was no mathematical computation which could be relied upon to provide a just account of profits; and indeed any such computation would give a spurious air of precision to an operation which was inherently imprecise. The only sound course, so the argument would run, would be to experiment (as it were) with various ways in which the arbitrator could try to do what Rainbow and Questar had not done for themselves; to select from the results thus obtained those which seemed most intellectually sustainable; to examine the range of tenable results thus established, and to fix on an award within this range, not by arithmetical average but by broad judgment on a round-figure basis which appeared best to reflect the broad justice of the case. Alternatively, in recognition of the inherent impossibility of any precise response to his mandate, the arbitrator could have decided that none of the figures advanced in argument were more

plausible than any other; that the task assigned to him by the court was impossible; and that the best he could do would be to give effect to a broad "feel" of the case gained from many days of hearing, perhaps erring on the side of generosity so as to acknowledge that it was because Rainbow had failed to bring forward contemporary documentation and evidence that he was forced to rely on speculation rather than solid fact.

If the First Award had made clear that this was the arbitrator's process of thought, and if the materials on which it was based had been sound, the award might well have been impregnable. At a later stage it will however be briefly explained why the Board cannot accept any of the figures quoted by the arbitrator as sound. Furthermore, there is no trace in the award that the arbitrator proceeded in this way. It is true that the expert evidence presented him with a range of possible results, from nil to $5 million with more than a score of intermediate stages; and it is also true that the evidence of Mr. Chisholm, to which the arbitrator evidently attached considerable weight, did include in his miscellany of conclusions some figures well in excess of $1.75 million. But the arbitrator includes none of these in his award, and their Lordships find it as impossible as did the courts in New Zealand to explain, even on the basis of a rough intuitive compromise, how he made the leap to $1.75 million. They conclude therefore that the Court of Appeal was right, in its Second Judgment, to hold that the Second Award, essentially a repetition of the First Award, could not be allowed to stand.

In saying this, the Board does not assert that if from the very start the court (when ordering the reference) and the arbitrator and parties (when performing it) had recognised that an orthodox arithmetical approach to the application of the equitable rules would lead to a blind alley, it would have been wrong to adopt the broader approach, on the basis of a soundly ascertained range of outcomes. Instead however, as the arbitrator rightly discerned, the Court was requiring him on the second remission to perform an arithmetical operation, and this is the basis on which the appeal to the Board has been argued. It is now far too late to adopt any other approach.

C. The 15 per cent point.

After satisfying its liability to Ewoch under the floating rate debenture Ryde was left with only 15 per cent of the revenue from the machines net of the nominal expenses. Rainbow contends that it is only this residue which should be used to calculate what proportion of the $5 million goodwill is attributable to its wrongful dealings with the machines. This argument is attractive, but the Board agrees with the arbitrator and the courts below that it must be rejected.

The misconception is that the purpose for an account of profits is to compensate the injured beneficiary for his loss. If this were so, Rainbow would be right to complain of an award based on 100 per cent of the revenue. As already explained, Ryde suffered little or nothing from Rainbow's wrongful act. The participants in the joint venture may have suffered more, but they have not sued and the amount of their loss has never been investigated. The object of an account is not to compensate the beneficiary but to deprive the trustee of profits wrongfully made. The greater the profit, the greater the order against him: and, quite possibly, the greater the windfall to the beneficiary. An early case gives a graphic example. In *Keech v. Sandford* (1726) Sel.Cas.T.King 61 the defendant held a lease in trust for the infant plaintiff. Before the expiry of the term the defendant applied to the lessor for a renewal. This was refused, because the infant could not give the lessor an effective personal covenant. Rather than letting the lease expire the trustee took a renewal to himself. In Chancery the trustee was ordered to assign the lease to the infant, and to account for the profits. Lord Kent L.C. recognised that this might seem hard, for the infant obtained through the order for an account something which he could never have had in his own right; and the penalised trustee was the only person who could not properly have taken the new lease. Nevertheless, as the Lord Chancellor said, "I very well see, if a trustee, under a refusal to renew, might have a lease to himself, few trust-estates would be renewed to *cestuis que use* ...". The jurisdiction is thus disciplinary, not compensatory, a proposition so well established that authority need scarcely be mentioned, although *Regal (Hastings) v. Gulliver* [1967] 2 A.C. 134 and *Boardman v. Phipps* [1967] 2 A.C. 46 provide more recent examples of high authority. In the present case the application of this clear rule has been somewhat clouded by the use of the word "undertaking" in the order for an account, for the wrongful act which Rainbow brought about was not the misappropriation of Ryde's undertaking but the unauthorised alienation of its only tangible asset, namely the machines; and it was the wrongful transfer of the machines, not of Ryde's business, which enabled Rainbow to make a profit. The word "undertaking" tends to suggest that Rainbow took over the business of Ryde in all its aspects, including its liabilities to Rainbow's End for the nominal expenses and to Ewoch for the capital and interests under the floating rate debenture. If this had been so, and if Ryde's obligations as well as rights had by novation been transferred to Questar and taken into account when computing the goodwill element, the argument would have been sound. But nothing of the kind took place, and it is plain from the fact that Hillyer J. was later to reject Ryde's argument on the 15 per cent point that he was under no misapprehension in this respect.

Ryde nevertheless contends that the only sensible basis for an award is the price of 15 per cent which its shareholders caused it to charge as consideration for being used as a tax-loss vehicle. Paradoxical as the figures

undoubtedly are their Lordships cannot agree. By the time the wrongful act was complete the fact that Ryde's right to 100 per cent of the revenue received from Rainbow's End was matched by a contractual duty to pay 85 per cent of it to Ewoch had become a matter of history. Neither the machines nor their revenue flow had ever been charged to Ewoch. They belonged in their entirety to Ryde. After the resale Rainbow's End could exploit them to the full extent of their earning capacity unencumbered by Ewoch's purely personal rights against Ryde, and it was this full earning capacity which made its contribution to the goodwill element of $5 million. The apportionment must be calculated accordingly.

D. The Foreign Videos point.

There seems little doubt that some of the machines in the amusement park belonged not to Ryde but to Rainbow or to other concessionaries. Rainbow's primary argument before the arbitrator was that none of Ryde's machines formed part of the sale to Questar. As an alternative to this argument, which the arbitrator rejected, Rainbow maintained that the sale included some of these "foreign" machines and that accordingly a discount should be made in the apportionment of profits. In his First Award the arbitrator allowed no such discount. On the application to remit this award Hillyer J. and the Court of Appeal referred to "the fact that not all the machines were owned by Ryde" as one of the matters not mentioned by the arbitrator, although it was acknowledged as a possibility that the arbitrator had disregarded them as inadequately proved. The arbitrator was directed to deal with this as part of his explanation of his award of $1.75 million. In his second award he responded to this as follows:-

> "At the original hearing in March 1989 there was a good deal of evidence about the ownership of the videos in the arcade. Lists of actual videos were presented, identifying those which belonged to Rainbows End Ltd and those which belonged to Ryde. It would not have been easy to overlook the fact that some of the videos included in the sale of the business did not belong to Ryde. Furthermore, there was evidence and submission about the allocation of takings as between the receipts referable to the Ryde videos and the receipts referable to the other videos. The problem was, in reaching, with confidence, any conclusion about the division of income from the two categories of videos. It was a matter that was not sufficiently established and accordingly the particular issue fell to be dealt with under the principle in *Lupton v. White*."

When the matter returned for a second time the Court of Appeal was referred to some, although it would appear by no means all, of the evidence on the issue and substituted its own findings that a deduction of 20 per cent should be made; largely it would appear on the basis

of evidence from Mr. P.D. Lane that not all of the video machines' income which was used as the basis of the forecast came from machines owed by Ryde. This opinion was based on an analysis of returns for two months closely preceding the agreement for the sale of the enterprise to Questar. It seems that counsel had also referred the Court of Appeal to figures for four or five previous months which were said to be to a similar effect. Apparently counsel did not deploy the documents themselves; and their Lordships have not themselves been shown these materials.

Whilst the Board does not doubt that the Court of Appeal was entitled to examine the arbitrator's reasoning, in the light of the principles already discussed, they must in this respect alone differ from its conclusion. The arbitrator had, according to his account, already considered the Foreign Videos point on the first occasion, and had re-examined it on the second. If there was no additional evidence to reach any conclusion on whether the price on the sale to Questar included the profitability of machines other than those belonging to Ryde he was entitled to follow *Lupton v. White* and do what he did, namely to take the matter at its worst for Rainbow. The Court of Appeal was entitled to reject this conclusion only if it was "against the evidence". This did not mean that the Court of Appeal might have considered, had it been trying the issue itself, that notwithstanding the paucity of the evidence (a paucity which Rainbow could have remedied if it had chosen) some discount could properly be awarded. But if the contrary opinion of the arbitrator were to be overturned substantially more than this would be required. The court would have to be satisfied on the evidence and arguments addressed to the arbitrator (not to the court itself) that the decision of the arbitrator was so far outside the range of feasible verdicts that it could not be allowed to stand. Their Lordships cannot find that this demand was met. Indeed, as on the materials, necessarily limited, brought forward on the appeal they believe that the decision of the arbitrator was right.

E. The Nominal Expenses point.

This raises no question of principle and their Lordships may deal with it briefly. It takes two forms.

First, it is one aspect of the 15 per cent argument, since all contentions which predicate a calculation based on Ryde's net revenue position must arrive at the revenue by deducting from the takings the artificially low charge for keeping and operating the machines at the Rainbow's End park. As their Lordships reject the 15 per cent argument, for the reasons already stated, the question need not be pursued.

Secondly, the figure of $731,000, which seems to have been generally accepted as the (March) budgeted figure for gross sales, was netted down by Mr. Chisholm to a figure of $691,000 representing projected profits by deducting the

nominal expenses, and was there used as the numerator of a fraction which yielded the figures of $1,091,000 (mistakenly given as $1,910,306) and $1,532,77, according to the choice of divisor. In their Lordships' opinion this process must be wrong. If, notwithstanding the Turnover point, one is to attempt an apportionment in terms of anticipated profits they must be ascertained by reference to the costs which would have been incurred in running the machines as part of the total Rainbow enterprise, not the artificially depressed costs (only about $5\frac{1}{2}$ per cent of the gross) which were being charged to Ryde as the nominal expense before the breach of trust. Thus, on this as well as many other grounds, the figures of $1,091,000 and $1,532,277 are unsustainable. The case is the same for the calculation in Appendix C to Mr. Chisholm's statement which enabled him to reach the figure of $3,342,500, or with a denominator drawn from the March budget, $1,531,824.

F. The March/August point.

This need be mentioned only briefly, and indeed mentioned at all only because the figures put in evidence by Mr. Chisholm in his Brief of Evidence were still in contention before the Board. One of these figures was $3,342,500, the only one of those placed before the arbitrator which might, in one way or another, have caused him, even on the basis of a rough approximation, to make an award as high as $1.75m. This figure was arrived at by applying to the goodwill element a fraction of which the nominator was a figure of $359,670, arrived at by taking $731,230 as the forecast gross revenue from the machines (a figure which seems to have commanded a fairly general acceptance among the experts) and deducting tax and the nominal expenses. The denominator of the fraction was $538,000, being the total forecast profit of Rainbow's End, according to a management budget produced in August 1986. The objection to employing the nominal expenses in the numerator has already been discussed. The March/August point relates to the denominator. If the purpose of the enquiry had been to determine what proportion of the actual revenue or profits from the Questar enterprise were derived from Ryde's machines this figure might, for want of anything better, have been a good point of departure. In fact, however, the arbitrator was directed to ascertain, not the true facts as they subsequently appeared, but what proportion of the projected profits related to the machines. The projection in the "negotiated budget" (Document 97F) was too optimistic, but it was the one which was actually used, and must be the proper basis for any account of profits. The point is important because the choice of the figure in document 97F, namely $1,174,000, for the total projected net profit after tax, in preference to the much lower figure in the August budget, halves the proportion attributable to the machines, and reduces the final figure (even ignoring all the other issues) to an award in the

region of $1.5 million, substantially below the arbitrator's choice of $1.75 million. It is unnecessary to pursue this further. Their Lordships mention the point at all only to demonstrate that the only high figure referred to in the final award is unsustainable.

G. The Turnover point.

This requires some words of introduction. Almost all of the arguments on the two sides have involved some form of apportionment based on a comparison of the profits from the machines with the profits of Rainbow's venture as a whole. Two versions of these arguments required the arbitrator to look backwards to the distorted trading position occupied by Ryde before Rainbow's wrongful act. For Ryde, the calculation involved the netting-down of the gross revenue only by the artificially low nominal expenses - yielding a higher profit figure and a correspondingly large fraction for the apportionment. For Rainbow, the netting-down took the shape of a deduction of the 85 per cent payable to Questar, yielding a low fraction for the apportionment. It is obvious that the latter argument, being cost-based, cannot co-exist with any contention on Rainbow's behalf that the apportionment should be based on gross earnings. In fact, now that their Lordships have rejected both of the arguments just summarised, the way is clear for Rainbow to reverse course and argue for revenue rather than profits. Nevertheless, it is material to record that Rainbow has for years maintained as their principal argument a profit-based approach which is inconsistent with the one which their Lordships are now considering.

Secondly, the turnover argument appears paradoxical at first sight. Although Ryde may be right to assert that the goodwill element was not directly related to estimated profits, this is so only to the extent that the arithmetical basis of the $5 million goodwill element cannot now be reconstructed by reference to the evidence on price/earnings ratio or anything else. Indeed it seems likely that it never was derived arithmetically. It is however undeniable that Questar were buying the anticipated profits of the enterprise through the $5 million: not the anticipated turnover. Surely, it may be said, the only logical way to apportion it is to see how much of the $5 million represented the profits of the video machines - as the parties recognised by offering to the arbitrator so many versions of just such an apportionment.

This objection would be sound if the argument now being considered did indeed focus exclusively on turnover. As presented, however, it assumes that since the various elements of Rainbow's enterprise were not costed separately at the time of the sale the only sensible course is to write them uniformly across all the attractions. Although this remains a profit-based computation, the fraction is expressed in terms of gross turnover.

The issues thus arising are two-fold. First, given the previous course of the dispute, was it open to Rainbow to raise the point when the award returned to the arbitrator for the first time? The case for saying that it was not is formidable. No evidence in support of it was given during the enquiry before the arbitrator and, indeed, it scarcelessly could have been, given that the gist of Mr. Gary Lane's testimony was that the Ryde videos had never been included in the sale to Questar. Nor was the argument mentioned in the First Award (the outcome of nine days' hearing before an experienced and obviously conscientious arbitrator) or in Rainbow's first notice of appeal. On the other hand, although the existence of this contention was masked by Rainbow's inconsistent argument on the 15 per cent point, the terms of the remission were wide enough to enable the arbitrator to reopen the whole question of computation. The Court of Appeal was willing to accept the assurance of counsel that the point had indeed been developed orally, even if not included in his written synopsis, and the Board as a court of final appeal sees no ground to take a different view. Indeed to do so would leave the arbitration in a chaotic state. The arbitrator's award of $1.75 million cannot stand. Nor can any of Ryde's cost-based figures, including in particular the figures which treated only the nominal expenses as being the deductible costs. Yet Rainbow's own proposals based on the 15 per cent argument must also be rejected. This means that unless the turnover argument is entertained there will be no sustainable basis for apportionment, so that the court is forced to award $5 million for want of any other conclusion. This result is directly contrary to the one which the arbitrator himself had expressed throughout, and also contrary to the plain justice of the case. After all, not only is it known that the future profits of the machines formed only one of the elements in the $5 million attributed to goodwill, but also the turnover figures show that the contribution was proportionately quite small, although large enough in absolute terms. The Court of Appeal, their Lordships believe, were entitled not to shut out the argument on procedural grounds, at a time when, it must be remembered, the court was in a process of declaring that the Second Award, like the First, must be set aside and that the arbitrator must once again be entrusted with the task of arriving as best he could at an account of the profits which Rainbow made by taking and re-selling the machines.

This leads to the merits of the argument, the general shape of which will already have appeared. According to Rainbow, since the transaction with Questar was never structured on the basis of projected differential rates of profit, and had no reason to be so structured, it would be wrong in principle as well as impracticable to speculate as to what the parties would have done if it had occurred to them to look at the overheads separately. Here, it is essential to bear in mind the distinction between the potential profitability of the machines and the other

attractions from the year end to year end on the one hand, and on the other the actual realised capital profit of $5m. resulting from the parties' estimate of what that profitability would be. It was to the latter alone that the arbitrator's task of apportionment was directed. He was not called upon to ascertain the true profitability of the machines and then capitalise it. For this purpose he would have had to visualise the machines as a separate free-standing concession within the leisure park, and try to work out what the owners of the park would charge for rent, commission and other expenses. It seems that one of the expert witnesses (Mr. Dennis Lane) did put forward a calculation on these lines, but it was not explored in any detail before the Board, and in the absence of the underlying material it would be impossible now to pursue it. In any event, their Lordships believe that the argument is unsound, for the purpose of the apportionment is not to investigate the true net profitability of the machines, but the value attributed to them as part of the $5m. goodwill element. The right approach is to have regard to the parties' own forecast (evidently some distance wide of the mark) of what the profitability might be. This forecast never allowed for a differential rate of profit, and had no reason to do so. So an attempt to load the leisure park attractions with differing rates of overhead would be to create for the parties a transaction which they had never created for themselves. If one turns by contrast to budgeted sale figures, one can see that these did exist at the time of the sale for the machines separately and for the Rainbow's End enterprise as a whole. Thus it seems perfectly rational to base the apportionment upon them.

Ryde objects, however, that if Rainbow's argument is right and the court is forced into an appropriation based on turnover, this has happened only because Rainbow compounded its initial wrongful act by selling-on the machines as part of an undivided business. The turnover argument, if accepted, would enable Rainbow to benefit from this intermingling of its own legitimate business with the business appropriated in breach of trust: something which, as *Lupton v. White* demonstrates, equity will not countenance. The benefit of Rainbow comes from the fact that the high profitability of the machines, which ought to yield a high apportionment, is washed out in the lower profitability of the enterprise as a whole. Put another way, the use of a turnover method writes the overheads evenly across the whole business, and thereby causes the cheap machines to subsidise the more expensive attractions.

Attractively though this argument was put, the Board must reject it for the same reasons as before. The history of the figure of $5 million, and the absence from this history of any reference to differential rates of overhead are facts. These cannot be changed retrospectively. If the whole was negotiated on the basis that overheads were evenly distributed, then any evaluation of a part must be made on the same footing.

This result is not only logical but sensible. The machines were never planned to operate as a "stand-alone" unit distinct from the park. There is no doubt that the principal reason why customers would visit the park was that there were other attractions such as the roller coaster. Once drawn to visit the park some of the customers would play the machines, while the traffic in the other direction would be relatively light. The profitability of the machines could not be fully exploited otherwise than in the framework of the park as a whole. This being so, it is reasonable to treat the relatively high overheads of the major attractions as being in some degree an additional overhead of the machines themselves. If the latter had been installed as a separate concession this factor would have been taken into account in the price of the licence. But since for obvious reasons it was never contemplated that the transaction would proceed in this way, an attempt to reconstruct what the parties might have agreed in wholly different circumstances is pointless. All the court can do is to take the bare bones of the transaction as presented. In the opinion of the Board, these lead to the conclusion that the best approximation to justice, in a case where commercial logic has throughout been at a discount, is to see the transaction in the same light as the parties saw it at the time and to perform the computation in terms of turnover alone.

VI. THE EWOCH DIVIDEND POINT

The question here is whether a defaulting trustee should be ordered to account for the whole of the profits made from the wrongful transaction, considered in isolation, or whether the "profits" for which he is required to account mean the net change in his position for the better resulting from the whole of the dealings at which the profit-yielding act formed part. Translated to the present situation, the issue is whether the order against Rainbow should allow for the fact that before the "unwinding" operation Rainbow was already making profits from the machines by its 82.35 per cent interest in Ewoch, which it lost when the tax avoidance scheme was dismantled and Ewoch ceased to receive 85 per cent of the revenue stream from the machines.

This issue is in a different category from all the others, since (so far as their Lordships can glean from the documents brought to their attention) it has not previously been canvassed at any time during the long history of this case. Instead, it was raised by the Board at a late stage of the argument to this appeal, and was of necessity dealt with by counsel only briefly and in an impromptu manner. Their Lordships have considered whether in the circumstances it would be right to take the point any further and have concluded that it would not. The Board could not in fairness decide the question (or some variant of it) adversely to Ryde without giving the latter an opportunity to challenge a proposition which has

never in all the numerous hearings been advanced against it by Rainbow, and which is indeed inconsistent with the 15 per cent argument on which Rainbow has relied throughout. Nor would it be at all prudent for their Lordships to pronounce upon what may be an important new question of equity, thereby creating a precedent, without the benefit of full research and adversarial argument. Moreover, even if the point were established as sound in principle it would still be necessary to apply the new rule to the facts. At first sight it might seem that a discount of 30 per cent would necessarily ensue, but further consideration has satisfied their Lordships that the question is by no means as simple as that, and that the matter might well have to be returned yet again to the arbitrator or the High Court to enquire, years after the event, into factual issues not previously investigated, in the light of material which (if Rainbow's performance as regards the disclosure is no better than before) may not be made available in full. To set the dispute off in this entirely new direction in the concluding stages of the last of a long and expensive series of hearings would not, in their Lordships' opinion, accord with the interests of justice.

VII. CONCLUSIONS

For these reasons their Lordships conclude that all the substantive contentions advanced by Rainbow should fail, and that all the contentions advanced by Ryde should also fail, with the exception of the argument on the 20 per cent point. The consequence will be to write back the 20 per cent deducted by the arbitrator (in accordance with the Second Judgment) in arriving at his third award of $461,538, thus yielding a figure of $576,928. This is not a result which it is possible to contemplate with satisfaction, given the comparatively modest value of the machines, but the anomaly of the result is no more than a reflection of the anomalous features of the transactions, combined with an orthodox order for an account of profits.

As previously mentioned the parties have expressed themselves willing that the Board should give direct effect to its opinions without ordering a further remission to the arbitrator or the court. The procedural means of achieving this result were not explored in argument. Their Lordships believe that an acceptable method will be for the Board of its own motion to revoke the submission to arbitration, and to enter judgment in the aforesaid figure of $576,928.

As regards costs, whilst recognising that Ryde has succeeded on the very short issue on the 20 per cent deduction, their Lordships consider that in all the circumstances there should be no order as regards the costs of this appeal. All the orders for costs made in the courts below will stand.

Their Lordships will humbly advise Her Majesty accordingly.