IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2009-404-7120

UNDER	Section 34 of the Receiverships Act 1993
IN THE MATTER OF	Plateau Farms Ltd, Ferry View Farms Ltd, Hillside Ltd and Taharua Ltd (all in Receivership)
BETWEEN	B J GIBSON AND M P STIASSNY Applicants
AND	STOCKCO LIMITED First Respondent
AND	NUGEN FARMS LIMITED Second Respondent
AND	A J CRAFAR Third Respondent
AND	R S CRAFAR Fourth Respondent
AND	G W CRAFAR Fifth Respondent

Hearing: 11-14 and 18-22 October and 9-12 November 2010

Counsel: R B Stewart QC, SCDA Gollin and A Simkiss for Applicants
F M R Cooke QC, B D Gustafson and M H L Morrison for the First Respondent
W G Manning for the Second Respondent (granted leave to withdraw)
No appearance by or on behalf of the Third, Fourth and Fifth Respondents

Judgment: 17 December 2010

JUDGMENT OF WHITE J

This judgment was delivered by me on 17 December 2010
at 2.30 pm pursuant to r 11.5 of the High Court Rules

Registrar/Deputy Registrar

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Introduction

[1] This case involves disputes about personal property interests in various categories of livestock on dairy farms owned by the Crafar Group, now in receivership. The disputes are between the Receivers of four companies in the Crafar Group and StockCo Limited (StockCo), and arise out of sales of livestock by one of the companies in the Crafar Group, Plateau Farms Limited (Plateau), to StockCo and the lease of livestock by a company called Nugen Farms Limited (Nugen) from StockCo.

[2] The Receivers have been appointed by Westpac New Zealand Limited, Rabobank Ltd, PGG Wrightson Limited and PGG Wrightson Finance Limited (the Banks) which had provided finance facilities to the four companies in the Crafar Group (the Charging Group). The Charging Group had granted various security interests in its assets, including its livestock, to the Banks.

[3] The first category of livestock involved 4,000 heifers sold by Plateau to StockCo on 1 August 2008 for $3.2 million plus GST and then leased by StockCo to Nugen. The Receivers seek directions under s 34 of the Receiverships Act 1993 that, notwithstanding the sale, this livestock remained subject to the security interest granted by the Charging Group to the Banks which ranked in priority to any claim by StockCo or Nugen, and that StockCo's interest in the livestock was subordinated to further advances made to the Charging Group by the Banks. These directions, opposed by StockCo, require determination of issues under provisions of the Personal Property Securities Act 1999 (the PPSA), including:

a) whether the sale was outside the ordinary course of the Charging Group's business (s 53);

b) whether the sale was expressly or impliedly authorised by the Banks (s 45); and

c) whether StockCo's interest was subordinated to further advances made by the Banks (s 88), including whether the Banks acted in good faith (s 25).

[4] The other categories of livestock involve livestock purchased by StockCo from Nugen or third parties and leased by StockCo to Nugen under the terms of lease agreements in 2008 and 2009. As StockCo claims that their livestock, including the 4,000 heifers, were on farms owned by the Charging Group when the Receivers were appointed, the Receivers seek directions that the livestock, including 545 of the 4,000 heifers, are not able to be identified and that StockCo therefore has no priority claims to them. These directions, opposed by StockCo, require determination of issues under s 18 of the Sale of Goods Act 1908 relating to the ascertainment of one category of these livestock, the application of ss 36 and 40 of the PPSA relating to the enforceability of StockCo's leases against the Banks, and, if the livestock are able to be identified, the appropriateness of a pro rata calculation of the numbers of livestock now involved.

The parties

[5] The four Crafar companies in the Charging Group which are in receivership are Plateau, Hillside Limited, Taharua Limited and Ferry View Farms Limited. At all material times the directors of these companies were Allan Crafar, his wife, Elizabeth Crafar, and his brother, Frank Crafar. They were also the shareholders of the companies in their capacities as trustees of their respective family trusts. From modest beginnings in the 1980s as sharemilkers and dairy farmers, the Crafar family built up a substantial dairy farming business which, when the Receivers were appointed on 5 October 2009, comprised one of the largest rural portfolios in New Zealand with approximately 20,000 cows on 21 farms owned or leased, primarily in the South Waikato, Taupo/Bay of Plenty, South Taranaki and Bulls. Currently the Receivers are operating the business from 16 farms: 13 dairy farms and three drystock grazing, ranging in size from 128 hectares to 1,750 hectares and totalling nearly 8,000 hectares. The properties are milking some 16,000 cows and supplying some 4,870,000 kilograms of milk solids per annum to Fonterra.

[6] The unaudited statements of financial performance of the four companies in the Charging Group, prepared by the Groups' accountants, Stretton & Ltd of Taupo, showed for the year ended 31 May 2008:

	Milksolids Production	Net Operating Surplus
Plateau	$ 12,565,372	$ 6,560,958
Hillside	8,425,252	6,962,830
Taharua	9,964,341	4,115,145
Ferry View	96,233	(180,679)
	$31,051,198	$17,458,254

[7] The same statements of financial position recorded that the total liabilities, including the liabilities to the Banks, for each company were:

Plateau	$ 113,871,841
Hillside	52,326,807
Taharua	29,439,094
Ferry View	26,174,189
	$221,811,931

At the time of the appointment of the Receivers, the Charging Group was indebted to the Banks in the sum of approximately $194 million.

[8] Nugen, now also in receivership, is a company owned by family trusts associated with Robert Crafar, Allan Crafar's son. Robert Crafar was the sole director of Nugen, which was not a part of the Charging Group. Mr Manning, counsel for Nugen, appeared at the outset of the hearing and subsequently on a watching brief, but otherwise played no active part and was granted leave to withdraw.

[9] There were several other companies owned and operated by members of the Crafar family which, like Nugen, were not part of the Charging Group, but which, like the four companies in the Charging Group and Nugen, were run as an overall

enterprise by, or at the direction of, Allan Crafar. There was little doubt that Allan Crafar was in charge and that he treated the 30 properties owned and operated by the family as 30 paddocks in the one enterprise. While Nugen may have been Robert Crafar's company, all significant decisions about the acquisition and disposition of its assets, including its farms and livestock, were made by his father.

[10] The Crafar family had a number of professional advisers, including their lawyer, Ian Blackman of Blackman Spargo Rural Law Limited, Rotorua, their accountant, Steven Bignell of Stretton & Co, Taupo, their livestock agent, John Dickson, and David Wiltshire, Finance and Administration Manager for the Crafar farm companies for three years. Together with Allan and Robert Crafar, all of these advisers provided affidavits and were cross-examined on their evidence. All of them confirmed that the Crafar enterprise was under the direction and control of Allan Crafar who made all major decisions and gave all the important instructions to the advisers.

[11] For Ian Blackman, the Crafars were his largest group of clients. He was a trustee of their family trusts and closely involved in the transactions the subject of this proceeding.

[12] The four Crafar companies in the Charging Group were financed by the three Banks: Westpac, Rabobank and PGG Wrightson. The Charging Group granted various securities to Westpac as agent for the Banks, in respect of their finance facilities, including:

a) A composite General Security Agreement (GSA) dated 16 May 2005 (granted by Plateau, Hillside and Taharua);

b) A Security Sharing Deed (SSD) dated 9 June 2006 (granted by Plateau, Hillside and Taharua); and

c) A further composite General Security Deed (GSD) dated 24 July 2008 (granted by the four companies).

The relevant provisions of these agreements are set out later in this judgment. Financing statements were registered on the Personal Property Securities Register (PPSR) perfecting the GSA and the GSD in relation to each of the companies in the Charging Group.

[13] As already mentioned, StockCo is a livestock finance company. It is registered in Hastings and carries on the business of owning and leasing livestock to farms, including the leasing of dairy herds. Two of the shareholders in StockCo are Marcus Kight, who has also been a director of the company for some 15 years, and Gerard (Ged) Donald, who is the senior finance manager of the company. Mr Kight deposed that StockCo offers various financing plans to farmers to allow them to free up capital. StockCo has standard form dairy herd leases. When the leases are for a term of more than one year, they constitute security interests for the purposes of the PPSA. StockCo is able to obtain priority under the PPSA by registering a financing statement on the PPSR within the requisite timeframe and, when necessary, obtaining a specific release from any prior secured creditors.

[14] Mr Kight also deposed that StockCo had "an extensive history of dealings with the Crafar Farming Group and an in-depth understanding of the Crafar Farming Group's operations". Mr Kight explained that StockCo had provided short-term finance secured by dairy cattle to the Crafar group at various times since 1998 and that StockCo was aware of the volume of cows and heifers that the Crafar Group sold each year, due to its relationship with Richmond Limited and PPCS meat processors, which each processed large numbers of stock for the Group annually. StockCo also considered and entered into a number of financial arrangements with the Crafar farm Charging Group and with Nugen, including the purchase of the 4,000 heifers from Plateau on 1 August 2008 and the lease agreements with Nugen relating to those heifers and the other categories of cows also the subject of this claim. The relevant provisions of the lease agreements are set out later in this judgment. Both Mr Kight and Mr Donald provided affidavits about these transactions and were cross-examined on their evidence.

Factual background

[15] The issues in this case need to be considered in the context of the factual background which emerges from the relevant documents and the evidence from the witnesses who provided affidavits and were cross-examined on their evidence. The factual background is largely undisputed and the following outline is based on the relevant documents, the unchallenged affidavit evidence and a detailed chronology provided by the parties after the conclusion of the hearing, which also incorporated the respective parties' versions of events. Any significant elements of disagreement are addressed in the course of the outline.

[16] The starting point is that from the early 1990s the Crafars bought and sold livestock. Mr Dickson, their livestock agent, gave evidence that on one occasion in the early stages of their setting up they sold all of their "young stock". He also referred to a similar sale in July-October 2005 when 2,360 rising year one heifers were put forward for export but only 616 were sold with the rest rejected because of inoculation. The financial statements for the Charging Group companies for the six years 2003 to 2008 inclusive, the Dairy Cattle Accounts and the Consolidated Livestock on Hand records all show sale and purchases of livestock in various categories. While Mr Blackman questioned the accuracy of the information relating to livestock in the statements and accounts, there is no reason to suppose that it did not convey the general picture reasonably accurately, especially as it was not disputed by Mr Crafar in any significant respect or by any other documentary evidence, and many of the financial statements, which were required to be prepared in accordance with the Financial Reporting Act 1993, were signed off by Mr Crafar, his wife or his brother as directors. The information in these statements and records showed that:

a) The size of the herd farmed by the Charging Group progressively grew over the six year period as a consequence of the Group's expansion and acquisition of farms over that period. This growth resulted from both the purchase of dairy cows and the retention of calves to rising one year, and then rising two year, and then their incorporation into the herd.

b) 2,376 calves were reared to rising one year heifers for the year ending 31 May 2005, 2,690 for the year ending 31 May 2006, and 3,355 for the year ending 31 May 2007. In each case the rising one year heifers became rising two year heifers during the course of the next year and then the following year a substantial number of them joined the herd as replacement cows: 1,281 of the 2,376 calves born in the year ending 31 May 2005 can be traced as joining the herd as replacement cows in the year ending 31 May 2007; 2,130 of the 2,690 calves born in the year ending 31 May 2006 can be traced as joining the herd in the year ending 31 May 2008; and 2,180 of the 3,455 calves born in the year ending 31 May 2007 had been retained and were available to the herd as milking animals for the 2009 year.

c) There were also sales of cows in various categories, including rising one year heifers. In the year ending 31 May 2005, 139 rising one year heifers were sold by Plateau out of an opening tally of 737. In the year ending 31 May 2006, 51 rising year one year heifers were sold by Plateau out of an opening tally of 1,172, four were sold by Hillside and 425 by Taharua. None were shown as having been sold in the years ending 31 May 2007 and 31 May 2008.

[17] The analysis of the financial statements and records of the four Crafar farms in the Charging Groups was provided primarily by the evidence of Dean Nikora, an experienced Hawkes Bay dairy farmer retained by the Receivers as an independent consultant, and supported by Peter Gordon-Glassford, an experienced chartered accountant whose firm specialised in farm accounting and business advice to rural business, who was called for the Receivers as an independent expert witness. Messrs Nikora and Gordon-Glassford were cross-examined closely on their evidence, but as it was based on the financial statements and records it remained convincing. It was also consistent with the evidence of Mr Wiltshire, the Crafars' Finance and Administration Manager, and Mr Donald of StockCo who, in cross-examination, confirmed the figures but was not prepared to accept that, as a percentage of the herd giving birth, the proportion of calves reared to rising one year heifers was relatively constant between 2005 and 2008. He claimed that this

assessment was complicated by the purchases, sales and deaths of cows and rising two year heifers in each year. Making allowance for Mr Donald's reservations does not, however, undermine the broad trends apparent from the analysis of the financial statements and records already referred to.

[18] Westpac had financed Hillside from 1999 and took over financing all of the Crafar companies from 2002. It entered into the composite General Security Agreement (GSA) with Taharua, Plateau and Hillside on 16 May 2005.

[19] Under the GSA the debtor companies charged in favour of Westpac all their "present and after-acquired Personal Property" as continuing security for the payment of the "Secured Money" and the performance of all other obligations of the companies, together with a charge over their other non-personal property assets. "Personal Property" was defined as having the same meaning as in the PPSA, which was accepted as including livestock. "Secured Money" was defined as including "all loans, advances, credits guarantees and any other financial accommodation" provided by Westpac. By clause 8.1 of the GSA the debtor companies undertook to:

> ...
>
> (e) **Carry on business**: Carry on its business in a proper and efficient manner and not without the prior written consent of the Creditor (which will not be unreasonably withheld) discontinue or materially alter the general character of its business or engage in a business not carried on by it as at the date of this Deed.
>
> ...
>
> (n) **Not dispose of assets**: Not without the prior written consent of the Creditor (which will not be unreasonably withheld) dispose of (whether by way of one transaction or a series of transactions and whether at one time or over a period of time):
>
> (i) any of its Personal Property, except where the Personal Property is Inventory and the disposal is in the ordinary course of the Debtor's business *and* on an arms length basis for full value;
>
> (ii) any of its assets subject to the fixed charge created by this Deed; or
>
> (iii) any of its assets subject to the floating charge created by this Deed except in the ordinary course of

> business of the Debtor's business and on an arms length basis for full value;

The GSA also conferred a right on Westpac to appoint receivers to the Charging Group's assets in the event of a default.

[20] In June 2006 Westpac sold down $20 million of its Crafar debt to PGG Wrightson. The parties then entered into the Security Sharing Deed (SSD) of 9 June 2006 by which Westpac became "Security Agent" for itself and PGG Wrightson in respect of all "Security Documents" and rights contained in those documents. By clause 15.1 of the SSD the Crafar companies as members of the Charging Group undertook to comply with the following financial covenants:

> **15.1.1 Equity Ratio**: the Equity Ratio of the Charging Group is to be at all times not less than 2 to 5;
>
> ...
>
> **15.1.6 Dealing with Assets**: it will not sell or transfer any assets valued in excess of $250,000 outside the Charging Group without the prior written consent of the Security Agent, other than normal livestock sales conducted in the normal course of business of the Charging Group ....

Clause 26.1 of the SSD provided that in the event of any conflict between the provisions of the SSD and any other Security Document Westpac as the Security Agent would "in its absolute discretion" determine which is to prevail.

[21] In August 2007 Rabobank was added to the SSD as a lender. Rabobank initially advanced $35 million which was used to reduce PGG Wrightson's debt by $15.5 million and Westpac's debt by $5 million with $14.5 million being used as new funding.

[22] With the support of the lending Banks, the Crafar dairy farming enterprise had by 2007 become a major operation. As David Little, Westpac's relationship manager for the Crafar Group from October 2007 to December 2008, deposed, the Crafars had been "extremely ambitious and entrepreneurial" with land acquisitions. They had a history of being effective in converting dry-stock land into dairy farms in an economical way so that they could made a profit and benefit from the increasing prices of dairy farm land in general. They borrowed, primarily, to pay for land, cows

and Fonterra shares so that additional milk supply could be generated to produce revenue. When Mr Little first assumed responsibility for the Crafar Group he was told of "an extra loan appetite" of $40 million that had been discussed with the Crafars for the purpose of further farm acquisitions. Allan Crafar recalled being told that the Banks were prepared to go up to $200 million. Mr Little deposed that Rabobank and PGG Wrightson provided the extra funding in April/May 2008 with Rabobank lending $25 million conditional on a $5 million reduction later in the year and Wrightson lending $10 million. Westpac also agreed to advance a further $10 million which was provided in May/June 2008.

[23] Under cross-examination Mr Little agreed that by 2008 the Crafars had decided to free up or borrow as much money as they could to buy more land because they saw that future growth was in owning land which they regarded as undervalued. Mr Little also agreed that for this purpose the Crafars were even talking about selling all their livestock as part of their strategy.

[24] Like other dairy farmers, the Crafars were also affected by the serious drought which occurred in the Waikato region in the summer and autumn of 2008. The Crafar farms' production manager's report for March 2008, contained in the minutes of the Crafar Group directors' meeting held on 14 April 2008, recorded:

> With cow condition deteriorating, his concern was that the drought had exposed the Group to very low cover. Although extensive regressing had occurred, this required to be protected by keeping cows off paddocks as far as possible so as to allow recovery and provide winter feed.

Mr Gordon-Glassford acknowledged in cross-examination that it would be a sensible business strategy to dispose of non-income producing rising year one and year two heifers during a drought, particularly when the price was high. Mr Nikora and Mr Diprose, another chartered accountant with expertise in the rural industry, agreed that a drought might lead to the sale of surplus stock.

[25] In early 2008 StockCo discussed with the Crafars a number of proposals for the sale and lease back of some of their cows in order to release capital for additional land acquisitions. Mr Donald of StockCo wrote to the Crafars with a range of models on 31 January 2008. Then in February 2008 StockCo prepared a

comprehensive finance proposal for Plateau involving the sale and lease back of 8,000 cows for $16 million plus GST. The term sheet for the proposed recorded that security would include:

> a) Ownership of 8000 Dairy cows purchased from Plateau Farms Limited with StockCo Holdings Ltd interest registered on PPSR
>
> b) Registered GSA over the borrower with specific security agreement over 1090 dairy cows owned by Plateau Farms Limited
>
> c) Registered GSA over Hillside Limited with specific security agreement over 5910 dairy cows owned by Hillside Limited
>
> d) Deed of Priority with Westpac noting StockCo Holdings Ltd as first and only security holder on 1090 dairy cows owned by Plateau Farms Ltd
>
> e) Deed of Priority with Westpac noting StockCo Holdings Ltd as first and only security holder on 5910 dairy cows owned by Hillside Ltd
>
> ....

[26] The proposal was considered by the directors of the Crafar Group at their meeting on 18 February 2008. The minutes of that meeting record:

> Looking forward, the $16 million deriving from the StockCo transaction was scheduled for receipt prior to the end of February; being 90 days from year-end. The proceeds would be utilised for property acquisitions, which would then substitute for the banks' security hitherto provided by the livestock. The terms of the lease provided for lease-back rates of 11.89% and equal instalments of $400 per head repayable on 31 May 2008, 31 January 2009 and 30 June 2009. These ranked as tax deductible.
>
> Overall, there was a material cost factor in the scheme, but with tax benefits and serving to release $16 million from in-house sources for property acquisition, assessed to yield greater capital appreciation than livestock and with lesser attrition rates.

[27] On 25 February 2008 StockCo submitted its finance proposal to the National Bank of New Zealand (NBNZ) for funding approval and on 27 February 2008 StockCo wrote to Ian Blackman of Blackman Spargo asking him to act for StockCo as well as the Crafars on the completion, execution and registration of the proposed lease and related documentation, including:

....

(h) First Ranking Registered Specific Security Agreement over 5,910 dairy cows owned by Plateau Farms Ltd and 1,090 dairy cows owned by Hillside Ltd;

(i) Second Ranking Registered General Security Agreements over Hillside Ltd and Plateau Farms Ltd;

(j) Deed of Priority between StockCo, Westpac, and both companies...

The letter of instructions also said:

....

9. If any of the securities to be taken by StockCo are to be other than first registered charges on the property then the prior charge holders acceptable to StockCo are:

(a) Westpac New Zealand Limited General Security Agreement....

[28] Blackman Spargo accepted StockCo's instructions. Subsequent correspondence between Blackman Spargo, David Wiltshire for the Crafars and Marcus Kight for StockCo referred to the discovery from up-to-date PPSR searches of other prior charges, including the GSA of 18 May 2005 in favour of Westpac, that conflicted with StockCo's instructions. StockCo amended its instructions to require a First Specific Security over Cows and GSA which ranked after all existing security holders so that only the release of Westpac and the Crafar family trusts security interests over the cows for the GSA would be required.

[29] On 12 March 2008 StockCo wrote to Mr Little of Westpac seeking the release of 8,000 mixed age cows from the Bank's security. This request was followed up by Mr Blackman by email to Mr Little on 18 March 2008 which after referring to the PPSR searches, said:

> To ensure we can give good title to StockCo Limited for the 8,000 cows sold, we request that Westpac provides a partial release of this livestock from their security interests. We look forward to receiving Financing Change Statements recording the release of such livestock as soon as possible.
> Furthermore, to ensure that StockCo Limited has first registered security over the aforementioned cows, they have requested that all parties holding prior charges sign a Deed of Subordination and Priority, a copy of which is attached for your information.

> Would you please give urgent consideration to our client's request and confirm that the livestock sold will be released from your security interest and that the Deed of Subordination and Priority will be signed by Westpac.

[30] On 19 March 2008 Westpac's internal credit people recommended approval of the release of security in respect of the proposed sale to StockCo and consent to subordinated GSAs being taken over Plateau and Hillside. The recommendation was subject to legal confirmation that the proposed security variations were acceptable and to approval from Rabobank and PGG Wrightson. Westpac's internal credit review analysis noted that the Crafars intended to use the funds received from StockCo to meet the purchase price of a drystock farm for $8.6 million and a dairy farm for $5.8 million and that these farms would be added to the Bank's security with registered first mortgages being taken by the Bank as well. Westpac's chief credit officer approved the recommendation on 1 April 2008. As Mr Little explained in cross-examination, this meant that internal Westpac credit sign-off had been obtained for the StockCo proposal, but Westpac itself had not given its approval to the Crafars or to StockCo or "anyone outside of Westpac Group".

[31] By emails sent on 1 April 2008 Mr Little referred the StockCo proposal to Ben Prain of PGG Wrightson and Malcolm Fluker of Rabobank, stating that Westpac had "approved the variation of security that is required for this transaction" and seeking PGG Wrightson's urgent consideration to the request and confirmation of consent to the required security variations.

[32] Ben Prain, the North Island Area Manager for PGG Wrightson, deposed that on 2 April 2008 his company's Credit Committee approved the release of security over the 8,000 cows provided that replacement security was obtained over the land that was to be purchased from the proceeds. He confirmed his company's decision under cross-examination.

[33] Antony Cliffe, the Head of Special Asset Management for Rabobank New Zealand, gave evidence for Rabobank and produced under subpoena a number of Rabobank documents, including documents relating to Rabobank's consideration of StockCo's sale and lease back proposal. Amongst those documents were copies of Mr Little's email of 1 April 2008 and internal Rabobank emails showing Rabobank's

consideration of the StockCo proposal. It is apparent from the internal emails that Rabobank wanted to understand "the full story here and the economics behind the transaction" and that even after discussions with Gerard Donald of StockCo and Dave Wiltshire of the Crafar Group on 3 April 2008, Rabobank was still asking why StockCo would take it on for an 11% return. After further internal emails recording continued Rabobank scepticism about the proposal, it appears that Rabobank's credit people may have been prepared to recommend release of 15,000 cows from their security in favour of StockCo subject to Westpac (under the SSD) "taking security over all additional land purchases including Fonterra shares".

[34] As a result of questions raised by Westpac and Rabobank and the impact of the drought conditions, the Crafars decided not to proceed with the StockCo sale and lease back proposal. The position as at 11 April 2008 was recorded in another internal Rabobank email:

> ....
>
> Crafars have purchased a NZD8 mil property. This was temporarily funded by Westpac (WP). WP's exposure is now at NZD 76mln.
>
> In discussion with David Little, the temp exposure was to be cleared from the sale and leaseback of livestock to Stocko, Stocko also required additional stock as security. Under the syndicate lending arrangement, funding above NZD 70 mln and intended release of security should have been disclosed to Rabo and consented to however this seems to have been overlooked. Budgets initially showed significant NPBT and therefore the sale and leaseback option was to provide tax benefits. The current drought conditions around Crafars farms have minimised profits and as such, they have now decided to cancel the lease option. Therefore cash to fund this property purchase, plus another NZD 5mln property due to settle 31 May 2008 will need to come from the syndicate lenders.
>
> Additionally, David Little was notified this morning by the Crafars, they have entered into conditional contracts to purchase more property at around NZD 30mln.
>
> Therefore total property purchases are as follows;
>
> NZD 8mln Westpac have temporarily funded
> NZD 5mln to settle 31 May 08
> NZD 30mln Unsure at this stage of settlement date.
>
> David Little is going to firm up with the Crafars exactly what the request is and report back to Rabo (Malcolm) and PGG next week ...

[35] The Crafars' decision not to proceed with the proposal was recorded in the minutes of the Crafar Group directors' meeting held on 14 April 2008 in a report from Dave Wiltshire:

> (d) LEASE: STOCKCO LTD
> Dave reported that a series of caveats and difficulties had emerged from Westpac and Rabobank, which had not regarded the provisions of the StockCo lease with any favour considering them to be of little benefit to the group as regards interest rates and the loss of tax benefits arising from late implementation. He was particularly disappointed with Rabobank which had not participated in a tele-conference call convened specifically to resolve the misgivings of the banks. As it was, much time and effort had been wasted in the exercise.

[36] The Crafars' decision not to proceed was also recorded in a Westpac internal report dated 17 April 2008 which noted that following "additional due diligence" the Crafars had decided not to proceed with the sale and leaseback with StockCo "as they have been unable to agree satisfactory resolution to a number of key clauses". Also on 17 April 2008 Ian Blackman wrote to Westpac and StockCo advising that they had received instructions not to proceed. The Blackman Spargo letter to StockCo stated:

> Our clients have had some difficulty obtaining the consent of Westpac Bank to the Deed of Subordination and Priority. Due to the difficulties that they have encountered they have instructed us that they will not be proceeding with the lease with StockCo Limited.

[37] Pausing here, it is appropriate to note the following points:

a) Following a decision to move from higher country land to lower altitude country, which was communicated to the Banks, the Crafars decided to sell livestock to pay for farm acquisitions.

b) The purpose of StockCo's sale and leaseback proposal was to provide funds for the settlement of Crafar farm purchases.

c) To give StockCo the security it required, the approval of the banks had to be obtained to the release of their securities.

d) Contrary to submissions for StockCo, the approval of the Banks was not obtained. While there was evidence of internal recommendations for approval in Westpac and Rabobank, as the minutes of the Crafar Group directors and the letter from Blackman Spargo made clear, no approval was in fact forthcoming.

e) The absence of the Banks' approval was the principal reason why the Crafars decided not to proceed with the proposal and instead accepted temporary finance from Westpac to settle the purchase of the drystock farm.

f) There was no suggestion by any of the parties at the time that the proposed sale and lease back of 8,000 cows would have been in the ordinary course of the Crafar Group business.

[38] Developments in the month after the decision not to proceed with the StockCo sale and lease back proposal are recorded in a Westpac internal memorandum dated 20 May 2008:

> Crafars had planned to enter into a Sale & Leaseback of cows with StockCo which would have realised $18,000 [that is $18 million]. Approvals were sought and gained in March 08 from the banking syndicate. However with further due diligence and in consultation with Westpac they decided not to proceed with this transaction. The main problem was an excessive charge out rate which was not fully disclosed in the offer from StockCo.
>
> In the expectation of these funds Crafars had unconditionally committed to the purchase of a farm (Pyes Pa) for $8.6m on 31/03/08. To assist with the settlement of the Pyes Pa farm and to assist with increased working capital requirements the excesses noted above were approved on 31/03/08 and 22/04/08 (attached) through to 20/05/08.
>
> Subsequent to this Rabo Bank have provided a further $25,000 [$25 million] of facility of which $23.15 [$23.15 million] has been used to purchase another dairy farm (Shetland) – Westpac approval dated 9/05/08.
>
> Crafars are contracted to purchase two further farms as follows:
>
> | | | |
> |---|---|---|
> | Whiskers | 20/05/08 | $6,000 [$6 million] |
> | Hawera | 29/05/08 | $5,800 [$5.8 million] |
>
> Clearance of the overdraft excesses and the purchase of these farms is planned as follows:

- Deposit held with Blackman Spargo will cover the Whisker purchase today.
- PGG Wrightsons have approved an increase in facility to $10,000 (+$10,000) [that is $10 million]. This is in the process of documentation which is expected to be completed by 29/05/08.
- Submission attached proposing increase of Westpac term loans of $10,000 [that is $10 million] and seasonal adjustment of $0.750 [$.75 million].

The group are current negotiating the sale of some Fonterra shares and some cows which would realise +$10,000 [that is $10 million] over the next two months. In the event that Westpac does not approve longer term funding these funds could be used to liquidate the OD excesses.

[39] Next, as the relevant contemporary documents show, a meeting was held in Rotorua on 28 May 2008 between representatives of the Banks and the Crafar Charging Group. Although Mr Little deposed that the meeting was on 29 May 2008, he corrected his evidence under cross-examination. Mr Little also deposed that those attending the meeting were:

Ben Russel and Malcolm Fluker of Rabobank;

Ben Prain of PGG Wrightson;

David McLean and himself from Westpac;

Allan, Beth and Frank Crafar;

David Wiltshire; and

Ian Farrelly, Crafar Advisory Board member

Neither Ian Blackman of Blackman Spargo nor Steven Bignell of Stretton & Co attended the meeting.

[40] Mr Little's handwritten notes of the meeting recorded that the Banks were happy with the Crafar growth aspirations, but that they were also "reaching the limits of our facilities – probably another $10 million" and that they would agree to an additional bank. Mr Little's typed notes of the meeting recorded that one of the goals for the Crafar Group for the next 10 years was family succession and that another was to grow the business by adding value. The notes also recorded that Ian Farrelly (an outside director of the Crafar Group companies) expected "dairy farms to increase in value by a further 20% in the coming months driven by the high global demand for dairy production and rising dairy payout" and that he was aware of

"significant investment interest from large offshore investment entities (BHP/Macquarie)." Mr McLean's internal Westpac email reporting on the meeting confirmed that one of the aims going forward was "to grow the family members own asset base" and that the Crafars were "very happy with Westpac but ASB [was] certainly a concern going forward ...".

[41] Mr Little deposed in his affidavit that the general message from the lending Banks at the meeting was that "it was time for consolidation" and that, beyond the $10 million advance in process at that time, lending was capped. Under cross-examination Mr Little acknowledged that his typed notes and Mr McLeans's email correctly recorded the meeting and that there was no written record of the message that it was time for the Crafars to consolidate. Mr Little was adamant, however, that, as recorded in his handwritten note, he said to the Crafars that the Westpac exposure was capped after the additional $10 million. Significantly, Mr Wiltshire, who arranged the 28 May 2008 meeting and a later one on 21 July 2008, deposed that the message was clear at both meetings that the Banks had reached or nearly reached the limits of their lending and that the Group should focus on consolidation and stop the pace of expansion. Mr Wiltshire agreed in cross-examination that, while the Banks were telling the Crafars to be careful and consolidate, at the same time they did not want to completely upset what was a very valuable relationship. Neither Allan nor Robert Crafar in their affidavits or in their evidence took issue with the evidence of Mr Little, as confirmed by Mr Wiltshire, on the nature of the message conveyed by the banks at the meeting. Indeed the cross-examination of Allan Crafar included the following exchange:

Mr Stewart QC	Now you had a meeting with the banks in Rotorua on the 29th of May 2008, probably at Mr Blackman's office, do you remember that?
Mr Allan Crafar	Yes.
Mr Stewart QC	I think a few bankers came down to see you and Mr Little's evidence is that the banks advised the meeting that it was time for the Crafar Group to consolidate and that the banks were not prepared to fund further farm acquisitions at that point in time. Do you recall that?
Mr Allan Crafar	Yeah they had – we had a meeting there, we've had those sorts of meetings over the years. Starting off when we bought our first farm and still going now.

Mr Stewart QC	And then there was a further meeting which Mr Blackman attended also, and yourself and other members of the Crafar family and the banks on the 21st of July 2008, do you remember that?
Mr Allan Crafar	Oh I couldn't say exactly but remind me.
Mr Stewart QC	Okay, and where Mr Little said, "The consolidation message was repeated and it was said the banks would not fund further farm acquisitions." Yes?
Mr Allan Crafar	Yes, we didn't do any further acquisitions under Crafar Group.

[42] When Mr Little was recalled at the request of StockCo to give further evidence, he was cross-examined about Mr Wiltshire's evidence that the Banks did not want to upset the valuable relationship with the Crafar Group. While Mr Little did not dispute that the Banks may have provided a mixed message at the meeting, he confirmed in re-examination that Mr Crafar's evidence gave a fair summary of how he responded at the meeting and that in fact following the May meeting there were no further farm purchases by the Crafar Group submitted to the Banks for consideration.

[43] Purchase of farms by the Crafar Group already the subject of agreements prior to the 28 May 2008 meeting with the Banks were settled with Bank funding provided after the meeting. Mr Wiltshire deposed that the properties in this category were:

(a) Hawera (July 2008) dairy farm;

(b) Forrest Road (June or July 2008) drystock;

(c) Maxwell (added to Glyn Park) (June or July 2008) drystock;

(d) Ferryview (June or July 2008) dairy;

(e) Pyes Pa (March 2008, sold in April 2009) drystock.

[44] After the 28 May 2008 meeting further farm purchases by the Crafar Group were made in the name of Robert Crafar's company, Nugen. Allan Crafar deposed that purchases in this category were:

(a) Waitotara Property 161 hectares, purchased June 2006;

(b) Northland Property 220 hectares, purchased June 2008;

(c) Mohaka (Springhill Station) 581 hectares, purchased July 2008;

(d) Turakina 190 hectares, purchased July 2008;

(e) Norsewood (No. 1) 128 hectares, (possessed 1 August 2008) delayed settlement;

(f) Norsewood (No. 2) 195 hectares purchased 23 July 2008;

(g) Hamilton property 167 hectares, purchased June 2008;

(h) Torrent Farms 107 hectares, a joint venture between RSC Limited and Dave Wiltshire, the last 40 hectares of which were purchased in June 2008.

Mr Crafar also deposed that of these farms, the Mohaka (Springhill Station), Turakina, Norsewood (No. 1), Hamilton and Torrent Farm properties were drystock grazing properties, not suitable for dairy farming. The others were dairy farming properties. Mr Kight deposed that StockCo was aware of the seven farm purchases by Nugen and the intentions of the Crafar Group in respect of them.

[45] As StockCo was involved in providing finance for three of these Nugen farm purchases, Northland and Norsewood (No. 1) and (No. 2), further detail about those purchases needs to be given.

[46] The two Norsewood purchases were from WHF and LTM Downs (the Downs). The agreement for sale and purchase of Norsewood (No. 2) dated 19 June 2008 involved the purchase of the farm property, plant and equipment and 520 mixed age dairy cows at $1,400 per head ($728,000) for a total purchase price of $7.85 million. A deposit of $375,000 was payable immediately on the agreement becoming unconditional and settlement was due on 1 August 2008. An undated copy of the agreement for sale and purchase of the Norsewood (No. 1) property was in evidence, which showed that the purchase price was $2.5 million and that a deposit of $125,000 was also payable with settlement on 20 May 2009.

[47] The Northland purchase was from Riverside Farms (Waipapa) Ltd and was originally by Plateau (or nominee). The agreement for sale and purchase of the

Northland farm dated 20 June 2008 showed that the purchase price was $7.5 million with a deposit of $750,000 payable by 20 June 2008 and with settlement on 28 November 2008.

[48] Following an urgent request from Blackman Spargo on behalf of the Crafar Group, StockCo agreed to advance Nugen, as Plateau's nominee, $750,000 to pay the deposit on the Northland farm purchase with security in the form of 750 mixed aged cows to be sold by Nugen to StockCo at $1,500 a head and to be leased back by StockCo to Nugen. The documentary evidence established that StockCo advanced the sum of $843,750 to Nugen by direct transfer to the vendor's solicitor's trust account on 20 June 2008 and that Nugen entered into a five year lease back agreement with StockCo also dated 20 June 2008. Mr Allan Crafar gave evidence that to enable Nugen to sell 750 cows to StockCo they were "given" to Robert Crafar on 20 June 2008 in return for his unpaid farm services over the previous 15 years. Under cross-examination, Mr Kight said that StockCo did not require the 750 cows to be identified or tagged as required by the terms and conditions of StockCo's standard dairy herd lease agreement, but instead relied on Blackman Spargo's solicitor's certificate dated 23 June 2008 that a search of the PPSR Registry disclosed no security registered over the Nugen cows.

[49] Payment of the deposits totalling $500,000 for the purchase by Nugen of the two Norsewood properties from the Downs was arranged later in June 2008. The agreement for sale and purchase of Norsewood (No. 2) was sent by Mr Wiltshire to StockCo which agreed to fund the deposits against the security of the 520 cows being purchased by Nugen. The funds were advanced by StockCo to Blackman Spargo which paid the deposits to the vendors' agent on 1 July 2008. As Nugen did not, however, acquire ownership of the cows from the Downs prior to settlement, then expected to be on 1 August 2008, it was unable to sell them to StockCo and lease them back before that date. Under cross-examination, Mr Kight was reluctant to acknowledge that he was aware at the time that StockCo had funded the payment of the deposits on the two Norsewood properties on the security of cows which Nugen did not own, but the documentary evidence showed that that was indeed the position and it is hard to believe that Mr Kight was unaware of it. A suggestion by counsel for StockCo that Mr Kight was not cross-examined on this issue is not

correct. Mr Kight was cross-examined extensively on StockCo's knowledge of the Nugen purchase of the Norsewood properties and the purpose of the funds advanced for the deposits on the security of the cows. I am satisfied from the cross-examination and the documentary evidence to which Mr Kight was taken and which included the agreement for sale and purchase sent to StockCo by Mr Wiltshire on 27 June 2008, an internal StockCo memorandum to Mr Kight dated 30 June 2008 referring to the Nugen purchase, relevant banking records and the subsequent livestock agreement, that StockCo was aware that it had funded the payment of the deposits on the two properties on the security of the cows before they were purchased by Nugen.

[50] Another aspect of the Crafar Group business at this time was the development of 50/50 sharemilking proposals with StockCo's assistance. Mr Crafar gave evidence under cross-examination that the Crafars got Ged Donald of StockCo to do a presentation to sharemilkers at the end of June 2008 about the benefits of buying cows. Mr Kight produced a copy of StockCo's PowerPoint presentation. Mr Wiltshire was cross-examined about the presentation, which he attended in Wanganui, and confirmed that he had also spoken supporting the sharemilking proposals.

[51] Mr Kight also deposed to the significant increase in the Fonterra dairy payout during the 2007-2008 season and the impact this had on large-scale dairy farmers who were seeking to sell non-productive stock to finance the purchase of farmland for conversion and the subsequent purchase or lease of replacement stock.

[52] In mid-June 2008 there had been a meeting between Mr Kight, Allan and Frank Crafar, Beth Crafar and Ian Blackman in Rotorua to discuss the financing of a transaction for a 50/50 sharemilking arrangement between Plateau and O and K Gibberd (OK Dairies). Mr Kight summarised his understanding of the proposed transaction in a memorandum for the Crafars and Mr Blackman dated 19 June 2008 which referred to the sale of 2,100 cows by Plateau to StockCo for $4.2 million plus GST with the proceeds from 1,100 cows relating to the sharemilker transaction and the balance applied to assist with the purchase of a new farm. A lease-back of the 1,100 cows was contemplated, as was a $2 million loan from StockCo to the Crafar

Group in respect of the 1,000 cows. Under cross-examination Mr Kight said that StockCo was not going to take ownership of the 1,000 cows, but a first ranking security with Plateau retaining title and OK Dairies having possession of them. Plateau would then lend $2 million to OK Dairies so that its interest ranked behind StockCo's prior charge. Mr Kight was then unable to explain how the loan could also be utilised by Plateau to pay a deposit on a farm.

[53] Not surprisingly, Mr Blackman responded to Mr Kight indicating that his memorandum differed significantly from the previous discussion. Mr Blackman's letter of 24 June 2008 read in part:

> Our clients do not wish to sell the cows direct to StockCo Limited on the basis that to do so requires the involvement of our client's lead financier and this will create a number of problems and issues.
>
> To avoid these problems, at our meeting last week we proposed the following structure. We understand from Dave Wiltshire that this is how the transaction should be structured:
>
> 1. Plateau Farms Limited will sell to OK Dairies Limited 2,100 cows. By doing this we can complete the sale in the course of ordinary business which means that our client's bank will release the stock from their security interests.
>
> 2. OK Dairies Limited will sell to StockCo Limited 2,100 cows for the sale price of $2,000 plus GST per cow.
>
> 3. OK Dairies Limited will lease the livestock back from StockCo Limited.
>
> 4. Plateau Farms Limited will receive from OK Dairies Limited the sum of $2.2 million on the settlement date. That balance of the purchase price of $2,000,000 will be lent to OK Dairies Limited by way of vendor finance with interest capitalised during the term of the lease of the livestock from StockCo Limited.
>
> 5. The trustees of the A J and E J Crafar Family Trust and the trustees of the F R Crafar Family Trust will guarantee the lease payments to StockCo Limited.

[54] While Mr Kight said he did not know what Mr Blackman was referring to when he mentioned "a number of problems and issues" with the Crafars' lead financier, he acknowledged in cross-examination that StockCo needed the Bank's consent for the sale of the 1,000 cows for which StockCo was paying no consideration. Mr Blackman was also unable to explain in cross-examination how it

would be a good deal for Plateau to leave $2 million in unsecured. He accepted that a risk would be involved, but suggested that with the buoyant market in the dairy industry no one would have anticipated what subsequently happened.

[55] On 30 June 2008 StockCo perfected its security interest in all livestock leased to Nugen, including the 4,000 heifers subsequently leased, by registration of a financing statement on the PPSR as F21996F92X1V3J05 against Nugen as a debtor.

[56] The transaction documents for the 50/50 sharemilker arrangement between Plateau and OK Dairies were executed on 7 July 2008 with an agreement for sale and purchase of 2,100 cows for $4.2 million and then a sale and lease back agreement between OK Dairies and StockCo. Blackman Spargo wrote to Westpac on 8 July 2008 seeking the Bank's release from its PPSR securities.

[57] The Crafar Group also entered into two other 50/50 sharemilker arrangements: one between Taharua and Milk Pride on 23 June 2008 involving the sale of 4,950 dairy cows and 195 bulls; and the other between Plateau and Vision View on 11 July 2008 involving the sale of 1,500 dairy cows. Mr Kight confirmed in cross-examination that he and Mr Donald understood that the Crafars still intended to use the proceeds of the sale for further farm purchases, but denied that he was aware that the Banks required the proceeds to be used for the reduction of debt and not for further acquisitions.

[58] The evidence for Westpac was that the Crafars had been advised of the requirement to use the proceeds for reduction of debt before 17 July 2008 when a Westpac credit approval memorandum drafted on that date recorded:

> The Crafars have a preference to use the surplus funds realised of $8,954 [that is $8.954 million] to purchase more farms. We have advised that in the short term we require the funds to be used to reduce debt pending an update on their financial position ....

Westpac's position was formally confirmed by letter dated 1 August 2008 when Westpac granted consent to the lease of its securities in respect of these three 50/50 sharemilker transactions, subject to a number of conditions, including a reduction in

the debt of the Charging Group in the sum of $8.954 million being the net proceeds of sale.

[59] There is little doubt that Allan Crafar knew that the Banks would require the proceeds of any sale of livestock by the Charging Group to be used for the reduction of debt and not for the purchase of further farms. He agreed under cross-examination that in mid July 2008 he was informed by the Bank that the proceeds of the sales to the sharemilkers of nearly $9 million had to be applied to reduce debt and that with the need for Nugen to settle the purchase of Norsewood (No. 2) on 1 August 2008 he would need to obtain funds from elsewhere. He agreed that, having received a message from Mr Blackman about difficulties with settlement of that purchase or another one, he had called Mr Blackman's legal executive who had recorded Mr Crafar's response in an email to Mr Blackman:

> Allan Crafar called [at] 10.55am.
>
> He said he was returning your message at 9.40am and that you've got the wrong end of the stick...
>
> He said that you were talking about the Norsewood Run-Off – he said it "is NOT a run-off, it's a DAIRY FARM"
>
> And that you said that they couldn't settle on Friday and were telling the solicitor that ... he said well that's wrong, they are GOING to do it, they will get the money from StockCo not the banks because they are useless.
>
> He said you need to call him. (Just to warn you – he was quite annoyed)

Mr Crafar agreed that he would have said something along those lines.

[60] Mr Blackman agreed under cross-examination that he knew that the Banks required the $9 million to be used for debt reduction and that settlement of the Norsewood (No. 2) purchase on 1 August 2008 would be in jeopardy without funds from another source. Mr Blackman confirmed that he was told by Mr Allan Crafar to get the money from StockCo.

[61] There is no doubt that there must have been discussions between representatives of the Crafar Group and StockCo at this time, because on 17 July 2008 Mr Kight wrote to Mr Blackman about the first proposal relating to the 4,000 rising year one heifers the subject of this case. Mr Kight's letter said:

> We understand that Plateau Farms Ltd wishes to:
>
> 1. Sell to StockCo and Lease back 4,000 R1 heifers at $800 plus GST per heifer.
>
> 2. Receive settlement of $3.60 million (incl GST) for these heifers on Friday 18th July.
>
> 3. Structure the lease so that there are no (cash) lease payments prior to 30th June 2009.
>
> 4. Have the ability to transfer the lease to another entity / sell the heifers around the 30th June 2009.
>
> We further understand that the heifers are subject to Security Agreements with Plateau's Banking group.
>
> Blackman Spargo wish to send a copy of StockCo's standard bank security release letter (attached) with a cover letter to Plateau's Banking group to effect a release of any security interests, and upon such release will provide StockCo with a Solicitors Certificate confirming the fact that clear title to the heifers will transfer to StockCo upon settlement.

Attached was a letter also dated 17 July 2008 from StockCo to Westpac seeking Westpac's release from its securities for the 4,000 heifers.

[62] Mr Kight explained that Westpac's consent was required because the proposal involved a sale and lease back to Plateau of the livestock. A leaseback to a vendor is not a purchase money security interest (PMSI) under s 16(1)(b) of the PPSA. It would be different if the lease was to a third party.

[63] Mr Kight also said that he could not recall whether Mr Allan Crafar had told him that he was approaching StockCo for the money to complete the farm purchase transactions because the Banks would not release the money for that purpose.

[64] On 18 July 2008 Mr Kight sent an email to Mr Blackman recording his understanding that some of the 4,000 heifers were owned by Hillside and that, if that was so, the letter to Westpac would be incorrect. As an alternative to amending it, Mr Kight said the StockCo would accept Mr Blackman's confirmation on settlement that all 4,000 heifers were released from any security interest.

[65] On the same day StockCo's finance proposal contained a description of the proposed transaction and, significantly, recorded the reason for the funds as follows:

> **Crafar's wish to transfer capital in livestock to capital in additional land**. This will be accomplished by moving lower order sharemilkers into 50:50 positions on their existing and recently purchased properties.
>
> This transaction will form part of that transition, with the potential to either transfer the lease to sharemilkers who are building their herds to sell the heifers out of this lease into a new one with the sharemilkers.
>
> (Emphasis added)

The proposal also noted the following "conditions precedent":

> StockCo solicitors to confirm Westpac release of proposed security and StockCo security interest registered on the PPSR for the livestock being purchased and leased back.

The importance of the "conditions precedent" for StockCo was reinforced by an internal StockCo email of the same date which referred to the need to have clear title to the livestock with "the Bank waiver being imperative in this regard".

[66] The reference in the proposal to "Crafar's wish to transfer capital in livestock to capital in additional land" confirmed that the purpose of the transaction was to use the proceeds from the sale of the 4,000 heifers to make or complete the Group's farm purchases. Bearing in mind that previous purchases had been funded by the Banks, it is hard to believe that Mr Kight would not have appreciated that the Crafars had approached StockCo for finance because the Banks were not prepared to provide further funds for that purpose.

[67] Also on 18 July 2008 Blackman Spargo wrote to Westpac to advise that Plateau, Hillside and Taharua would be selling all livestock owned by them and to seek the Bank's confirmation that all livestock would be released from the Bank's PPSR securities. Mr Little gave evidence that he did not recall receiving this letter, but there is no dispute that the Bank did not advise Blackman Spargo or the Crafars that it agreed to the release of its securities in respect of all the livestock.

[68] On the contrary, the Westpac internal credit approval summary dated 24 July 2008 with an attached memorandum drafted on 17 July 2008 referred to a Crafar group request for the release of "some cattle" from our security interest, namely 1,500 mixed aged cows to be gifted to their children, 2,100 mixed aged cows sold by

Plateau to OK Dairies, and 5,000 mixed aged cows, together with 200 two year old bulls, sold by Taharua to a sharemilker. The total number was 8,800 which equalled 36% of the herd. Of these, 7,300, in the ownership of sharemilkers on Crafar farms, would remain within the Bank's security. The net amount released for debt reduction was $8.954 million, which would improve the equity ratio marginally from 40.1% to 43.9%. As already noted, the Bank had advised the Crafars that it required the funds obtained from these sales to be used for debt reduction and not for the purchase of more farms. It was on this basis that the release of security was approved.

[69] On 21 July 2008 there was a further meeting between representatives of the Bank and members of the Crafar family and their advisers in Rotorua. Mr Little deposed that Ben Prain of PGG Wrightson, Malcolm Fluker of Rabobank and David McLean and himself for Westpac represented the Banks, and that with Allan, Beth and Frank Crafar were David Wiltshire and Ian Blackman. Mr Little's evidence was that the Crafars acknowledged further farm acquisitions, but outside the Charging Group, and that the consolidation message was delivered again as was the advice that there would be no further loans for funding farm acquisitions. None of the Crafars or either of their advisers gave evidence disputing Mr Little's account of this meeting. At one stage Mr Bignell thought he had been present at the meeting, but on further reflection he accepted that he had not been.

[70] On the same day, however, "completely coincidental" according to Mr Blackman, the directors of Plateau resolved to sell 4,000 rising one year heifers to StockCo for $800 plus GST per heifer and to enter into a Dairy Herd Lease Master Deed and a Supplementary Agreement for a lease back of the 4,000 heifers for a term of five years with a first lease payment due on 20 December 2009. The directors also passed a resolution:

> That in the opinion of the Directors, having regard to all relevant factors, the entry into and execution by the Company of the above documents is for the benefit of and in the best interests of the Company.

[71] On 23 July 2008 Blackman Spargo wrote to StockCo forwarding the executed lease documents for execution and return by StockCo.

[72] On 24 July 2008 the Crafar companies in the Charging Group entered into a further General Security Deed (GSA) with Westpac in its capacity as Security Agent for the Banks. Clause 13.1 of the further GSA included the following negative undertakings:

> **13.1** **General**: Each member of the Charging Group undertakes that it will not:
>
> (a) **Financial Accommodation**: lend or otherwise provide any financial accommodation or give any Guarantee to, or for the benefit of, any person;
>
> (b) **Change of Business**: make, or threaten to make, any material change in the nature or scope of its business as presently conducted;
>
> ...
>
> (j) **Disposal of Secured Property**: dispose or permit the disposal of any part of the Secured Property except that, at any time before:
>
> (i) the Charges over such Secured Property created by this Deed become enforceable; or
>
> (ii) the Secured Party gives notice following an Event of Default or Potential Event or Default that such disposals and collection are no longer permitted,
>
> the Charging Group may, subject to any other restriction binding on it, dispose of Inventory and collect Accounts Receivable in each case in the ordinary course of business of the Charging Group;

[73] Also on 24 July 2008 Ian Blackman wrote to the solicitors acting for the Downs putting forward a proposal in the event that Nugen was unable to settle the purchase of Norsewood (No. 2) in full on 1 August 2008. The proposal involved payment of a further deposit of $3 million and an estimated $920,000 plus GST for all the livestock, plant and machinery.

[74] By this time Mr Blackman was becoming increasingly concerned about the need to obtain $4 million for his proposal in respect of the purchase of Norsewood (No. 2) due to occur on 1 August 2008. As he acknowledged in cross-examination, he knew that StockCo would not provide the funds for the proposed Plateau sale and lease back of the 4,000 heifers without the Bank's consent and that the Bank would

not give its consent if the funds were going to be used for a purchase rather than the repayment of debt. Mr Blackman said:

> ... we certainly knew at that stage that any proposed sale of livestock – capital livestock would – we would likely get the answer if we applied for consent because we've had it before. This money is to be used to repay debt, you can't use it to buy land.

[75] Mr Blackman's concerns led him to have a discussion with Messrs Wiltshire and Allan Crafar on 24 July 2008 which he recorded in a file note of that date. The note was headed "NUGEN FARMS LIMITED – NORSEWOOD" and read as follows:

> This memorandum records my discussion with Dave Wiltshire and Allan Crafar regarding the funding of approximately $4 million for the further deposit and the purchase of livestock and machinery.
>
> Dave expressed the view that it was no longer his problem and I should talk directly with Allan.
>
> Allan was upset by the fact that the bank could not release the livestock, but assured me that the $4 million required would be found for settlement on 1 August.
>
> He suggested that if necessary he would sell the heifers, his trading stock and fund the heifers through StockCo. I advised him that we would still need release of the livestock from the bank and he debated that issue with me.
>
> I was looking from [sic] some assurance that we should proceed with the arrangement with the vendor which necessitated the payment of $4 million on 1 August to allow the vendor to have sufficient funds to settle an on-purchase. I was instructed to proceed on that basis although I did not have any confidence that the $4 million would be available on 1 August as required.

[76] Allan Crafar was cross-examined about Mr Blackman's file note of their discussion. As far as Mr Crafar was concerned, the StockCo transaction with the yearlings was "a done deal" and the consent of the Bank was not required because in his view the Bank had no security over the young stock. The file note was correct in recording that he and Mr Blackman "debated" the issue. Mr Crafar agreed that "in hindsight" it would have been easy simply to have told the Bank what was happening.

[77] On 30 July 2008 the solicitors for the Downs sent Blackman Spargo a settlement statement for Nugen's purchase of Norsewood (No. 2) showing a balance due on settlement on 1 August 2008 of $7,679,401.81. On 1 August 2008 the solicitors for the Downs sent Blackman Spargo a statement of funds to pay as at that date for Nugen's partial settlement of Norsewood (No. 2) for $4,726.498.69 and a GST invoice for $2,812,500 for Nugen's purchase of Norsewood (No. 1).

[78] With the need for Nugen to find $7,538,998.69 for the two Norsewood purchases, 1 August 2008 was going to be a busy day for the Crafars, their lawyers and StockCo. Mr Blackman admitted that they were under a lot of pressure to settle. It started with a discussion in the morning between Marcus Kight and Ian Blackman which led to an email at 12.09 pm recording what StockCo required to enable settlement to occur:

> Undertaking from Allan Crafar or Blackman Spargo that Westpac have given a verbal consent of release of the banks security interest in the 4,000 heifers to be acquired by StockCo. We understand that the Heifers are currently owned by Plateau and Hillside.
>
> Undertaking that Blackman Spargo will provide a copy of the banks written confirmation of release of security by 20th August 2008.
>
> In the event that this is not provided, the Crafar group will (upon request by StockCo) provide mortgage based security over land with an unencumbered security value of not less than $3.2m. Such security to be provided within 14 days of StockCo's request.
>
> We understand that time is of the essence and we wish to settle this transaction today.
>
> We look forward to your instructions.

[79] Mr Kight was cross-examined at some length about this email. He acknowledged, albeit with some reluctance, that his request for an undertaking from Blackman Spargo was necessary because the written consent of the Banks had not been obtained and was unlikely to be obtained that day. He also acknowledged that time was of the essence because the Crafar Group had been looking to generate cash from the sale of livestock in order to buy farms with deferred settlements. He denied that he had in his possession a copy of the contract for Nugen to settle the purchase of the Norsewood (No. 2) property on 1 August 2008, but, as already noted, the evidence established that a copy of the agreement for sale and purchase of the

property had been sent to StockCo by Mr Wiltshire (on 27 June 2008) and the agreement showed that settlement was scheduled for 1 August 2008. StockCo had also already provided the funds for Nugen to pay the deposits for the purchase of the two Norsewood properties on the security of the cows which Nugen did not own. In light of this evidence and the fact that Mr Kight knew that the funds from the sale of the heifers were required for the settlement that day of a farm purchase, and in view of the discussions which Mr Kight had with Mr Blackman at the time of the negotiations, I find it inherently unlikely that he was not aware that the funds were required for the purchase by Nugen of the Norsewood (No. 2) property.

[80] When Mr Blackman was referred in cross-examination to his 12.09 pm email, he agreed that the undertakings sought by StockCo would not be provided by Blackman Spargo because no consent had been or would be obtained from the Banks as none had been or would be sought. Mr Blackman also agreed that no mortgage based security would be provided because the Crafar Group had no unencumbered land. Mr Blackman explained that he had difficulty in dealing with Mr Kight who didn't understand the legal structures. Mr Blackman was "pretty sure" that Mr Kight knew that the money was needed for a property purchase with a settlement deadline, but thought that he wouldn't know anything more about it.

[81] It was Mr Kight's email, however, which made Mr Blackman realise that, as he put it under cross-examination:

> In order to facilitate the deal – in order to settle that transaction or part settle that transaction I needed to find a way to enable the organisation to sell assets without the consent, without needing the consent of the bank.

According to Mr Blackman, the suggestion that the heifers were "trading stock" so that the bank's consent was not required and the idea of introducing Nugen came from Allan Crafar, but it was necessary for him (Mr Blackman) to check the security documents to determine whether the heifers could be sold free of any security. Mr Blackman said that, after checking the security documents, he discussed the position with Allan Crafar who satisfied him that the sale of the heifers would be in the ordinary course of their business. Mr Blackman accepted that the sale was plausible because they were trying to ramp up maize production on Plateau land and denied that Nugen was brought in to ensure that StockCo had a PMSI. It was Mr

Blackman's evidence that he did so that day and had a further discussion with Mr Kight about the way we were doing it before sending him further emails. Before the emails were sent, however, another event intervened.

[82] At 2.13 pm Blackman Spargo, having received Westpac's letter dated 1 August 2008 consenting to the release of the stock for the sales by Plateau to Vision View Limited and OK Dairies and by Taharua to Milkpride Limited on the condition that the net proceeds of $8.954 million were used to reduce the debt to the Banks (the Variation Letter), mailed David Little of Westpac seeking an amendment to the Variation Letter because as Milkpride was purchasing shares in Taharua for $4,383,855.20 the net sale proceeds were $4,336,144.80. Mr Little immediately responded by email recording that the Bank had been advised that that the share sale figure was $3 million and that he had left a message for Mr Blackman and his legal executive "to discuss".

[83] At 3.35 pm Mr Blackman sent the following email to Mr Kight:

> We act for Nugen Farms Limited. I understand that you have, or intend to purchase 4,000 yearling heifers from Plateau Farms.
>
> We confirm on behalf of our client, Nugen Farms Limited ("Nugen") that it will lease such livestock from StockCo upon normal terms and conditions.
>
> We advise that the livestock will depasturing on approximately 160 hectares owned by Nugen situated at Waitotara near Wanganui.
>
> We will arrange for the lease documents and other securities to be executed as soon as possible.
>
> May we have therefore as soon as possible your instructions with respect of those security documents.

Mr Blackman explained under cross-examination that he believed he would have discussed with Mr Kight the introduction of Nugen into the transaction before he sent this email. He also said that information about the depasturing of the heifers would have come from Allan Crafar or Dave Wiltshire.

[84] One minute later at 3.36 pm Mr Blackman sent Mr Kight the following further email:

> Further to our discussion this morning I now <u>enclose</u> for your consideration

> the relevant clause relating the disposal of assets pursuant to the composite general security agreement and guarantee given by Plateau Farms Limited and Hillside Limited to Westpac Banking Corporation.
>
> Please note that the debtor (ie Plateau Farms Limited and Hillside Limited) may dispose of personal property in circumstances where such personal property is inventory and the disposal is in the ordinary course of the debtors business and on an arms length basis for full value.
>
> I am advised by Allan Crafar that in his view the 4,000 heifers have been in the past and in are currently inventory and will be sold for full value in accordance with the exception contained in clause 8.1(n) in the security agreement.
>
> On this basis it is our view that the heifers do not form part of the security held by the bank as their disposal falls clearly within the exception.
>
> On this basis we do not consider that it is necessary or desirable to require any of the security holders under the General Security Agreement to consent to the sale and purchase of the livestock in question.
>
> On the basis of this arrangement we enclose for your consideration an Agreement for Sale and Purchase of Livestock for signing by StockCo. Once the agreement is signed we expect settlement of the sale of occur as soon as possible by the depositing of the purchase price plus GST in our trust account as soon as possible.
>
> We agree in consideration of your paying the purchase price today that you hold the security documents given by Plateau Farms in escrow pending the signing of a lease upon terms satisfactory to the parties by Nugen Farms Limited.
>
> Thank you for your assistance in finalising this matter.

Attached to the email were copies of clause 8.1(n) from the GSA dated 16 May 2005 and an agreement for the sale and purchase of livestock between Plateau and StockCo.

[85] Under cross-examination Mr Blackman confirmed that his advice had been based on clause 8.1(n) from the 16 May 2005 GSA rather than on the equivalent clause from the latter GSA dated 24 July 2008 and that in his view the livestock were inventory because they were trading stock rather than capital stock. In Mr Blackman's view replacement stock were not capital stock until they became part of the herd when they were pregnant and being milked or were to be milked during the season. Retention of replacement stock was also an old-fashioned and conventional way of doing things. The practice of dairying farming had changed significantly in the last ten years. Mr Blackman did not consider that the fact that the

Crafar Group accounts showed that the sale of first year heifers by Plateau in the six years between 2003 and 2008 was negligible was conclusive because only Allan Crafar knew what was being sold and there was a huge difference between what actually happened on the farm and what the accounts recorded as having happened. Mr Blackman admitted that he was unaware of the records when he gave his advice, but said that he would have trusted what Allan Crafar told him a lot more than the accounts or the records. Even if the records had been accurate, Mr Blackman would have considered that the rising one year heifers were inventory and not capital stock because of the way the Crafars farmed. Mr Blackman agreed that the heifers were sold in order to fund the deposit on the Norsewood purchase, but said that that did not detract from the possibility that, as the Banks knew, the Crafars had in the past treated their rising one-year heifers as trading stock. Mr Blackman said that the Banks knew this because it was in the documentation and they knew how the Crafars operated. He was, however, unable to explain how the Banks knew this from the accounts which they received and relied on, which he claimed were inaccurate because they did not disclose such sales. Mr Blackman did not recall checking the meaning of "inventory" in the PPSA which, while he acknowledged would have been a good thing to have done, did not take him any further.

[86] Mr Blackman agreed in cross-examination that the view in his second email that the 4,000 heifers were inventory and would be sold for full value was based on advice from Allan Crafar. He agreed that his view that the heifers could be sold without the consent of the Banks was based on that advice. He also explained that he considered it was not "desirable" to approach the Banks because he did not want to find out that they stood in the way of the deal which was "definitely a risk". Finally, Mr Blackman confirmed that he had signed the enclosed agreement for sale and purchase of the 4,000 heifers on behalf of Plateau.

[87] Mr Kight was also cross-examined about the 3.36 pm email he received from Mr Blackman. He did not believe that he had had any discussion with Mr Blackman about the desirability or not of contacting Westpac. He claimed that the 11th hour restructure of the transaction was not particularly surprising and that it did not cause him to hesitate, but he acknowledged:

> All I can say is, with the benefit of hindsight with knowing what we do now, I would've looked at it differently but at the time it did not appear irregular.

Mr Kight also said that he considered that the sale of the 4,000 heifers was sale of "inventory" in "the ordinary course of the business" of the Crafar Group.

[88] The next step was an email at 3.49 pm from StockCo to Blackman Spargo requesting confirmation of the bank account to which StockCo should transfer the funds on settlement of the sale of the 4,000 heifers. By email timed at 3.57 pm Blackman Spargo provided StockCo with their National Bank trust account number and asked for confirmation that the funds were cleared. By email timed at 4.41 pm StockCo advised Blackman Spargo that $3.6 million in "clear funds" had been transferred to their trust account.

[89] Mr Blackman gave evidence in cross-examination that the $3.6 million would have gone into the Plateau trust account and would then have been "journalled to be documented at a later date from Plateau to Nugen." There was also evidence that Nugen received a temporary loan from Taharua of $1,126,498.69 on 1 August 2008. Having received these funds into his firm's trust account, Mr Blackman was then able to use them to arrange to direct credit the account of the solicitors for the Downs at 4.50 pm with $4,726,498.69 "as a further deposit on the agreed terms" for the partial settlement of the purchase of the Norsewood property.

[90] Mr Blackman also gave evidence in cross-examination that there was no directors' resolution by Plateau for the loan to Nugen and no security was given by Nugen to Plateau for the loan until later (17 December 2008). When Blackman Spargo subsequently reported to Strettons on 25 August 2008 about the loan of the whole of the sale proceeds (including GST) to Nugen it was noted that this created a GST problem for Plateau which did not have the GST from the sale to meet its IRD obligations. Strettons was told to discuss with Dave Wiltshire how to access repayment of the $400,000 GST from Nugen to meet the Plateau payment due to IRD at the end of September.

[91] To complete the new lease back transaction between StockCo and Nugen, StockCo completed a letter dated 1 August 2008 confirming the new transaction.

The agreement for sale and purchase of 4,000 heifers for $3.2 million (800 per head) plus GST was dated 1 August 2008. The lease of the herd by Nugen from StockCo was dated 1 August 2008, but executed on 5/6 August 2008.

[92] Pausing then at the end of the day on 1 August 2008 when the sale the subject of this case occurred it is apparent that:

a) At all times the purpose of the transaction was to obtain funds to enable Nugen to settle or partially settle the purchase of the Norsewood property on 1 August 2008.

b) StockCo knew that funds were required by the Crafars for the settlement of a farm purchase that day, namely the Norsewood property.

c) Until the morning of 1 August 2008, the original proposal involved a sale and lease back by Plateau of 4,000 rising year one heifers for $3.2 million.

d) The original proposal would have required the consent of the Banks, at least in part because the lease back to Plateau would mean that StockCo would not have a PMSI.

e) Neither the Crafars nor their advisers sought or obtained the consent of the Banks to the original proposal.

f) The transaction involving the sale of the 4,000 heifers by Plateau to StockCo and the lease back by Nugen was a new proposal developed for the first time on 1 August 2008. It proceeded without notification to the Banks because StockCo accepted the advice of Mr Blackman, who acted on the basis of information provided by Allan Crafar, that the livestock were inventory and that a sale of 4,000 rising year one heifers was within the ordinary course of business of Plateau.

g) The $3.2 million received by Plateau for the sale of the livestock passed through the Blackman Spargo trust account to meet the deposit on the partial settlement by Nugen of the Norsewood property. At no time did the funds pass into or through the Crafar accounts with the lending Banks.

h) Neither the Crafars nor their advisers sought or obtained the consent of the Banks to do the transaction which proceeded because they knew it was unlikely that the Banks would have agreed to the funds on the sale and purchase of a farm property by Nugen, a company outside the Charging Group, rather than the reduction of debt.

i) There was no documentation for the loan to Nugen of the $3.6 million received by Plateau from StockCo. The documentation was not completed until 17 December 2008. Nor was any security given by Nugen to Plateau for the loan until later.

j) The 4,000 rising year one heifers remained on the Charging Group farms and were not moved to Nugen farms.

[93] Events after 1 August 2008 may be summarised relatively briefly as they occurred after the critical transaction. On 3 August 2008 Westpac wrote to the Crafars noting that, while the business of the group was highly valued and there was a great deal of admiration for what had been achieved, the Bank had concerns about governance of the group and its interaction with the Bank. The letter confirmed the advice given at the meeting in Rotorua on 28 May 2008 that, beyond the extra $10 million, exposure was capped. The letter recorded that, despite the Banks' position, more farms were being purchased in breach of the covenants of the SSD and without prior notice to the Banks. It was not clear how the Crafars intended to meet their commitments. The strategy of the sale of cows to sharemilkers should not be a problem from a purely security viewpoint if the proceeds were invested in land, but the concern was the impact of reduced income and a lessening of control of that income. The Banks required full details of planned capital expenditure and written notification of significant proposals. The letter concluded by recording that it was

written in good faith and that there were no doubt ways the Crafars believed the Banks could "lift our game".

[94] On 5 August 2008 there was an exchange of emails between StockCo and Blackman Spargo relating to documenting the lease to Nugen. On 6 August 2008 Blackman Spargo reported to Nugen on the partial settlement of the Norsewood (No. 2) purchase utilising the temporary loans from Plateau and Taharua and setting out new terms to obtain possession. On the same date the Master Deed of Dairy Herd Lease, Supplementary Agreement and associated documents relating to the 4,000 heifers were sent by StockCo to Nugen.

[95] The lease documents in StockCo's standard form contained the following provisions about the location, inspection, identification and tagging of livestock:

a) Master Deed of Dairy Herd Lease:

> 11. LOCATION AND INSPECTION
>
> (a) You will not move the Herd from the Land unless you have our prior written consent. We, our assignees and any of our agents have the right to enter any land where the Herd is located in order to confirm the existence, proper identification, condition and proper maintenance of the Herd and the Herd's mix, as required by clause 8.
>
> ....
>
> 14. IDENTIFICATION AND ANNUAL VERIFICATION
>
> (a) You must at all times ensure that the Herd is separately identifiable from any other cows that may be depastured on the Land.
>
> (b) You must maintain complete and up to date records and details of each Cow.

b) Supplementary Agreement:

> 3 The Tag Numbers for each cow comprised in the Herd shall be provided by you to us and may be comprised in a separate Schedule.

[96] There was no evidence that Nugen complied with the requirements of clauses 11(a) or 14(a) and (b) of the Master Deed or that StockCo ever inspected the livestock as permitted by clause 11(a). Nor was there any evidence that Nugen

provided StockCo with the Tag Numbers for each cow as required by clause 3 of the Supplementary Agreement.

[97] On 7 August 2008 Mr Wiltshire sent Westpac a StockCo invoice for $3,263,625 for the purchase of Windburn Farms' livestock to be funded by loan advances as arranged.

[98] On 11 August 2008 the solicitors for the Downs sent Nugen an amended calculation of unpaid purchase price for monthly lease/rental calculation of $3,522,288. On 19 August 2008 Blackman Spargo reported to Strettons, the Crafars' accountants, on the partial settlement of the Norsewood property.

[99] On 20 August 2008 there was a further sale and lease back between Nugen and StockCo in respect of 206 heifers from Mohaka, a Nugen farm, at $1,050 per head.

[100] The Crafar farms were revalued in September 2008 resulting in an increased value of $12 million.

[101] On 10 October 2008 Nugen and Plateau entered into a forward sale and purchase contract for the 4,000 heifers at $1,800 per head with settlement on 1 June 2009. On the same date StockCo forwarded a finance proposal for Nugen to the ANZ Bank for approval. The proposal recorded StockCo's position in relation to Nugen:

> This proposal is seeking the transfer of $4,050,612 from StockCo Limited to StockCo Holdings. The facility relates to 4,206 Dairy Heifers which are being farmed by Nugen Farms. The heifers are currently being joined by natural mating.
>
> This lease is guaranteed by the Crafar Group. The Bank has previously approved the following Holdings facility relating to the Crafar Group:
>
> - $16,000,000 capital allocation associated with 15,000 MA Dairy Cows. This transaction did not settle due to the drought last summer
> - $310,000 facility associated with 333 MA Cows which is now in Holdings

> Upon completion of this transactions [sic] the total Bank exposure through Holdings to the Crafar Group will be $4,360,612 secured by 333 Cows and 4,206 Heifers. This equates to $961/head.
>
> 4,000 of the heifers are subject to a forward sale contract to Plateau Farms Ltd at $1,800 per head with settlement on the 01 June 2009. The heifers will form replacement heifers for the Plateau Group of farms. At this point it is feasible that StockCo Holdings will fund through a lease facility the purchase of some of the heifers in order to transfer high performing lower order sharemilkers to 50/50 positions. The structure would be similar to that of the OK Dairies Holdings Lease where by StockCo's exposure is limited to $1,000 per cow. Any such funding would be supported by credit submission.

[102] On 17 November 2008 Mr Little of Westpac spoke to Mr King of Strettons about other loans totalling $10.351 million, including loans by Plateau totalling $9.225 million. Among these loans Mr Little discovered were the loans of $3.6 million by Plateau to Nugen and $1.126 million by Taharua to Nugen. As this was the first information the Banks had about these loans to Nugen, Mr Little sent an email to Mr Wiltshire seeking further information about them.

[103] On 18 November 2008 Mr Wiltshire responded to Mr Little's inquiry by email which read as follows:

> I can confirm the breakdown below as accurate. I am advised the loan to Nugen Farms originated from the sale of weaner heifers held by the Crafarms Group but they have not left the farms and are apparently on a lease back scheme with Stock Co due to commence on Dec 2009. I have requested details from Stock Co. The arrangement was initiated and and completed outside of my knowledge and control and no funds ever appeared though our accounts. It is now clear that Allan used the funds to secure the Norsewood Dairy Farm for Nugen.
> From my perspective I am concerned that this should not detract from the change of management and direction that I have initiated since gaining practical control of this business.
> If this is to become a major issue I need to do more research in the actual process followed but can at this stage add no further details as I was not consulted.
> At worst case scenario we can on sell a Nugen Farm to repay the loan, provide a guarantee or amalgamate the Nugen business into the overall group.
> But please, lets not focus on things that I couldn't influence and focus on what need to be done going forwards

[104] Under cross-examination Mr Little acknowledged that the information in this email from Mr Wiltshire provided Westpac with knowledge of the sale of the weaner heifers by the Crafars to StockCo, the loan to Nugen to secure the Norsewood

property and the lease back by StockCo. Mr Little also acknowledged that Westpac did not then demand repayment of the advance to the Charging Group or require Nugen to provide any security to Westpac. Nor were any enforcement steps taken by Westpac in its capacity as security agent for the Banks. Mr Little explained that the Banks were focused on other more pressing problems concerning the Charging Group at that time.

[105] Confirmation that the Banks were not aware of the transaction until this time is provided by an internal Rabobank report dated 17 December 2008 stating:

> The Banking Group has discovered that CG [Crafar Group] has sold secured livestock without repaying Bank debt. The proceeds were used to enable the Crafars to settle on a Nugen Farms purchase.... CG contends that these transactions were in the ordinary course of business and therefore allowable under their securities.

[106] On 17 December 2008 the term loan agreement between Plateau and Nugen for $3.6 million and the Nugen GSA to Plateau were executed. On the same day Nugen received and signed a loan offer from South Canterbury Finance for $9.070 million which recorded the existing securities provided by Nugen as including the GSA by Nugen and a mortgage over Norsewood (No. 2).

[107] On 12 January 2009 Plateau registered a financing statement in respect of Nugen.

[108] On 27 January 2009 StockCo recorded an internal approval and a Supplementary Agreement, including 1,168 mixed age cows leased to Nugen with a purchase price of $1,157,607.

[109] On 11 March 2009 StockCo made a further advance of $150 per head over the 4,000 heifers ($600,000) to Nugen.

[110] On 24 March 2009 the Crafars engaged Cranleigh Merchant Bankers to prepare a private and confidential report on the integrity of their company asset values, the ability of the group to continue operating and generate positive cash flow, and options as to how the group should operate moving forward. The Independent Report on Crafarms prepared by Cranleigh Merchants Bankers dated 5 April 2009

(the Cranleigh Report) contained a full description of the sale of the 4,000 heifers by Plateau to StockCo, the lease of the livestock by StockCo to Nugen, and the temporary loan of the $3.6 million by Plateau to Nugen for the partial settlement of the Norsewood property purchase. The Cranleigh Report recorded the following conclusions in respect of these transactions:

> - Prior to committing to the sale of the 4,000 heifers from Plateau to StockCo the Directors of CraFarms sought and relied upon legal advice from Blackman Spargo.
>
> - The loan of $3.6m from Plateau to Nugen has been provided on appropriate terms and conditions and the loan and security were formally documented/registered on 17 December 2008.
>
> - The loan of $1.126m from Taharua to Nugen was not formally documented until recently, effective 20 February 2009 but the agreed loan terms and conditions are appropriate.
>
> - The 4,000 heifers are still located on properties owned by the Charging Group (essentially being Plateau properties).
>
> - We have recommended (and it has subsequently been completed) that a formal grazing/lease agreement be prepared between Nugen and Plateau whereby Plateau is entitled in due course to sell or retain the offspring of the heifers and to receive all the revenue from the heifers that may arise over time. This clarity underpins Plateau's ability (as part of the Charging Group) to generate returns and contribute to meeting its future commitments to the Consortium Banks.
>
> - A potential issue revolves around the question of who has priority security over the heifers given that StockCo has security over the cattle and the Consortium Banks may believe that they will have security over these assets. The reality is that the heifers are still located on properties owned by the Charging Group but the issue of security needs to be clarified.

[111] Under cross-examination Mr Cliffe of Rabobank, Mr Wisnewski of Westpac and Mr Prain of PGG Wrightson all acknowledged that their Banks had received copies of the Cranleigh Report in April 2009 and that the Report provided them with details of the Plateau – StockCo – Nugen transactions. They also acknowledged that no steps were taken at that time to recover the proceeds from Nugen or the stock from Plateau or Nugen or to register a financing change statement under s 88 of the PPSA. They explained that the Banks were pre-occupied with higher priorities. Mr Cliffe said the focus primarily was on trying to contain and take an appropriate strategy to manage the bigger, wider situation in terms of the rate of the deterioration

of the Crafar group. Mr Prain pointed out that the Banks had $180 odd million worth of assets heading for trouble and getting a strategy out of the Crafar Group to fix that was seen as a higher priority.

[112] On 5 April 2009 Nugen and the Charging Group companies entered into a bailment (lease) of livestock in respect of the 4,000 heifers. The background section of the bailment agreement recorded that Nugen was in possession of the livestock and wished to graze the livestock on Charging Group companies' land from 1 August 2008 to 31 May 2009. The agreement section recorded that the Charging Group companies would graze the livestock on the terms appearing in the Second Schedule under the heading "Grazing Agreement". The Second Schedule read:

Term:	From the 1st day of August 2008 to 31 May 2010
Payment:	$5.00 per head per week (plus GST) payable by the Farmer [the Charging Group companies] to the Owner [Nugen] at the expiration of the term referred to above
Land:	All the land owned by the Farmer from time to time.

[113] On 20 April 2009 Blackman Spargo wrote to StockCo advising that the leased stock may be depastured on Crafar farms contrary to clause 4(4) of the terms and conditions of the lease to Nugen, noting the grazing agreement through to 1 June 2010 and seeking StockCo's consent to a Bailment agreement which was enclosed. StockCo acknowledged receipt on 23 April 2009. Mr Kight deposed that he had no recollection of ever receiving the Blackman Spargo letter of 20 April 2009 and that a search of StockCo's offices had not produced either the letter or the response.

[114] Between 8 May and 7 October 2009 the Banks continued to make loans to the Charging Group. Details were:

a) Loans made by Rabobank to the Charging Group on:

i) 15 July 2009 $1.88m

ii) 18 August 2009 $1.4m

iii) 11 September 2009 $2,907,280

b) Loan made by PGG Wrightson to Charging Group on 10 September 2009: $1,125,911.

c) Westpac's overdraft to Taharua increased by $346,547.98 between 11 May 2009 and 2 October 2009.

d) Westpac's overdraft to Plateau increased by $1,280,628 between 8 May 2009 and 6 October 2009.

[115] On 5 October 2009 the Receivers of Plateau, Hillside, Ferry View and Taharua were appointed.

[116] Mr Kight deposed that at a meeting on 6 October 2009 with Ged Donald and Ian Blackman he was shown a copy of the Blackman Spargo letter of 20 April 2009 and that he subsequently received a copy of the letter and the Bailment Agreement. StockCo sought further details to enable it to consider the request for consent and promptly (on 7 October 2009) registered a financing change statement in respect of the Nugen financing statement, noting the presence of Plateau, Hill, Taharua and Ferry View as debtors. On 15 October 2009 StockCo wrote to Blackman Spargo advising that it did not consent to Nugen's sublease which was in breach of the Master Deed of Dairy Herd Lease.

[117] On 28 October 2009 the solicitors for the Downs wrote to Blackman Spargo advising that as Nugen had not settled the contract was cancelled and the stock currently depastured on the property were to be removed by 4.00 pm on 30 October 2009. Nugen removed the stock.

The interim injunction

[118] Following the appointment of the Receivers, StockCo's solicitors wrote to the Receivers on 8 October 2009 claiming that the livestock leased by Nugen was subject to a security interest in StockCo's favour that had been perfected by registration of a financing statement on the PPSR. The Receivers' position was that

this livestock was subject to the security interest granted by the Charging Group companies to Westpac and that Westpac's security interest had priority. The basis for the Receivers' position was set out in a letter dated 23 October 2009 from their solicitors to StockCo's solicitors.

[119] On 19 October 2009 StockCo's solicitors had advised the Receivers' solicitors that StockCo would terminate the lease in favour of Nugen and take possession of the livestock. In response, the Receivers' solicitors sought assurances that no such steps would be taken and that the livestock would remain on the land operated by the companies in receivership for the meantime, pending resolution of the claims. While no substantive response or entirely satisfactory assurance was received by the Receivers, they were initially left with the impression that the previously threatened action of taking possession of the livestock had been superseded by events and that StockCo would be pursuing a proper process to identify the cows that were the subject of their claim.

[120] The Receivers' solicitors in their letter of 23 October 2009 pointed out that StockCo needed to identify the cows that were subject to its claimed lease and security interest. StockCo proposed a process for identification of the cows which was not acceptable to the Receivers. The Receivers proposed a stock take of all animals, but StockCo objected to that proposal and purported to proceed with its own process.

[121] On 29 October 2009 the Receivers discovered that agents of StockCo and members of the Crafar family had entered on to land owned or leased and operated by the companies in receivership and had tagged selected cows with blue StockCo identification tags. The Receivers believed that between 600 and 700 of the best cows had been tagged in this way. On 30 October 2009 the Receivers also received a letter from StockCo critical of aspects of their conduct of the receivership.

[122] In view of StockCo's activities and failure to provide the Receivers with assurances that they would maintain the status quo, the Receivers applied to the High Court on 30 October 2009 for directions under s 34 of the Receiverships Act 1993 and on a without notice basis for urgent orders restraining all of the respondents, their employees or agents or associates and anyone acting for or purporting to act for

those parties from entering onto the farms owned or leased and operated by the companies in receivership or interfering in any way whatsoever with the livestock. The interim injunction was granted by the Court that day.

[123] Apparently before the interim injunction was served on the respondents, a number of the cows were removed from the farms and relocated on other farms in both the North and South Islands. This action and the subsequent action of the Receivers in repossession a number of the cows led to further applications by the parties and a series of telephone conferences with their counsel and, by consent, on 9 November 2009 replacement interim orders whereby the Receivers returned the cows taken by them, StockCo returned cows located in the Taupo region taken by them, cows in the South Island taken by StockCo remained there and both parties held the respective cows in a state capable of identification pending determination of the Receivers' application for directions. These interim orders have remained in place since then.

The application for directions

[124] The Receivers filed an amended originating application for directions under s 34 of the Receiverships Act 1993 on 19 July 2010. In their amended application the Receivers sought the following orders:

> 1. In relation to the 4,000 heifers originally purchased by StockCo Limited (StockCo) from Plateau Farms Limited (Plateau) and leased by StockCo to Nugen Farms Limited (Nugen) pursuant to the Leases... (the Plateau Stock):
>
> (a) the Plateau Stock remain subject to the security interest granted by the Companies .... to Westpac New Zealand Limited (Westpac) which security interest ranks in priority to any claim by StockCo or Nugen to the Plateau Stock;
>
> (b) Additionally or alternatively:
>
> (i) Nugen's interest in the Plateau Stock leased or bailed by it to the Companies in receivership is a security interest which ranks in priority behind the security interest granted by the Companies in receivership to Westpac; and/or
>
> (ii) StockCo's interest in the Plateau Stock is subordinated to further advances made to the Companies by the Lenders .... from 8 May 2009.

(c) the approximately 545 of the Plateau Stock that were born in 2006 cannot be identified and distinguished from other cows on the Companies' farms that were born in the same year.

2. In relation to the balance of the stock purchased by StockCo from third parties and from Nugen and leased by StockCo to Nugen pursuant to the Leases .... (the Non-Plateau Stock), StockCo cannot establish that these stock were on the farms owned by the Companies on the date of receivership.

[125] StockCo in its notice of opposition dated 24 September 2010 opposes the orders sought by the Receivers in their amended application and says that the Court should give directions:

(a) that the Receivers return all such stock identified as subject to StockCo's priority interests;

(b) for the determination of StockCo's claim for recovery of all proceeds obtained by the Receivers from StockCo's livestock, including progeny born to such livestock and milk proceeds produced by such livestock.

[126] There was no dispute that the Court has jurisdiction under s 34(1) of the Receiverships Act 1993 to give the directions sought by the Receivers in this case. Nor was it disputed that, if the Court declined the Receivers' application, it had jurisdiction to give the directions sought by StockCo, presumably under its inherent jurisdiction which is preserved by s 34(4)(a) of the Receiverships Act 1993.

StockCo's claims

[127] It is convenient to summarise StockCo's claims first because StockCo's claims to priority to the livestock must be established in order to prevent the Receivers from obtaining the orders they seek.

[128] StockCo's claims to priority are set out in its notice of opposition:

2 StockCo's first ranking security interest over the livestock arises as a consequence of:

2.1 the lease of all such animals to Nugen pursuant to two Master Deeds of Dairy Heard Lease between StockCo and Nugen dated 24 June 2008 (Lease #4034) and 1 August 2008 (Lease #4039) respectively;

2.2 the Nugen Cows and Third Party Stock were leased under

Lease #4034, the Plateau Heifers and Nugen Heifers were leased under Lease #4039;

2.3 StockCo's registration on the PPSR of its security interest over the Livestock by financing statement no. F21996F92X1V3J05 on 30 June 2008, creating a Purchase Money Security Interest (PMSI) in such animals.

3 The sale by Plateau referred to .... above was in the ordinary course of Plateau's business. In particular:

3.1 Plateau's business included the breeding of its herds of dairy cows, and the sale of the progeny, as well as the sale and purchases of other animals, which all formed part of its overall farming enterprise;

3.2 the 4,000 Plateau Heifers so acquired by StockCo were heifers, comprising progeny of Plateau's milking herd together with progeny of related Crafar companies, Taharua Limited and Hillside Limited – transferred to Plateau for the purposes of such sale – and thus available to Plateau to sell in the ordinary course as part of its farming enterprise;

3.3 the sale of Plateau Heifers was a management decision made by Plateau as part of its ongoing farming enterprise, and was specifically confirmed to StockCo to be in the ordinary course of its business.

4 The sale by Plateau .... was expressly or impliedly authorized by the Lenders (Lenders) who appointed the Receives pursuant to section 45 of the PPSA:

4.1 The GSA granted by Plateau to the Lenders authorised sale of inventory in the ordinary course of the debtor's business and on an arm's length basis for full value. The sale of the 4,000 Plateau Heifers was a sale of inventory in the ordinary course of the debtor's business and on an arm's length basis for full value;

4.2 That in 2008, after discussions and agreement with the Lenders, the Crafar Farms' management embarked on a process of moving from a full dairy operation including ownership of farms and herds to owing the farms and installing 50/50 sharemilkers on those farms;

4.3 That the Lenders know that the Crafar Farms management did not always carry progeny through to replace culled or dead animals from its milking herd but in previous years had purchased replacement in-calf dairy cattle to replace culled animals and to grow the herd size;

4.4 That Crafar Farms had always used the Progeny as inventory and had sold progeny to generate cashflow.

5 There was no transfer of the 4,000 Plateau Heifers by Nugen to

Crafar Farms by operation of the alleged bailment and lease agreement between Crafar Farms and Nugen dated 5 April 2009.

6 StockCo did not consent to the transfer of rights in the 4,000 Plateau Heifers pursuant to the Lease of Livestock dated 5 April 2009 between Nugen and Plateau, nor any other transfer of rights in the Plateau Heifers or the remainder of the Livestock, with any such transfer being without its consent, and amounting to a breach of Leases #4034 and #4039 between StockCo and Nugen as referred to in paragraph [2.1], and also being conduct not in the ordinary course of Nugen's business.

7 Plateau was aware that the Livestock was owned by StockCo as recorded in the Lease of Livestock referred to in paragraph [5], and was aware that StockCo's standard terms of Dairy Herd Lease, and of Leases #4034 and #4039 in particular, required consent for any transfer of such Livestock.

8 Upon becoming aware that Nugen had purported to transfer rights in the Livestock in the manner referred to paragraph [5], notwithstanding that no consent to any such purported transfer had been given, StockCo registered an amendment of its PPSR financing statement over the stock on 7 October 2009 identifying the relevant further parties.

9 That the Lenders knew that the 4,000 Plateau Heifers had been sold to StockCo, had not objected and it would be a breach of the Lenders' duty of good faith under the PPSA for them to now try to claim priority over the 4,000 Plateau Heifers and/or to claim that advances were made on the basis that such Livestock were still subject to the Lenders' security post 5 April 2009.

10 The 4,000 Plateau Heifers included all of the 2007 born progeny in Crafar Farms' possession as at 1 August 2008. No other animals were purchased by Crafar Farms' possession as at 1 August 2008 that were born in 2007. StockCo is therefore entitled to all of the 2007 progeny in the Receivers' possession.

11. Those of the Plateau Heifers that were born in 2006, together with the Nugen Cows and Third Party Stock (which included mixed age cows and 2006 born animals), are inextricably mixed with the 2006 progeny and mixed age dairy cows owned by Crafar Farms as at Receivership.

12 StockCo has a priority claim over that Livestock in the Receivers' possession comprising Plateau Heifers that were born in 2006 together with the Nugen Cows and third Party Stock (which include mixed age cows and 2006 born animals).

13 Alternatively Stock and the Lenders should be entitled to share the 2006 born animals and the mixed age dairy cows in the Receivers' possession pro-rated to reflect the percentages of stock owned and present on the farms respectively by StockCo and the Crafar Farms prior to Receivership.

The Receivers' responses

[129] The Receivers' responses to StockCo's claims to priority are set out in its amended application for directions:

> (h) The Plateau Stock [the 4,000 rising year one heifers] were at all relevant times held by Plateau and/or the Companies for the purpose of replacement of the dairy herd on the Companies' farms;
>
> (i) The Sale Agreement [of 1 August 2008] was:
>
> (i) entered into without the knowledge or permission of Westpac;
>
> (ii) was not in relation to inventory; and
>
> (iii) was not in the ordinary course of Plateau's or the Companies' business;
>
> (j) StockCo was aware or ought to have been aware that, in relation to the Sale Agreement:
>
> (i) the consent of Westpac was required;
>
> (ii) the consent of Westpac had not been obtained;
>
> (iii) the Plateau Stock were held for the purpose of replacement of the dairy herd on the Companies' farms and were not inventory; and
>
> (iv) the Sale Agreement was not in the ordinary course of Plateau's business or the ordinary course of the Companies' business;
>
> (k) Notwithstanding the Sale Agreement the Plateau Stock remained on land belonging to or leased by the Companies and/or under their management since the date of the Sale Agreement;
>
> (l) StockCo was aware that Nugen would not be taking possession of the Plateau Stock, but that the Plateau Stock would continue to be in the possession and under the management and/or control, of the Companies;
>
> (m) From 1 August 2008 the Plateau stock was leased and/or bailed to the Companies for a period in excess of one year (the Sublease);
>
> (n) The Sublease:
>
> (i) was formalised by a written Bailment (Lease) of Livestock Agreement dated 5 April 2009;
>
> (ii) constitutes a deemed security interest under the PPSA as a lease for a term of more than one year; and

(iii) effected a transfer of an interest in collateral for the purposes of section 88 of the PPSA.

(o) On 30 June 2008, StockCo registered a financing statement in relation to the Leases, recording Nugen as the debtor;

(p) No financing statement has been registered in relation to the Sublease;

(q) On or around 23 April 2009, StockCo acquired knowledge of the Sublease between Nugen and the Companies;

(r) On 7 October 2009, StockCo registered a financing change statement amending the financing statement described at (o) so as to include the Companies as debtors;

(s) Between 8 May 2009 and 7 October 2009, further advances of $8,358,411 were made by the Lenders to the Companies, secured by the GSA;

(t) The parties have been unable to reach agreement in relation to the priority of their interests in the Plateau Stock;

(u) StockCo is unable to establish that any of the Non-Plateau Stock were, at the date of receivership, located on the Companies' farms;

(v) StockCo has not been able to identify the Non-Plateau Stock that are subject to its claimed security interest;

(w) The applicants require the Court's direction on which of the competing claims of the applicants and of the first respondent prevail so that the receivership of the Companies can be properly conducted.

The issues

[130] As is apparent from StockCo's claims and the Receivers' responses, and the submissions for the parties during the hearing, there are four principal issues in this case, namely:

a) whether the sale of the 4,000 heifers by Plateau to StockCo on 1 August 2008 was outside the ordinary course of the Charging Group's business under s 53 of the PPSA;

b) whether the sale of 4,000 heifers was expressly or impliedly authorised under s 45 of the PPSA;

c) whether StockCo's security interest under its lease of the heifers to Nugen was subordinated under s 88 of the PPSA to further advances by the Banks to the Charging Group from 8 May 2009 (that is 15 days after the Banks claim StockCo had knowledge of the bailment (lease) agreement between Nugen and the Charging Group) and 7 October 2009 when StockCo registered its financing change statement (this issue includes the question whether the Banks acted in good faith under s 25 of the PPSA); and

d) what livestock, if any, in the various categories leased by StockCo to Nugen is StockCo entitled to (this issue includes a question under the Sale of Goods Act 1908 and questions relating to the identification and location of the livestock and the appropriateness of a pro-rata calculation).

[131] Within these principal issues there are a number of subsidiary issues. It is convenient to address each issue and the submissions for the parties on them sequentially.

Ordinary course of seller's business

[132] This issue arises under s 53 of the PPSA which provides:

> 53 **Buyer or lessee of goods sold or leased in ordinary course of business takes goods free of certain security interests**
>
> (1) A buyer of goods sold in the ordinary course of business of the seller, and a lessee of goods leased in the ordinary course of business of the lessor, takes the goods free of a security interest that is given by the seller or lessor or that arises under section 45, unless the buyer or lessee knows that the sale or the lease constitutes a breach of the security agreement under which the security interest was created.
>
> (2) This section prevails over section 3 of the Mercantile Law Act 1908 and section 27 of the Sale of Goods Act 1908 where this section applies and either or both of those sections apply.
>
> **Example**
> Person A has a perfected security interest in person B's (a car dealer's) inventory (cars).
> Person B sells a car to person C (a customer).
> Person C takes the car free of person A's perfected security interest in the car.
>
> Compare: Personal Property Security Act 1993 s 30(2) (Saskatchewan)

[133] There was no dispute between the parties that, under s 53(1), if Plateau sold the 4,000 heifers to StockCo on 1 August 2008 in its "ordinary course of business", StockCo would have acquired ownership of the heifers free of the Banks' security interest in the heifers under the GSA. As the Receivers did not argue that StockCo knew that the sale constituted a breach of the Charging Group's security agreement (the GSA), the issue is whether in terms of s 53(1) the sale was in Plateau's "ordinary course of business".

[134] For StockCo, Mr Cooke QC submitted that:

a) Bona fide purchasers are protected by s 53: *Fairline Boats Ltd v Leger* and *Ford Motor Credit Co of Canada v Centre Motors of Brampton Ltd.*[1] Whether a sale is in the "ordinary course of business" under s 53 involves a relatively narrow inquiry requiring identification of the business of the seller and determination of whether the sale was within the ordinary course of that business: *Tubbs v Ruby 2005 Ltd.*[2] The policy of s 53 is to protect trade by removing the need for buyers to research the seller's title. An audit or exhaustive analysis of the seller's title as conducted during the hearing of this case was not contemplated. That would stultify not facilitate the operation of commerce.

b) Whether a sale is in the "ordinary course of business" is to be objectively ascertained given the circumstances that would have been known to the purchaser: *Ford Motor Credit Co of Canada Ltd v Central Motors of Brampton Ltd* at 521-527 and *369413 Alberta Ltd v Pocklington.*[3] It does not matter that these are other circumstances not known to the purchaser that would take the transaction outside the advisory course. A purchaser can obtain good title even if the seller's transaction was fraudulent vis-à-vis his bank. The section still operates to protect a purchaser buying in the normal way.

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[1] *Fairline Boats Ltd v Leger* (1980) 1 PPSAC 218; *Ford Motor Credit Co of Canada v Centre Motors of Brampton Ltd* (1982) 38 OR (2d) 516.
[2] *Tubbs v Ruby 2005 Ltd* [2010] NZCA 353.
[3] *369413 Alberta Ltd v Pocklington* [2001] 4 WWR 423 at [22].

c) Here the Crafars did sell livestock and StockCo paid fair market price and did not know the sale was in breach of the security arrangements.

d) If a wider inquiry is relevant, the Canadian cases relied on by the Receivers are not directly applicable as they involve very different circumstances and a different kind of inquiry. None of the Canadian cases involved enterprises anywhere near the scale or complexity of the Crafar operation. This was a $200m business whose growth was attributable to entrepreneurial activities, that is doing deals. The Crafar's ordinary business was much more extensive than that considered in the Canadian precedents. There is little comparison with the smaller and more linear businesses considered by these cases.

e) Most of the Canadian cases involved businesses with a public trading component or a linear public trader (car dealers, timber merchants etc) where the ultimate inquiry was whether the transaction was consistent with that trading operation. The Charging Group's livestock trading was consequential upon its wider activities, which in turn was strongly influenced by circumstances as they evolved. The Crafars' "business" was not simply as livestock traders. They were dairy farming entrepreneurs, which involved not just milk solid production but commercial deal making in the dairy sector. In 2008 they had sold 8,600 cows to sharemilkers, proposed a significant sale and leaseback transaction with StockCo, and purchased millions of dollars' worth of farms. Westpac described that business in their documents – "*The Crafars are by nature entrepreneurial. They are experienced at sourcing, developing and managing effective dairy farms"*. That is the "business" the s 53 question must focus on.

f) The Charging Group was going through a period of enormous (arguably volatile) growth leading up to the sale. It grew its dairy herd from 11,205 to 20,250 between 2004 and 2008 (and it similarly grew its land holdings). It then made a decision, in early 2008 to effectively reverse that massive herd increase by implementing a

strategy involving the sale of its livestock . What then matters was the nature of the Crafars' business as it had developed to be up to 1 August 2008. The sale of the heifers reflected the new business strategy at that time (selling livestock to buy land) so that it was a sale in the ordinary course of the business they had decided to then implement.

g) The new plan meant that the 4,000 heifers were not needed as replacements for the herd, because the Charging Group were seeking to sell the herd. It had already reduced its size to 11,900 and yet it held a total of 7,240 one and two year heifers. The one year heifers were not going to be productive for more than a year so it made no sense to keep them, particularly when prices were so high, feed was so short, and cash was wanted to proceed with the Norsewood farm purchase.

h) The wider arrangements associated with a sale are not the focus of s 53, but in any event they were not only typically Crafar, but involved leveraging substantial additional advantages for the Charging Group. The heifers were sold at a high price in drought conditions, but remained available to be milked when they became productive given the relationship with Nugen. The land purchase funded by the sale meant the Nugen land became available to the Group. So Mr Crafar effectively "kept" the animals, got the land, and got the sale proceeds as well. He plainly thought he was better off proceeding with this strategy rather than keeping the heifers as replacements for a herd he was selling. And he seems to be right as the heifers halved in value the next year, and could have been repurchased as rising year twos for essentially the same price (whilst at the same time saving the cost of raising them).

i) The PPSA not only specifies that it is the ordinary course of business "of the seller" but it also deals directly with the level of knowledge that will prevent a buyer getting good title. The buyer must actually

know of the breach. Many of the Canadian cases do not have this specified in the legislation, and accordingly address circumstances that might cause "suspicion" for a buyer. That is not relevant here.

[135] In the course of his oral argument, Mr Cooke resiled from his submission based on the decisions in *Ford Motor Credit Co of Canada Ltd v Centre Motors of Brampton Ltd* and *369413 Alberta Ltd v Pocklington* that "the circumstances that would have been known to the purchaser" were relevant to the objective determination of whether the sale was in the "ordinary course of business". Mr Cooke accepted that in the *Ford Motor* case Potts J had said at 526:

> Whether a transaction is in the ordinary course of business under s 30(1) [of the Personal Property Security Act, R S O 1970 – that is the Revised Statutes of Ontario] is a question of fact to be objectively assessed, taking into consideration all circumstances which were known **or ought reasonably to have been known, to the purchaser**.
>
> (emphasis added)

Mr Cooke agreed that the addition of a knowledge requirement of this nature, including constructive knowledge, would not only constitute an unwarranted gloss on s 53(1) of the New Zealand PPSA, but would also be likely to create difficulties for StockCo in the circumstances of this case. As Mr Cooke pointed out s 30(1) of the Ontario PPSA differs in significant respects from s 53(1) of the New Zealand provision in that it refers simply to selling the goods "in the ordinary course of business" (not to "the ordinary course of business of the seller") and applies "even though it [the security interest] is perfected and the purchaser actually knows of it".

[136] At the conclusion of his oral argument Mr Cooke emphasised the text and purpose of s 53 of the PSA, as required by s 5 of the Interpretation Act 1999. He pointed out that the long title to the PPSA and its opening provisions showed that it was not consumer protection legislation, but a code for personal property securities with a regime for determining priorities between those with competing claims. Mr Cooke also referred to the 1988 report to the Law Commission by Professor John H Farrar and Mark A O'Regan which, ultimately, led to the PPSA.

[137] Mr Cooke did not agree that assistance in determining "the ordinary course" of a business could be derived by drawing a distinction between a company's trading

producing taxable income and the sale of capital assets unless that was the company's business. Mr Cooke did not consider that s 53 should be interpreted that "narrowly". In this case the sale by the Crafars of say three of ten farms would have been in the ordinary course of the business.

[138] For the Receivers, Mr Stewart QC submitted that:

a) There was no dispute as to the two step approach to the question whether a dealing was in the ordinary course of business of the seller: first determine the business of the seller and second inquire whether the dealing falls within the ordinary course of that business: *ORIX New Zealand Ltd v Milne*.[4]

b) Determining the business of the seller is a purely factual inquiry and should in most cases be readily ascertainable. In this case Plateau was involved in the business of dairy farming on a substantial scale as part of the Charging Group of companies whose operations were funded by a banking syndicate on standard security documentation and terms.

c) The test for determining whether the transaction falls within the ordinary course of Plateau's business is uncontroversial. It is a question of fact to be objectively assessed, based on all the circumstances of the particular case: *GE Canada Equipment Financing GP v ING Insurance Co of Canada.*[5]

d) The decision in *Tubbs v Ruby 2005 Ltd* did not support the submission for StockCo that the inquiry was limited to whether the sale involved goods of the type sold by the seller and whether they were sold at an appropriate price.

e) The cases show that the courts have regard to a wide range of circumstances in objectively assessing whether the transaction under review falls within the ordinary course of the seller's business.

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[4] *ORIX New Zealand Ltd v Milne* [2007] 3 NZLR 637 (HC) at [66].
[5] *GE Canada Equipment Financing GP v ING Insurance Co of Canada* (2009) 308 DLR 127 at [66].

f) In the vast majority of trade transactions, s 53 allows purchasers acquiring goods in the ordinary course of the seller's business to rely on sellers using the proceeds of sale to repay any liens on the property sold: *Fairline Boats Ltd v Leger* at 221. Accordingly, in all but a very few trade transactions issues as to the application/usage of purchase monies paid by the purchaser are totally irrelevant to the question whether the transaction, objectively assessed, was in the ordinary course of business of the seller.

g) There is no justification for adding a gloss to s 53 relating to the knowledge of the buyer beyond the express reference to the buyer's knowledge that the sale constituted a breach of the security agreement.

h) The objective of section 53, that is, to permit trade and commerce to proceed expeditiously without the need for checks and audits as to title, has no role to play in sophisticated, high value transactions involving millions of dollars. It is to be expected that buyers engaging in those types of transactions will operate through lawyers, and those lawyers will give close attention to issues such as clear title before handing over their client's cheque for say $4 million. Indeed, you could go as far as to say that it is inconceivable that a buyer would pay $4 million without a PPSA search, or a formal release or a letter of acknowledgment from a secured creditor of the seller that the goods being purchased will be released from the security creditor's charge before the purchaser settles the transaction. And it would be ludicrous to suggest that such an elementary search or request for an acknowledgment on the part of the purchaser acquiring goods to the value of $4 million could possibly "stultify commercial dealings". If a purchaser nevertheless decides to proceed with a transaction for the purchase of stock or goods for an amount involving $4 million in reliance upon the protection afforded by section 53, then they run the risk that the sale may not be in the ordinary course of the seller's

business, when assessed objectively, having regard to all the circumstances of the case.

i) It would have been easy for a purchaser like StockCo to check with the Banks before proceeding with the transaction in this case. If, however, a purchaser decides not to take that simple step, then it runs the risk that it will be in the hands of the Court in making an objective assessment.

j) An approach whereby the issue is determined without reference to the buyer's knowledge accords with the text and objectives of s 53 and recognises that sophisticated, high value, occasional transactions are in a separate category.

k) Here, on an objective assessment of all the circumstances of this case, the sale was not in the ordinary course of Plateau's business. The sale was made for the purpose of obtaining funds to lend to Nugen, a loan transaction expressly prohibited by clause 13.1(a) of the GSA signed by Plateau's directors on 24 July 2008.

l) Alternatively, if lack of knowledge on the part of the purchaser is a pre-requisite to the protection of s 53, then StockCo does not qualify because StockCo knew or ought to have known of the circumstances which meant that the sale was outside the ordinary course of Plateau's business.

m) The various changes in strategy adopted by the Charging Group show that the sale was not in the ordinary course of Plateau's business: the livestock were not sold for cashflow reasons; the sale did not involve the whole herd and was not approved by the Banks; the sale of livestock to sharemilkers was limited; there was no previous history of the Charging Group utilising livestock sales to purchase land; the entrepreneurial" and "opportunistic" decisions were not part of the ordinary course of the operation of the business; family succession

planning would have been achievable by changes in shareholding not asset stripping without Bank consent or a reduction in Bank debt; and the heifers did not become inventory with the decision to sell them.

[139] The correct approach to the interpretation of s 53 of the PPSA has been considered in two New Zealand decisions, both of which have referred to relevant Canadian authorities: *ORIX New Zealand Ltd v Milne* and *Tubbs v Ruby 2005 Ltd.*[6]

[140] In *ORIX New Zealand Ltd* Rodney Hansen J said:

> *Ordinary course of business*
> [62] The remaining issue is whether the sale was in the ordinary course of business of the seller. The phrase "in the ordinary course of business" has frequently been considered by the Courts in New Zealand but in different legislative contexts and, without the additional words "of the seller" which appear in s 53. They require a focus on the business of the seller in each case. The North American cases which consider the identical phrase in personal property security legislation provide the best guidance (see the discussion in Gedye at section 5).
>
> [63] One of the leading cases, *Camco Inc v Frances Olson Realty (1979) Lt*d discusses s 30(1) of the Personal Property Security Act S.S. 1979-80, (since replaced by the Personal Property Act S.S. 1993) which provides in s 30(2):
>
> > (2) A buyer or lessee of goods sold or leased in the ordinary course of business of the seller or lessor takes free of any perfected or unperfected security interest therein given by or reserved against the seller or lessor or arising under section 29, whether or not the buyer or lessee knows of it, unless the secured party proves that the buyer or lessee also knows that the sale or lease constitutes a breach of the security agreement.
>
> [64] In discussing what a sale of goods in the ordinary course of business of the seller is, Tallis J.A. said at p 276:
>
> > "Since the question whether a buyer is a buyer under s. 30(1) is a question of fact, I would not attempt to articulate an all inclusive definition of what is a sale of 'goods … in the ordinary course of business of the seller'. I do, however, hold that the trier of fact should consider whether the person was a person in the business of selling goods of that kind and whether the transaction(s) took place in the ordinary course of that business. And in my opinion the court should give a generally liberal interpretation to the phrase "buyer … of goods sold … in the ordinary course of business of the seller", in order to carry out the purpose of s 30(1) – to protect the buying public in cases where the secured party furnishes goods which are sold to the public by the debtor in the regular course of the debtor's business. This comports with the underlying philosophy of the

[6] *ORIX New Zealand Ltd v Milne* [2007] 3 NZLR 637 (HC); *Tubbs v Ruby 2005 Ltd* [2010] NZCA 353.

provision to protect the security interest so long as it does not interfere with the normal flow of commerce."

[65] In *Royal Bank of Canada v 216200 Alberta Ltd* Vancise JA, giving the judgment of the Court, said at p 87:

> "In my opinion, a sale, in the ordinary course of business, includes a sale to the public at large, of the type normally made by the vendor in a particular business where the basic business dealings between buyer and seller are carried out under normal terms and consistent with general commercial practice. It does not include private sales between individual buyers."

[66] **As the discussions in these judgments indicate, a two-step process will generally be warranted. The first is to determine the business of the seller. The second is to enquire whether the sale was made in the ordinary course of that business**.

....

[70] The fact that sales were made infrequently and were only a small part of Comquip's business does not affect this conclusion. The circumstances are analogous to those in *Alberta Pacific Leasing Inc v Petro Equipment Sales* where the sale by a company of a crane was held to be in the ordinary course of its business, although it was the only sale that occurred in the course of a year. The company was in the business of leasing cranes that it sold when they became obsolete or difficult to hire. **The Court said that if the company deemed a sale to be in its greater economic interest, it was appropriate to treat it as a sale in the ordinary course of business.**

[71] The next question is whether the sale of the paver took place in the ordinary course of Comquip's business. The evidence establishes to my satisfaction that it did. The leadup to the sale had all of the hallmarks of a normal trade transaction. Nicholls was a user of paving machines who approached Comquip as a reputable and established dealer. **The way in which the deal was negotiated, agreed and implemented was unremarkable. Everything points to a straightforward deal in the mainstream of Comquip's business.**

....

[73] Ms Ifwersen also relied on Comquip's **motive for selling as taking the transaction outside the ordinary course of its business**. She referred me to cases in which the Canadian Courts declined to treat disposals made under financial pressure for the purpose of raising money as sales made in the ordinary course of business – for example, *MacDonald v Canadian Acceptance Corp Limited*; *Northwest Equipment Inc v Daewoo Heavy Industries America Corp*; and *Re 547592 Alberta Limited (Receivership)*.

[74] On my reading of the evidence, **the sale to Nicholls was not made for the primary or even the substantial purpose of raising money**. The companies were not under serious financial pressure at the time; it was not until after 31 March 2004 that a decision was made to liquidate the assets. The sale took place in response to an approach from Nicholls, not as part of a planned sale of assets. Of course, the sale provided cash for a business that was suffering cashflow difficulties, but that was an incidental benefit, not the motivation for the sale.

> [75] Whichever way the transaction is viewed, it presents as a commonplace trade of the kind in which Mr Milne had been engaged for many years. I am satisfied that s 53 applies and Nicholls took the paver free of the security interest of ORIX.
>
> (Footnotes deleted. Emphasis added)

[141] In *Tubbs v Ruby 2005 Ltd* Baragwanath J delivering the judgment of the Court of Appeal said:

> [35] As is clear from the wording of s 53, the section protects a buyer where the sale is in the ordinary course of business, unless the buyer knew that the sale constituted a breach of the relevant security agreement.
>
> *(1) 2005–2008 transactions*
>
> [36] The "business of the seller", Waimate, was to sell timber. Between 2005 and 2008, Waimate sold Ruby timber, for cash, at full market value. The practical effect of these transactions was that Waimate sold its timber earlier than it would otherwise have done. **This was wholly in the interests of Waimate and its creditors; the transactions removed Waimate's inventory from the reach of the Bank's security, but replaced that inventory with cash.** The fact these sales were to a related party is here immaterial. There was no suggestion there was otherwise a breach of the security agreement. In these circumstances, the receivers cannot realistically impugn the sales between 2005 and 2008.
>
> [37] The Canadian cases cited by Mr Russell do not assist his argument on this point. In *MacDonald v Canadian Acceptance Corp Ltd*, for example, the relevant sales were by a used car dealer of a number of cars to another dealer to "lessen financial pressure". These sales were held to be outside the ordinary course of business and the buyer accordingly did not take the cars free of the creditor's chattel mortgages. It is highly unlikely that in that case the cars were sold to the fellow dealer at full market value, rather than at wholesale rates. If, as we expect, the sales were sold below market value, we agree with the result. "Market value" would naturally include such usual activities as sales promotions at a reduced price; it is difficult to see how a sale even below such a market value could be in the ordinary course of business. Insofar as the judgment could be read to suggest that the only important consideration was the *purpose* for which the onsale to the dealer was entered into, ie to relieve financial pressure, we respectfully disagree; that is commonly the reason for conventional sales campaigns.
>
> [38] We note for completeness that we agree with the comments of Linden J in *Fairline Boats Ltd v Leger*, also cited by Mr Russell, as to the purpose of the Ontario equivalent of s 53:
>
> > The objective of this section, as I understand it, is to permit commerce to proceed expeditiously without the need for purchasers of goods to check into the titles of sellers in the ordinary course of their business. Purchasers are allowed by our law to rely on sellers using the proceeds of sales to repay any liens on the property sold. In these days inventory is almost invariably financed, and as a result is almost invariably subject to liens of one kind or another. To require searches and other measures *to protect lenders* in every transaction

> would stultify commercial dealings, and so the Legislature exempts buyers in the ordinary course of business from these onerous provisions, even where they know that a lien is in existence.
>
> (Emphasis added.)

The purpose of s 53 is to limit protection of creditors where a buyer takes goods in a specific way. **But in this case there was no need to protect the Bank: the transactions did not diminish, and quite possibly enhanced, the value of its security by less liquid stock being converted into cash**. (Contrast another case cited by Mr Russel, *Estevan Credit Union Ltd v Dyer* where there was a specific breach of the security agreement in that the proceeds of the relevant sales went directly to another creditor, rather than into the debtor's general account, which was subject to the creditor's security.)

(2) The 2009 transactions

[39] **The 2009 transactions are another matter**. We do not yet know what the facts are. We have noted that there has been no discovery and there is no affidavit from the former manager. If at the time the stockpile was depleted the manager acted with Ruby's express or implied approval, Ruby then waived rights against Waimate and its timber. In that event the receivers' submission that Ruby became a mere unsecured creditor is correct. If he acted without Ruby's approval he may be party to a conversion by Waimate of Ruby's property, namely the proceeds of depletion of the stockpile. Receipt of such proceeds would have given Ruby a claim for their amount against Waimate. We do not agree with the Judge ([25] above) that the events of 2009 are to be characterised as mere completion of the 2005–2008 sale contracts. Waimate was passing to Ruby title to timber belonging to Waimate and thus within the Bank's security.

[40] While Ruby had paid cash at full market value in the earlier transactions, this time the "sales" from Waimate to Ruby, which entailed the transfer of Waimate's inventory to Ruby's stockpile (and later to third parties who paid Ruby), were not for cash. They were in satisfaction either of Ruby's existing claim for conversion (if the manager's actions were unknown and unauthorised) or of Waimate's debt to Ruby (if Ruby's directors had known of the manager's actions). Again in contrast to the earlier sales, the 2009 transactions certainly had the effect of undermining the Bank's security. We hold they were arguably not sales and were outside the ordinary course of business, either because:

(a) **they were in satisfaction of Waimate's existing debt to Ruby, rather than for cash;** or

(b) **they were to account to Ruby for Waimate's conversion, via the manager, of Ruby's stock**.

[41] Since we accept Mr Russell's submission that there is an arguable case that the 2009 "sales" did not occur "in the ordinary course of business" of Waimate, the appeal must be allowed in respect of those transactions.

(Footnotes deleted. Emphasis added)

[142] As it apparent from these two New Zealand decisions and the Canadian cases to which they refer, the correct approach to the interpretation of s 53 is, as counsel accepted, reasonably settled:

a) The purpose of s 53 is to limit protection of creditors when a buyer takes goods in the ordinary course of the seller's business. This purpose reflects the policy behind the provision which is to permit commerce to proceed expeditiously without the need for purchasers of goods to check into the titles of the sellers in the ordinary course of their business.

b) The purpose is confirmed by the heading to s 53 and implemented by the text of the provision.

c) The provision applies to all sales of goods "sold in the ordinary course of business", including sales to the public at large, but probably not private sales between individual buyers. Sales to persons who are not ordinary consumers, such as dealers or financial institutions, may be protected, depending on the circumstances: *Fairline Boats v Leger* at 223.

d) A two step process will generally be warranted:

    i) determine the business of the seller; and

    ii) inquire whether the sale was made in the ordinary course of the seller's business.

e) In determining the business of the seller, the focus should be on the ordinary course of that business.

f) Both steps involve objective determination of questions of fact: what is the ordinary course of the business of the seller; and was the sale made in the ordinary course of that business?

g) It is true that the reference to the business of "the seller" introduces a subjective element in that the focus should be on the ordinary course of the seller's business and not on the ordinary course of the seller's type of business, but the inquiry should still be an objective one: *Garrow and Fenton's Law of Personal Property in New Zealand*.[7]

h) In answering the first question, that is determining the ordinary course of the seller's business, the focus should be on the trading activities of the seller at the time of the sale and whether the sale was "a straightforward deal in the mainstream" of the seller's business as Rodney Hansen J put it in *ORIX New Zealand Ltd* at [71].

i) In answering the second question, that is whether the sale was made in the ordinary course of the seller's business, a range of factual considerations may be relevant, including the way in which the deal was "negotiated, agreed and implemented": *ORIX New Zealand Ltd* at [71]. In this context the purpose or effect of the transaction may also be relevant. In *Tubbs* the practical effect of the 2005-2008 transactions in replacing inventory timber with cash in the Bank, which held the security, was decisive.

[143] Significantly, neither New Zealand decision suggested that in applying s 53 a court should consider the circumstances which were "known, or ought reasonably to have been known, by the parties at the time" as held in *Ford Motor Credit Co of Canada v Centre Motors of Brampton Ltd* and *369413 Alberta Ltd v Pocklington*. I agree with Mr Stewart QC that s 53 does not import a knowledge requirement of this nature. The only reference to knowledge in s 53 is the express reference to the buyer's knowledge that the sale constitutes a breach of the security agreement under which the security interest was created. This express reference to knowledge, which has the effect of excluding the operation of s 53, supports the view that no other knowledge requirement, one way or the other, should be implied. To imply such a requirement would add an unwarranted gloss to s 53 which would direct attention

[7] R Fenton *Garrow and Fenton's Law of Personal Property in New Zealand* (7th ed, LexisNexis NZ, Wellington, 2010) Vol 2, at 533-534.

away from the objective factual inquiry and consequently have the potential for undermining the purpose of the provision. Mr Cooke QC was therefore right to resile from the original submission to the contrary for StockCo.

[144] Notwithstanding the view that the Canadian "knowledge" gloss does not apply to s 53, the Canadian decisions do provide support for the view that s 53 requires an objective factual assessment based on all the circumstances of the particular case, including consideration of a range of potential relevant factors: *Fairline Boats Ltd v Leger* at 222-223, *369413 Alberta Ltd v Pocklington* at [22] and *GE Canada Equipment Financing CP v ING Insurance Company of Canada* at [66].

[145] In *Fairline Boats Ltd v Leger* Linden J at 222-223 identified the following potentially relevant factors:

> One factor that must be examined is where the agreement is made. If it is at the business premises of the seller it is more likely to be in the ordinary course of business. If it is away from the business premises of the seller, in suspicious circumstances for example, a court may hold that it is not in the ordinary course of business.
>
> The parties to the sale may also be significant, although certainly not controlling. **If the buyer is an ordinary, everyday consumer, the likelihood of his being involved in a sale in the ordinary course of business is greater. If the buyer is not an ordinary consumer, but a dealer or financial institution, then the Court may take this out of the ordinary course of business, but not necessarily so because dealers and others too may, in proper circumstances, receive the benefit of the provision**.
>
> The quantity of the goods sold must also be considered, although this too is not definitive. If there is only one or a few articles sold in the ordinary way, the Court is more likely to hold this to be a sale in the ordinary course of business. On the other hand, if a large quantity of items are sold, many more than are sold in the ordinary course of business, and perhaps forming a substantial proportion of the stock of the seller, then the Court is less likely to consider it to be in the ordinary course of business.
>
> The price charged for the goods must also be examined, thus if the price charged is in the range of the usual market price, courts are more likely to consider the sale in the ordinary course of business, whereas if the price is unduly low, the courts may hold that this is not a transaction in the ordinary course of business.
>
> There are other circumstances and factors in each sale that may also be viewed by the Court in determining whether, on all of the facts of the case, the sale in question is in the ordinary course of business.
>
> (Emphasis added)

As the emphasised passage indicates, there is no reason why in principle a financier, such as StockCo, should not, in appropriate circumstances, receive the benefit of s 53. It will all depend on the circumstances of the particular case.

[146] To the factors identified in the New Zealand decisions and *Fairline Boats Ltd* might be added the following further factors identified by Fruman J delivering the judgment of the Alberta Court of Appeal in *369413 Alberta Ltd* at [22]:

> (i) The nature and significance of the transaction: it ought to be one that a manager might reasonably be expected to carry out on the manager's own initiative without making prior reference back or subsequent report to superior authorities, such as the board of directors or the shareholders: *Roynat Inc. v. Clark Motors Ltd.* (1991), 1 P.P.S.A.C. (2d) 191 (Ont. Gen. Div.), at 197; and *85956 Holdings Ltd v Fayerman Bros. Ltd*., [1896] 2 W.W.R. 754 (Sask. C.A.);
>
> ....
>
> (vi) The frequency of the type of transaction: an unusual or isolated transaction might be viewed differently from a routine one; and
>
> (vii) The arm's length nature of the transaction: a transaction between a company and a party with whom it is related should receive careful scrutiny.

[147] In making an objective factual assessment based on all the relevant circumstances of the particular case to determine whether a sale of goods was in the ordinary course of business of the seller, that is whether the sale was "a straightforward deal in the mainstream" of the seller's business, the Court will not focus on the particular sale of goods in isolation. Where the sale is part of a deal or inextricably linked with a wider transaction the Court will look at the whole deal or wider transaction to answer the question. It is well established in commercial law that the nature, purpose and effect of a composite transaction will be determined from an examination of its constituent parts as a whole: cf *Birkdale Service Station Ltd v Commissioner of Inland Revenue*[8] and *Chitty on Contracts*.[9] If a sale of goods is part of a composite transaction and would not have been entered into on its own, its nature, purpose and effect will therefore be determined in the context of the whole transaction.

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[8] *Birkdale Service Station Ltd v Commissioner of Inland Revenue* [2001] 1 NZLR 293 (CA) at [31].
[9] H Beale *Chitty on Contracts* (13th ed, Sweet & Maxwell, London, 2008) at [12-067].

[148] In view of this approach to the interpretation of s 53 based on *ORIX New Zealand Ltd* and *Tubbs*, and the relevant Canadian authorities, I do not accept Mr Cooke's submission that "a relatively narrow inquiry" is necessarily involved to the extent that he suggested it should be limited to whether the sale involved goods of the type sold by the seller, and whether they were sold at an appropriate price. An objective factual determination of the issue with a consideration of all the relevant circumstances may involve a wider inquiry in some cases, particularly those where the sale of goods is one part of or inextricably linked with a wider transaction.

[149] Turning then to the first factual question in this case: what was the ordinary course of business of the seller, Plateau, at the time of the sale of the 4,000 heifers to StockCo on 1 August 2008 for $3.2 million (plus GST)? There is no doubt, as Mr Stewart submitted, Plateau was involved in the business of dairy farming on a substantial scale as part of the Charging Group of companies whose operations were funded by the Banks on standard security documentation and terms. There is also no doubt that, as its financial and livestock records showed, Plateau's dairy farming business included the production of milksolids and the buying and selling of categories of livestock, including rising one year heifers. Equally, as Mr Cooke submitted and Westpac recognised, the Crafars were "entrepreneurial": they purchased and developed dairy and drystock farms; they entered into arrangements with sharemilkers; and they considered proposals for the sale of significant numbers of livestock. But care needs to be taken to avoid jumping from a description of the Crafars as "entrepreneurial" to the conclusion that the ordinary course of their substantial dairy farming business automatically included any transaction, however unique or unusual, that Allan Crafar decided one of his companies or his son Robert's company should enter into. That would involve adopting a subjective approach to what is an objective factual assessment. I therefore do not accept the submission for StockCo that the ordinary course of Plateau's business included by definition any "commercial deal making in the dairy sector" that Allan Crafar decided on.

[150] As Mr Stewart submitted, the ordinary course of Plateau's business was funded by the Banks on the terms contained in the security documentation. Without that funding, there would have been no business. And the funding was provided on

the basis that the general character of Plateau's business did not change without the Bank's prior written consent and that Plateau did not make loans to, or for the benefit of, any person: 16 May 2005 GSA clause 8.1(e) and 24 July 2008 GSD clause 13.1(a) and (b). These covenants in the security documentation served to limit the authorised scope of Plateau's ordinary course of business.

[151] Turning then to the second factual question in this case: was the sale of the 4,000 heifers by Plateau to StockCo on 1 August 2008 for $3.2 million (plus GST) in the ordinary course of Plateau's business? At one level and without considering all the circumstances of the transaction the answer could be in the affirmative in that a livestock sale, apparently at arms-length and for fair market value, was in the course of the ordinary business of Plateau. But to look at the sale in this case in this isolated way would not constitute an objective examination of all the relevant circumstances of the wider transaction of which the sale was an inextricable part. The sale in this case was not a simple or straightforward stockyard or farmyard sale of livestock by Plateau to a meat processor or another farmer with the livestock being replaced with cash in the bank as in *Tubbs*, which, in normal circumstances, would be protected by s 53.

[152] The sale in the present case was not simple and straightforward or isolated. It involved:

a) A structured transaction of which the sale of the 4,000 heifers by Plateau to StockCo was an integral part, inextricably linked with the other parts without which the sale would not have proceeded, that is the loan by Plateau to Nugen of the proceeds from the sale for the partial settlement of the Norsewood purchase and the lease back of the heifers by StockCo to Nugen;

b) Negotiations between Plateau's lawyer, acting on instructions from Plateau's principal director, and StockCo's principal director with the structure and terms of the transaction settled at the last minute in a manner which the parties involved believed did not require the consent of the Banks;

c) A finance company buyer, with a financial interest in ensuring the completion of one part of the transaction (that is the settlement by Nugen of the Norsewood (No. 2) purchase and the acquisition by Nugen of the cows on that property which StockCo had already purported to purchase from Nugen, as security for its loan for the deposits on the two Norsewood properties);

d) The goods being all of Plateau's rising year one heifers sold at a discounted price;

e) The purpose being to obtain, urgently, funds to be lent, in breach of Plateau's Bank security covenants, to another company (Nugen) to settle the farm purchase;

f) An undocumented and unsecured loan by Plateau to Nugen with Plateau not obtaining security for its loan until 17 December 2008 when Nugen and Plateau entered into a GSA that ranked behind the securities already granted by Nugen to South Canterbury Finance;

g) The effect of removing the livestock from the Bank's security and not replacing it with cash in the Bank (as in *Tubbs*); and

h) A lease back of the livestock by StockCo to Nugen.

[153] When these features of the sale by Plateau to StockCo are taken into account, it is clear that the sale was not in the ordinary course or mainstream of Plateau's business:

a) The sale itself was unique and unprecedented in that Plateau had not previously sold its entire herd of rising year one heifers. From 2003-2008 the Charging Group had only sold a total of 755 rising year one heifers. In each year from 2005 to 2008 the number of rising year one heifers retained for replacement stock had increased.

b) The sale was also an integral part of a unique and unprecedented transaction in that Plateau had not previously sold livestock to purchase land in this way. As Mr Wiltshire said in evidence in response to questions from me, funds for the purchase of farms by the Crafars normally came directly from the Bank consortium. StockCo adduced no evidence to show otherwise, let alone any evidence that Plateau had ever previously sold its livestock to provide an unsecured loan to Nugen or any other company outside the Charging Group for any purpose or that it had entered into any similar transaction without the consent of the Banks.

c) The way in which the deal, of which the sale was an integral part, was negotiated, agreed and implemented was remarkable involving negotiations between Plateau's principal director and lawyer and StockCo's principal director, last minute restructuring and receipt of the sale proceeds into the lawyer's trust account for an immediate undocumented and unsecured loan to another company in the Crafar group but outside the Charging Group.

d) The initially unsecured loan of the proceeds from the sale by Plateau to Nugen, a further integral part of the transaction, was not only in breach of Plateau's Bank covenants but was also not in the economic interests of Plateau in that Plateau did not receive the benefit of the funds and any cashflow needs of the Charging Group were not addressed. The proceeds of the sale were not used within the Charging Group's business to purchase replacement milking cows or as working capital or to repay debt. As already noted, this provides the basis for distinguishing the decision of the Court of Appeal in *Tubbs*. It also answers the submission for StockCo that the Charging Group and hence the Banks benefited financially from the transaction.

e) The lease back of the heifers by StockCo to Nugen with the heifers continuing to graze on Charging Group farms at Charging Group

expense confirmed the absence of any economic benefit from the transaction for the Charging Group.

[154] For these reasons I have therefore concluded that the sale by Plateau to StockCo of the 4,000 rising year one heifers on 1 August 2008 was not in the ordinary course of Plateau's business. I have reached this conclusion without considering whether the livestock were "inventory", which Mr Stewart QC conceded in his final reply submissions is an awkward term in the dairying industry, and without taking into account the knowledge, actual or constructive, of StockCo.

[155] For completeness I record that if, contrary to my view, the actual or constructive knowledge of StockCo was considered to be relevant under s 53, then I would have been satisfied that StockCo knew or ought reasonably to have known all the circumstances that I have taken into account in reaching my conclusion. My reasons would have been the nature and extent of StockCo's knowledge and understanding of the Crafar group's dairy and livestock business gained from its close involvement with the group over several years, its previous purchase and loan agreements with the group and its comprehensive financial proposals for the group, its awareness of the Bank's security interests and the need to obtain the Bank's consent to the original sale and lease back proposal, its involvement in the unsecured loan for the deposit for the Norsewood properties and its knowledge of Nugen's urgent need for funds to complete the partial settlement on 1 August 2008 for the sale of the livestock by Plateau to obtain funds for Nugen for the Norsewood settlement, the last minute change in the structure of the transaction based on the advice of Allan Crafar and his lawyer and their view that the Bank's consent was no longer required, and its knowledge that Nugen was outside the Charging Group and in dire financial straits.

[156] I do not overlook Mr Kight's evidence that he was unaware that the proceeds from the sale of the 4,000 heifers were required for the partial settlement of the purchase price of the Norsewood (No. 2) property. As already mentioned, I found his claim inherently unlikely in view of his otherwise detailed knowledge of the whole transaction, his personal involvement in the crucial negotiations on 1 August 2008 and Allan Crafar's evidence that StockCo did know what the proceeds from the

sale were required for. It is, however, unnecessary for an adverse finding of credibility to be made because, if the knowledge of StockCo were relevant, it would be both actual and constructive and I would have had no difficulty in concluding that StockCo ought reasonably to have known that an integral part of the transaction was the loan by Plateau to Nugen to enable the partial settlement of the purchase of the Norsewood property to occur that day. Mr Kight also knew, or ought reasonably to have known, that without taking his own independent advice and in relying on the advice of Allan Crafar and his lawyer that the sale was in the ordinary course of Plateau's business and that therefore the Bank's consent was not required, he was taking a significant risk in all the circumstances.

[157] Having reached the conclusion that the sale of the 4,000 heifers was not in the ordinary course of Plateau's business and therefore outside the protection of s 53 of the PPSA, it is necessary to consider the second principal issue in the case.

Authorisation

[158] This issue arises under s 45 of the PPSA which provides:

> **45 Continuation of security interests in proceeds**
>
> (1) Except as otherwise provided in this Act, a security interest in collateral that is dealt with or otherwise gives rise to proceeds—
>
> (a) Continues in the collateral, unless the secured party expressly or impliedly authorised the dealing; and
>
> (b) Extends to the proceeds.
>
> Example
> Person A has a security interest in person B's car.
> Person B sells the car without person A's consent.
> Person A has a security interest in the car and in the money received by person B from the sale of the car.
>
> (2) The amount secured by a security interest in collateral and the proceeds is limited to the value of the collateral at the date of the dealing that gave rise to the proceeds, if the secured party enforces the security interest against both the collateral and the proceeds.
>
> Example
> Person A has a perfected security interest in person B's car.
> The car had a value of $6,000 at the date that person A advanced $4,000 to person B.
> Two years later, without person A's consent, person B sells the car for $3,500, which is the value of the car at that time.
> Person A enforces its security interest in the car and the proceeds.

Person A can recover only $3,500 as the amount secured by person A's security interest.

Compare: Personal Property Security Act 1993 s 28(1) (Saskatchewan)

[159] There was no dispute between the parties that, if it were concluded that the sale of the 4,000 heifers was in the ordinary course of Plateau's business, it would have been unnecessary to consider the application of s 45(1) further because:

a) StockCo would have taken the heifers free of the Bank's security by operation of s 53; and

b) In terms of the Bank's security documentation (the GSA, the SSD and the GSD) the dealing would have been "expressly" authorised under s 45(1).

[160] Conversely, there was also no dispute between the parties that, in the event of a finding that the sale was outside the ordinary course of Plateau's business, the sale was not "expressly" authorised by the Bank's security documentation. The Charging Group's covenants not to sell assets other than in the ordinary or normal course of the Charging Group's business contained in clause 8.1(n)(i) of the 16 May 2005 GSA, clause 15.1.6 of the 9 June 2006 SSD and clause 13.1(j) of the 24 July 2008 GSD were to the same effect as s 53(1).

[161] This means that the question under s 45(1) is whether the sale was in any other way "expressly or impliedly authorised" by the Banks.

[162] For StockCo, Mr Cooke QC submitted that the sale was "expressly or impliedly authorised" because:

a) The secured creditor must accept the consequences of the latitude it gives its customer and the consequences of the plans that it has agreed with the customer: *Lanson v Saskatchewan Valley Credit Union Ltd*; *National Livestock Credit Corp v Schultz*; *Dougal Farms Ltd v Bank of Montreal*; *Royal Bank of Canada v Canadian Commercial Corp*;

and *Motorworld Ltd (In Liquidation) v Turners Auctions Ltd*.[10] These authorities establish that it is not knowledge of the actual transaction that will give rise to an implied authorisation that defeats a secured creditor's claim, but knowledge that the types of transaction similar to the one that is the subject of the inquiry were previously carried out.

b) The provisions in the GSA, the SDD and the GSD were inexact and non-prescriptive. Moreover the Banks paid no attention to the nature and scope of the livestock trading activities – that was left to the Crafars. As in *Lanson*, the Banks knew the Crafars would either sell or keep the Group's progeny as replacements – the Crafars could decide what livestock to keep and what to sell. The real covenant of significance to the Banks was the ratio of debt to assets (the QE ratio).

c) The Group was an extremely valuable client for the Banks, and they encouraged the Group's entrepreneurial approach and its massive expansion programme in the period leading up to the sale. That encompassed supporting the huge farm acquisition plans implemented from late 2007 into 2008. It was the Banks' funds that were fuelling this extraordinary growth period;

d) The Banks also supported the plan to dispose of livestock as part of this land acquisition strategy, with that consent provided in July 2008. The sale of 8,600 cows was part of the wider plan to sell as much as possible (also reflected in the sale and lease back transaction with StockCo that did not proceed, and ultimately the challenged transaction);

e) Before the sale the Banks began to have second thoughts about the extent of their funding of the expansion, and the Crafars breaches of the security document covenants, but they dealt with the position

[10] *Lanson v Saskatchewan Valley Credit Union Ltd* (1998) 172 Sask R 106; (1998) 14 PPSAC (2d) 71; *National Livestock Credit Corp v Schultz* Okl App, 653 P. 2d 1243; *Dougal Farms Ltd v Bank of Montreal* [2006] O J No 3377; *Royal Bank of Canada v Canadian Commercial Corp* (2001) NBQB 199; and *Motorworld Ltd (In Liquidation) v Turners Auctions Lt*d HC Auckland CIV 2007-404-6558, 17 February 2010.

ambiguously at the May and July 2008 meetings as they did not want to upset an extremely valuable customer. They did not prohibit the Group from continuing with its expansion plans. After the May meeting Rabobank stated that further funding could be available. The new GSD then implemented in July 2008 did not impose more prescriptive requirements – it in fact it loosened them; and

f) The Norsewood contract had already been signed up by the time of the July meeting. The Banks have to share some responsibility for the decisions Mr Crafar made at that stage. They had heard about the further purchases, but left Mr Crafar to manage the situation himself with his own resources. Given that they were at the same time agreeing to his livestock disposal plans, it was almost inevitable that Mr Crafar would dispose of unproductive animals, which he no longer needed, to generate cash to continue with the Norsewood purchase. It is true the Norsewood contract was in Nugen's name, but the Banks had also been advised that family succession was part of the new plans.

g) The Banks' subsequent conduct in not objecting to the sale confirmed that they had authorised it.

[163] For the receivers, Mr Stewart QC submitted that there was no evidence that the sale was "expressly or impliedly authorised" by the Banks. On the contrary, the evidence established that the sale was not authorised because:

a) Plateau, through Allan Crafar and Mr Blackman, knew that if authorisation had been requested it would not have been provided.

b) Mr Blackman would not have needed to have formed the view that the sale was expressly authorised by the security documentation if, as StockCo contends, the authorisation was implied.

c) To have obtained the Banks' informed consent, the Charging Group would need to have disclosed to the Banks that all the proceeds from the sale were going to be lent to Nugen, a company outside the Charging Group, to complete the partial settlement of its Norsewood purchase. The Banks would not have authorised the sale of Charging Group assets to find the acquisition of a farm outside the Group.

d) No question of the Banks granting authorisation to obtain some of the proceeds of sale arose because Nugen needed all of the proceeds for the partial settlement.

e) As was accepted for StockCo in closing, the restructuring of the transaction at the last minute was to avoid seeking the Bank's consent. That was entirely inconsistent with the position that the dealing was impliedly consented to.

[164] In response to StockCo's submissions, Mr Stewart submitted that:

a) The decision in *Dougal Farms Ltd v Bank of Montreal* should be distinguished because in that case the sale had been expressly authorised.

b) The decisions in *Royal Bank of Canada v Canadian Commercial Corp*, *National Livestock Credit Corp v Schultz* and *Motorworld Limited (In Liquidation) v Turners Auctions Limited* should also be distinguished because they all rested on a course of conduct between the secured party and the debtor which in effect amounted to a waiver of the security agreement such that the secured party could not rely on its strict terms. There was no course of conduct in the present case because the Banks did not have knowledge of the Crafar Group's plans and intentions so as to be taken as acquiescing. The fact that the Banks were aware of some sales, namely those within the ordinary course of business and those outside the ordinary course of business

which they authorised, did not mean that the Banks authorised any other sales outside the ordinary course of business.

c) The evidence did not establish that the Banks consent to the sale of the heifers could be implied.

d) The subsequent conduct of the Banks is not relevant to the issue of implied authorisation.

[165] There was no dispute between the parties as to the correct approach to the interpretation and application of s 45:

a) The purpose of the provision is to enact the common law principle that no one can give a better title than he or she has (nemo dat quod non habet): M Gedye, R C C Cumming QC & R J Wood *Personal Property Securities in New Zealand*[11] and *Garrow and Fenton's Law of Personal Property in New Zealand* at [12.8.2]. When collateral is "dealt with", a security interest in it continues after the dealing. A perfected security interest persists in the collateral even though the debtor may no longer own the collateral. Subject to the other provisions of the Act, the security interest is not affected by a sale or other disposition and can be enforced against the buyer.

b) As s 45(1)(a) makes clear, however, the security interest will be lost if the secured party "expressly or impliedly authorised the dealing".

c) In order to "authorise" a dealing, whether expressly or impliedly, the secured party would need to be aware of the specific "dealing" or, at least, previous dealings of the same type, and either have expressly authorised the dealing or by its conduct be taken as having done so impliedly: *Royal Bank of Canada v Canadian Commerical Corp, National Livestock Credit Corp v Schultz* and *Motorworld Limited (In Liquidation) v Turners Auctions Ltd.*

[11] M Gedye, R C C Cumming QC and R J Wood *Personal Property Securities in New Zealand* (Thomson Brookers, Wellington, 2002) at [45.1].

d) Whether in a particular case the secured party did "expressly or impliedly" authorise the dealing will be a question of fact in that case.

e) As the use of the word "authorised" in s 45(1)(a) indicates, the authorisation of the dealing needs to be given before the relevant dealing has taken place: *Lanson v Saskatchewan Valley Credit Union Ltd* at [9] and *Royal Bank v Ag-Com Trading Inc*.[12]

f) In contrast to s 53 where the focus is on the dealings between the seller (debtor) and the purchaser, s 45 focuses on the arrangement between the security holder and the debtor: *Ford Motor Credit Co of Canada v Centre Motors of Brampton Ltd* at 525 and *Motorworld Limited (In Liquidation) v Turners Auctions Limited* at [39].

[166] Adopting this approach to the interpretation and application of s 45(1), I am satisfied for the following reasons that the sale by Pleateau of the 4,000 rising year one heifers to StockCo for $3.2 million (plus GST) on 1 August 2008, which I have already found was a sale outside Plateau's ordinary course of business, was not expressly or impliedly authorised by the Banks.

[167] First, there was no evidence that the Banks were aware of the sale or the loan of the proceeds to Nugen for the partial settlement of the Norsewood purchase or the lease back of the heifers by StockCo to Nugen until 18 November 2008 when Mr Wiltshire provided Mr Little with details of the transaction for the first time. On the contrary, the evidence established that neither the original proposal for Plateau to sell the heifers to StockCo and lease them back itself nor the proposal formulated at the last minute on 1 August 2008 was disclosed to the Banks. StockCo had specifically asked Blackman Spargo to obtain the Banks' consent to the original proposal, but it was clear from the evidence of Allan Crafar, Mr Blackman and Mr Little that no consent was sought. Messrs Crafar and Blackman acknowledged that, if the proposal had been disclosed and consent sought, it would not have been granted because the Banks had made it clear by then that any proceeds from the sale of livestock were to be used for the reduction of debt and not for the purchase of further

[12] *Royal Bank v Ag-Com Trading Inc* (2001) 2 PPSAC (3d) 1 at [92].

properties. There was no suggestion that the proposal formulated at the last minute on 1 August 2008 was disclosed to the Banks before it was implemented on that day. It was not disclosed because Mr Blackman, acting on Allan Crafar's views, had advised StockCo that the sale did not require the Banks' consent as it was within Plateau's "ordinary course of business".

[168] Second, in the absence of any evidence establishing that the Banks were aware of the sale before 18 November 2008, there is no basis for StockCo's argument that the Banks "authorised" the specific sale either "expressly" or "impliedly". The Banks would need to have known about the proposed sale before it occurred in order to authorise it one way or the other.

[169] Third, in the absence of any evidence establishing that the Banks were aware of the proposed sale before it occurred, or of any sales of this type having occurred before, there is no basis for StockCo's argument that the bank "impliedly" authorised it by a course of conduct. There was no evidence that the Banks by their previous conduct, had "impliedly" authorised sales of large numbers of livestock which were outside Plateau's ordinary course of business. The Banks had received requests for express authorisation in respect of the proposed sale and lease back of 8,000 cows in March 2008, which did not proceed, and for the three 50/50 sharemilking proposals in July 2008, which did proceed, but the express authorisation of the latter transactions did not constitute a course of conduct giving rise to a waiver or acquiescence in respect of any other later sale of large numbers of livestock outside Plateau's ordinary course of business, of which the Banks were unaware.

[170] Fourth, as Mr Stewart submitted, if the sale had been "impliedly" authorised, there would have been no need for Mr Blackman to have given the advice, based on his reading of clause 8.1(n) of the 16 May 2005 GSA and Allan Crafar's views, that the sale was within Plateau's "ordinary course of business" and therefore "expressly" authorised by the Banks' security documentation.

[171] Fifth, the Canadian decisions relied on by StockCo may all be distinguished from the present case on their facts. None of them is authority for the proposition that in the absence of any knowledge of a proposed dealing outside the ordinary

business of the seller or a course of conduct in relation to such dealings the security holder authorised the dealing. The decision in *Motorworld Limited (In Liquidation) v Turners Auctions Limited* may also be distinguished on similar grounds. In that case it was held on the facts that as the secured party had never objected to sales of the type at issue it was impossible for it to argue that it had not, either expressly or impliedly, authorised the types of sale at issue: at [42]-[44]. In the present case, as Plateau had never entered into a similar transaction, the Banks could not be said to have authorised transactions of that nature, either expressly or impliedly.

[172] Sixth, the submission for StockCo that the Banks' general approach to the Crafar group, their encouragement of the group's expansion until the meetings in May and July 2008, the ambiguous message given at the meeting on 21 July 2008 by which time Nugen had purchased Norsewood, the absence of any objection by the Banks to the group's proposal to sell all its livestock and the Banks' subsequent conduct, meant that the Bank "impliedly" authorised the sale does not withstand scrutiny. The short answer is that the Banks were simply unaware of the proposed sale of the 4,000 heifers, the "dealing" the subject of s 45(1)(a), before it occurred and therefore were not in a position to authorise it. No consent was sought for the sale because the Crafars knew from the May and July 2008 meetings that no consent would be given. No transactions of a similar nature had previously occurred.

[173] As a consequence of deciding that the sale was not expressly or impliedly authorised by the Banks, the Banks' security interest in the heifers continues notwithstanding the sale by Plateau to StockCo.

[174] In view of the conclusions I have reached on the first and second principal issues, it is not necessary for me to consider the third principal issue, but in case I am wrong on one or both of the first and second issues, I turn now to the third issue.

Subordination

[175] This issue proceeds on the basis that StockCo did acquire clear title to the 4,000 heifers, either because the sale on 1 August 2008 was in the ordinary course of Plateau's business or because it was expressly or impliedly authorised by the Banks.

The issue then is whether StockCo's security interest under its lease of the heifers to Nugen was subordinated under s 88 of the PPSA to further advances by the Banks to the Charging Group from 8 May 2009 (that is the expiration of 15 days after StockCo's receipt of the Blackman Spargo letter dated 20 April 2009 on 23 April 2009) and 7 October 2009 when StockCo registered is financing change statement.

[176] This issue in turn raises the following sub-issues:

a) whether the arrangements recorded in the bailment (lease) agreement between Nugen and the Charging Group dated 5 April 2009 constituted a transfer of an interest in the heifers for the purposes of s 88 of the PPSA;

b) whether StockCo had knowledge of that transfer as a consequence of its receipt of the letter dated 20 April 2009 from Blackman Spargo enclosing a copy of the bailment (lease) agreement;

c) to what extent further advances were made by any of the Banks to the Charging Group after StockCo acquired that knowledge; and

d) whether Westpac in this context is acting in good faith in relying on its GSD in relation to the heifers for the purposes of s 25 of the PPSA.

[177] These issues involve consideration of the following provisions in the PPSA:

> **16 Interpretation**
>
> (1) In this Act, unless the context otherwise requires,-
>
> ....
>
> **Advance**—
>
> (a) Means the payment of money, the provision of credit, or the giving of value; and
>
> (b) Includes any liability of the debtor to pay interest, credit costs, and other charges or costs payable by the debtor in connection with an advance or the enforcement of a security interest securing the advance:
>
> ....

Lease for a term of more than 1 year—

(a) Means a lease or bailment of goods for a term of more than 1 year; and

....

(c) Does not include—

(i) A lease by a lessor who is not regularly engaged in the business of leasing goods; or

(ii) A lease of household furnishings or appliances as part of a lease of land where the use of the goods is incidental to the use and enjoyment of the land; or

(iii) A lease of prescribed goods, regardless of the length of the lease term:

.....

17 Meaning of "security interest"

(1) In this Act, unless the context otherwise requires, the term **security interest**—

(a) Means an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to—

(i) The form of the transaction; and

(ii) The identity of the person who has title to the collateral; and

(2) A person who is obligated under an account receivable may take a security interest in the account receivable under which that person is obligated.

.....

19 Meaning of "knowledge"

(1) For the purposes of this Act,—

(a) .....

(b) An organisation knows or has knowledge of a fact in relation to a particular transaction when—

(i) The person within the organisation with responsibility for matters to which the transaction relates has actual knowledge of the fact; or

(ii) The organisation receives a notice stating the fact; or

(iii) The fact is communicated to the organisation in such a way that it would have been brought to the attention of the person with responsibility for matters to which the transaction relates if the organisation had exercised reasonable care.

....

(2) For the purposes of subsection (1),—

(a) A person receives a notice when the notice is given to the person in accordance with sections 184 to 189 (service of notices):

(b) An organisation exercises reasonable care if—

(i) It takes reasonable steps to ensure that significant information is brought to the attention of the person within the organisation with responsibility for matters to which a particular transaction relates; but

(ii) Nothing in subparagraph (i) requires a person acting on behalf of the organisation to communicate information unless the communication is part of that person's regular duties or unless the person has reason to know of the transaction and that the transaction would be materially affected by the information.

.....

25 Rights or duties that apply to be exercised in good faith and in accordance with reasonable standards of commercial practice

(1) All rights, duties, or obligations that arise under a security agreement or this Act must be exercised or discharged in good faith and in accordance with reasonable standards of commercial practice.

(2) A person does not act in bad faith merely because the person acts with knowledge of the interest of some other person.

....

40 Attachment of security interests generally

(1) A security interest attaches to collateral when—

(a) Value is given by the secured party; and

(b) The debtor has rights in the collateral; and

(c) Except for the purpose of enforcing rights between the parties to the security agreement, the security agreement is enforceable against third parties within the meaning of section 36.

(2) Subsection (1) does not apply if the parties to a security agreement have agreed that a security interest attaches at a later time, in which case the security interest attaches at the time specified in the agreement.

(3) For the purposes of subsection (1)(b), a debtor has rights in goods that are leased to the debtor, consigned to the debtor, or sold to the debtor under a conditional sale agreement (including an agreement to sell subject to retention of title) no later than when the debtor obtains possession of the goods.

(4) To avoid doubt, a reference in a security agreement to a floating charge is not an agreement that the security interest created by the floating charge attaches at a later time than the time specified in subsection (1).

.....

87 Rights of debtor may be transferred

....

(3) In this section, transfer includes a sale, the creation of a security interest, or a transfer under judgment enforcement proceedings.

88 General priority of security interest in transferred collateral over security interests granted by transferee

(1) If a debtor transfers an interest in collateral that, at the time of the transfer, is subject to a perfected security interest, that security interest has priority over any other security interest granted by the transferee, except to the extent that the security interest granted by the transferee secures advances made or contracted for—

(a) After the expiration of 15 days from the date that the secured party who holds the security interest in the transferred collateral had knowledge of the information required to register a financing change statement disclosing the transferee as the new debtor; and

(b) Before the secured party referred to in paragraph (a) took possession of the collateral or registered a financing change statement disclosing the transferee as the new debtor.

(2) Subsection (1) does not apply if the transferee acquires the debtor's interest free of the security interest granted by the debtor.

89 Transfer of debtor's interest in collateral with prior consent of secured party

Despite section 88, if a security interest is perfected by registration and the debtor transfers all or part of the debtor's interest in the collateral with the prior consent of the secured party, the security interest in the transferred collateral is subordinate to—

(a) An interest, other than a security interest in the transferred collateral, arising during the period commencing on the expiration of the

fifteenth day after the transfer to the time the secured party amended the registration to disclose the name of the transferee of the interest in the collateral as the new debtor or took possession of the collateral; and

(b) A perfected security interest in the transferred collateral that is registered or perfected during the period referred to in paragraph (a); and

(c) A perfected security interest in the transferred collateral that is registered or perfected after the transfer and before the expiration of the fifteenth day after the transfer if, before the expiration of the 15 days,—

(i) The registration of the security interest first referred to in this section is not amended to disclose the transferee of the interest in the collateral as the new debtor; or

(ii) The secured party does not take possession of the collateral.

.....

185 Method of service of notices, etc

(1) Any notice or any other document required or authorised by this Act to be served on or given to any person must be in writing and is sufficiently served or given if—

(a) It is delivered to that person or that person's agent; or

(b) It is left at that person's or that person's agent's usual or last known place of abode or business or at an address specified for that purpose in the security agreement; or

(c) It is posted in a letter addressed to that person or that person's agent by name at that place of abode or business or address; or

(d) It is given by facsimile, electronic mail, or other similar means of communication.

.....

187 How to effect service of notice, etc, by post

If any notice or other document is sent to any person by post, it is deemed to have been delivered to that person at the time when the letter would in the ordinary course of post be delivered and, in proving the delivery, it is sufficient to prove that the letter was properly addressed and posted.

[178] For the Receivers, it was submitted that:

a) the grazing of the heifers on the Charging Group's land pursuant to the bailment (lease) agreement constituted a bailment of the heifers by Nugen to the Charging Group;

b) the bailment by Nugen to the Charging Group under the bailment (lease) agreement is a "lease for a term of more than one year" under the definition in s 16(1) of the PPSA, and as such, is a "security interest" under 17(2): cf *Graham v Portacom New Zealand Limited* and *Waller v New Zealand Bloodstock Limited*;[13]

c) the Charging Group's interest in the bailed stock constitutes sufficient "rights in the collateral" for Westpac's security interest under the GSA to attach to the bailed stock, pursuant to s 40(1)(b) of the PPSA;

d) as the bailment by Nugen to the Charging Group created a security interest under s 17(2) of the PPSA, the bailment was a "transfer" (see s 87(3) of the PPSA) of an interest in collateral already subject to StockCo's perfected security interest (as lessor to Nugen), and accordingly, in determining the priority of the security interests claimed by Westpac and StockCo, the special priority rule in s 88 of the PPSA will apply (instead of the usual priority rules in s 66);

e) accordingly, Westpac's security interest will have priority to the extent that it secures advances made or contracted for in the period from the expiry of 15 days from the date StockCo had knowledge of the information necessary to register a financing change statement recording the change of the debtor, to the date such financing change statement was registered;

f) StockCo had knowledge of the transfer as a consequence of its receipt of the letter dated 20 April 2009 from Blackman Spargo enclosing a copy of the bailment (lease) agreement of 5 April 2009; and

---

[13] *Graham v Portacom New Zealand Limited* [2004] 2 NZLR 528 (HC) at [28]; *Waller v New Zealand Bloodstock Limited* [2006] 2 NZLR 629 (CA) at [54].

g) there is no basis for finding that Westpac and/or the Banks acted in bad faith or are precluded by s 25 of the PPSA from now relying on their rights under the security.

[179] For StockCo, it was submitted that the Receivers' argument had no real merit. The only reason why the heifers remained on the Crafar farms was because Mr Allan Crafar treated all of the farms as one big enterprise. As a consequence the Crafar Group assisted Nugen in a breach of StockCo's lease agreement by having the heifers on the Charging Group farms, rather than on Nugen's farms as was required. Mr Blackman subsequently appreciated that this was in breach of Nugen's arrangements with StockCo, and sought StockCo's consent to a bailment and lease of the heifers back to the Crafar Group. StockCo did not consent. None of this amounted to a "transfer" of an interest in the heifers. In any event, the mere possession of the heifers by the Crafar Group did not create a security interest in the heifers capable of defeating StockCo's claims. For that reason, neither the Crafar Group nor, therefore, the Banks have a legitimate security interest in the heifers. There are four reasons why s 88 of the PPSA does not operate in this case:

a) StockCo did not have actual knowledge of the fact that Nugen had transferred an interest in the heifers to the Charging Group: s 19(1)(b), *Re Searcy* and *Bank of Nova Scotia v Royal Bank of Canada*;[14]

b) What Nugen sought to give the Charging Group was merely a bailment, arising from a grazing arrangement, and was not a "transfer" of an interest in the heifers as defined under the PPSA: *Guntel v Kocian, Ward and Bank of Nova Scotia* and *Farm Credit Corporation v Valley Beef Producers Co-operative Ltd*.[15]

c) Given that the Banks knew that StockCo had acquired an interest in the disputed heifers, that the disputed heifers had been leased to Nugen and that the Charging Group had possession of the heifers in

[14] *Re Searcy* (1991) 61 BCLR (2d) 247 (SC); *Bank of Nova Scotia v Royal Bank of Canada* (1998) BCTC LEXIS 2231.
[15] *Guntel v Kocian, Ward and Bank of Nova Scotia* (1985) 36 Man R (2d) 179; *Farm Credit Corporation v Valley Beef Producers Co-Operative Ltd* (2002) 5 PPSAC (3d) 1 at 277.

breach of those lease arrangements, before the Banks made the further advances in issue, it is not possible for the Banks to rely on s 88 in good faith in accordance with s 25: *Bank of Nova Scotia v Royal Bank of Canada*;

d) Finally, whilst the Banks made further advances to the Charging Group during the period in question, there were also repayments by the Charging Group during the same period, such that only the net advances during the relevant period will be relevant.

[180] There is no dispute that to succeed in establishing that StockCo's security interest under its lease of the heifers to Nugen was subordinated under s 88(1) of the PPSA to further advances by the Banks to the Charging Group the Receivers must establish that:

a) The heifers were "collateral" that, at the time of the alleged transfer on 5 April 2009, was subject to a "perfected security interest" under the PPSA;

b) Nugen was "a debtor" in respect of the "collateral", that is the heifers;

c) The bailment (lease) agreement between Nugen and the Charging Group dated 5 April 2009 constituted a "transfer" of an interest in the collateral;

d) StockCo had "knowledge" of information that required StockCo to register a financing change statement disclosing the Charging Group as the new debtor before the expiration of the prescribed 15 day period;

e) StockCo did not do so until 7 October 2009;

f) The Banks made further advances to the Charging Group in the period between 8 May 2009 and 7 October 2009; and

g) In making the further advances under the GSD, the Banks acted in good faith and in accordance with reasonable standards of commercial practice in terms of s 25 of the PPSA.

[181] There is no dispute that the heifers were "collateral" that, at the time of the alleged transfer on 5 April 2009, was subject to a "perfected security interest". StockCo's lease of the 4,000 heifers to Nugen was for a period of five years. As a lease for a period of more than one year, it was therefore a deemed security interest for the purposes of the PPSA: s 17(1)(b). StockCo's security interest in all animals leased to Nugen, including the 4,000 heifers, had been perfected by registration of a financing statement on the PPSR on 30 June 2008 against Nugen as a debtor.

[182] There is therefore no dispute that in terms of s 88(1) Nugen was "a debtor" in respect of "collateral", that is the 4,000 heifers.

[183] Although StockCo argued otherwise, I agree with the submission for the Receivers that the bailment (lease) agreement between Nugen and the Charging Group dated 5 April 2009 constituted a "transfer" of an interest in the collateral because:

a) A "transfer" is defined in s 87(3) of the PPSA as including:

> ... a sale, the creation of a security interest, or a transfer under judgment enforcement proceedings ...

b) The term "security interest" is defined in s 17(1)(b) of the PPSA as including:

> ... an interest created or provided for by ... a lease for a term of more than one year ...

c) The expression "a lease for a term of more than one year" is defined in s 16(1)(a) of the PPSA as:

> a lease or bailment of goods for a term of more than one year.

d) As the term "bailment" is not defined in the PPSA, it should be given its ordinary meaning at common law.

e) At common law a bailment of goods arises where one person (the bailee) is voluntarily in possession of goods (including animals) belonging to another person (the bailer) and a bailment may be either gratuitous or for consideration: *Laws of New Zealand, Animals.*[16] A contract of agistment is an example of a bailment which arises where one person (the agister) takes another person's livestock to feed or graze on the agister's land for reward, usually at a weekly rate, on the implied terms that the agister will redeliver the stock to the owner on demand: *Laws of New Zealand*, *Animals* at [33], and *Grazing & Export Meat Co Ltd v Anderson.*[17]

f) The bailment (lease) agreement between Nugen and the Charging Group (Plateau) dated 5 April 2009 recorded that the 4,000 heifers would be grazed on the Charging Group's land from 1 August 2008, being the date the heifers were originally sold by Plateau to StockCo, to 31 May 2010. While Recital C to the agreement recorded that the grazing rights were to be until 31 May 2009, the Second Schedule to the agreement recorded the term of the grazing agreement as lasting until 31 May 2010. Recital D also recorded that on the expiration of the grazing agreement, Nugen would sublease the heifers to the Charging Group, and both clause 2 and the Third Schedule recorded that the commencement of that lease arrangement would be 1 June 2010. It is clear from the agreement read as a whole that the date of 31 May 2009 in Recital C is an error. It is well established that the principal provisions of an agreement or contract will take precedence over a recital containing an obvious error: *Chitty on Contracts* at [12-066] and *Totara Investments Ltd v Crismac Ltd.*[18] Mr Blackman's evidence expressing his subjective views on the interpretation of the

[16] *Laws of New Zealand, Animals* (Reissue 1, LexisNexis, Wellington, 2003) at [32].
[17] *Grazing & Export Meat Co Ltd v Anderson* [1976] 1 NZLR 187.
[18] *Totara Investments Ltd v Crismac Ltd* [2010] 3 NZLR 285 (SC) at [31].

bailment (lease) agreement that he prepared are irrelevant: cf *Vector Gas Ltd v Bay of Plenty Energy Limited*.[19]

g) As the bailment (lease) agreement was for a term of more than one year, it was within the definitions of "a lease for a term of more than one year" and a "security interest" so that it constituted a "transfer" of an interest in the collateral by Nugen to the Charging Group.

[184] StockCo submitted that a simple bailment did not come within the definition of "transfer" because no interest in the property bailed was transferred. A bailment for one year or more created a deemed security interest in favour of the bailor over the asset that was bailed, but did not create an interest in favour of the transferee. For the following reasons I do not accept StockCo's argument. First, it overlooks the plain meaning of the express provisions in the relevant statutory definitions.

[185] Second, it introduces a qualification to the definitions which was not intended. As pointed out by M Gedye, RCC Cumming QC and R J Wood in *Personal Property Securities in New Zealand* at 16.1.31:

> The definition of "lease for a term of more than 1 year" identifies the types of true lease that would not otherwise come within the definition of "security interest" but that (under s 17(1)(b)) are brought within that definition for the purpose of the Act's conflict of laws, perfection and priority provisions.
>
> The definition of "lease for a term of more than 1 year" includes all leases that have a term of more than one year, but also covers leases that have the potential to extend beyond one year. There is no requirement in para (a) of the definition that the bailee pay a rental or other consideration and accordingly it would appear to include gratuitous bailments of goods.
>
> Paragraph (b) of the definition (which does not refer expressly to bailments) ensures that the substance of the transaction will govern. ...

[186] Third, neither of the Canadian decisions relied on by StockCo was concerned with the interpretation of the equivalent definitions: cf *Guntel v Kocian, Ward and Bank of Nova Scotia* and *Farm Credit Corp v Valley Beef Producers Co-operative Ltd.* In the latter case the examination of the agreement for the purpose of determining whether it was in substance a security transaction within the scope of

[19] *Vector Gas Ltd v Bay of Plenty Energy Limited* [2010] 2 NZLR 444 (SC) at [14], [19]-[20] and [151].

the Saskatchewan PPSA or a true bailment or consignment that was excluded from the PPSA was in a different context. Furthermore, the judgment of Klebuc J, in a passage not referred to by StockCo, included at [21] an extract from a Canadian text which explained the focus on the substance of the transaction and pointed out that in practice the characterisation of the transaction was relevant only when issues associated with *inter partes* rights and obligations on breach of the contract were involve. If the transaction were a security agreement, most of the issues would be regulated under the PPSA.

[187] For completeness on this aspect of this issue, I note that StockCo did not argue either that the bailment agreement did not represent the reality of the position of the heifers in the Charging Group or that the exclusion from the definition of "lease for a term of more than 1 year" of "a lease by a lessor who is not regularly engaged in the business of leasing goods" applied. The facts would not have supported either argument.

[188] Next, although StockCo argued otherwise, I agree with the submission for the Receivers that StockCo had "knowledge" of information that required StockCo to register a financing change statement disclosing Plateau as the new debtor within 15 days because:

a) By s 19(1)(b) of the PPSA, an organisation (which includes a company) "knows or has knowledge of a fact in relation to a particular transaction" when

> .....
>
> (ii) The organisation receives a notice stating the fact; or
>
> (iii) The fact is communicated to the organisation in such a way that it would have been brought to the attention of the person with responsibility for matters to which the transaction relates if the organisation had exercised reasonable care.

b) By s 19(2):

> ....

(2) For the purposes of subsection (1),—

(a) A person receives a notice when the notice is given to the person in accordance with sections 184 to 189 (service of notices):

(b) An organisation exercises reasonable care if—

(i) It takes reasonable steps to ensure that significant information is brought to the attention of the person within the organisation with responsibility for matters to which a particular transaction relates; but

(ii) Nothing in subparagraph (i) requires a person acting on behalf of the organisation to communicate information unless the communication is part of that person's regular duties or unless the person has reason to know of the transaction and that the transaction would be materially affected by the information.

c) By s 185 (1):

185 Method of service of notices, etc

(1) Any notice or any other document required or authorised by this Act to be served on or given to any person must be in writing and is sufficiently served or given if—

....

(c) It is posted in a letter addressed to that person or that person's agent by name at that place of abode or business or address; or

....

d) On 20 April 2009 Blackman Spargo wrote to StockCo by letter addressed to PO Box 678, Hastings 4156, and marked for "Merilyn Derwin", who was Mr Kight's administrative assistant, as follows:

> ....we have received advice from our client that the stock may be depastured on land owned by other entities in the Crafarms Group and as a result we have prepared a Grazing Agreement. Upon the termination of this Grazing Agreement on 1 June 2010 Nugen Farms Limited wishes to sub-lease the livestock to other entities in the Crafarms Group.
> We note that clause 4(a) of the terms and conditions of the Lease prohibits further hire of the herd. We therefore seek your consent to such lease occurring and an

> acknowledgment that the stock may be depastured on other farms.
>
> We enclose for your information a copy of the Bailment document.

e) On 23 April 2009 Merilyn Derwin replied to Mr Blackman by email acknowledging receipt of "your letter and Bailment of Livestock document this morning".

f) In the face of Merilyn Derwin's email acknowledgment of Blackman Spargo's letter of 20 April 2009, there can be no dispute that the letter and bailment (lease) agreement were received by StockCo.

g) While Mr Kight deposed that he had no recollection of ever receiving the Blackman Spargo letter of 20 April 2009, and that a search of StockCo's offices had not produced either the letter or the email response, there was and could be no real dispute that in accordance with the requirements of ss 19(1) and (2) and 185(1)(c), the Blackman Spargo letter was received by StockCo and that, if StockCo had exercised "reasonable care", it would have been brought to the attention of Mr Kight on receipt: cf M Gedye, RCC Cumming QC and R J Wood in *Personal Property Securities in New Zealand* at [19.2] and Law Commission Report, *A Personal Property Securities Act for New Zealand.*[20]

h) StockCo therefore had notice of the information in the Blackman Spargo letter of 20 April 2009 on 23 April 2009 when Merilyn Derwin acknowledged receipt of the letter.

i) It is clear from the Blackman Spargo letter of 20 April 2009 and the enclosed bailment (lease) agreement, that is the executed agreement between Nugen and the Charging Group dated 5 April 2009, that StockCo had notice of the grazing agreement which recorded that the

[20] Law Commission Report, *A Personal Property Securities Act for New Zealand* (NZCC R8, 1989) at 100.

4,000 heifers would be grazed on the Charging Group's land from 1 August 2008 to 31 May 2010. Disclosure to StockCo of this grazing agreement meant that StockCo was on notice that, in terms of the relevant definitions in the PPSA, there was a bailment of the 4,000 heifers for more than one year so that a "transfer" of a "security interest" was involved. In terms of s 88(1)(a) StockCo therefore had knowledge of the information required to register a financing change statement disclosing the Charging Group as the new debtor.

j) Confirmation that StockCo had knowledge of this information and appreciated the need to act on it is provided by Ms Derwin's subsequent letter to Blackman Spargo dated 15 October 2009 which read:

> We recently received notification that cows leased to Nugen Farms Limited by StockCo Limited may be depastured on land owned by other entities in the Crafarms Group and that the livestock may also be sub-leased to other entities in the Crafarms Group.
>
> This sub-lease is not consented to by StockCo Limited and is in breach of the Master Deed of Dairy Herd Lease.
>
> Notwithstanding we have amended our PPSR Financing Statement No. F21996F92X1V3J05 to include those companies in the Crafarms Group as debtors. Please find enclosed the Verification Statement showing the inclusion of these companies.

[189] StockCo's argument was that StockCo did not have actual knowledge of the fact of the transfer of collateral because the Blackman Spargo letter of 20 April 2009 stated only that the stock "may" be depastured on Crafar Group land, sought consent to the proposed sublease from 1 June 2010, and enclosed a copy of the bailment (lease) agreement with the erroneous date in Recital C. I do not accept StockCo's argument. First, I have already held that, notwithstanding the error in Recital C, the substantive provisions of the bailment (lease) agreement which incorporate the grazing agreement in the Second Schedule make it clear that the term of the agreement was from 1 August 2008 to 31 May 2010.

[190] Second, the fact that the Blackman Spargo letter sought consent to the proposed sublease from 1 June 2010, which was not forthcoming, did not detract from the separate notice given by the letter about the grazing agreement component of the bailment (lease) agreement.

[191] Third, neither of the Canadian decisions relied on by StockCo assists in this context. *Re Searcy* and *Bank of Nova Scotia v Royal Bank of Canada* were concerned with the interpretation and application of different statutory provisions in different factual settings.

[192] There is no dispute that StockCo did not register a financing change statement disclosing the Charging Group as the new debtor before the expiration of the 15 days prescribed by s 88(1)(a) that is by 8 May 2009. StockCo did not take this step until 7 October 2009.

[193] There is also no dispute that in the period from 8 May 2009 to 7 October 2009 when StockCo registered its financing change statement the Banks made the following further advances to the Charging Group:

Rabobank	$6,267,280.00
PGG Wrightson	1,563,473.00
Westpac	1,627.176.30
	$9,457,929.30

[194] While Rabobank and PGG Wrightson made further advances, Westpac granted overdraft excesses which enabled the Charging Group to meet interest payments on Westpac loans. As the definition of advance in s 16 of the PPSA covers "the provision of credit" and "any liability of the debtor to pay interest", the Westpac overdraft excesses would be included.

[195] StockCo argued that during the period in question there were also repayments by the Charging Group which meant that only the net advances would be relevant. StockCo did not, however, refer to any evidence quantifying the amount of any such repayments or suggest that, taking into account such repayments, the total amount of

the further advances would not in any event have extinguished StockCo's equity in the heifers.

[196] This means that, subject to StockCo's submission that the Banks did not act in good faith and in accordance with reasonable standards of commercial practice in terms of s 25 of the PPSA, StockCo's interest in the heifers will be subordinated to the advances made by the Banks during the period that StockCo could have, but failed to, register a financing change statement to protect its interest under s 88.

[197] StockCo's "good faith" submission is that the Banks cannot in good faith rely on s 88 given that they knew of the sale of the heifers to StockCo before making the further advances in the period after 8 May 2009. The submission is made on the following grounds:

a) Where the secured creditor of a transferee has knowledge of the fact that the collateral has been transferred in breach of the transferor's obligations to its secured creditor then taking advantage of that transfer would be a breach of good faith: *Bank of Nova Scotia v Royal Bank of Canada*.

b) All the Banks knew from the Cranleigh Report that, as at 20 April 2009, there was at the very least a real prospect that StockCo had the paramount security interest in the 4,000 heifers. No steps were taken by the Banks to determine whether they still had priority.

c) Because the Banks had actual knowledge of the intricacies of the transaction from the Cranleigh Report, the mischief s 88 was designed to protect against did not exist.

d) The effect of s 88 could be very draconian on a party in StockCo's position if a party in the position of the Banks sought to take advantage of the provision by making further advances with complete knowledge of StockCo's interest in the 4,000 heifers.

e) The very reason for s 25 is to ameliorate conduct that would otherwise breach reasonable standards of commercial practice.

[198] It was submitted for the Receivers in response that:

a) Knowledge of the interest of another does not constitute bad faith: s 25(2).

b) A financier is not under a duty to contact another financier to advise of a deficiency in a security.

c) The Banks were entitled to benefit from the operation of s 88 by making further advances.

d) To establish "bad faith" some positive act is required tantamount to conduct or a representation which would give rise to an estoppel or waiver: *518718 Alberta Ltd v Canadian Forest Products Ltd* and *Harvestpro Logging Ltd v Cordyline Holdings Ltd*.[21]

e) StockCo was the author of its own misfortune by failing to take steps to protect its interest under s 88 when it acquired knowledge of the transfer pursuant to the bailment (lease) agreement.

f) The party alleging a failure to act in good faith has the onus or burden of proving it: *Canadian Imperial Bank of Commerce v AK Construction (1988) Ltd*.[22]

g) StockCo is unable to discharge the onus as there is no evidence of any conduct or communication by the Banks to StockCo at all, let alone any conduct that could be described as amounting to an estoppel or waiver. Nor was there any action in reliance by StockCo, as the

[21] *518718 Alberta Ltd v Canadian Forest Products Ltd* [1999] 3 WWR 672 at [69] and [76]; *Harvestpro Logging Ltd v Cordyline Holdings Ltd* HC Auckland CIV-2006-404-3107, 3 October 2006.
[22] *Canadian Imperial Bank of Commerce v AK Construction (1988) Ltd* (1995) 9 PPSAC (2d) 257 at [42].

relevant action had already been taken by StockCo on 1 August 2008 when it acquired the heifers and leased them to Nugen.

h) The decision in *Bank of Nova Scotia v Royal Bank of Canada* should be distinguished.

[199] StockCo's "good faith" submission is based on s 25 of the PPSA which provides:

> **25 Rights or duties that apply to be exercised in good faith and in accordance with reasonable standards of commercial practice**
>
> (1) All rights, duties, or obligations that arise under a security agreement or this Act must be exercised or discharged in good faith and in accordance with reasonable standards of commercial practice.
>
> (2) A person does not act in bad faith merely because the person acts with knowledge of the interest of some other person.

[200] The purpose of s 25, which is a provision of general application, is to prescribe a general standard of conduct applicable to the exercise or discharge of rights, duties, and obligations arising under a security agreement or the PPSA: M Gedye, R C C Cumming QC, R J Wood, *Personal Property Securities in New Zealand* at [25.1] and *Garrow and Fenton's Laws of Personal Property in New Zealand* at [2.4.1]. Two standards are imposed: good faith and in accordance with reasonable standards of commercial practice. It is not necessary to consider the meaning of these standards further in the present case because the focus here was on the interpretation and application of s 25(2).

[201] It is clear from s 25(2) that knowledge of the interest of another person will not of itself amount to bad faith so as to deprive a secured party of the priority it would otherwise enjoy: M Gedye, R C C Cumming QC, R J Wood, *Personal Property Securities in New Zealand* at [25.2]. Canadian decisions on equivalent statutory provisions have held that "bad faith" therefore requires some form of positive action: *Canadian Imperial Bank of Commerce v AK Construction (1998) Ltd* at [38] and *518718 Alberta Ltd v Canadian Forest Products Ltd* at [69]. In the former case Veit J said:

> [38] In summary, "bad faith" for the purpose of the P.P.S.A. requires some form of positive action on the part of the party with the prior perfected security interest. Mere knowledge of the prior unperfected security interest that will be defeated by the registration is not sufficient. The required action is action that could constitute a waiver or support an estoppel argument or actively mislead or hinder the perfection of the prior interest.

The requirement for some form of positive action is reinforced by the references in s 25(1) to rights, duties and obligations being "exercised" or "discharged, which would involve action, and the contrast with the mere possession of knowledge in s 25(2).

[202] In *Bank of Nova Scotia v Royal Bank of Canada*, the Canadian decision relied on by StockCo, it was held, under the relevant provisions of the British Columbia PPSA, that the registration of a second financing statement did not improve the priority position of a transferee's secured creditor. The Court also indicated that, if it was wrong on that point, it would have found that the creditor did not act in good faith in proceeding as it did in terms of the equivalent of s 25 of the New Zealand PPSA because it did not act merely with knowledge of the other creditor's interest, but it acted while in discussions with the other creditor about settling the matter without seizing the asset in question (a truck). As a result of the discussions, the other creditor took no action to protect its position. The case therefore involved a representation which was relied on, similar in effect to an estoppel.

[203] I see no reason why a similar approach to the interpretation of s 25 should not be adopted, that is that "bad faith" requires some form of positive action such as a representation amounting to a waiver or leading to an estoppel, and mere action with knowledge will not suffice. Such an approach would appear to be consistent with the text and purpose of s 25.

[204] When this approach is adopted in the present case, I do not consider that the Banks acted in "bad faith" in making further advances to the Charging Group when they knew from the Cranleigh Report which they received in April 2009 that the heifers had been sold by Plateau to StockCo and leased to Nugen and were then the subject of the bailment (lease) agreement between Nugen and the Charging Group. While the Banks made the further advances with this knowledge, there is no

evidence that they took any other positive action which could constitute "bad faith" or breach of reasonable standards of commercial practice. There is simply no evidence of any communication at this time between the Banks and StockCo, no representations on which StockCo could claim to have relied, no waiver and no estoppel. None was suggested by StockCo.

[205] Contrary to the submissions for StockCo, the Banks were under no obligation to protect StockCo's interests in these circumstances. No such obligation is imposed by ss 25 or 88. I agree with the submission for the Receivers that StockCo was the author of its own misfortune. It had notice of the bailment (lease) agreement from Blackman Spargo on 23 April 2009 and yet it took no steps to register a financing change statement disclosing the Charging Group as the new debtor until 7 October 2009.

[206] This means that, if my answer to one or both of the first two principal issues in this case is wrong, my answer to the third principal issue is that in terms of s 88 of the PPSA StockCo's interest in the heifers would have been subordinated to the further advances made by the Banks in the period from 9 May 2009 to 7 October 2009 when StockCo registered its finance change statement. The total amount involved in the further advances, even on a net basis, would have extinguished StockCo's equity in the heifers.

[207] I now turn to the fourth principal issue in the case, namely the identification of the 2007 born heifers, the 2006 born heifers and the mixed aged cows, that is 2005 born or older.

Identification

[208] The identification issue arises because StockCo claims that the following livestock on the Charging Group's farms on 5 October 2009 when the Receivers were appointed were owned by StockCo and leased to Nugen:

a) The 4,000 rising year one heifers sold by Plateau to Stock on 1 August 2008 (the Plateau Stock);

b) 206 heifers purchased by StockCo from Nugen and leased back to Nugen on 20 August 2008 (the Nugen Heifers);

c) 750 mixed age cows purchased by StockCo from Nugen and leased back to Nugen on 20 June 2008 (the Nugen Cows); and

d) 648 mixed age cows and heifers (Third Party Stock) leased by StockCo to Nugen on 27 January 2009 comprising:

i) 148 head, comprised of 139 mixed age in-calf cows and 9 in-calf heifers purchased by StockCo from various third party farmers between 5 June 2008 and 27 January 2009; and

ii) 500 mixed age cows and heifers purchased by StockCo from various third party farmers between 6 June 2008 and 10 October 2008.

[209] The identification of the livestock the subject of StockCo's claim has been complicated because those of the Plateau Stock that were born in 2006, together with the Nugen Cows and Third Party Stock (which include mixed age cows and 2006 born animals), were inextricably mixed with other 2006 progeny and mixed age dairy cows owned by the Charging Group when the Receivers were appointed. Matters were not made easier by early attempts to tag cows and the movement of selected livestock from the farms which led to the various interim orders made by the Court. The positions of the parties have also changed over time as a result of the affidavit evidence presented to the Court for this hearing, the respective submissions for the parties and discussions between counsel which have been encouraged by the Court. At the end of the hearing it was necessary to invite the parties to provide the Court with a joint memorandum clarifying:

a) The number of cows involved in the identification issue;

b) The respective positions of the parties in relation to the different categories of cows involved;

c) Whether there is agreement or disagreement; and

d) If there is disagreement, the nature of that disagreement.

[210] A joint memorandum dated 25 November 2010 provided the clarification requested. The memorandum helpfully narrows the specific issues for determination significantly and summarises the positions of the parties when they differ. I propose to address the issues as they are identified in the memorandum.

[211] The starting point is that having rejected StockCo's claim to the Plateau Stock on all grounds it is unnecessary to address or resolve the issues relating to the Plateau Stock. But in case I am wrong in rejecting StockCo's claim to the Plateau Stock, I should record that the agreed position of the parties in relation to the 4,000 heifers comprising the Plateau Stock made up of 3,455 x 2007 born heifers and 545 x 2006 born heifers is as follows:

a) 3455 x 2007 born Plateau Stock

i) At 1 August 2008, the 3455 x 2007 born heifers included all of the 2007 born age group then on the Charging Group's farms. It is accepted by the Receivers that no identification issue arises in relation to these animals.

ii) The Receivers' stocktake in November/December 2009 counted 2346 x 2007 born animals on the Charging Group's farms. If StockCo succeeds in its claim to the Plateau Stock, the parties agree it is entitled to all 2346 x 2007 born animals counted by the Receivers.

b) 545 x 2006 born Plateau Stock

The 545 of the Plateau Stock that were born in 2006 were only some of the 2006 born animals on the Charging Group's farms and cannot now be distinguished from other animals born in 2006. If StockCo succeeds in its claim to the Plateau Stock, the parties agree that a pro-

rata calculation is necessary to calculate StockCo's entitlement to a proportion of the 1331 x 2006 born animals identified in the Receivers' November/December 2009 stocktake as being on the Charging Group's farms.

[212] The pro-rata calculation issue is addressed later in this part of the judgment.

[213] Turning next to the 206 Nugen Heifers, which were born in 2007 and came from the Mohaka property, the agreed position of the parties is that if StockCo succeeds in its claim to the 4,000 Plateau Stock (also leased with the 206 Nugen Heifers under Lease No 4039) StockCo recovers all 2007 born cows on the properties in receivership. In that scenario no identification issue arises in respect of the 206 Nugen Heifers. If, however, StockCo does not succeed in respect of the 4,000 Plateau Heifers, an issue arises as to the identification and pro-rata calculation in respect of these 2007 born cows. These issues are addressed later.

[214] Next there are two contained issues in relation to the 750 Nugen Cows. The first is whether, at the time of their purported sale to StockCo, they were unascertained goods for the purposes of the Sale of Goods Act 1908. The second is whether the cows were adequately described in StockCo's lease.

[215] The Receivers' position is that:

a) The 750 cows were unascertained goods for the purposes of s 18 of the Sale of Goods Act 1908 and therefore StockCo never obtained title to the cows to be in a position to lease them to Nugen, such that a security interest in those cows was not created in favour of StockCo; and

b) Even if title did pass and a security interest was created by virtue of a lease of those cows to Nugen for more than one year, Lease No 4034.1 did not adequately describe the relevant cows by item or kind in any way that enables those cows to be identified, such that:

i) StockCo's security interest under Lease No 4034.1 is not enforceable against Westpac, as a third party (s 36(1)(b)(i) of the PPSA); and

ii) StockCo's security interest did not attach (s 40(1)(c) of the PPSA).

[216] StockCo's position is that:

a) A security interest attached to the 750 Nugen Cows pursuant to s 36(1)(b)(i) and s 40(1)(c) of the PPSA irrespective of the Sale of Goods Act requirements. StockCo says that one of the objects of the PPSA was to do away with the significance of the particular mechanisms used to obtain a security interest. Its contention is that what matters is the PPSA's requirements – and in particular whether StockCo's security interest "attached" to the 750 cows; and

b) The description of the collateral in StockCo's security agreement (Lease No 4034.1) is sufficient for that security interest to attach to these cows for the purposes of s 36(1)(b)(i) and s 40(1)(c) of the PPSA.

[217] The parties are agreed that if either of the Receivers' arguments is accepted, the 750 Nugen Cows are removed from StockCo's potential claim. The parties are also agreed that if both of StockCo's arguments are accepted the 750 Nugen Cows are included in StockCo's claim to mixed age cows. That claim is then subject to further issues mentioned later.

[218] The Receivers' argument under the Sale of Goods Act 1908 arises under s 18 of the Act which provides:

> **18 Goods must be ascertained**
>
> Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained.

[219] The submissions for the Receivers in support of this argument were:

a) Before any question relating to StockCo's security interest in the Nugen Cows arises by virtue of the lease from StockCo to Nugen, StockCo must have had title to the cows, that is StockCo must have acquired title from Nugen which in turn must have acquired title from Plateau or the Charging Group.

b) The requirements of s 18 of the Sale of Goods Act 1908 were not met in respect of the sales on 20 June 2008, that is the sale from Plateau or the Charging Group to Nugen in consideration of Robert Crafar's "many years of hard work" or the sale on the same day from Nugen to StockCo for $750,000 to obtain the deposit for Nugen's purchase of the Northland property, because the 750 Nugen cows were never ascertained.

c) As the Nugen Cows were "unascertained goods", property in them was not transferred to StockCo to enable StockCo to lease them back to Nugen: *Karlshamns Oljefabriker v Eastport Navigation Corp*.[23]

d) Nor was there any evidence that there was a subsequent unconditional appropriation of the Nugen Cows to either of the contracts of sale sufficient to become ascertained and for property to pass: s 20, r 5(1) of the Sale of Goods Act 1908.

e) There was no evidence that the Nugen Cows were separated out of the Charging Group herd. No documentation exists in respect of the transfer from Plateau or the Charging Group to Nugen. The Cows were not identified for that sale. Nor did StockCo insist on any steps being taken to tag the Cows so as to identify them and therefore appropriate them to the sale from Nugen. Indeed it appears from StockCo's internal credit analysis of the transaction that this was a

[23] *Karlshamns Oljefabriker v Eastport Navigation Corp* [1982] 1 All ER 208 at 212.

deliberate choice because it was recorded that the stock being purchased "will not be identified".

[220] For StockCo it was submitted in response that the common law principles that title only passed in personal property if it is sufficiently identified, which are encapsulated in *Re Goldcorp Exchange Ltd,*[24] do not apply in the present circumstances because:

a) The approach of the PPSA is to modify the common law rules on what amounts to a "security interest" in personal property. That definition involves a substance over form approach (s 17). StockCo obtains a security interest in the 750 Nugen Cows if the PPSA's criteria are met. The old common law requirements are no longer relevant to identifying the validity of the security interest. The particular issue under the PPSA is whether the security interest "attached" to particular collateral under s 40 irrespective of whether legal title passed. Here that security interest did so attach because value was given by StockCo (s 40(1)(a)), Nugen gave rights in that collateral (s 40(1)(b)) and the agreements between Nugen and StockCo were enforceable against third parties because there was an adequate description of the collateral by item or kind (s 40(1)(c) and s 36(1)(b)(i)). On the last requirement, it has been held that a broad collateral description, such as "motor vehicles" is sufficient for the property to attach: *GE Capital Canada Acquisitions Inc v Dix Performance (Trustee of)*.[25]

b) It is not a requirement of the PPSA that Nugen, or even the Charging Group, specifically appropriate property to the security interest by particular steps, for example by placing ear tags on the relevant animals. Here the animals were supposed to be in the possession of Nugen under the terms of the lease with StockCo, and this would have effected "attachment" under s 36(1)(a). But the livestock were in the possession of the Charging Group (and therefore the Receivers) in

[24] *Re Goldcorp Exchange Ltd* [1994] 3 NZLR 385 (PC).

breach of the terms of the lease between Nugen and StockCo. The breach does not destroy the security interest that StockCo obtained under the operation of the PPSA, however. The PPSA contemplates not only possession as involving attachment to a security interest, but also that description is sufficient to achieve this (s 36);

c) It does not assist the Receivers to question the transfer from the Charging Group to Nugen. Even if this transfer is regarded as a gift by Plateau to Nugen in breach of the terms of the Banks' contractual requirements, good title passed to StockCo, as the transfer to StockCo was still in the ordinary course of Nugen's business under s 53, and in any event the security properly "attached" to the 750 animals; and

d) To the extent that it is permissible to look at the common law approach, there is authority that assists with this kind of issue which was distinguished in *Goldcorp*. In particular there are common law cases where property has passed in relation to a portion of a collection of personal property. The issue in *Goldcorp* was whether there was insufficient gold to go around all the customers, the gold was by nature ubiquitous, and no steps had been taken to identify any part of the gold that belonged to any particular person. Here, by contrast, the Charging Group definitively identified 750 cows to be transferred to Nugen, Nugen then sold them to StockCo (with Blackman Spargo warranting that the 750 animals were unencumbered) and then StockCo leased those animals back to Nugen. Again the legal form of that transaction, which was undertaken in a manner which met the requirements of the PPSA, is sufficient to be effective to create a security interest in 750 animals.

[221] I accept the submission for the Receivers that unless StockCo had acquired title to 750 Nugen Cows from Nugen on 20 June 2008 it had no entitlement to lease the Cows back to Nugen and therefore no question of any security interest under the PPSA arose. The question of the adequacy of the description of the Cows as

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[25] *GE Capital Canada Acquisitions Inc v Dix Performance (Trustee of)* (1994) 8 PPSAC (2d) 197.

collateral under the PPSA is a separate question which does not arise if property in the cows was not transferred to StockCo in the first place. The decision in *GE Capital Canada Acquisitions Inc v Dix Performance (Trustee of)*, relied on by StockCo, was not concerned with the issue of title to the goods.

[222] There is no provision in the PPSA to suggest that it expressly or impliedly repeals or prevails over the requirements of the Sale of Goods Act 1908 relating to the transfer of property in goods as between seller and buyer (ss 18-22). There is, however, one provision in the PPSA which does prevail, expressly, over another specific provision in the Sale of Goods Act 1908: s 53(2). And s 27 of the Sale of Goods Act 1908 was expressly amended by s 191(1) of the PPSA. The existence of these specific provisions supports the view that there is no basis for considering that the PPSA has impliedly repealed ss 18 to 22 of the Sale of Goods Act 1908: cf J F Burrows and R I Carter, *Statute Law in New Zealand*.[26]

[223] I therefore also accept the submission for the Receivers that StockCo would not acquire title to the Nugen Cows unless they were "ascertained goods" as required by s 18 of the Sale of Goods Act 1908. The importance of the requirement for specific goods to be ascertained before property in the goods may be transferred was explained by Lord Mustill, delivering the judgment of the Privy Council in *Re Goldcorp Exchange Ltd (in Receivership)* at 392–394:

> Their Lordships begin with the question whether the customer obtained any form of proprietary interest, legal or equitable, simply by virtue of the contract of sale, independently of the collateral promises. In the opinion of their Lordships the answer is so clearly that he did not that it would be possible simply to quote s 18 of the Sale of Goods Act 1908 (New Zealand) (corresponding to s 16 of the Sale of Goods Act 1893 (UK)) and one reported case, and turn to more difficult issues. It is, however, convenient to pause for a moment to consider why the answer must inevitably be negative, because the reasons for this answer are the same as those which stand in the way of the customers at every point of the case. It is common ground that the contracts in question were for the sale of unascertained goods. For present purposes, two species of unascertained goods may be distinguished. First, there are "generic goods". Those are sold on terms which preserve the seller's freedom to decide for himself how and from what source he will obtain goods answering the contractual description. Secondly, there are "goods sold ex-bulk". By this expression their Lordships denote goods which are by express stipulation to be supplied from a fixed and a pre-determined

[26] J F Burrows and R I Carter, *Statute Law in New Zealand*, (4th ed, Lexis Nexis, Wellington, 2009) at 453 – 457.

source, from within which the seller may make his own choice (unless the contract requires it to be made in some other way) but outside which he may not go. For example, "I sell you 60 of the 100 sheep now on my farm".

Approaching these situations a priori common sense dictates that the buyer cannot acquire title until it is known to what goods the title relates. Whether the property then passes will depend upon the intention of the parties and in particular on whether there has been a consensual appropriation of particular goods to the contract. On the latter question the law is not straightforward, and if it had been decisive of the present appeal it would have been necessary to examine cases such as *Carlos Federspiel & Co. S.A. v Charles Twigg & Co. Ltd.* [1957] 1 Lloyd's Rep 240 and other cases cited in argument. In fact, however, the case turns not on appropriation but on ascertainment, and on the latter the law has never been in doubt. It makes no difference what the parties intended if what they intend is impossible: as is the case with an immediate transfer of title to goods whose identity is not yet known. As Lord Blackburn wrote in his *Treatise on The Effect of the Contract of Sale* (1845), pages 122-123, a principal inspiration of the Sale of Goods Act 1893:

> "The first of [the rules] that the parties must be agreed as to the specific goods on which the contract is to attach before there can be a bargain and sale, is one that is founded on the very nature of things. Till the parties are agreed on the specific individual goods, the contract can be no more than a contract to supply goods answering a particular description, and since the vendor would fulfil his part of the contract by furnishing any parcel of goods answering that description, and the purchaser could not object to them if they did answer the description, it is clear there can be no intention to transfer the property in any particular lot of goods more than another, till it is ascertained which are the very goods sold. This rule has existed at all times: it is to be found in the earliest English law books...
>
> It makes no difference, although the goods are so far ascertained that the parties have agreed that they shall be taken from some specified larger stock. In such a case the reason still applies: the parties did not intend to transfer the property in one portion of the stock more than in another, and the law which only gives effect to their intention, does not transfer the property in any individual portion."

Their Lordships have laboured this point, about which there has been no dispute, simply to show that any attempt by the non-allocated claimants to assert that a legal title passed by virtue of the sale would have been defeated, not by some arid legal technicality but by what Lord Blackburn called "the very nature of things". The same conclusion applies, and for the same reason, to any argument that a title in equity was created by the sale, taken in isolation from the collateral promises. It is unnecessary to examine in detail the decision of the Court of Appeal in *Re Wait* [1927] 1 Ch 606 for the facts were crucially different. There, the contract was for a sale ex-bulk. The 500 tons in question formed part of a larger quantity shipped on board a named vessel; the seller could supply from no other source; and once the entire quantity had been landed and warehoused the buyer could point to the bulk and say that his goods were definitely there, although he could not tell which part they were. It was this feature which prompted the dissenting opinion of

> Sargant LJ that the sub-purchasers had a sufficient partial equitable interest in the whole to found a claim for measuring-out and delivery of 500 tons. No such feature exists here. Nevertheless, the reasoning contained in the judgment of Atkin L J, at pp 625-641, which their Lordships' venture to find irresistible, points unequivocally to the conclusion that under a simple contract for the sale of unascertained goods no equitable title can pass merely by virtue of the sale.

[224] Following this approach to the question of the ascertainment of the 750 Nugen Cows, I do not accept the submission for StockCo that the Charging Group "definitely identified 750 cows" to be transferred to Nugen or that Nugen identified the Cows to be transferred to StockCo. There was no evidence that the 750 Nugen Cows were ever specifically or separately identified or ascertained for the purpose of either sale. The evidence of both Allan and Robert Crafar was that the 750 Nugen Cows were mixed in with the rest of the herd on the farms. A sale of 750 cows from the Crafar herd was no more specific or adequate than Lord Mustill's example of "60 of the 100 sheep now on my farm".

[225] There was also no evidence that the 750 Nugen Cows were subsequently ever specifically or separately identified. There was therefore no subsequent unconditional appropriation of these Cows to either of the contracts of sale sufficient to enable them to become ascertained and for property to pass: s 20, r 5(1) of the Sale of Goods Act 1908.

[226] This means that the Receivers' Sale of Goods Act argument is accepted with the result that the 750 Nugen Cows are removed from StockCo's potential claim. In case I am wrong, however, I also consider the Receivers' second argument that even if title did pass to StockCo the Cows were not adequately described in StockCo's lease to Nugen.

[227] This second argument arises in the context of ss 36(1) and 40(1) of the PPSA, the relevant parts of which provide:

> **36 Enforceability of security agreements against third parties**
>
> (1) A security agreement is enforceable against a third party in respect of particular collateral only if—
>
> (a) The collateral is in the possession of the secured party; or

(b) The debtor has signed, or has assented to by letter, telegram, cable, telex message, facsimile, electronic mail, or other similar means of communication, a security agreement that contains—

(i) An adequate description of the collateral by item or kind that enables the collateral to be identified; or ....

....

40 Attachment of security interests generally

(1) A security interest attaches to collateral when—

(a) Value is given by the secured party; and

(b) The debtor has rights in the collateral; and

(c) Except for the purpose of enforcing rights between the parties to the security agreement, the security agreement is enforceable against third parties within the meaning of section 36.

[228] Here, the "security agreement" is the lease between StockCo and Nugen dated 20 June 2008 which describes the collateral as:

No. Head	Breed and Type
750	M/A Cow

The issue is whether in terms of s 36(1)(b)(i) that is "an adequate description" of the collateral "by item or kind" that "enables the collateral to be identified".

[229] A textual analysis of s 36(1)(b)(i) indicates that its requirements are twofold: a description of collateral by item or kind; that is adequate (sufficient) to enable the collateral to be identified. Clearly the description may be "by item or kind". A generic description is permitted. Precise identification is not required as long as the generic description is sufficient to enable that to be done, if necessary by extrinsic evidence. This approach to the interpretation of s 36(1)(b)(i) is reinforced by the purpose of the provision and the scheme of the PPSA: M Gedye, R C C Cumming QC and R J Wood *Personal Property Securities in New Zealand* at [36.6] and *Garrow and Fenton's Law of Personal Property in New Zealand* Vol 2 at [10.5.2]. The purpose of the provision is only to provide evidence consistent with a claim that a security interest has been taken in particular collateral. The scheme of s 36(1) shows that the description of the collateral is only one of the means by which an

interested third party may determine whether a particular item of property is subject to a security interest. Significantly, under the PPSA the security agreement itself is not registered and may never be seen by third parties. If a third party requires further information as to whether a particular item of property is subject to a security interest, additional details may be obtained from the secured party using the procedure set out in s 177(1)(c).

[230] On this issue of interpretation care is required in following Canadian decisions because of the differences in the wording of the relevant statutory provisions. The provision in the British Columbian PPSA considered in *GE Capital Canada Acquisitions Inc v Dix Properties (Trustee of)* did not require a description that "enables the collateral to be identified", while the Ontario provision mentioned in that decision does not expressly permit descriptions by "kind". Perhaps of greater significance in supporting the approach recommended by M Gedye, R C C Cumming QC and R J Wood *Personal Property Securities in New Zealand*, is the contrast between the text and purpose of the ascertainment of the specific goods required by s 18 of the Sale of Goods Act 1908 and the text and purpose of s 36(1)(b)(i) of the PPSA as described above.

[231] Adopting the recommended approach to the interpretation of s 36(1)(b)(i) in this case, I consider that the description in the lease between StockCo and Nugen dated 20 June 2008 of 750 mixed aged cows constituted a description of the collateral by "kind" which was sufficient to enable the collateral to be identified. For this purpose I accept the evidence of Allan Crafar that, if he had been required at the time to identify specifically and separately the 750 mixed age cows, he would probably have been able to do so. As he did not ever do so, the Nugen Cows were not in fact identified for the purpose of s 18 of the Sale of Goods Act 1908, but his ability to do so would have met the requirements of s 36(1)(b)(i) of the PPSA.

[232] This means that if I am wrong to accept the Receivers' Sale of Goods Act argument, but right to accept StockCo's argument as to the adequacy of the description of the collateral in StockCo's security agreement (the lease of 20 June 2008), the 750 Nugen Cows will be correctly included in StockCo's claim and subject to the further matters addressed later in this judgment.

[233] Turning next to the identification of the 648 Third Party Stock, the parties note in their joint memorandum that this category comprised:

a) 2 x 2007 born cows;

b) 219 x 2006 born cows; and

c) 427 mixed age stock (2005 born or older).

Together with the 206 Nugen Heifers and the 750 Nugen Cows, the 648 Third Party Stock are subject to the identification/pro-rata calculation issues addressed next.

[234] As regards the non-Plateau Stock (that is the 206 Nugen Heifers, the 750 Nugen Cows and the 648 Third Party Stock), the key issue agreed between the parties is whether I am satisfied on the balance of probabilities that the non-Plateau Stock were in possession of the Charging Group as at 5 October 2009 when the Receivers were appointed and, if so, in what numbers.

[235] In relation to this key issue, StockCo's position was that:

a) The non-Plateau Stock were located on the Charging Group properties when the Receivers were appointed on 5 October 2009;

b) By 5 October 2009 all non-Plateau Stock were mature productive cows, being 2007 born or older, and therefore being milked in the 2009-10 season by that date;

c) By 5 October 2009, Nugen had only three milking platform properties, Kerikeri (which had a 50/50 sharemilker on it and thus no Nugen Stock); Norsewood No 2 (which simply kept the 520 cows purchased with the property on it, and which are not the subject of this claim) and Waitotara (which was leased to Plateau in any event and indeed included in the Receivers' November/December 2009 stock take for that reason). That left Mohaka as the only remaining Nugen property, which was a dry stock property, also confirmed by the

Receivers to be subject to an undocumented lease to Plateau. In any event, it is a dry stock property upon which productive dairy cows would not be (and were not) located as at October 2009.

d) Allan Crafar, who was responsible for stock movements, as a matter of common sense and confirmed by his evidence, located Nugen Stock on the milking platform Charging Group properties available to him;

e) StockCo was the innocent victim of the Crafars' wrongdoing both in:

i) Their failing to hold its stock identifiable; and

ii) In failing to locate and hold its stock on Nugen properties.

The Crafars' wrongdoing was in breach of Leases No 4034 and No 4039. StockCo had no knowledge of such wrongdoing until after the Receivers were appointed.

f) It was appropriate that the Court apply "rough justice" analogous to the approach in *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)*[27] and calculate StockCo's entitlement in respect of the herd by pro-rata calculation in relation to its rights.

[236] The Receivers' position was that:

a) The Court ought not attempt a calculation as suggested by StockCo. StockCo cannot satisfy the Court that the non-Plateau Stock are on the Charging Group's farms without the Court drawing an inference in StockCo's favour;

[27] *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)* HC Wellington CIV-2007-485-1563, 20 June 2008.

b) An inference ought not to be drawn because StockCo created this uncertainty and, because of other disentitling conduct, did not have clean hands;

c) The lack of evidence as to the identification and location of the stock was because StockCo chose not to require tag records and did not enforce the contractual obligation in its lease documentation for stock to be identified;

d) StockCo never ensured that the stock was depastured on the land designated in the lease; and

e) StockCo took no care as to the location of the stock, although it knew that they could not all be located on the land specified in the leases, and it knew of the Crafar Group's practice of moving stock between farms.

[237] StockCo's position was supported by the following submissions at the hearing:

a) StockCo owned the animals in issue. The Charging Group did not get title to them simply because they possessed them. Neither did the Banks get rights to them simply because of such possession. The evidence showed they were on the Charging Group farms, and StockCo remained entitled to its rights.

b) Whilst it was true that the Receivers had not prevented identification, the actions of the Crafar Group had (through assisting Nugen in breach of identification requirements). The Banks could not in fairness obtain a windfall because of the Group's conduct.

c) Any criticism of StockCo applied just as much to the Banks given that the evidence demonstrated that the Banks must accept that they knew that the Crafars were running all of the farms together as one enterprise incorporating stock over which StockCo had an interest.

d) It was clear that the Nugen animals were on the Crafar farms, and it was wrong to say that the Receivers had rights over animals simply because they were in the Crafars' possession. The Receivers would need to show the debtor had "rights to the collateral" under s 40(1) – which could be rights of possession, but still necessitated some possessory right. If they belonged to somebody else they had no such rights.

e) While it was accepted that the non-Plateau Stock leased by StockCo to Nugen could not be separately identified, the evidence established that the Stock were located on the Charging Group properties when the Receivers were appointed.

f) Equity developed tracing rules to follow money into mixed funds and deal with those funds when the precise asset lost its identity. The right to trace is created by statute and the equitable rules of tracing have been utilised as a guide for this statutory right in Canada: *Transamerica Commercial Finance Corporation Canada v The Royal Bank of Canada*.[28] The essence of tracing through a mixed fund is the ability to re-divide the mixed fund with its constituent parts pro rata according to the value of the contributions made to it: *Foskett v McKeown*.[29]

g) The "rough justice" approach to a pro-rata calculation adopted in *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)* in relation to a claim for proceeds of sale of commixed goods reflected the decisions in *Edinburgh Corp v Lord Advocate, Transamerica Commercial Finance Corporation Canada v The Royal Bank of Canada, Agricultural Credit Corp of Saskatchewan v Pettyjohn*,[30] and

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[28] *Transammerica Commercial Finance Corporation Canada v The Royal Bank of Canada* (1990) 84 Sask R 8 at [22].
[29] *Foskett v McKeown* [2000] 3 All ER 97 (HL).
[30] *Edinburgh Corp v Lord Advocate* (1879) 4 App Cas 823 (HL) at 833 and 835; and *Agricultural Credit Corp of Saskatchewan v Pettyjohn* (1991) Sask R 206 at [77], [80] and [90]-[94].

the approach of Lord Hope, albeit dissenting, in *Foskett v McKeown* at 113-114.

[238] The Receivers' position was supported by the following submissions at the hearing:

a) The primary position remained that a person claiming a security interest was required to identify the personal property in which the security interest was claimed and the PPSA did not replace that requirement: *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)*. The Court applied a "rough justice" apportionment because identification of the product supplied and not paid for was rendered impossible largely due to the Receivers' conduct in that case.

b) StockCo had not discharged the onus on it to prove that the non-Plateau stock leased to Nugen were among the herd on the farms under the control of the Receivers.

c) In terms of the decision in *Spencer v Jacques*[31] StockCo did not come to Court with clean hands because: it did not require the stock to be identified; it waived the requirement for the stock to be tagged; it took no care as to the location of the stock; it wrongly claimed that the stock could be identified by ear tags; and it abandoned its claim in relation to 520 cows which it settled with Nugen in February 2010 only after discovery of documents evidencing the settlement.

d) This was not an appropriate case for a pro rata approach because the maxim of equity that where two innocent persons must suffer by the act of a third party the person who has enabled the third party to occasion the loss must suffer was applicable: *National Livestock Credit Corp v Schulz.*[32]

[31] *Spencer v Jacques* 2000 SKQB 321 at [134].
[32] *National Livestock Credit Corp v Schulz* Okl App 653 (2d) 1243 at 1247

e) The Banks would not receive a windfall in respect of the 750 Nugen Cows that were allegedly transferred to Nugen for doubtful consideration and without the Banks' knowledge to enable Nugen to pay the deposit on the Northland farm because the Banks received no money for those cows and the $750,000 advanced against the security of the cows was paid to Nugen as the deposit for a property outside the Charging Group.

[239] As is apparent from the key issue agreed between the parties, their positions on the issue and their supporting submissions, the specific issues for my determination were:

a) Has StockCo established on the balance of probabilities that at least some of the cows in the three categories of non-Plateau Stock were located on Charging Group properties rather than Nugen properties on 5 October 2009?

b) If so, can the non-Plateau Stock be identified so that the numbers involved are able to be calculated?

c) If so, is StockCo disqualified on equitable principles from "rough justice" analogous to *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)*?

d) If not, is it appropriate to follow the approach in *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)* to calculate StockCo's entitlement in respect of the non-Plateau Stock on a pro-rata basis?

[240] StockCo's case summarising the evidence relating to the location of the three categories of non-Plateau Stock was provided towards the end of the hearing in comprehensive supplementary submissions dated 11 November 2010. I propose to follow the approach adopted in StockCo's supplementary submissions and consider the evidence in relation to each of the three categories separately.

[241] There is no dispute that the 206 Nugen Heifers were acquired by Nugen with the Mohaka (Springhill Station) property and sold to StockCo on a sale and lease back. They were all 2007 born animals which at the time of purchase and the commencement of the lease were located on the Mohaka property. By October 2009 they were productive dairy cows and were no longer on the Mohaka property, a dry stock property, on which the Receivers found only young unproductive stock. StockCo then relied on common sense and the evidence of Allan Crafar, corroborated by the evidence of his son, Robert, and Dave Wiltshire, to establish that the 206 Nugen Heifers would have been moved with other Nugen stock in accordance with Crafar farm practice to milking platform Charging Group properties by October 2009. StockCo acknowledged that in the absence of comprehensive stock identification records there could be no certainty as to the location of any stock, whether StockCo owned Nugen Stock or Charging Group stock subject to the Banks' security, but submitted that it was known "with absolute certainty", in respect of such stock as was identifiable, that StockCo owned stock was on Charging Group properties.

[242] In my view, on the basis of the evidence summarised in the StockCo supplementary submissions, StockCo has established on the balance of probabilities that at least some of the 206 Nugen Heifers were located on Charging Group properties on 5 October 2009. As productive dairy cows, they would have been moved by that date from the dry stock Mohaka property to Charging Group milking platform properties. The fact that they were not found on the Mohaka property by the Receivers confirms that they were moved. In the absence of evidence to the contrary, I am prepared to accept that, in accordance with Crafar farm practice, they would have been moved to Charging Group milking platform properties. Whether they are now able to be identified on those properties is a separate question considered later in this judgment.

[243] There is no dispute that the 750 Nugen Cows were purchased on 20 June 2008 by StockCo from Nugen and leased back to Nugen. These "mixed age" cows were 2005 born or older. StockCo then relied again on the evidence of Allan Crafar, his son, Robert, and Ged Donald to establish that these cows were originally located on Charging Group properties and were intended to be transferred to Nugen's newly

acquired Kerikeri farm in Northland, but in fact stayed on the Charging Group properties because a 50/50 sharemilker was put on the Kerikeri property instead. There was no evidence that those cows ever left the Charging Group properties.

[244] In my view, on the basis of the evidence summarised in the StockCo supplementary submissions, StockCo has established on the balance of probabilities that at least some of the 750 Nugen Cows were located on Charging Group properties on 5 October 2009. There is no reason not to accept the evidence relied on by StockCo in respect of those cows. These are the cows in respect of which the Receiver's Sale of Goods Act 1908 was advanced. For present purposes, it is assumed that I was wrong to accept that argument. Whether, however, these cows are now able to be identified on these properties is a separate question to be consider later.

[245] There is no dispute that the 648 Third Party Stock were purchased by StockCo for full market value from third parties and leased to Nugen. There is also no real dispute that at least some of these cows were located on Charging Group properties on 5 October 2009. While the Receivers submitted that the number of these cows should be discounted by the number taken to non-Charging Group and non-Nugen farms, that is the 54 that went to Windburn, they did not adduce evidence to show that none of the remaining 594 cows in this category were not located on Charging Group properties on 5 October 2009. I therefore accept that StockCo has established on the balance of probabilities that at least some of the cows in this category were so located.

[246] The separate question of the identification of the non-Plateau Stock on the Charging Group properties for the purpose of calculating the numbers involved is more difficult because there is no dispute that these cows are now inextricably mixed with the rest of the herd on the Crafar farms. StockCo acknowledged that the cows in these categories were not able to be separately identified and therefore proposed a "rough justice" pro rata calculation as occurred in *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)*.

[247] In considering StockCo's proposal, I note that:

a) StockCo is not asking the Court to apply PPSA tracing rules in respect of "the proceeds" of the cows: cf s 45(1)(b) of the PPSA and M Gedye, R C C Cumming QC and R J Wood *Personal Property Securities in New Zealand* at [45.7]. Such rules are inapplicable when the claimed collateral still exists. The Canadian decisions in *Transamerica Commercial Finance Corp Canada v Royal Bank of* Canada and *Agricultural Credit Corp of Saskatchewan v Pettyjohn* would have been relevant if the issue had arisen in that context.

b) StockCo is not relying on s 82 of the PPSA which applies to goods that become part of processed or commingled goods. That provision is not applicable in the circumstances of the present case: cf *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)* at [21]-[25] and M Gedye, RCC Cumming QC and R J Wood in *Personal Property Securities in New Zealand* at [82.1].

c) In the absence of any applicable provisions under the PPSA, StockCo relies by analogy on *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)* where a "rough justice" pro rata approach was adopted in respect of the allocation of the proceeds from the sale of foodstuffs by a supplier to the Company which went to receivership. There was no dispute that prior to their sale the foodstuffs would have been identifiable on inspection and stocktake. The Receivers were party responsible for there being no stocktake. The Judge, Dobson J, dealt with the claim "on a contractual, compensatory basis, rather than by imposing trustee obligations on the receivers" and the adoption of the "rough justice" approach referred to be Lord Mustill in *Ryde Holdings Ltd v Rainbow Corporation Ltd*.[33] StockCo relies on *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)* by analogy because, unlike the supplier in that case, here there is no direct contractual relationship

[33] *Ryde Holdings Ltd v Rainbow Corporation Ltd* PC 50/92, 15 November 1993: *Re Service Foods Manawatu Ltd (In Receivership and Liquidation)* at [54] and [59].

between StockCo and the Charging Group in respect of the non-Plateau Stock which were leased to Nugen.

d) As recognised by the reference to the decision of the House of Lords in *Foskett v McKeown* at 114 and 124-125, cited for StockCo, the leading decision on the doctrines of English law applicable to cases where goods belonging to different owners have become mixed so as to be incapable of either being distinguished or separated is *Sandeman & Sons v Tyzak and Branfoot Steamship Co Ltd*[34] where Lord Moulton said at 694-695:

> .... I do not think it is a matter of difficulty to define the legal consequences of the goods "A." becoming indistinguishably and inseparably mixed with the goods of "B." If the mixing has arisen from the fault of "B.," "A." can claim the goods. He is guilty of no wrongful act, and therefore the possession by him of his own goods cannot be interfered with, and if by the wrongful act of "B." that possession necessarily implies the possession of the intruding goods of "B.," he is entitled to it (2 Kent's Commentaries, 10th ed., 465). But if the mixing has taken place by accident or other cause, for which neither of the owners is responsible, a different state of things arises. Neither owner has done anything to forfeit his right to the possession of his own property, and if neither party is willing to abandon that right the only equitable solution of the difficulty, and the one accepted by the law, is that "A." And "B." become owners in common of the mixed property.

[248] As pointed out in *Garrow & Fenton's Law of Personal Property,*[35] the apparent strictness of the approach of Lord Moulton, was modified in *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)*[36] by Staughton J who, after referring to relevant authorities, concluded:

> Seeing that none of the authorities is binding on me, although many are certainly persuasive, I consider that I free to apply the rule which justice requires. This is that, where B wrongfully mixes the goods of A with goods of his own, which are substantially of the same nature and quality, and they cannot in practice be separated, the mixture is held in common and A is entitled to receive out of it a quantity equal to that of his goods which went into the mixture, any doubt as to that quantity being resolved in favour of A.

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[34] *Sandeman & Sons v Tyzak and Branfoot Steamship Co Ltd* [1913] AC 680 (HL).
[35] R Fenton *Garrow & Fenton's Law of Personal Property* (6th ed Butterworths 1998) at [2.025] and repeated in the shortly to be published 7th ed.
[36] *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* [1988] 1 QB 345 at 370-371.

> He is also entitled to claim damages from B in respect of any loss he may have suffered, in respect of quality or otherwise, by reason of the admixture.

This passage was cited with approval by Cooke P in *Coleman v Harvey*[37] and Richardson J agreed with Cooke P. It should therefore be followed in this Court.

[249] The law in New Zealand relating to the intermixture of goods is conveniently summarised in *The Laws of New Zealand, Personal Property*:

> **41. Intermixture.** Although the law is still developing, it appears that a person who deliberately mixes his or her goods with those of another without the approval or knowledge of the other does not obtain ownership to the mixture; the resulting mixture is co-owned. Where an owner has deliberately mixed his or her chattels with those of another and in doing so has destroyed the ability of the non-consenting owner to establish what he or she lost, the non-consenting owner is entitled to receive an interest equivalent to the value of his or her chattels that went into the mixture. However, where there is any doubt as to quantities, there is a presumption of value in favour of the non-consenting or innocent owner.[1] If the goods are mixed by agreement or consent, the proprietors have an interest in common in proportion to their respective shares.[2] Where the goods are mixed by accident, or by the act of a third person (for which neither owner is responsible), the proprietors become owners in common of the mixed property in proportion to the amounts contributed.[3]
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> [1] *Coleman v Harvey* [1989] 1 NZLR 723 (CA), *Re Goldcorp* (High Court, Auckland, M 1450/88, M 1332/89, M 1572/89, CP 498/89, CP 21/88, 17 October 1990, Thorp J), *Re Weddel New Zealand Ltd* (1996) 5 NZBLC 104,055, *Spence v Union Marine Insurance Co Ltd* (1868) LR 3 CP 427 (goods belonging to different owners became indistinguishable after the identification marks were obliterated), and *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* [1988] QB 345; [1987] 3 All ER 893. See para 38. See also BAILMENT para 41.
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> [2] *Coleman v Harvey* [1989] 1 NZLR 723 (CA), *Re Weddel New Zealand Ltd* (1996) 5 NZBLC 104,055, *Frank Stewart Sandeman & Sons v Tyzack and Branfoot Steamship Co Ltd* [1913] AC 680, and *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* [1988] QB 345; [1987] 3 All ER 893.
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> [3] *Frank Stewart Sandeman & Sons v Tyzack and Branfoot Steamship Co Ltd* [1913] AC 680, *Spence v Union Marine Insurance Co Ltd* (1868) LR 3 CP 427, and *Gill and Duffus (Liverpool) Ltd v Scruttons Ltd* [1953] 1 WLR 1407; [1953] 2 All ER 977.

[250] As the decisions in *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* and *Coleman v Harvey* and the summaries in *Garrow and Fenton's Law of Personal Property* and *The Laws of New Zealand*, *Personal Property* were not cited during argument, I gave the parties the opportunity to make further submissions

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[37] *Coleman v Harvey* [1989] 1 NZLR 723 (CA) at 726-727.

on the issue of the law relating to the intermixture of goods. Both parties took advantage of this opportunity in memoranda dated 15 December 2010. Both parties agreed that the law in these authorities and the summary in *The Laws of New Zealand, Personal Property* should be applied in this case.

[251] It is apparent from this summary and the authorities on which it is based that if the goods are mixed by agreement or consent, the owners have an interest in common in proportion to their respective shares. In the absence of agreement or consent it may be necessary to examine the cause of the intermixture and decide whether it was the responsibility of either owner or a third party for which neither owner was responsible. Subject to the right of an innocent owner to the favourable presumption of value in cases of doubt as to quantities and the separate right to claim damages from the party responsible for the wrongful intermixture, both owners have an interest in common in proportion to their respective shares. In my view a similar, practical common sense approach should be adopted in a case where both owners have contributed to the intermixture of the goods, whether or not by agreement or express consent. In other words, in this context the consent of the owners to the intermixture may be implied.

[252] In the present case the intermixture of the three categories of non-Plateau Stock arose in the following circumstances:

a) The 206 Nugen Heifers acquired by Nugen with the Mohaka property would have been identifiable when they were sold to StockCo and leased back by StockCo to Nugen. Contrary to the express terms of the lease, Tag Numbers for the Nugen Heifers were not provided to StockCo which took no steps to ensure that the animals were separately identifiable either then or when they were subsequently moved from Mohaka to Charging Group properties before October 2009.

b) The 750 Nugen Cows purchased by StockCo from Nugen on 20 June 2008 and leased back by StockCo to Nugen on the same day were not separately identified either by Nugen or StockCo at any time. They

were simply part of the Charging Group herd which Allan Crafar said that he would have been able to identify if necessary, but never did. The cows were not tagged. StockCo waived the requirements in the lease for the cows to be identified and tagged.

c) The 648 Third Party Stock purchased by StockCo from third parties and leased to Nugen were presumably able to be identified at the time StockCo purchased them and leased them to Nugen, but once these cows were mixed with the Charging Group herd they too lost any separate identify because in breach of the lease they were not tagged. StockCo would have known that these animals were mixed with the Charging Group herd without being separately identified by tagging.

[253] In these circumstances it is apparent that the three categories of non-Plateau Stock owned by StockCo were mixed with the herd owned by the Charging Group as a result of a combination of:

a) The failure of Nugen, as lessee (a third party), to have the animals tagged and to keep them separately identifiable;

b) The failure of StockCo, as owner of the animals, to ensure that its animals were tagged (when it knew that they had not been because of Nugen's failure to provide it with Tag Numbers as required by the terms of the leases) and separately identifiable; and

c) The actions of the Charging Group, as owner of the herd, in arranging for the animals leased by Nugen from StockCo to be mixed with the herd without ensuring that they could be separately identified.

[254] On this basis both owners, StockCo and the Charging Group, together with a third party, Nugen, have all contributed to the intermixture of StockCo's cows with the Charging Group's herd. The intermixture effectively occurred by agreement or consent or at least none of the parties can be described as "innocent". This means that, in accordance with the authorities I have referred to, both owners, StockCo and

the Charging Group, have an interest in common in the cows in proportion to their respective shares.

[255] I do not accept the submission for StockCo that it was "the innocent victim of the Crafars' wrongdoing" and that it had no knowledge of any wrongdoing until after the Receivers were appointed. The evidence established that Messrs Kight and Donald of StockCo were well aware of the way in which Allan Crafar farmed with stock being moved around the farms and with Charging Group owned stock being mixed with Nugen leased stock. StockCo relies on the evidence relating to the manner in which Allan Crafar operated to establish the location of the non-Plateau stock leased by Nugen. The evidence also established that StockCo waived the requirement for Nugen to tag the 750 Nugen Cows notwithstanding the express requirement in the terms of the lease agreement. StockCo did not undertake any stocktake or inspection of the cows it acquired from Nugen. Nor did StockCo require Nugen or the Charging Companies, which had possession of the cows, to identify them in any way.

[256] Nor, however, do I accept the submission for the Receivers that StockCo's conduct disqualifies it from claiming or participating in a proportional division of the cows. The authorities establish that where, as here, both owners agree or consent to the intermixture they have an interest in common in the cows in proportion to their respective shares.

[257] In my view, therefore, there is no need in this case for a "rough justice" approach to calculating StockCo's entitlement to the non-Plateau Stock by analogy with the decision in *Re Service Foods Manawatu Ltd (In Receivership and Liquidation).* In the present case application of the law relating to the intermixture of goods provides a fair, commercial solution.

[258] On this basis I turn next to the proportionality calculation which is required, and the preliminary question whether 54 cows transported to farms owned by Windburn should be included in the calculation. The parties are in agreement that the 54 cows delivered to Windburn were mixed age cows comprised within the Third Party Stock Lease.

[259] StockCo submitted that the 54 cows should be included, on the basis that the Crafars treated the Charging Group's properties, Nugen's properties and Windburn's properties all as one "big farm" and moved all animals (whether StockCo owned or Charging Group owned) around all properties accordingly. StockCo submitted that there was no evidence as to what stock was actually on Windburn when the Receivers were appointed and that the proposed pro-rata calculations fairly addressed attrition, whether by deaths, losses or movements to Windburn.

[260] The Receivers submitted that stock supplied to Windburn farms should not be included as Windburn was neither a Charging Group nor a Nugen property, the circumstances of that entity and the number of stock held by it was unknown, and the current number of Windburn stock would need to be included in the overall herd size if animals supplied to that entity were to be included in a proportionality calculation.

[261] As there is now apparently no dispute between the parties that 54 cows owned by StockCo and leased to Nugen under the Third Party Stock Lease were delivered to Windburn, a farm property which was not owned by either the Charging Group or Nugen, there should now also be no dispute that those 54 cows are no longer within StockCo's claim before the Court which relates only to cows on Charging Group properties in the possession of the Receivers. StockCo, which changed its PPSR registration on 30 April 2010 to include Windburn, ought to have pursued its claim in respect of the 54 cows separately.

[262] The fact that the proposed pro-rata calculation addresses attrition, whether by deaths, losses or movements to Windburn, does not provide an answer because, as the Receivers submitted, the current number of Windburn stock would need to be included in the overall herd size to ensure a fair proportionality calculation. On this issue StockCo has not discharged the onus of proof on the balance of probabilities.

[263] The parties have recorded in their joint memorandum of 25 November 2010 that, if a proportionality approach is taken, they have agreed that the appropriate methodology is to calculate the percentage that each category of stock made up of the herd in 2008, and apply that percentage to the number of cows in each relevant category that were counted in the Receivers' November/December 2009 stocktake.

Their joint memorandum then sets out all the agreed alternative pro rata calculations depending on the decisions reached on the various relevant issues. As the parties have commendably reached agreement on the alternative calculations, I need only record the agreed calculations that apply as a result of the decisions I have reached. If I am wrong on any of these decisions, any changes required to the calculations will be able to be made in accordance with the agreement reached by the parties.

[264] Based on the decisions I have made and applying the methodology the parties have agreed, the agreed calculations and results are as follows:

a) 2007 born stock (on the basis StockCo has failed in respect of the Plateau Stock, but succeeded in respect of the 206 Nugen Heifers and 2 x Third Party Stock):

    i) In this scenario, the calculation is based on a 2008 herd size of 3,663 being all of the 3,455 x 2007 born Plateau Stock plus the 206 Nugen Heifers and the 2 x Third Party Stock (the 208 non-Plateau Stock being 6% of the total herd).

    ii) 6% of the 2,346 x 2007 born cows identified in the Receivers' November/December 2009 stocktake amounts to 141 cows – this being StockCo's entitlement under this scenario.

b) 2006 born stock (on the basis StockCo succeeded only on the 219 Third Party Stock):

    i) In this scenario the calculation is based upon a 2008 herd size of 4,001 [being the 545 x 2006 born Plateau Stock, the 3,237 x 2006 born Charging Group Stock and the 219 x Third Party Stock], the 219 Third Party Stock being 5% of the then total herd.

    ii) 5% of the 1,331 x 2006 born cows identified in the Receivers' November/December 2008 stocktake amounts to 67 cows –

this being StockCo's entitlement under this scenario.

c) Mixed age cows (on the basis StockCo succeeded on the 427 Third Party Stock, but not on the 750 Nugen Cows):

i) In this scenario the calculation is again based on a 2008 herd size of 12,397, of which the 427 Third Party Stock amounted to 3.4%.

ii) 3.4% of the 8,588 total mixed age cows identified in November/December 2009 amounts to 292 cows – this being StockCo's entitlement if successful under this scenario.

iii) On the basis that the 54 Third Party Stock delivered to Windburn ought not to be included, StockCo's entitlement becomes 373 of 12,343 which amounts to 3% of the 2008 herd. 3% of the 8,588 total mixed age cows identified in November/December 2009 amounts to 258 cows.

Result

[265] For the reasons given in this judgment, my answers to the four principal issues are:

a) The sale of the 4,000 heifers by Plateau to StockCo on 1 August 2008 was outside the ordinary course of Plateau's business under s 53 of the PPSA;

b) The sale of the 4,000 heifers was not expressly or impliedly authorised by the Banks under s 45 of the PPSA;

c) StockCo's security interest under its lease of the heifers to Nugen was subordinated under s 88 of the PPSA to the further advances made by

the Banks to the Charging Group in the period from 8 May 2009 to 7 October 2009;

d) StockCo is entitled to the following numbers of cows as its pro rata proportion of the intermixture of its cows with the Charging Group's herd calculated in accordance with the agreement reached by the parties and recorded in the joint memorandum of counsel as to the identification issue dated 25 November 2010:

i) 141 x 2007 born cows;

ii) 67 x 2006 born cows; and

iii) 258 mixed aged cows.

[266] In terms of the directions sought by the Receivers under s 34 of the Receiverships Act 1993, the formal orders of the Court are:

a) The 4,000 heifers purchased by StockCo Limited from Plateau Farms Limited and leased by StockCo Limited to Nugen Farms Limited remain subject to the security interest granted by the Charging Group companies to Westpac New Zealand Limited which security interest ranks in priority to any claim by StockCo or Nugen to the 4,000 heifers.

b) StockCo has established its claim to the following numbers of cows:

i) 141 x 2007 born cows;

ii) 67 x 2006 born cows; and

iii) 258 mixed aged cows.

[267] Leave is reserved to the parties to apply if any clarification of the formal orders of the Court is required.

[268] Unless the parties agree otherwise or a stay is obtained, the interim orders made by the Court will lapse on the sealing of this judgment.

[269] StockCo's claim for recovery of all proceeds obtained by the Receivers from StockCo's livestock, including progeny born to such livestock and milk proceeds produced by such livestock was not the subject of specific submissions at the hearing. It may be that the parties are able to resolve this claim following the second order I have made, but if not leave is reserved to StockCo to bring its claim on for determination.

[270] As the Receivers have succeeded on three of the four principal issues and also in part on the fourth principal issue, my provisional view is that they should be entitled to an order for a substantial proportion of their costs on a category 3 basis with disbursements to be fixed by the Registrar. If the parties are unable to agree, however, the Receivers may file and serve a memorandum by 28 January 2011 and the StockCo may reply by 11 February 2011.

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D J White J