IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2011-404-005819
[2013] NZHC 2291

BETWEEN	GRAHAME and JANICE CAREY Plaintiff
AND	BRUMAC ENTERPRISES LIMITED Second Plaintiff
AND	BRUCE JAMES COPELAND SMITH First Defendant
AND	INGAR MARIANNA DOLK Second Defendant
AND	EKO GARDEN LIMITED Third Defendant

Hearing: 8-12 April 2013;
[Final Submissions Received on 15 May 2013]

Counsel: N W Woods for the Plaintiffs
R A Edwards and A Borchardt for the Defendants

Judgment: 5 September 2013

JUDGMENT OF DUFFY J

This judgment was delivered by Justice Duffy
on 5 September 2013 at 10.30 am, pursuant to
r 11.5 of the High Court Rules

Registrar/Deputy Registrar
Date:

Counsel: R A Edwards, Auckland
A Borchardt, Auckland

Solicitors: Rice Craig, Papakura

[1] The first plaintiffs, Grahame and Joyce Carey, and the second plaintiff, Brumac Enterprises (hereafter Brumac), together with the first defendant, Bruce Smith, and the second defendant, Ingar Dolk, were shareholders of a company that has gone into liquidation, NZ Peat Southland Limited (hereafter NZ Peat). The third defendant, Eko Garden Limited (hereafter Eko), is a company that took over the business of NZ Peat after it went into liquidation.

[2] In its trading days, NZ Peat was in the business of producing and selling peat and peat-based products in the North Island. During this time, Brumac and the Careys purchased and paid for a large pile of peat from NZ Peat (hereafter the peat pile). They never took delivery of the peat pile. It remained on land that was leased by NZ Peat. They planned over a period of time to sell this peat back to NZ Peat. There are aspects of this arrangement that are in dispute in this proceeding, including whether it can be properly characterised as a sale that gave Brumac and the Careys free and clear ownership of the peat pile. However, it is clear that, in various ways, the peat pile was reduced without Brumac and the Careys receiving all that they say they were entitled to receive for it under the terms of purchase. They have no realistic recourse against NZ Peat. Therefore, they have sought to recover their losses in this proceeding by making claims in conversion and alternatively, claims in trespass, against Mr Smith and Ms Dolk. They have also claimed in conversion and alternatively, trespass against Eko in relation to that company's allegedly wrongful acquisition of the peat pile from the liquidation of NZ Peat. The defendants deny the claims against them.

[3] The issues for this Court to determine are:

(a) Did Brumac and the Careys have the right to demand immediate possession of the peat pile at the time of the alleged conversions;

(b) Did Mr Smith and Ms Dolk personally convert or trespass against the peat pile;

(c) Did Mr Smith, Ms Dolk or Eko, either severally or jointly, cause the losses that Brumac and the Careys claim they have suffered;

(d) Did Brumac and the Careys acquire free and clear ownership of the peat pile;

(e) Did Eko's acquisition of the remains of the peat pile from the liquidators of NZ Peat amount to a conversion or trespass; and

(f) Have Brumac and the Careys proved their losses either in the volumes of peat taken or the market rate for the peat?

Facts

[4] NZ Peat was incorporated in 2002. It ran peat harvesting and processing operations in the North Island and South Island. The North Island operations are relevant here. They were spread over three sites:

(a) Ngatea, which was a peat farm on land leased from Landcorp. Peat was harvested and stockpiled on this land;

(b) Kerepehi, where there was a peat processing factory. Harvested peat was transferred to this site for screening and processing, and finished products were delivered from there to customers; and

(c) Maramarua, which was a bark and composting site.

NZ Peat exited from the Maramarua site and those operations in 2009. The head office of NZ Peat was located in Mount Wellington, Auckland.

[5] The growing and harvesting of peat is referred to as "peat mining". Peat fields are cultivated in a way that allows the peat to be dry enough to be harvested. The peat is dried by cultivating the top 20 centimetres with tine cultivators. This is known as "milling" the peat. Once the top layer of peat is dry enough, it is rowed up into windrows with a tractor. Once the peat is in rows, a peat harvester picks up the peat and loads trailers. This is the process known as "harvesting" the peat. The trailers of harvested peat deliver the peat to stockpiles, where they are dumped before returning for another load. From the stockpile, peat would then be loaded on

to trucks and carted to the factory in Kerepehi for screening, so that it could be used to make up specific growing media products.

[6] In early 2006, NZ Peat employed Grant McComb under a consultancy agreement and in May 2006, Mr McComb became a director and chairman of NZ Peat. In addition to his duties as a director, he advised NZ Peat on business strategy, governance, capital and other financial matters. Mr McComb was an accountant. One of the roles he undertook was to prepare and present investment proposals to potential shareholders and investors. In the context of this role, he proposed a share issue to new shareholders as a means of raising additional capital for NZ Peat. This is how Brumac and Mr Carey were introduced to NZ Peat. In May 2006, Brumac and the Careys became shareholders in NZ Peat. Mr Brewster, who is a shareholder/director of Brumac, became a director of NZ Peat in May 2009.

[7] Mr Smith gave unchallenged evidence about how NZ Peat came to have a peat pile of 10,000 cubic metres and the reasons for "banking" it. His evidence made sense to me and, given that it was unchallenged, I accept it. He said that in the summer of 2007 to 2008, there was a bumper peat harvest due to particularly dry weather conditions. Peat cannot be mined when it is wet. At the time, NZ Peat was trading at a loss. Mining the bumper crop meant increased harvest costs, which would have placed considerable pressure on NZ Peat's cashflow. NZ Peat was faced with two alternatives: leaving the crop in the ground to be mined at some later time; or mining it and then either finding additional sources of sale to fund the additional harvest costs, or bearing those costs and stockpiling the peat. Mr Smith said in his evidence that NZ Peat had regular customers who took regular amounts of peat. I gained the impression that finding additional customers to purchase the extra peat, especially without a reduction in price, would not have been easy. I also gained the impression that from NZ Peat's perspective, it was strategically better to mine the bumper crop and "bank" it, rather than to leave it in the ground. This was because any change for the worse in weather conditions could hold up any further peat harvesting for anything up to three to four weeks, if rain made the ground wet. Mr Smith said that the challenge in managing a peat harvesting and processing operation was in maintaining a steady supply of peat to the regular customers, hence the advantage to be gained from "banking" any bumper crop.

[8] In January 2008, Mr McComb proposed that the bumper peat harvest and overall cash shortage could be funded through selling surplus peat to Brumac and the Careys, with NZ Peat purchasing it back in 2009 under contract at a set price. This gave Brumac and the Careys a guaranteed return. It provided NZ Peat with funds. It meant NZ Peat did not have to find the funds to harvest that peat from elsewhere and, under the agreement, it would only pay for peat as and when it required the peat. The addition of a put option gave Brumac and the Careys added protection, as by this means they could compel NZ Peat to buy back the peat at a pre-determined price. There were further discussions between NZ Peat on the one hand, and Brumac and the Careys on the other, all of which concluded with them entering into a sale and buy-back agreement for 10,000 cubic metres of peat.

The general security agreement

[9] Six years prior to the discussions regarding the sale and buy-back agreement, on 25 September 2002, NZ Peat had executed a general security agreement (GSA) as debtor, with the ANZ Bank as lender. The GSA covered all present and future indebtedness of the company to the bank.

[10] The GSA was registered on the Personal Property Securities Register and was a perfected security under the Personal Property Securities Act 1999 (PPSA).

[11] The GSA created a fixed and a floating charge over the assets of NZ Peat. Clauses 5 and 8 stipulated what the obligations were of NZ Peat in relation to maintaining the collateral affected by the GSA. Under clause 5.2, NZ Peat was permitted to sell its inventory if the sale was in the ordinary course of business:

> Unless otherwise required in writing by the Bank, the Debtor may, in the ordinary course of business of the Debtor, without the consent of the Bank, sell or purchase, or lease (whether as lessor or lessee) inventory and collect accounts receivable which are the proceeds of inventory.

[12] Clause 8.1 stipulated that unless it was permitted by clause 5.2, NZ Peat was not to sell or otherwise dispose of any collateral:

> The Debtor must not:

> (a) except as may be permitted by clause 5.2, sell, lease or dispose of, or permit the sale, lease or disposal of, any Collateral, or permit to subsist any other security in relation to any Collateral (other than, in relation to Personal Property, a purchase money security interest) …

[13] On default by the debtor, clause 13.2 authorised the bank to exercise the powers of a receiver, or the powers a receiver would have had if one had been appointed. Clause 14.3 authorised the receiver to do all things in relation to the collateral as if the receiver had absolute ownership of the collateral. These powers were in addition to the relevant powers given to the bank by the PPSA, including s 109, which authorises a secured party to take possession of and to sell the collateral on the debtor's default.

The sale and buy-back agreement

[14] As mentioned above, on 29 February 2008, Brumac and the Careys entered into a sale and buy-back agreement with NZ Peat for the peat pile. The agreement noted in the introduction that NZ Peat wanted to sell the peat, whilst retaining certain rights to buy back the peat at a future date, and that the investors (being Brumac and the Careys) wished to purchase half of the peat each, whilst retaining certain rights to sell back the peat at a future date. In the definitions clause to the agreement, the buy-back price was defined by rates set out in schedule 1 of the agreement under the heading "Buy Back Rate per m^3" plus GST. The peat pile was defined as 10,000 cubic metres of peat, as surveyed by a registered surveyor, plus a compaction factor, as calculated by NZ Peat. The purchase price was the sum of $250,000 plus GST, to be paid by each investor, calculated at the rate of $25 plus GST per cubic metre. The put price was $33.74 plus GST per cubic metre.

[15] Clause 1 provided that the peat pile was sold to the "Investors" on the date of sale.

[16] Clause 2 of the agreement provided that on the date of sale, Brumac and the Careys would pay NZ Peat their respective halves of the purchase price by cheque made out to NZ Peat. Ownership and risk in the peat transferred to Brumac and the Careys upon receipt of cleared funds by NZ Peat of the full amount of the purchase price.

[17] Clause 3 provided that from the date of sale, the peat was to be kept in a separate pile at NZ Peat's premises at Pouarua Road, Ngatea, for a storage rental of $1 per annum. NZ Peat agreed to keep the peat in good order and condition, and NZ Peat agreed to take out insurance for the peat on behalf of Brumac and the Careys. Brumac and the Careys agreed to reimburse NZ Peat for half each of the cost of such insurance upon receipt of an insurance invoice.

[18] Under clause 4, Brumac and the Careys respectively agreed that they would not remove the peat from NZ Peat's premises, or sell, transfer, use as security, or in any way encumber the peat at any time until after the expiry of NZ Peat's buy-back option on 31 December 2009.

[19] Under clause 5, NZ Peat warranted and guaranteed to Brumac and the Careys that the quantity of the peat was as stated in the definition of the peat, and should for some reason the quantity of peat be less than that stated, NZ Peat agreed that it would refund each investor its half share of the shortfall of the peat at the rate of $33.74, plus GST per cubic metre on 1 December 2009.

[20] The buy-back arrangements for the peat were set out in clauses 6 to 9. Under clause 6, each of the investors granted NZ Peat the option to buy back all or some of the peat from each investor at the quantity and at the times and dates decided by NZ Peat in its sole discretion at the buy-back price, providing that such option could only be exercised by NZ Peat between 1 March 2009 and 31 December 2009. The option could be exercised as many times as NZ Peat decided within the option period.

[21] Clause 7 set out the procedure for the exercise of the option. To exercise the option, NZ Peat was required to provide written notice to the investors in accordance with dates set out in schedule 1 to the agreement. Once such notice was given to the investors, they were required to provide NZ Peat with a GST invoice from each of them for half of the quantity stipulated in NZ Peat's notice. Payment of the invoice was due on the first of the month following NZ Peat's notice, following which NZ Peat would then acquire the quantity of peat stipulated in this notice. Payment was to be made by direct credit to the relevant accounts nominated by the investors.

[22] Under clause 8, NZ Peat was required to account for the stock-take in each month and prepare a statement each month showing the amount of the peat removed from the stockpile and the amount of peat remaining in the stockpile.

[23] Clause 9 provided that in the event that NZ Peat bought back all of the peat during the term of the agreement and yet there was still some product remaining in the stockpile following the uplifting of the peat, then the remaining amount was to be deemed to belong to NZ Peat, and no further payment was required to be made to the investors.

[24] Clause 10 dealt with the put option. Under clause 10, NZ Peat granted each investor a put option to require NZ Peat to buy back each investor's half share of any remaining peat that had not already been bought back by NZ Peat as at 2 December 2009 at the put price. The option was to be exercised by the investors providing written notice to NZ Peat at the address for notice, as set out in schedule 2, no later than 2 November 2009 (time being of the essence).

[25] The agreement provided for a purchase price refund. Under clause 11, this provided that should the official cash rate increase at any time during the term of the agreement (being from the date of sale until 31 December 2009) by more than 0.5 per cent above the Official Cash Rate at the date of sale, then NZ Peat agreed to refund part of the purchase price to each investor at the rate of $25 plus GST per cubic metre of peat, multiplied by the percentage amount of increase in the official cash rate above 0.5 per cent adjusted on a per annum basis. Any refund in accordance with clause 11 was to be paid on 14 January 2010.

[26] Schedule 1 set out a series of buy-back rates and exercise dates. Notice was to be given on the first day of the month, running from the period 1 March 2009 to 1 November 2009. Payment was due on the first day of the month, running from the period 1 April 2009 to 1 December 2009. The buy-back rate per cubic metre of stock taken over those months was expressly provided for. It commenced at $30.40 plus GST for peat taken during the month of April 2009, and ended at a cubic metre rate of $33.74 plus GST for peat taken during the month of December 2009.

Action taken under the sale and buy-back agreement

[27] Brumac and the Careys exercised the put option under clause 10 of the sale and buy-back agreement on 25 and 26 February 2009 respectively. This required NZ Peat to buy back any remaining peat from the peat pile, which it had not already purchased as at 2 December 2009, at the "put price".

[28] In fact, none of the peat that was removed from the peat pile was taken in accordance with the terms of the sale and buy-back agreement. Under the sale and buy-back agreement, the peat was to be paid for before it was removed. However, Brumac and the Careys were never paid for the peat that was removed from the peat pile. At no time did NZ Peat perform its obligations under the sale and buy-back agreement.

Removal of the peat pile

[29] Apart from the measurements that were done at the time the sale and buy-back agreement was entered into, and the surveys commissioned by the liquidator in January 2010 and May 2010, no one appears to have kept track of the size of the peat pile. There is little in the way of direct evidence to inform the Court of the size of the peat pile in the latter part of 2009 and in particular at the time NZ Peat went into liquidation. There are photographs of the peat pile, which show it to be relatively intact as at 16 September 2009; then there were photographs taken on 13 November 2009 by Mr Sargison of Gerry Rea (an insolvency accounting firm engaged by NZ Peat), and later on 26 or 27 November 2009, when Mr Brewster went to the peat pile and took photographs of it. From the photographs taken in November 2009, the peat pile appears to be considerably reduced from its size in the September 2009 photographs. All the photographs of the peat at Ngatea at the various times show that the peat pile was not the only peat at Ngatea.

[30] Brumac and the Careys contend that approximately 70 per cent of the peat pile had been removed by 27 November 2009, which was before NZ Peat went into liquidation. Mr Smith disputes this. He takes the position that unless the peat pile was measured in November 2009, it is not possible to say how much was removed

from it. I acknowledge that judging the extent of the removal from drawing comparisons of the size as shown in photographs taken at different times is a rough and ready way of estimating the reduction in size. However, in addition to conflicting evidence from the parties who saw the peat pile at the relevant times, it is the best evidence available to the Court.

[31] On 19 October 2009, Brumac and the Careys invoiced NZ Peat for 150 cubic metres of peat each. The invoice was not paid.

[32] Then on 27 November 2009, following a joint visit to the peat pile by Mr Brewster and Mr Smith, Brumac and the Careys, by a letter dated the same day, gave notice to NZ Peat that it was in breach of the sale and buy-back agreement, that "upwards of 70%" of the peat pile had unlawfully been removed and that what remained was "not in good condition". NZ Peat was told not to remove any more peat and advised that legal action would follow. Mr Smith responded that day with an email to Brumac and the Careys inviting them to invoice NZ Peat for 947.5 cubic metres. The email recorded that the opening stock was 10,000 cubic metres, that 2,195 cubic metres had been uplifted to date and that 7,805 cubic metres remained. The email asserted that the remaining peat was in good condition and that no more peat would be removed until further notice. In line with the request in the email, Brumac and the Careys invoiced NZ Peat for 947.5 cubic metres each. The invoices stated that the peat had already been uplifted contrary to the sale and buy-back agreement.

[33] The invoices issued by Brumac and by the Careys mirror each other. Significantly, nothing was said on the invoices about the peat pile being less than was stated in Mr Smith's email, or about Brumac and the Careys being owed more than the sum invoiced. By 27 November 2009, Mr Brewster had been to Ngatea and had seen the reduced peat pile. Yet, there is no evidence of any recorded communication made by him at the time, either to the Careys, to NZ Peat or to Mr Smith, disputing the size estimates in Mr Smith's email and asserting that the peat pile was less than the amount that Mr Smith asserted.

[34] In the latter part of 2009, NZ Peat was experiencing financial difficulties. By 30 November 2009, Mr Smith had received advice from Gerry Rea that payment of money owing to Brumac and the Careys would constitute a voidable transaction, so no payment was made to them. On 21 December 2009, NZ Peat went into voluntary liquidation.

[35] On 23 December 2009, the liquidator of NZ Peat signed an operating agreement with Eko authorising that company to deal with NZ Peat's peat, including the peat pile. Eko paid the liquidator the sum of $15 plus GST per cubic metre for the peat uplifted. Mr Smith was a director of Eko; Ms Dolk was not. Nor was she an employee of Eko.

[36] On 26 January 2010, the peat pile was surveyed. The surveyor said there was 2,583.1 cubic metres (compressed) of peat in the peat pile. On 25 May 2010, a further survey of the peat pile was carried out. By then, it was assessed at 594.3 cubic metres (compressed).

Analysis

[37] I find it surprising that Mr Brewster and the Careys did not make more of a fuss about what they now say was a 70 per cent reduction in the size of the peat pile by 27 November 2009, especially since under the terms of the sale and buy-back agreement, any removal of peat was to be paid for in advance. However, in the end, I do not consider that the outcome of their claim hinges on the amount by which the peat pile was reduced before NZ Peat went into liquidation. The more important issue is what their rights to the peat pile were up to and at the time NZ Peat went into liquidation. After liquidation, the liquidator made decisions about the peat. Those decisions may have an impact on the claim insofar as it relates to Eko and Mr Smith's actions after the liquidation of NZ Peat, but that is another matter.

[38] Because the legal considerations change once NZ Peat went into liquidation, I shall deal with the first three issues identified in [3] in the context of the pre-liquidation period, save for the liability of Eko, which, together with the remaining three issues, falls for consideration in the context of the post-liquidation period. The

claim against Mr Smith covers the period in which he is alleged to have dealt with the peat while NZ Peat had possession of it in the pre-liquidation period and when Eko dealt with the peat, which was in the post-liquidation phase. His liability will, therefore, be considered in each context.

The legal effect of the sale and buy-back agreement

[39] Brumac and the Careys argue that on executing the sale and buy-back agreement, ownership of the peat pile passed to them. They rely on ss 19 and 20 of the Sale of Goods Act 1908, as well as clauses 1 and 2 of the buy-back agreement. I accept that under the sale and buy-back agreement ownership in the peat passed to Brumac and the Careys once NZ Peat received clear funds following payment of the purchase price of $250,000. However, their ownership was stripped of the usual rights of ownership by the terms of the sale and buy-back agreement, in particular clauses 4 and 6 to 9.

[40] Brumac and the Careys also argue that once the put option was exercised (if NZ Peat did not buy back the peat by 2 December 2009), the restrictions that the sale and buy-back agreement imposed on their ownership of the peat were at an end and so from that time onwards, all the rights of ownership, including the right to immediate possession of the peat, were theirs. I do not accept this argument. It does not accord with the terms of the buy-back agreement. It also fails to recognise the impact of the GSA on this agreement. This is a separate issue that is dealt with elsewhere in the judgment.

[41] The interpretation that Brumac and the Careys' advance requires clause 10 to be read as if the date reference of 2 December 2009 imposes a time requirement for when NZ Peat would purchase the remaining peat. As Brumac and the Careys would have it, clause 10 imposes a requirement that once the put option has been exercised, NZ Peat must acquire all the remaining peat by no later than 2 December 2009. But the language of clause 10 does not support this interpretation. The clause reads:

> NZP[eat] grants each Investor a put option to require NZP to buy back each Investor's half share of any remaining Peat that has not already been bought back by NZP *as at* 2 December 2009 at the Put Price. ... (emphasis added)

I consider that the reference to “as at 2 December 2009” is intended simply to identify the peat which will be subject to the put option.

[42] Secondly, if clause 10 is read in the way that is argued for by Brumac and the Careys, the clause would be at odds with clause 4 in the sale and buy-back agreement, which required Brumac and the Careys:

> ... not to remove the Peat from NZP’s premises or sell, transfer, use as security or in any way encumber the Peat at any time until after the expiry of NZP’s buy back option on 31 December 2009.

On the other hand, if the date reference in clause 10 is read as being for the purpose of identifying the peat that would be subject to the put option, all clauses of the sale and buy-back agreement fit well together.

[43] Furthermore, the sale and buy-back agreement fails to expressly provide for what would happen in the event that the put option was exercised and NZ Peat did not buy back the remaining peat by 2 December 2009. Nowhere in the agreement is there a provision that suggests that if NZ Peat failed to perform in response to the exercise of the put option, time was of the essence. The reference in clause 4 to the requirement for Brumac and the Careys not to deal with the peat until 31 December 2009 suggests that even if clause 10 did impose a time limit of 2 December 2009 for NZ Peat to perform under the put option, some leeway would be allowed and that Brumac and the Careys were not free to deal with the peat pile themselves until the expiry of the later date.

[44] Indeed, the sale and buy-back agreement makes no provision for what was to occur in the event of NZ Peat’s failure or inability to perform its obligations under this agreement. Thus, there is no condition giving Brumac and the Careys the right to take possession of the peat, or vesting them with other rights to protect the removal of the peat on the happening of events such as NZ Peat’s insolvency, any departure by NZ Peat from the contractual process for the removal of the peat from Ngatea, or any other failure to perform its obligations under the agreement. The only remedies that I can see that would have been available to Brumac and the Careys in the event of a breach or inability to perform by NZ Peat would be the remedies

provided in the Contractual Remedies Act 1979, which would include the right to cancel the agreement under s 7(2), and those provided under the common law.

[45] Brumac and the Careys may have been entitled to cancel the sale and buy-back agreement under s 7(2) if NZ Peat did not perform as required by the put option, and any such cancellation may have brought the agreement to an end earlier than 31 December 2009. But without this occurring, I consider that irrespective of any breach or failure to perform by NZ Peat, the restraints that the agreement imposed on their rights to the peat would have remained effective.

Did Brumac and the Careys have a right to immediate possession of the peat?

[46] Clause 3 of the sale and buy-back agreement provided that the peat pile was to be stored at Ngatea on land leased by NZ Peat. Under clause 4, Brumac and the Careys had essentially agreed that the peat pile would remain beyond their control at Ngatea until 31 December 2009. Clause 4 prohibited Mr Brewster and the Careys from dealing with the peat in any way up to 31 December 2009. Under clause 6, NZ Peat could exercise the options to purchase the peat at any time up to 31 December 2009. Further, by triggering the put option under clause 10 as early as February 2009, Brumac and the Careys had then put NZ Peat in the position where it was contractually obliged to purchase whatever remained of the peat pile as at 2 December 2009. This would have reinforced the obligation of Brumac and the Careys under clause 4 and clause 6 not to deal with the peat themselves, which would include not exercising possessory rights, and instead, preserving the peat for NZ Peat.

[47] If the agreement is to be construed as a sale and purchase agreement, then the clauses that grant NZ Peat buy-back rights represent finite restrictions on the ability of Brumac and the Careys to deal with the peat pile before the expiry period. It was only once those finite restrictions had expired that they would then, in principle, have become free to enjoy all the rights of ownership, including rights to immediate possession.

[48] I am satisfied that under the terms of the sale and buy-back agreement, Brumac and the Careys had no right to immediate possession of the peat pile until such time as NZ Peat's rights under this agreement had expired, or were extinguished. That would not have occurred until after 31 December 2009, or earlier if the contract was cancelled for breach.

[49] There was no cancellation, even though the sale and buy-back agreement was breached more than once by NZ Peat. Indeed, the contemporaneous conduct of Brumac and the Careys in invoicing NZ Peat for specified amounts of peat after the peat was taken is indicative of them electing to affirm the continuance of the agreement in the face of NZ Peat's repeated breaches of the provisions relating to the removal of peat from the peat pile.

[50] The sale and buy-back agreement contained no provision giving Brumac and the Careys the right to immediate possession of the peat on the contractual default of NZ Peat. So NZ Peat's breaches of the sale and buy-back agreement could not of themselves vest Brumac or the Careys with a right to immediate possession of the peat pile. While this agreement remained on foot, its terms deprived Brumac and the Careys of a right to immediate possession of the peat pile. What they had were contractual rights entitling them to be paid for the peat that was taken. Moreover, once the put option was exercised, it is clear that Brumac and the Careys lost any present reversionary right to possession of the peat, as they were then contractually bound to transfer ownership of the peat to NZ Peat on payment of the agreed price. What they would have retained was at best a contingent reversionary right, the existence of which hinged on recognising the possibility of NZ Peat failing to perform in accordance with the put option.

The conversion claim

[51] The tort of conversion has traditionally been seen to be confined to tangible property: see discussion in Stephen Todd (ed) *The Law of Torts in New Zealand* (6th ed, Thomson Reuters, Wellington, 2013) at 597. The House of Lords recently affirmed this principle in *OBG Ltd v Allan* [2007] UKHL 21, [2008] 1 AC 1 when it

held that a conversion action in respect of the loss of a company's contracts could not be maintained against invalidly appointed receivers.

[52] To maintain a claim in conversion, the plaintiff also has to establish that he or she had a right to immediate possession of the tangible property allegedly converted: see *Whenuapai Joinery (1988) Ltd v Trustbank Ltd* [1994] 1 NZLR 406 (CA) at 415.

[53] In *Kuwait Airways Corp v Iraqi Airways Co (Nos 4 and 5)* [2002] UKHL 19, [2002] 2 AC 883 at [39], Lord Nicholls, who gave judgment for the majority, described the essential features of the tort of conversion in general as being threefold:

(a) The defendant's conduct is inconsistent with the rights of the owner or other person entitled to possession;

(b) The conduct is deliberate; and

(c) The conduct is so extensive an encroachment on the rights of the owner or other person as to exclude him or her from use and possession of the goods.

This statement of principle was recently adopted by the Court of Appeal in *Glenmorgan Farm Ltd (in rec and in liq) v New Zealand Bloodstock Leasing Ltd* [2011] NZCA 672, [2012] 1 NZLR 555 at [26].

[54] I do not consider that when Lord Nicholls referred to the "rights of the owner" he was departing from settled principle by expanding the character of ownership to include owners who did not have a right to immediate possession of the subject goods. Indeed, in the same case, Lord Steyn framed the principle with specific reference to the dependence on possession (at [119]):

> Despite elaborate citation of authority, I am satisfied that the *essential feature of the tort of conversion, ... is the denial by the defendant of the possessory interest or title* of the plaintiff in the goods: see [Stephen Todd (ed) *The Law of Torts in New Zealand* (3rd ed, Brookers, Wellington, 2001) at [11.3]] for an illuminating discussion.

[55] Relevant to the present case is a passage on conversion in the 6th edition of the text relied on by Lord Steyn. At [12.3.03], following a discussion on case law relating to when an owner whose goods are subject to a bailment might be entitled to sue a tortfeasor for their conversion, the author states:

> Interference with the plaintiff's possession is at the heart of conversion, and conversion therefore protects that possessory right. Thus ... an owner who lacks any possessory right in goods may not claim in conversion, and may even be liable in conversion to a bailee to whom exclusive possession of the goods has been surrendered. In such a case the existence of a proprietary right is simply irrelevant; it alone confers no right to sue if the possessory right is vested elsewhere.

[56] This statement by the author is applicable to the facts of this case. Under the sale and buy-back agreement, Brumac and the Careys had given up all possessory rights to the peat pile from the time the agreement came into effect until 31 December 2009, or the cancellation of the agreement. As the agreement was never cancelled, it follows that their possessory rights lay dormant until 31 December 2009. By that date, on their evidence, at least 70 per cent of the peat had been removed; they say this had occurred by 27 November 2009. Thus, for the time when 70 per cent of the peat was removed, they had no possessory right to the peat and, therefore, no basis for making a claim in conversion.

[57] Had a thief removed the peat during this period, Brumac and the Careys could not have sued the thief for conversion. All that the thief would have done to them by removing the peat was to frustrate the performance of the sale and buy-back agreement, and so to have interfered with their contractual right to receive payment for the peat as and when it was taken by NZ Peat.

[58] In the time up to 21 December 2009 (the pre-liquidation period), NZ Peat was the party entitled to possession of the peat under clauses 3 and 4 of the sale and buy-back agreement, and it was entitled to acquire ownership of the peat under that same agreement. Accordingly, nothing that NZ Peat did over this period of time could be an interference with Brumac and Careys' possessory interest in the peat, as they simply did not have such an interest then. Insofar as NZ Peat failed to adhere to the sale and buy-back agreement when it removed peat from the peat pile before

31 December 2009, this was a breach of that agreement, but the removal was not and could not be a conversion of the peat.

[59] The findings I have made regarding Brumac and the Careys' rights to immediate possession of the peat pile hinge on the finding that the restrictions the sale and buy-back agreement imposed on them continued in effect until 31 December 2009. They have argued that in the event no peat was paid for under the put option by 2 December 2009, they were then free to deal with the peat as they wished, which would also mean they had possessory rights to the peat after that time. If I am wrong and their interpretation of clause 10 of the sale and buy-back agreement is correct, it would mean that in the period after 2 December 2009 and before 21 December 2009, when the company went into liquidation, they had rights of immediate possession to the peat pile. However, after the company went into liquidation, their legal rights to the peat pile, including rights to immediate possession, were detrimentally affected by the bank's GSA. I will deal with this later in the judgment.

Did Mr Smith and Ms Dolk personally convert or trespass against the peat pile?

[60] Given that the contractual restrictions on Brumac and the Careys' possessory rights in the peat pile were effective up until 31 December 209, it follows that in the pre-liquidation period, Brumac and the Careys had no claim in conversion against Mr Smith and Ms Dolk. Further, there is no direct evidence that they were personally responsible for the removal of the peat. It was removed from Ngatea to the Kerepehi processing plant by other persons, who were engaged as employees, agents or contractors of NZ Peat, and from there, it was processed and on-sold to NZ Peat's customers.

[61] An action in conversion against Mr Smith and Ms Dolk personally would also raise legal questions regarding whether directors of a company can be personally liable for the actions of other persons engaged by the company as employees, contractors or agents. In view of the conclusions that I have reached on the absence of any foundation for a claim in conversion, I see no need to consider this further question.

[62] Trespass, like conversion, is a wrong to possession. If there is no interference with possession, there is no trespass: see *Penfolds Wines Pty Ltd v Elliott* (1946) 74 CLR 204 (HCA). It follows that just as there is no foundation here for Brumac and the Careys to sue in conversion, their claim in trespass must fail for the same reason.

[63] In the alternative, if my interpretation of clause 10 of the sale and buy-back agreement is wrong and so Brumac and the Careys acquired rights of immediate possession in the peat pile the day after 2 December 2009, I am still of the view that their claims in conversion and trespass must fail. The burden of proof would be on them to prove that the alleged conversion and/or trespass occurred at some time between the day after 2 December 2009 and the day before NZ Peat went into liquidation (21 December 2009). After that, the bank's GSA gave it first claim on the peat pile. The evidence regarding the removal of peat from the peat pile is not precise enough to enable Brumac and the Careys to prove whether the alleged torts occurred during this time and, if they did, the size of the amounts of peat then taken.

[64] There is evidence that following the visit to Ngatea on 27 November 2009, Mr Brewster formed the view that 70 per cent of the peat pile had been removed, and that he and the Careys gave notice the same day that no more peat was to be removed without NZ Peat adhering to the terms of the sale and buy-back agreement. Mr Smith emailed Mr Brewster on 27 November 2009 stating that no further peat would be removed from the peat pile until further notice. There is no evidence that any more peat was removed from the peat pile after 2 December 2009 and before 21 December 2009. Further, the peat pile was not the only source of peat at Ngatea during this period, and a complete set of records showing dates and loads of peat removed is no longer available. Therefore, it is impossible through inferential reasoning to reach a view on whether any more of the peat pile was taken after 27 November 2009 and before 21 December 2009, and, if so, how much was taken. Thus, even if Brumac and the Careys did acquire possessory rights in the peat after 2 December 2009 and before 21 December 2009, any claim Brumac and the Careys might have in either tort that was relevant to this period of time would fail on the facts.

[65] Brumac and the Careys also pleaded in their statement of claim that Mr Smith and Ms Dolk had converted the peat pile by putting NZ Peat into liquidation, so that the GSA took effect and the liquidator took possession of the peat under the GSA. This aspect of the claim was given little attention by the close of the hearing. I consider it to be untenable. Conversion cannot be committed in such an indirect way. The tort requires direct interference with the possessory rights of another, either by the tortfeasor, or the agent/employee of the tortfeasor.

Did Mr Smith, Ms Dolk or Eko cause the losses that Brumac and the Careys have suffered?

[66] The answer is no. The losses that Brumac and the Careys have suffered through not obtaining a return on the $250,000 they invested under the sale and buy-back agreement are the direct result of NZ Peat failing to perform its obligations under the agreement. Under that agreement, their ownership of the peat was simply a means to them receiving the benefit of the agreed return on the price that they paid for the peat. Their exercise of the put option in clause 10 shows that they never envisaged obtaining possession of some of the peat pile at some future time. Instead, they required their shares in the peat to be purchased by NZ Peat. That this did not occur is due to NZ Peat's failure to perform its obligations under clause 10, its inability to make any payments for the peat after 27 November 2009 without the risk of such payment constituting a voidable transaction; and the fact that by 21 December 2009, there was an intervening event in the form of the company going into liquidation.

[67] Brumac and the Careys base their case on the peat pile being relatively intact on or about 16 September 2009, with the allegedly unlawful removals from it occurring after that time. It may well be, therefore, that even if NZ Peat had performed its obligations under the sale and buy-back agreement, the payments that it would have made for peat removals would have been from around August or September 2009 onwards. As NZ Peat went into liquidation on 21 December 2009, the payments would have been made within six months of the company going into liquidation.

[68] Therefore, these payments would have fallen within the scope of ss 292(6) and 292(4A) of the Companies Act 1993, which deem all payments made by a company within six months of the liquidation date to be transactions “entered into at a time when the company is unable to pay its due debts”. Given the extent to which NZ Peat’s financial position had deteriorated by September 2009, it is unlikely that NZ Peat would be able to rebut the presumption that it was unable to pay due debts at that time. Furthermore, Mr Sargison’s evidence was that there were not enough funds realised by the liquidator to meet the debts owing to the secured creditors, let alone the unsecured creditors. Therefore, it is likely if NZ Peat had paid in advance of taking the peat, these payments would have enabled Brumac and the Careys to receive more towards satisfaction of the debt owed by NZ Peat than they would have received on the company’s liquidation (s 292(2)(b)). That is to say, the payments would have been insolvent transactions that are voidable by the liquidator.

[69] Thus, whilst the loss is directly due to NZ Peat’s breach of the sale and buy-back agreement, together with its unwillingness to pay for the peat after its removal (owing to accountancy advice that the payment would constitute a voidable transaction), I think that the outcome would have been much the same, even if NZ Peat had performed under the sale and buy-back agreement.

Did Brumac and the Careys acquire free and clear ownership of the peat pile?

[70] Brumac and the Careys contend that their acquisition of the peat pile under the sale and buy-back agreement was a sale of goods, and so their ownership of the goods is subject to the Sale of Goods Act 1908. Under this Act, they say that they acquired free and clear ownership of the peat pile. If they are correct, the following questions arise: (a) whether, as a result of NZ Peat’s failure to buy back the peat, the possessory rights in the peat would have reverted to them as owners of the peat; (b) if the possessory rights did revert in this way, whether the engagement of Eko to dispose of the peat to third parties was an interference with those rights that amounted to conversion or trespass by those involved; and (c) whether Mr Smith could be personally liable for the conversion or trespass.

[71] The defendants contend that the liquidators were right to treat the peat as an asset of NZ Peat, which under the PPSA was available for them to realise in order to meet the bank's priority debt. The defendants argue that: (a) the sale of the peat to Brumac and the Careys was not a sale in the ordinary course of business, and so under the terms of the GSA (clause 5.2) and s 53 of the PPSA, they did not take the assets free of the bank's GSA; and (b) the sale and buy-back agreement is actually no more than an unregistered security interest under the PPSA over which the bank's GSA had priority. Consequently, the cause of their loss was their failure to ensure that their financial security interest was registered and not able to be trumped by the bank's GSA.

Was the sale in the ordinary course of business?

[72] There is a real issue as to whether the sale and buy-back agreement was a sale transaction at all, rather than a financing instrument. As noted by Professor Gedye in "A Hoary Chestnut Resurrected: The Meaning Of 'Ordinary Course of Business' In Secured Transactions Law" (2013) 37 MULR 1 at 8:

> It is only if a 'buyer' is truly a buyer, and not a disguised secured creditor, that the buyer protection rules apply, including the rule protecting buyers in the ordinary course of business.

In view of what Professor Gedye states, it may seem that by focusing on whether the sale and buy-back agreement was a sale in the ordinary course of business first, rather than to determine if Brumac and the Careys were truly buyers, is to put the cart before the horse. However, that is how the argument was developed by them, perhaps because they realised that if the transaction were seen to function as a finance security, rather than a true sale, the fact it was not registered would mean that the GSA would take priority over it. To argue that they were buyers of peat in the ordinary course of NZ Peat's business is the only way that they can avoid the detrimental impact that the GSA would otherwise have on their case. Accordingly, the functional character of the sale and buy-back agreement will be dealt with later.

[73] Mr Sargison's evidence was that the liquidators relied on clause 5.2 of the GSA as the basis for exempting the sale of NZ Peat's inventory from the effect of the GSA. They could also have relied on s 53 of the PPSA. I consider that the case law

on the meaning of "ordinary course of business" under s 53 is equally apposite to understanding the meaning of that term as it is used in clause 52. Thus, the outcome would be the same whether it was clause 5.2 or s 53 that was relied on.

[74] In *StockCo Ltd v Gibson* [2012] NZCA 330, (2012) 11 NZCLC 98-010 at [50] and [51], the Court of Appeal affirmed the use of a two-stage process for determining whether a sale was in the ordinary course of business under s 53. The first step is to identify the ordinary course of the seller's business, and the second step is to identify whether the subject sale was made in the ordinary course of that business. At [42], the Court of Appeal emphasised the facts specific character of this assessment:

> ... what is required is an objective factual assessment based on all the circumstances of the particular case. (footnotes omitted)

[75] Professor Gedye in his article "A Hoary Chestnut Resurrected: The Meaning Of 'Ordinary Course of Business' In Secured Transactions Law" at 20, citing from passages in *StockCo*, opines that the reference to "ordinary course of business" in the first step of the approach means an "examination of the nature of the business looks at the business flow or continual operation', which will involve 'some anticipated repetition of business activities'". This is reinforced by the comment in *StockCo* at [69] that whilst there is room for a company to change the character of its business, "a sudden change [is] contrary to the concept of the 'course' of business". Also relevant and of similar effect are tests which Professor Gedye has drawn from cases involving the test of "ordinary course of business" in other contexts, such as voidable transactions in insolvency, where the phrase has been described as meaning (at 23-24):

> ... part of the undistinguished common flow of business ... carried on, calling for no remark and arising out of no special or particular situation.

[76] Factors that Professor Gedye suggests should form part of the assessment include (at 24-27):

(a) Where the agreement was made – sales made at the seller's premises are more likely to be in the ordinary course than sales made away from those premises;

(b) The type of buyer – a sale to an everyday consumer buyer is more likely to be in the ordinary course of business than a sale to a dealer or financial institution;

(c) The quantity of goods sold – a sale of one or a few items is more likely to be ordinary course than a bulk sale of a large proportion of the seller's inventory;

(d) The sale price – a sale at or near market price is more likely to be ordinary course than a sale well below market price;

(e) Advertising – if the seller advertises that it sells such goods, a sale is more likely to be in the ordinary course;

(f) The nature and significance of the transaction – it ought to be a transaction 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;

(g) The transaction ought not to resemble a liquidation of assets;

(h) The reason for the transaction – it ought not to have occurred as a response to financial difficulties or in suspicious circumstances;

(i) The intent of the transaction – neither its intent, nor its effect should have been to undermine a security interest;

(j) The frequency of the type of transaction – an unusual or isolated transaction might be viewed differently from a routine one; and

(k) The arms-length nature of the transaction – a transaction between a company and a party with whom it is related should receive careful scrutiny.

[77] Professor Gedye suggests that where different factors point in opposing directions, the Court may be required to adopt a balance sheet approach, with those factors suggesting the sale was within the ordinary course weighed against those which may take the particular sale outside of the ordinary course. He opines (at 26) that this approach will "[require] a differential weighting to be applied to the various factors, rather than simply counting those for and against ordinariness". He suggests that on any such analysis, the factors pointing to extraordinariness are likely to be given greater weight than those that raise no concerns. At 27, he opines that "[a] single non-ordinary factor may be sufficient to carry the day", though he also notes that a single factor will not always be determinative.

[78] I find the relevant factors suggested by Professor Gedye for determining the ordinary course of business and the approach that he proposes to be most helpful. They present an accurate synthesis of the relevant PPSA case law in New Zealand and overseas jurisdictions with much the same legislation.

[79] The ordinary course of NZ Peat's business was as a harvestor, or miner of peat that was taken from peat fields at Ngatea, trucked to the processing plant at Kerepehi where it was processed, bagged and on-sold to NZ Peat's customers, who were wholesalers in the gardening and horticultural industry. They then on-sold the processed and bagged peat to retailers in this industry. NZ Peat was not in the business of selling large amounts of unprocessed stockpiled peat to other persons. Indeed, it had never done anything like sell a pile of 10,000 cubic metres of peat to one group of buyers before the sale and buy-back agreement. Because NZ Peat usually sold, processed and bagged peat to wholesalers in the gardening and horticultural industry, it had a regular base of customers whom it supplied.

[80] There are a number of factors regarding the sale of the peat pile under the buy-back agreement that take it out of the ordinary course of NZ Peat's business:

(a) The sale was not to the usual or ordinary customers of NZ Peat, and further, the sale was not to arms-length customers, but to persons with an interest in NZ Peat in the form of their shareholding in that company;

(b) The size of the peat pile and NZ Peat retaining possession of this peat, with it being stored at the Ngatea peat field in an unprocessed state, set it apart from the other sales, so much so that it was clearly a one-off event;

(c) The terms of the sale and buy-back agreement that required:

    (i) Brumac and the Careys to leave the peat in NZ Peat's possession and prevented them from dealing with it themselves in any way whatsoever until NZ Peat's rights to re-acquire the peat under this agreement had expired;

    (ii) NZ Peat, on the exercise of the put option, to re-acquire the peat pile, or any part thereof that remained unsold at the time the put option was exercised, at a pre-determined fixed price of $33.74 per cubic metre, when the original sale price was $25 per cubic metre and when the put option price made no allowance for any downwards change in the market price of peat;

(d) The absence of any evidence to show that the peat was originally sold under the sale and buy-back agreement at the current market value, or that the pre-determined price under the put option represented a fair and reasonable estimate of the anticipated current market value of the peat at the time of its re-acquisition by NZ Peat (by no later than 31 December 2009);

(e) The purpose of the sale and buy-back agreement, which was to provide NZ Peat with a means of paying for the costs of harvesting

the unusual bumper crop that became available in 2008 so that it could be stockpiled and available for sale to NZ Peat's regular customers, or alternative customers to be found at a later date;

(f) The sale and buy-back agreement was devised by a senior company officer, Mr McComb, who at the time was a director and chairman of NZ Peat, which places the nature and significance of the transaction apart from the usual sales made by NZ Peat;

(g) There was no advertising of the peat pile for sale; and

(h) The intent of the transaction, as admitted in evidence by Brumac's director, Mr Brewster, was to give the investors a security for the funds they were advancing to NZ Peat in the event that NZ Peat did not perform under the sale and buy-back agreement. Mr Brewster said, "I thought that by buying the peat I would have something to sell if the put option was not exercised. You cannot get better than being the owner". Mr Carey gave evidence in which he confirmed the evidence of Mr Brewster.

[81] Furthermore, there is little, if anything about the sale and buy-back agreement that resembles the other sales undertaken by NZ Peat. Indeed, there is so much that sets this sale apart from NZ Peat's usual sales, that it can only be seen as something extraordinary that falls well outside the ordinary course of this company's business.

[82] In *Tubbs v Ruby 2005 Ltd* [2010] NZCA 353, (2010) 12 TCLR 746, the Court of Appeal found that a sale and buy-back arrangement was within the company's ordinary course of business, even though it had some unusual features. I have considered whether the reasoning that was applied in *Tubbs* might save the sale and buy-back agreement from being seen as not in the ordinary course of NZ Peat's business. However, I have concluded that the present transaction is distinguishable from the transaction in *Tubbs*. A key factor which distinguished the buy-back arrangement in *Tubbs* from the present sale and buy-back agreement was that in *Tubbs*, there was no put option that obliged *Tubbs* to re-acquire the goods at a pre-

determined fixed price: see [30] of the judgment. This was an important saving feature that is absent here, and is enough to distinguish the transaction in *Tubbs* from the present transaction.

[83] Brumac and the Careys submitted that the sale of peat under the sale and buy-back agreement was a sale in the ordinary course of NZ Peat's business. They gave the following reasons:

(a) The sale occurred in the context of an exceptionally dry season and it made good sense for the company to harvest the bumper crop and store it for the future. It had stored smaller amounts of peat in this way in the past;

(b) The company's direction and purpose remained the same after the sale, and its business operations, including methodology for harvesting, storage and processing, remained the same as well;

(c) It was not unusual for the company to sell peat to commercial customers as, by and large, its customers were commercial customers who purchased peat in bulk;

(d) There was a conflict on the evidence as to whether it was usual for the company to sell unprocessed peat and whether it had done so before;

(e) There was no financial pressure on the company until July 2009, which was one and a half years after the sale under the sale and buy-back agreement;

(f) The requirement to increase cashflow was incidental. The idea was to have a stockpile of peat to obtain a smooth and secure future supply of peat;

(g) The sale was accounted for as inventory;

(h) The directors did not consider the sale of the peat pile to be subject to the GSA;

(i) Whilst the sale of the peat pile might have been a first for the company, it was the first time that the issue of excess peat had arisen for the company to consider.

[84] I have considered all the factors identified by Brumac and the Careys. However, I am not persuaded that those factors qualify the sale of the peat pile as a sale in the ordinary course of NZ Peat's business. Admittedly, this was the first such bumper crop that the company had experienced, but the way that it "banked" the excess peat was entirely different to its usual run of sales to its regular customers. Whilst the company continued after the sale of the peat pile to conduct its usual course of business, there is no getting away from the fact that the sale of the peat pile was very different from its other sales, for the reasons I have identified in [80] and [81].

[85] The argument of Brumac and the Careys that NZ Peat did not experience financial difficulty until July 2009 does not advance their case. Whatever the company's general financial position might have been before July 2009, there was clear, unchallenged evidence from Mr Smith that the company was trading at a loss in the summer of 2007 to 2008, and that it did not then have the cashflow to cover the extra costs associated with harvesting the bumper crop of peat that season. The sale and buy-back agreement enabled the company to fund the harvest of the bumper crop, which in turn gave the company the benefit of having a stockpile of peat as insurance against a poor harvest in the future. I am satisfied, therefore, that from the company's perspective, this was the purpose of the sale and buy-back agreement.

[86] Brumac and the Careys argued that the PPSA only governs priorities between secured creditors, and between secured and unsecured creditors, so that under the terms of the sale and buy-back agreement and ss 19 and 20 of the Sale of Goods Act, ownership in the peat pile passed to them once the funds they paid to purchase the peat were cleared. It is true that clause 2 of the sale and buy-back agreement states that ownership in the peat pile passed to them once there were cleared funds from

payment of the purchase price. However, this does not assist them to defeat the bank's GSA. The PPSA affects sales of goods when they are not in the ordinary course of business. Provided a security interest recognised by the PPSA is perfected and otherwise meets the Act's requirements, it will remain attached to any inventory that is not sold in the ordinary course of business, and the purchasers of such inventory will take ownership of it, subject to that security interest. Until the bank's rights under the GSA were exhausted (by payment of the debt owed to the bank), they precluded any rights to immediate possession of the peat pile vesting in Brumac and the Careys.

[87] Brumac, the Careys and Mr McComb denied any knowledge of the bank's GSA. I accept their evidence, and it would follow that the intent of the sale and buy-back agreement was not to undermine the bank's GSA. However, when it comes to enforcing a security like the GSA, absence of intent to undermine it is irrelevant. Provided the GSA was perfected, which it was, any transaction that fell within its terms and outside the provisions of s 53 would be affected thereby.

[88] As I have found that the sale and buy-back agreement was not in NZ Peat's ordinary course of business, it follows that any property that Brumac and the Careys acquired in the peat under this agreement was subject to the GSA. Thus, they did not acquire a free and clear ownership of the peat pile.

Was the sale and buy-back agreement a financial security?

[89] As another reason for why Brumac and the Careys did not acquire free and clear ownership of the peat, the defendants argued that the sale and buy-back agreement was really no more than a financial security under s 17 of the PPSA.

[90] Generally, provided "a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance": see *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 at 323-324; approved in *Mills v Dowdall* [1983] NZLR 154 at 157. However, the PPSA requires the Court to concentrate on the function of a transaction, rather than its form. Section 17 of the PPSA defines a security interest as something that "in substance secures payment or performance of

an obligation". The sale and buy-back agreement makes it plain that Brumac and the Careys purchased peat from NZ Peat for the sole purpose of re-selling the peat to NZ Peat on the terms and conditions contained in the agreement. Nine months before the stipulated date, Brumac and the Careys went so far as to exercise the put option, which required NZ Peat to purchase all their remaining shares in the peat. Clearly, they never envisaged any of the peat becoming available to them at some later date. In this way, the sale and buy-back agreement secured performance of NZ Peat's obligations under that agreement.

[91] Brumac and the Careys had advanced $250,000 to NZ Peat to enable the company to harvest the bumper peat crop, which it could not otherwise afford to do. The buy-back arrangements provided a way by which NZ Peat could acquire the funds it needed to harvest this peat, whilst Brumac and the Careys' funds were ultimately to be returned to them, plus profit in the form of the higher price. The return of the $250,000 was secured through the agreement giving them ownership of the peat, which meant that had NZ Peat not bought back any or some of the peat under clause 6, they could have sold the remaining peat once it was free of any contractual claim that NZ Peat might have to it. Furthermore, once the put option clause (clause 10) was exercised, and NZ Peat was obliged to buy back the peat at the pre-determined higher price, had NZ Peat not performed this obligation, once again, they could have sold the peat elsewhere, once NZ Peat's contractual rights to acquire the peat had expired. I consider, therefore, that the sale and buy-back agreement functioned as a security interest.

[92] I have already found that the sale and buy-back agreement was not created to undermine the bank's GSA. There appears to me to have been a genuine idea to provide NZ Peat with funds to harvest peat that it otherwise could not afford to harvest, and at a time when it did not have additional customers readily available to buy the extra peat. In return for the funds advanced, the sale and buy-back arrangement gave the "investors" the security of ownership in the peat to protect their investment. Further, because the agreement enabled NZ Peat to acquire and stockpile additional peat until such time as it had customers for this peat, I consider that it was new collateral in terms of any security interest. When the peat was first sold to Brumac and the Careys, they gave $250,000 in return. Thus, at this time,

liquid funds were exchanged for the peat. Then when NZ Peat bought back the peat, the exchange was reversed. It gave liquid funds in return for the peat. Thus, at all times, whilst potentially in different forms, there was additional collateral to what there would have been if the sale and buy-back agreement had not been made. I do not see this as a case, therefore, where the security interest was attempting to secure existing collateral at the bank's expense.

[93] If at the outset, the sale and buy-back agreement had been registered on the Personal Property Securities Register, it may well have later withstood scrutiny as a purchase money security interest (PMSI), which, if perfected through registration, would take precedence over the bank's GSA. However, unfortunately Mr McComb, who thought of the idea of the sale and buy-back agreement, was not legally qualified, and he said in evidence that he was not familiar with securities like the bank's GSA. He seems not to have realised the need to check to see if there were any existing security interests, and, if so, how to provide some protection for the investors in the sale and buy-back agreement. The same applies to Brumac and the Careys. It seems that neither Mr McComb, nor Brumac and the Careys recognised the need for caution and, in particular, for sound legal advice before they proceeded to implement the idea behind the sale and buy-back agreement.

[94] As the sale and buy-back agreement can be properly characterised under s 17 as an unregistered financial security, then even if the transaction was a sale in NZ Peat's ordinary course of business, Brumac and the Careys would not have acquired free and clear ownership of the peat pile. However, this finding is only relevant post-liquidation of NZ Peat. Before then, whether the sale and buy-back agreement functioned as a security interest under s 17 has no relevance when it comes to providing the defendants with a good defence against the claim in conversion and trespass.

[95] The scheme and purpose of the PPSA, which are outlined in Part 1 of the Act, make it clear that its coverage, including the preference s 17 has for function over form of transactions, only applies to situations between opposing parties in litigation where one is attempting to enforce a security interest under that Act. Nor am I aware of any case law to the contrary. Thus, I do not consider that defendants in

proceedings for conversion or trespass can ordinarily raise s 17 as a defence to such claims simply by asking the Court to view the plaintiff's rights through the prism of s 17 and to find, therefore, that the plaintiffs were really no more than holders of a security interest in the subject goods.

[96] In this case, the key issue pre-liquidation was not so much whether the interest of Brumac and the Careys in the peat pile functioned as a security interest or an ownership interest acquired under a sale and purchase agreement, but whether the interest that they held gave them a right to immediate possession of the peat pile. Without that possessory right, their claims in conversion and trespass could never succeed. Post-liquidation, the key issue was whether the GSA gave the bank superior rights to seize and possess the peat pile and use it to pay the secured debt. If the bank held such rights, the liquidator was free to act in accordance with them.

Did Eko's acquisition of the remains of the peat pile from the liquidators of NZ Peat amount to a conversion or trespass?

[97] Before Brumac and the Careys can maintain an action in conversion or trespass against Eko and Mr Smith as Eko's director, they would need to establish that Eko's acquisition of peat from the liquidator was an interference with their possessory rights in the peat.

[98] The operating agreement between Eko and the liquidator of NZ Peat was executed on 23 December 2009, which is two days after NZ Peat went into liquidation.

[99] I have found that insofar as the sale and buy-back agreement did function as a sale transaction, it was not a transaction in the ordinary course of NZ Peat's business. So for this reason, Brumac and the Careys purchased the peat pile subject to the GSA, which attached to the peat pile. I have also found under s 17 of the PPSA, the sale and buy-back agreement functioned as an unregistered financial security interest that ranked below the GSA. Clauses 13 and 14 of the GSA, as well as s 109 of the PPSA, gave the bank rights to take possession of, and to sell the collateral on the occurrence of certain events. On either view of the sale and buy-back agreement,

therefore, once an event entitling the bank to recover the collateral had occurred, its rights would take precedence over any rights that Brumac and the Careys might have had.

[100] Clause 3 of the GSA provided for when the floating charge became fixed. There is no doubt that the GSA would have become fixed by the time NZ Peat went into liquidation on 21 December 2009. As this event pre-dated 31 December 2009, the bank's rights under the GSA took effect over the peat at a time when I have found that Brumac and the Carey's possessory rights in the peat were still suspended by the terms of the sale and buy-back agreement. Even if, as they argue, they had acquired possessory rights in the peat pile after 2 December 2009, once NZ Peat went into liquidation, the bank's rights to recover its collateral under the GSA would have overridden any rights that Brumac and the Careys might have acquired.

[101] The available evidence does not establish when the GSA's attachment on the peat would have expired. Mr Sargison said that the "secured creditors" were not paid in full, but it is not clear from that evidence whether there were more secured creditors than the bank and, if so, to what extent the proceeds from the peat pile sale to Eko were expended on reducing the bank's debt.

[102] I consider that under the GSA, the proceeds from the sale of the remainder of the peat pile to Eko should have been applied to reduce the bank's debt, and that after this, any remaining peat in the peat pile should, under the sale and buy-back agreement have reverted to Brumac and the Careys. In this regard, I do not think that the unsecured creditors of NZ Peat could have challenged the sale and buy-back agreement.

[103] The difficulty that Brumac and the Careys face, however, is that as plaintiffs suing Eko and Mr Smith (as Eko's director) in conversion and trespass, the onus of proof was on Brumac and the Careys to establish that they had possessory rights in the peat pile at the times the liquidator was selling the peat to Eko. This required Brumac and the Careys proving that at the time the alleged acts of conversion and trespass occurred, the liquidator had satisfied the bank's claims, and so there was surplus peat that had reverted to them under the sale and buy-back agreement. They

did not adduce any evidence to this effect. Nor do I think that they could have done so. There is no evidence to support the idea that following satisfaction of the bank's debt, there was some peat remaining in which Brumac and the Careys would have possessory rights. Indeed, Mr Smith gave evidence under cross-examination that the bank had made demand of him under a personal guarantee of NZ Peat's indebtedness that he had given to the bank. This suggests that the liquidator obtained insufficient funds from the liquidation of NZ Peat to repay the company's debt to the bank. Thus, the evidence that there is tells against there being any peat after payment of the debt to the bank in which Brumac and the Careys might claim a possessory interest. It follows that the claim for conversion and trespass after the liquidation of NZ Peat against Eko and Mr Smith must fail for want of proof.

Have Brumac and the Careys proved their losses in the volumes of peat taken or the market rate for the peat?

[104] I have found that Brumac and the Careys have no claim in conversion or trespass; consequently, they have suffered no loss in terms of those claims.

Conclusion

[105] Brumac and the Careys have failed to establish their claims, in either conversion or trespass, against any of the defendants. Whilst as purchasers of the peat pile under a sale and buy-back agreement they had contractual rights in the peat, their rights to immediate possession of the peat were stifled by the terms of this agreement. At all material times, they lacked the right to immediate possession of the peat, which is an essential element of these torts. Furthermore, the peat was not sold in the ordinary course of NZ Peat's business and so their contractual rights in the peat were subject to a perfected security interest that was held by a bank. Finally, as they had exercised rights under the sale and buy-back agreement that required NZ Peat as the original seller to buy back all the peat, the most they could have expected was to have NZ Peat perform its obligations under this agreement. In this regard, what they had functioned as a security interest under the PSA. Furthermore, had NZ Peat performed its contractual obligations, they would still have suffered loss as the payments they would have received from NZ Peat would have been made

within six months of the company going into liquidation. The payments could have been deemed to be voidable transactions under the Companies Act 1993 and so recoverable by NZ Peat's liquidator. This is not a case where the plaintiffs can even show that but for the acts constituting the alleged torts of the defendants, they would not have suffered the losses for which they claim.

Result

[106] The claims that Brumac and the Careys have made against the defendants have not been established. Accordingly, the claims are dismissed. Judgment is entered for the defendants.

[107] Leave is reserved to the parties to file memoranda as to costs.

Duffy J