IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2007-485-1563

IN THE MATTER OF	the Receiverships Act 1993
AND	
IN THE MATTER OF	SERVICE FOODS MANAWATU LIMITED (IN RECEIVERSHIP AND LIQUIDATION)
BETWEEN	NEW ZEALAND ASSOCIATED REFRIGERATED FOOD DISTRIBUTORS LIMITED Applicant
AND	RICHARD GRANT SIMPSON AND RONALD WALTON Respondents

CIV-2005-485-1820

IN THE MATTER OF	the Receiverships Act 1993
AND	
IN THE MATTER OF	SERVICE FOODS MANAWATU LIMITED (IN RECEIVERSHIP AND LIQUIDATION)
IN THE MATTER OF	an application for directions
BETWEEN	RICHARD GRANT SIMPSON AND RONALD WALTON AS RECEIVERS OF SERVICE FOODS MANAWATU LIMITED (IN RECEIVERSHIP AND LIQUIDATION) Applicants

Hearing: 13 March and 28 May 2008

Counsel: G J Toebes & P J Niven (on 13 March) for the receivers of Service Foods Manawatu Ltd (in receivership and liquidation)
B Gustafson & D M Hughes (on 13 March) for NZ Associated Refrigerated Food Distributors Ltd

Judgment: 20 June 2008

RESERVED JUDGMENT OF DOBSON J

Introduction

[1] In the earlier of these two proceedings commenced in 2005, Messrs Simpson and Walton as receivers of Service Foods Manawatu Limited ("Service Foods") applied for directions on how to allocate the proceeds of sale of Service Foods' assets between the appointing creditor, Westpac Bank, which held a General Security Agreement ("GSA"), and New Zealand Associated Refrigerated Food Distributors Limited ("NZARFD") which held a Purchase Money Security Interest ("PMSI") under the Personal Property Securities Act 1999 ("PPSA").

[2] For its part, NZARFD applied in its own, 2007 proceedings, under s 301 of the Companies Act 1993 and ss 34 and 37 of the Receiverships Act 1993 for distribution of certain Service Foods' assets in which NZARFD claims a security interest. It also applied for removal of the receivers.

[3] In the end, the argument focused on the extent of NZARFD's entitlement to monies being held by the receivers, pending resolution of this argument. As distribution in accordance with this judgment ought to be the last substantive step required of the receivers, no argument was addressed to grounds for their removal.

[4] I delivered judgment, on the basis of argument heard on 13 March 2008, on 28 April 2008. That resulted in a Memorandum on behalf of NZARFD dated 29 April 2008, inviting recall of the judgment. Despite opposition to that course on

behalf of the receivers, I indicated by Minute of 6 May 2008 that I would recall the judgment. The 6 May 2008 Minute acknowledged that I had omitted to deal with two matters that I had intended to address in the judgment, namely entitlement to interest, and whether marshalling could apply so as to affect the amount NZARFD was entitled to. I recorded my views on those two points in the Minute, and they are now incorporated in this judgment. Interest is dealt with in [67] and [68] and the analysis on marshalling at [26] to [32] below.

[5] NZARFD also invited recall on reasoning which adopted s 293 of the Companies Act 1993, to exclude any indebtedness incurred prior to NZARFD's security being perfected. This approach resulted in a "ruling off", limiting the value of NZARFD's security to amounts that became owing after it was perfected. As well as being an incorrect basis for any such "ruling off", I acknowledged that misapplication of a provision intended to apply only when invoked on behalf of unsecured creditors, in a contest between two secured creditors, had the potential to adversely affect interests not represented in the proceedings. I was satisfied that this raised special circumstances where justice required that that aspect of the judgment be recalled. It could not adequately be dealt with on the papers, and I therefore directed further argument of the "ruling off" issue. That was heard on 28 May 2008. Being keen to confine the extent to which my original judgment was re-opened, it was argued for the receivers at the second hearing that this rationale for recall only warranted reconsideration of the content from what is now [43] on. Although that somewhat disrupts the flow of reasoning, and I have found it appropriate to recast small parts of the reasoning before that point, essentially I have respected that wish.

Background

[6] The incorporation of Service Foods was registered on 14 February 2003. Its business involved purchasing foodstuffs from wholesalers such as NZARFD and selling them to retailers. NZARFD became a supplier to Service Foods in mid 2004. A trading account was established on 19 November 2004 and terms of trade were agreed to on 15 December 2004 which granted NZARFD a PMSI in terms of s 16 of the PPSA. It was registered on the Personal Property Securities Register and

perfected on 23 December 2004. The specific term was cast as a usual retention of title provision, so that property in goods supplied did not pass until they were paid for in full. It was expressed as follows:

> Prior to the buyer paying in full for all goods supplied to the buyer by the Company [NZARFD], ownership of any such goods will remain with the Company.

[7] On 8 June 2005, NZARFD attempted to re-take possession of stock it had supplied, but Service Foods' employees refused access to the stock. Later on the same day, Service Foods was placed into liquidation and the liquidators also refused access. Westpac, in reliance on its GSA over all Service Foods' assets, appointed the receivers on 13 June 2005. The receivers also refused NZARFD access to the stock it had supplied. The liquidators began to sell stock after this date, with all remaining assets of Service Foods being sold as a going concern by the receivers on 23 June 2005. NZARFD issued proceedings against the liquidators following this sale of stock.

[8] NZARFD was to issue proceedings against the receivers also, but the receivers filed an originating application in this Court for directions on 3 October 2005. The directions sought included a determination as to whether NZARFD had perfected its PMSI, what priority that PMSI had as against Westpac's GSA and, if superior, the method the receivers should employ when determining the value of the PMSI. In a judgment on 30 January 2006, Goddard J confirmed that NZARFD had perfected its PMSI and that it is was in priority to Westpac's GSA, but Her Honour also held that the Court was ill-equipped to direct a methodology for determining the PMSI's value. Her Honour recorded:

> …I understand from counsel that a co-operative approach to ascertaining the value of the security covered would be adopted in the event that I reached the conclusions that I have.

Alas, not so.

[9] The receivers appealed that decision, but Goddard J's judgment was upheld in the Court of Appeal ((2007) 10 NZCLC 264,263). Under the heading "What is covered by a perfected security interest?", the Court of Appeal observed:

> [35] This is a non-issue as Mr Toebes accepted before us. The answer self-evidently is only what is covered by the security agreement. Registration does not create any interest different from that which exists in the security interest itself. The collateral is only about goods supplied and not paid for, and the proceeds thereof. NZARFD's security interest is confined to goods supplied and not paid for, and any traceable proceeds of sale of those goods.

The current proceedings

[10] Following the judgments of this Court and the Court of Appeal, the receivers have, in effect, contended that it is too difficult to identify a process for determining the extent of NZARFD's PMSI, and apply to this Court for final directions in this regard. Specifically, their further application in July 2007 sought a direction that the value of NZARFD's collateral (to be paid to them out of the receivership) "is the sum of $0".

[11] That application foreshadowed argument that the onus was on NZARFD to identify the stock it had supplied that had not been paid for, that it was impossible to establish that on an individually itemised basis, and that the security was accordingly worthless.

[12] For its part, NZARFD sought enforcement of Goddard J's judgment, which it says amounts to orders pursuant to s 37(4)(b) of the Receivers Act 1993 that the receivers pay NZARFD:

a) $134,781.66, amounting to the NZARFD stock on hand at time of liquidation; and

b) $178.795.54, amounting to the proceeds of the NZARFD stock already sold (ie the accounts receivable).

[13] NZARFD's grounds for such orders are twofold. First, NZARFD argues that the receivers are issue estopped in terms of the stock on hand at time of liquidation (a) above) because of an admission by the receivers made earlier in the proceedings. Secondly, if this argument does not succeed, then the stock was a commingled mass and NZARFD has a PMSI over that mass. NZARFD had a PMSI in the accounts

receivable for the same reason; it is impossible to distinguish which goods were supplied by NZARFD from those supplied by others.

[14] NZARFD contends that the best way to deal with the issue (i.e. its recommendations for directions should the Court provide them) is to pro-rate the proceeds of the liquidation and receivership using the proportion of NZARFD goods out of the total goods supplied to Service Foods in its last six months of trading (agreed at 57%). NZARFD also alleges the receivers breached their duties by not marshalling certain accounts, which, if they had done so, would have avoided the present proceedings because Westpac would have been fully paid out of the proceeds of realisations other than of the stock.

[15] There were two problems in dealing with this contest between general and specific security holders. The first was that their competing claims were advanced from very different propositions, so that there was not the usual contrast of opposing arguments on the same points. On several issues, the competing cases steered past each other. To an extent, that mis-match remained even after re-argument. The second problem was that the accounting evidence was confused and in some respects inconsistent. The receivers' stance on this was that the onus to establish the value of the PMSI rested squarely on NZARFD, and if it could not prove, item by item, the relevant collateral, then the PMSI was worthless. However, in the present circumstances that is both an inadequate and inappropriate approach to adopt.

[16] Before addressing a quantification of the collateral covered by the PMSI in terms of paragraph [35] of the Court of Appeal decision, it is necessary to clear away certain preliminary issues.

Issue Estoppel

[17] NZARFD seeks to hold the receivers to what is characterised as an admission made by one of them in an affidavit filed before the argument which was determined by Goddard J. Mr Simpson deposed:

> "If it is determined in accordance with the application for directions that NZARFD has a perfected money security interest in respect of the collateral

> [defined as the invoiced cost of NZARFD's supplied stock that was on hand at the time of liquidation, regardless if it is paid for or not] then that sum plus the resale proceeds obtained by the receivers will be paid to NZARFD"

[18] NZARFD argued that this admission by the receiver, combined with Goddard J's judgment, requires Service Foods to pay the value of all NZARFD's stock that was in the premises of Service Foods at the date of the receivership. NZARFD relies on the definition of issue estoppel, enunciated by Lord Diplock in *Thoday v Thoday* [1964] 1 All ER 341 at 352:

> If in litigation on one such cause of action any of such separate issues whether a particular condition has been fulfilled is determined by a court of competent jurisdiction, either on evidence or on admission by a party to the litigation, neither party can, in subsequent litigation between them on any cause of action which depends on the fulfilment of the identical condition, assert that the condition was fulfilled if the court has in the first litigation determined that it was not, or deny that it was fulfilled if the court in the first litigation determined that it was.

[19] A first difficulty is that the extent of NZARFD's PMSI (viz only those goods not paid for or the proceeds where they have been on-sold) is different to the extent NZARFD relies upon for their argument of issue estoppel. This reliance on *Thoday* suggests that NZARFD have interpreted the concept of issue estoppel in the opposite sequence. Goddard J's determination was not conditional on Mr Simpson's admission – rather the admission was conditional on the determination, which is the reverse of the requirements outlined by Lord Diplock above. However, even if issue estoppel would work if a condition in the admission above was met so that the Court determined NZARFD had a PMSI in the collateral as defined by Mr Simpson, it still would not succeed. The Court did not make the requisite determination. The Court and Mr Simpson's respective definitions of 'collateral' do not reconcile. In short, NZARFD does not have a PMSI in all of its stock that Service Foods had on hand, but rather only that stock supplied under the terms of the PMSI that Service Foods had not paid for – a different determination to that required in the admission. The total value of the stock on hand supplied under the PMSI, and the value of the stock on hand but not paid for, may be very different, and so the admission cannot work to estop the issue; it must be capable of argument; the dictum in *Thoday* does not apply.

[20] In any case, an issue estoppel can only be founded on the determinations which are fundamental to the earlier decision and without which it cannot stand:

Talyancich v Index Developments Ltd [1992] 3 NZLR 28. There was never any determination about the admission made by Mr Simpson in Goddard J's judgment, so it cannot be fundamental to the proceedings, and moreover, the only determination that Goddard J made, namely whether NZARFD had a perfected PMSI is not being re-litigated in these proceedings; it has been accepted by Service Foods. Accordingly, Service Foods are not issue estopped on the argument as to the extent of the value of collateral covered by NZARFD's PMSI.

Commingling

[21] NZARFD argued that s 82 of the PPSA applies. It provides:

> 82 **Continuation of security interests in goods that become part of processed or commingled goods**
>
> A security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled, or commingled that their identity is lost in the product or mass.

[22] In determining the value of the PMSI in situations covered by s 82, it is appropriate to take a pro-rata assessment of the total mass of commingled goods, which NZARFD proposes the Court should do in this instance. Unlike the issue estoppel argument, commingling covers both the NZARFD stock on hand and the proceeds thereof.

[23] There is no New Zealand case law on point, but in his article "Rights for Suppliers of Inventory Under the Personal Property Securities Act 1999" (2002) 8(3) NZBLQ 266, Barry Allan relies on identical British Columbian legislation to state s 82 "…only deals with the situation of goods being combined with other goods to form some third product (such as sugar and milk to make ice cream)" (275). This approach would exclude the goods supplied by NZARFD; they have not been combined in the same way as the sugar or milk have in the example above.

[24] NZARFD relied on *In the Matter of San Juan Packers Inc, Peoples State Bank v San Juan Packers* 696 F. 2d 707. That case dealt with a vegetable processing plant where three different farmers provided vegetables for canning. This

is clearly akin to the ice cream example, and similarly distinguishable from the present case. A more liberal reading could include such products supplied by NZARFD, but only so long as they had become unidentifiable. NZARFD claim that their products became part of an indistinguishable mass, but also acknowledge that they can identify the individual product lines they supplied to Service Foods. On the basis of the latter proposition, the commingling provisions cannot apply. Accordingly, I find that the goods supplied to Service Foods have not been commingled for the purposes of s 82. NZARFD's argument for pro rata division must fail, for such a direction only applies to those commingled PMSI claims.

[25] For similar reasons, the subsidiary argument advanced by NZARFD, that the stock sold and now in the form of accounts receivable has been "commingled" is an incorrect interpretation of the commingling provisions in the PPSA. When stock has been sold, the commingling provisions lose their effect; NZARFD must rely on proceeds/tracing provisions with respect to the accounts receivable.

Marshalling

[26] NZARFD asserted an obligation on the receivers to apply the doctrine of marshalling, to apportion the proceeds of recoveries from all the debtor's assets in a manner that recognised NZARFD's security over just some of them, rather than electing a mode of satisfying Westpac's indebtedness from the assets that were charged to NZARFD when that would leave a surplus from other Service Foods' assets over which Westpac had security, but NZARFD did not.

[27] The receivers raised two grounds against marshalling applying in the present circumstances. First, that the different assets being realised by the controlling creditor had to belong to only one debtor, so that the doctrine could not apply where Westpac was, for example, resorting to securities granted by Service Foods on the one hand, and guarantors of its obligations to Westpac on the other.

[28] Secondly, that the doctrine does not extend to directing the controlling creditor as to which assets should be realised. Rather, where marshalling applies, equity intervenes after realisation by the senior creditor to ensure that the junior

creditor is left in no worse a position than if a different sequence of realisations, respecting its interest, had occurred. In this sense, marshalling can operate as a form of subrogation: see *National Bank of New Zealand v Caldesia Promotions Ltd* [1996] 3 NZLR 467 at 474.

[29] The first point could involve factual enquiries going beyond the evidence, as to the status of guarantors of Service Foods' indebtedness to Westpac, but on the view I have come to, that is unnecessary in any event.

[30] The second point, which I take as a correct characterisation of the doctrine, leads to the point that the doctrine does not affect the quantification of what is covered by a security. Rather, once quantified, it preserves rights to recovery of such amounts where there is a shortfall relative to the claims of both secured creditors. That cannot avail NZARFD to increase the amount it claims in this case. The Court of Appeal has clearly confined the value of its security to the value of goods supplied after the PMSI was perfected and which have not been paid for. The receivers stand committed to paying the full extent of that security once it is quantified, so that the cause of NZARFD's concerns is not that there is inadequate to pay them the extent of their security, but in the rules that are to apply to its quantification.

[31] It could not avail NZARFD to argue that if the receivers elected to satisfy the indebtedness of Westpac by realisation of assets other than those covered by NZARFD's PMSI, then NZARFD would have avoided a contest with the receivers. In enforcing their security, NZARFD have to be prepared to make out its value, and cannot complain of the need to establish that on a contested basis. The absence of a challenge from the receivers could not make the PMSI any more valuable.

[32] It was argued for NZARFD that quantification for marshalling purposes was not confined to the extent of super security applying since the PMSI was perfected, so that it should also be protected for its "ordinary security interest" in respect of previous supplies. Consideration of the claims NZARFD might make in reliance on any such lesser security was not within the issues before the Court. All the evidence and argument focused on quantification of the security from 23 December 2004,

consistently with the Court of Appeal's definition of its scope. There is some evidence that Service Foods made application for a trading account on 19 November 2004, and that was accepted on 15 December 2004, but there was no evidence of the value of goods supplied in any defined period prior to 23 December 2004. Accordingly, marshalling could not apply to advance the relevantly secured interest of NZARFD.

The determination of the value of NZARFD's PMSI

[33] That brings the dispute to the core issue of determining the value of NZARFD's PMSI. That value will be equivalent to the value of those goods supplied by NZARFD after 23 December 2004 and not paid for by Service Foods, or the proceeds of sale of such goods. The method of determining this value is the crux of these proceedings.

[34] There is a range of means by which the value of goods supplied by NZARFD, and the part of those deemed not to be paid for, might be quantified. The lack of direct contest between the parties means that the range of outcomes is even more "at large" than it would otherwise be.

[35] The total extent of indebtedness to NZARFD on appointment of the liquidator in June 2004 was $579,732.65. That amount is not contested by the receivers. Rather, because a large measure of it will not be secured in priority to Westpac, the total appears to be a matter of indifference to them.

[36] An early affidavit for the receivers analysed that $890,249.92 of goods were supplied by NZARFD between 23 December 2004 and 7 June 2005, and payments made or credits given of $816,817.77. If prior indebtedness was ignored, that would leave a shortfall of only $73,432.15. Yet another calculation was reflected in submissions for the receivers. Relying on a more recent affidavit for NZARFD that annexed all of that company's invoices for supplies to Service Foods after 23 December 2004, the unpaid balance of those invoices was calculated for the receivers at $157,791.61.

[37] Very substantial work was done for NZARFD in an attempt to relate the stock supplied after 23 December 2004, to the amounts remaining owing to NZARFD. The receivers were not able to provide copies of the invoices issued by Service Foods, which NZARFD sought to identify the stock lines supplied by them that had been on-sold. The analysis of what was available quantified $134,781.66 (exclusive of GST) as the cost price of stock presumed to be supplied after the PMSI was perfected on 23 December 2004, and remaining on hand for inclusion in the liquidator's stock-take as at 8 June 2005. A separate and entirely unrelated analysis calculated that sales of all NZARFD products to Service Foods between 1 May 2005 and 22 June 2005 totalled $431,625.01. This was intended to demonstrate how much trading there was towards the end of the period up to liquidation.

[38] The amount of $134,781.66 is described in the affidavit producing the analysis as the loss that NZARFD suffered from being denied the right to repossess the stock by the receivers. For the receivers, Mr Toebes argued that any breach of NZARFD's right to repossess had not caused any loss at all, in essence because even at the time, NZARFD could not have discharged an obligation to identify individual items of stock supplied but not paid for. I do not accept that argument. The right to retake possession was an important aspect of the contractual terms, and a prompt stock-take focusing on NZARFD's contractual rights would inevitably have advanced their interests by enabling at least a stock-take reflecting what had been supplied and was still on hand.

[39] Mr Toebes sought to distance the receivers' participation in obstructing NZARFD's access to the stock it had supplied by suggesting there was no evidence that the receivers were acting as agents for the company. Given that the receivers have taken the formal step of applying for directions, the withholding from the Court of any material information in their possession which might help arguments for the appointing creditor, hardly seems appropriate in the present circumstances. Ultimately, it does not affect the outcome because NZARFD's claim is not framed as one for breach of this provision in the contract. However, when pressed, Mr Toebes was inclined to acknowledge that the receivers were indeed acting as agents for the company.

Goods supplied after 23 December 2004

[40] NZARFD cannot identify the goods it supplied to Service Foods after 23 December 2004 on an individual basis. However, in argument, counsel for NZARFD stated that Service Foods had not proffered any evidence to suggest that any of the relevant stock had been supplied prior to this date. It seems most unlikely that any of the stock on hand at 8 June would have been supplied before 23 December 2004; the expiry date of the goods supplied is probably less than six months, and it is likely that Service Foods on-sold oldest stock first. Without any positive evidence in rebuttal, the inference of NZARFD that all stock on hand was supplied after 23 December 2004 is a reasonable one to make. Whilst the onus to identify the relevant stock rests on NZARFD, the standard of proof required has to take account of their being deprived of the opportunity to conduct a stock-take. In these particular circumstances, the receivers cannot complain that this very reasonable inference is relied on in finding that, on the balance of probabilities, all stock on hand was supplied after the PMSI was perfected.

Goods supplied but not paid for

[41] Service Foods argues that the onus is upon NZARFD to determine which goods supplied by it to Service Foods were paid for and which were not paid for. They argue that the party seeking to enforce a security interest must be the party to establish the property subject to that security. Mr Toebes cited a pre-PPSA regime decision relating to retention of title provisions. In *Geal Investments Limited v Ivil Hotels* (HC HAM CP 195/91, 27 May 1992) per Master Kennedy-Grant at page 22:

> In my view, identification of the stock as not having been paid for is necessary under the contract. Taking the clause as a whole, the payment referred to in the passage quoted above is payment for the goods supplied on a particular occasion not payments for all goods. It follows that it is necessary to identify the stock over which it is sought to assert a reservation of title as being stock supplied on an invoice which has not been paid for.

[42] NZARFD argued that counsel for Service Foods was "stuck in the old retention of title law" and that the same law does not apply under the PPSA so that the ruling in *Geal* does not apply. I do not consider that the PPSA has made a

material change that requires the approach in *Geal* to be distinguished. That approach merely reflects the structure of contractual arrangements in that case, and also in this one. If the parties wished to strike a bargain on different terms, such as that the security extends until the buyer has positively established full payment for particular goods, then it would be open to them to contract on a basis reversing the onus in such a way. Retention of title provisions do come within the definition of "security interest" with which the PPSA is concerned, by the terms of the definition of that phrase in s 17(3). The Act does not require, for its own sake, a recasting of the contractual effect. That only arises if insolvency provisions in the Companies Act 1993 intrude in regulating the relationship. That effect is discussed below.

[43] Dealing then just with the application of the contract, this was a quite usual supplier/wholesaler relationship, where the wholesaler appears to have paid rounded amounts as and when it could. The pattern was that Service Foods were in arrears, and that applied to the relationship both before the PMSI was perfected, and in the six months between that time and the appointment of liquidators and receivers. In the absence of any other agreed terms about how payments made were to be appropriated, I consider it appropriate to infer that, if asked, the parties would have both volunteered that oldest debts (i.e. for stock supplied first) would be paid for first. Acceptance of that as the default position goes back to *Clayton's Case (Devaynes v Noble, Clayton's Case* (1861) MER 529) and would fit logically into this type of trading relationship. At the further hearing, Mr Toebes argued that I should not make this finding which was recorded in the original judgment; that *Clayton's case* is now "a dead duck", and that the Court should instead infer the mode of application of payments most favourable to the debtor. He argued this would result in treating all payments as being for the most recent deliveries first, so that the oldest debt would be repaid last. I can find nothing in the evidence on this trading relationship that would justify such an implication. Prior to agreeing to a PMSI, allocation of payments would have been a matter of indifference to both parties. Given the commercial dynamic, it is most unlikely that a wholesaling business would risk its relationship with its major supplier by proposing, when the PMSI was agreed to, that the supplier remain entirely unsecured for substantial deliveries not paid for.

[44] It was originally argued for the receivers that if the presumption in *Clayton's case* was applied, there would need to be a "ruling off" of the indebtedness as it existed on the date the PMSI was perfected, so that thereafter all payments received would have to be applied to liabilities incurred after that date. This argument drew an analogy with s 293(4) and (5) of the Companies Act 1993. Those provisions relevantly provide:

> (4) Nothing in subsection (1) providing for voidable charges applies to a charge given by a company that secures the unpaid purchase price of property, whether or not the charge is given over that property, if the instrument creating the charge is executed not later than 30 days after the sale of the property or, in the case of the sale of an estate or interest in land, not later than 30 days after the final settlement of the sale.
>
> (5) For the purposes of … subsection (4), where any charge was given by the company within the period specified in subsection (1), all payments received by the grantee of the charge after it was given shall be deemed to have been appropriated so far as may be necessary –
>
> …
>
> (b) towards payment of the actual price or value of property sold by the grantee to the company on or after the giving of the charge;

[45] On the basis of reasoning I no longer need to record, I originally came to the view that s 293 applied. NZARFD correctly responded that the receivers had no standing to invoke that provision. Since it was intended to regulate the position only between secured and unsecured creditors, application of s 293 arguably risked an unjustified outcome between different secured creditors and risked unintended consequences for unsecured creditors who had not been heard. Hence the necessity for further argument on whether there was some other basis for a "ruling off", and if not, what is the appropriate mode of determining the value of the PMSI.

[46] At the further hearing, Mr Toebes characterised NZARFD as having dealt with Service Foods in two quite distinct characters. First, as an unsecured creditor, and then as a secured creditor. Arguably, the positions flowing from those distinct relationships had to remain distinct. He maintained that the analogy with s 293 was apt, in that secured and unsecured interests should not be merged. Accordingly, the "ruling off" should apply.

[47] He also maintained an argument that not requiring a "ruling off" was wrong in principle. This was because it would allow for an uncontrolled "leveraging up" of the value of the PMSI, by deferring recognition of the passing of title for goods supplied pursuant to the PMSI, until all prior goods that were supplied on an unsecured basis had been paid for.

[48] Mr Toebes also criticised NZARFD's stance as claiming, to the very end, on a basis that avoided its obligation to establish the goods that had been supplied and not paid for. It was argued that NZARFD's preferred mode of valuing its security sought to avoid that fundamental obligation, and had to be rejected because of that.

[49] NZARFD's justification for the way its claim was presented, was that it got to the same point of what had been delivered and not paid for, by the best alternative that could be applied. It was unable to establish the value directly, first because it was prevented from carrying out a stock-take before, and at the time of, the receivership, and secondly by the inability of the receivers to produce invoices that would identify the goods comprised in the accounts receivable recovered by the receivers.

[50] Although not presented as a claim for damages for breach of the contractual entitlement to re-take possession of stock not paid for when the company passed into liquidation and receivership, the measure of loss in the first part of NZARFD's claim amounts to that. It seeks $134,781.66 as the invoiced value of stock on hand when the liquidators were appointed. Assuming the application of *Clayton's case*, and no "ruling off" to exclude the indebtedness prior to the PMSI being perfected, then on the basis that NZARFD was owed some $579,000 at that time, it must be safe to assume that the last $134,000 or so of stock still on hand will comprise stock not yet paid for. NZARFD argues it need not be concerned with what the receivers subsequently sold that misappropriated stock for, as NZARFD should have been able to retake possession, and it still had its full invoice value to it as vendor.

[51] As to the second element of its claim, the approach is consistent, but the rationale somewhat different. The receivers recovered $380,306 of accounts receivable that were outstanding at the time of their appointment. Applying the

agreed figure of 57% that NZARFD-supplied stock represented of all stock sold in the last six months, and deducting the identified margin of 17.52% for the cost of sales, NZARFD claims $178,795.54 as its share of those accounts receivable. This analysis relies on the same assumptions that underpin the first element of the claim. If $579,000 was owing at the time of receivership (assuming *Clayton's case* applies) and if the oldest stock was sold first, then it is safe to assume that the sales for which the receivers collected payment also comprised part of the $579,000 of stock still not paid for.

[52] The rationale for this claim depends on a separate alleged breach of the contract between NZARFD and Service Foods. The clause in the terms of trade between NZARFD and Service Foods addressing ownership and recovery of goods included:

> …If the Buyer on-sells any goods (supplied by the Company) before ownership is passed to the Buyer, the proceeds of such sale shall be received and held by the Buyer in trust for both the Company and the Buyer. The Buyer's interest as beneficiary under that Trust shall be that portion of the proceeds which does not exceed the Buyer's indebtedness to the Company.

[53] NZARFD argues that as agent for the company, the receivers ought to have complied with this obligation to hold the proceeds of sale of NZARFD-sourced stock that had not been paid for in a separate trust account, and that their admitted failure to do so now renders them liable to account for breach of that trust.

[54] NZARFD further argued that this Court is bound to apply the approach of the Privy Council in *Ryde Holdings Ltd v Rainbow Corporation Ltd* PC50/92 15 November 1993 per Lord Mustill when dealing with misappropriated trust property that had become part of a larger, undifferentiated whole which the total accounts receivable represented. That protracted litigation involved what his Lordship described as "…a series of transactions whose only logic was that of tax avoidance and market fluctuation, and whose conception and execution had little to do with arithmetic" (p 1). The judgment makes a number of references to "rough justice", and endeavours to reach an outcome that reflects the broad justice of the case. That is a softening of a harder line that has previously been applied to the misappropriation of trust property, to the effect that if the trustee's own conduct has

rendered an accurate apportionment from a larger fund impossible, then he may be liable to disgorge it all. The Privy Council reasoning included:

> The object of an account is not to compensate the beneficiary but to deprive the trustee of profits wrongfully made. The greater the profit, the greater the order against him: and, quite possibly, the greater the windfall to the beneficiary. […] The jurisdiction is thus disciplinary, not compensatory. […] (p 22)

[55] The receivers support their refusal to hold proceeds of pre-receivership sales of NZARFD stock paid to them in a separate trust account because they were not persuaded at the time that NZARFD could make out a claim under its PMSI. Further, that they stood ready to account in any event, and that a claimed security interest is inconsistent with an assertion of trustee-type duties. There are certainly reasons why the full rigour of trust obligations ought not to be visited upon the receivers here, when the basis for quantifying liability is not to compensate the claimant, but to ensure full disgorgement of profit wrongly retained by the party treated as having misappropriated trust property. The relevant part of the terms of sale is inserted, not to extend the scope of the security, but to bolster the quality of the credit protection sought by the supplier. In dealing with accounts receivable recovered by them, the receivers have assumed liability to pay whatever value is attributed to the PMSI, so in dealing with an inarguably solvent party NZARFD is not exposed to the credit risk which the particular provision was intended to protect it against.

[56] In the context of an on-going trading relationship on such terms, there is some justification for a buyer in Service Foods' position expecting that the provision would be "policed" by the supplier for whose benefit it was imposed. Here, there is no suggestion that NZARFD had required Service Foods to have such a trust account in place, prior to liquidation. Although the initial correspondence after appointment of the liquidators did draw attention to clause 5 of the terms of sale, the focus was on re-taking possession of NZARFD's stock, and there appears not to have been any assertion, to either liquidators or receivers, that a separate trust account had to be established, to deal with proceeds of sale of NZARFD-supplied stock. Put another way, breach of trust would generally follow from some positive assumption of a trustee's responsibilities. Here, the receivers were not inclined to accept at the time

that any trustee's obligations would arise, and backed their judgement on that point by the implicit acknowledgement that if they were wrong, they would be liable in any event for the amount they should have put into a separate trust account.

[57] The assumptions on which the second part of the claim depends involve a much larger element of conjecture that goods were sold by Service Foods more or less in the order in which they were received from NZARFD. Also, that Service Foods' creditors paid more or less within a consistent time after being invoiced. The further back one is required to go from the date of receivership, the less reliable such assumptions are.

[58] This part of NZARFD's claim does not depend in the same way on their inability to carry out a stock-take at the time of receivership. Rather, they argue that they were entitled to expect the receivers to retain Service Foods' invoices relating to the sales for which they recovered the accounts receivable, and from which NZARFD claims they could have reconstructed which of the goods on-sold in such invoices were those that had not been paid for. NZARFD points to an early acknowledgement by one of the receivers in a September 2005 affidavit, that the accounts receivable would have included proceeds of some NZARFD stock that had not been paid for.

[59] I do not consider it appropriate to impose the full rigour of trust obligations for misappropriated property against the receivers in these circumstances. For goods that had not been paid for when they go out of the possession of Service Foods, the contractual terms give NZARFD an interest in the proceeds of their sales. That interest is not lost merely because the proceeds have not been lodged in a separate trust account. I prefer to deal with this aspect of the claim on a contractual, compensatory basis, rather than by imposing trustee obligations on the receivers. Nonetheless, I would take comfort from Lord Mustill's resort to "rough justice". If this part of the matter is not determined as a breach of trust, but rather the more conventional right to trace into the proceeds of sale of stock that had not been paid for, then in the present messy circumstances justice still necessitates a degree of "rough justice".

[60] Clearly, of the $579,000 outstanding, somewhat more than the $134,000 (using round figures) in stock still on hand could safely be included in stock not paid for, and that will be represented by a portion of the more recent sales by the company, the bulk of which should be reflected in the accounts receivable recovered by the receivers.

[61] The receivers expected NZARFD to prove, on the balance of probabilities, each item of stock supplied and not paid for, irrespective of whether it had been on-sold by Service Foods or not. The inability to conduct a stock-take and the unavailability of Service Foods' invoices render it appropriate for the civil onus to be discharged in another way, at a less specific level than individual items of stock. On the accounts receivable, the more abstracted approach to proof means that a just conclusion requires me to be satisfied by some margin that the proceeds must, on the balance of probabilities, have represented payment for stock Service Foods had still not paid for. Doing the best that I can, I am only able to be so satisfied in respect of 20% of the accounts receivable recovered by the receivers. That figure is to have 17.52% deducted, for the recognised cost of sales.

[62] If I am wrong in treating this as compensation to which the supplier is entitled as a matter of contract, and instead the issue had to be determined as a matter of misappropriation of trust property, then, again, "rough justice" would have brought me to the same conclusion. That is, that an apportionment of the total accounts receivable recovered by the receivers is possible, that the secured interest of NZARFD in those proceeds of sale is approximately 20%, and that would be the extent of the obligation on the receivers as trustee to disgorge.

[63] Having quantified the value of the PMSI in this way, I return to ask whether such an outcome reflects an unprincipled or wrong "leveraging up" of the value of that security to extend it to stock supplied before the PMSI was perfected, so as to require some form of "ruling off" at that point as urged for the receivers? The position of competing secured creditors is that, once perfected, registration ought to enable each to assess the relative strength of its position in relation to various categories of the borrower's/debtor's assets. I appreciate that on the facts here the bank, as holder of the GSA, might have complained that the paucity of detail about

the PMSI could have misled it, but that would never extend to the very existence of another security. Once on notice of its existence, a competing secured creditor has standing to pursue enquiries that would reveal the extent of that other creditor's security. I do not see any error in principle in allowing the contractual extent of perfected securities to prevail, subject to statutory override in insolvency situations. I do not consider that any injustice arises in this case if a degree of "leveraging up" is permitted beyond the security NZARFD would enjoy if it had to "rule off" so as to exclude all indebtedness prior to 23 December 2004.

[64] I am satisfied this achieves a just conclusion in the present context. The case is one on its own facts, and the mode of proof accepted in present circumstances may well not be sufficient to discharge the onus in other cases.

GST

[65] NZARFD claimed the value of its stock on hand at Service Foods at the time of receivership was $134,781.66 plus GST. Presumably, sometime after that, a GST adjustment was claimed in respect of non-payment of that amount. On its recovery, NZARFD will again have to account for GST on the receipt, so is not fully compensated unless GST is added to the amount.

[66] The converse is the position with the apportionment of the accounts receivable recovered by the receivers. Those payments will be GST inclusive, and NZARFD's entitlement to 20% of them is therefore to be treated as GST inclusive.

Interest

[67] As to interest, I had intended to accede to NZARFD's application for interest at the rate or rates under s 87 of the Judicature Act 1908 payable since 30 January 2006. I note that such additional relief, certainly to the extent of the value of the PMSI determined in the 28 April judgment, was not opposed by the receivers.

[68] However, interest is not payable on the GST content of the payments to be made, as that liability will only be met by NZARFD once the amounts on which GST is assessable have been paid.

Conclusion

[69] Accordingly, I determine that the value of NZARFD's PMSI which is to be paid to it by the receivers is

- $134,781.66 plus GST
- 20% of $380,306 less the margin of 17.52%, to be treated as inclusive of GST.
- Interest at Judicature Act rates from 30 January 2006 to the date of payment on the sums of $134,781.66, and the net apportionment of accounts receivable after deduction of GST on that amount.

Costs

[70] Counsel requested that I defer the issue of costs, and I do so. Memoranda may be filed if necessary.

Dobson J

Solicitors:
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