

**IN THE HIGH COURT OF NEW ZEALAND
INVERCARGILL REGISTRY**

**CIV-2013-425-261
[2013] NZHC 2863**

BETWEEN JOHN STANLEY HUGHES and
IRMA AINSLIE HUGHES
Appellants

AND DUNCAN VARNHAM FEA and PETER
HEENAN
Respondents

Hearing: 22 October 2013

Appearances: C S Withnall QC and J G Lucas for appellants
J N P Young and E L R Higbee for respondents

Judgment: 30 October 2013

**JUDGMENT OF LANG J
[on appeal against decision on preliminary question]**

*This judgment was delivered by me on 30 October 2013 at 4.30 pm,
pursuant to Rule 11.5 of the High Court Rules.*

Registrar/Deputy Registrar

Date.....

[1] Mr and Mrs Hughes, the appellants in this proceeding, trade in partnership as Blue Mountain Gardens. In 2005, they entered into a deed of lease with a company called Global Bulbs Limited (“Global Bulbs”) in which they agreed to lease or bail a large quantity of bulbs to Global Bulbs for a period of five years.

[2] Global Bulbs subsequently went into liquidation, and then into receivership. The respondents are the receivers of the company. They took the view that Mr and Mrs Hughes lost any interest they held in the bulbs when they failed to register their interest under the provisions of the Personal Property Securities Act 1999 (“the Act”). The receivers therefore sold the bulbs, and retained the proceeds of sale on the basis that they formed part of the assets of the company.

[3] Mr and Mrs Hughes issued proceedings in the District Court in which they sought damages from the receivers in respect of the losses they have suffered as a result of the receivers selling the bulbs. In a judgment delivered on 30 May 2013, Judge Callaghan found in favour of the receivers in respect of an argument on a preliminary issue.¹ Mr and Mrs Hughes now appeal to this Court against the Judge’s decision.

Procedural background

[4] The substantive trial of the proceeding was originally scheduled to commence in the District Court on 30 January 2013. Three days had been allocated for the trial.

[5] On 12 December 2012, however, Judge Moran vacated the fixture on the basis that there was an unacceptable risk that the trial might not be ready to proceed on the allocated date. In a minute issued on 12 December, the Judge said:

There is a legal argument that might put paid to these proceedings. Estimate half a day. If time is available during the three days from 30 January 2013 the parties would like that argument to be heard.

[6] For some reason the legal argument did not proceed on 30 January as anticipated. Rather, it took place before Judge Callahan on 15 April 2013. The

¹ *Hughes v Fea & Heenan* DC Invercargill CIV-2010-025-000348, 30 May 2013.

hearing must have related to the determination of a separate question as provided for by r 3.73 of the District Courts Rules 2009. Unfortunately, however, the issue the Judge was required to determine was never formulated prior to the hearing.

The Judge's decision

[7] The Judge recorded the issue he believed he was required to determine as follows:²

[2] This decision is on a preliminary point, namely, whether or not the lease of the bulbs was “a security interest” as defined in the Personal Properties Securities Act 1999 (PPSA). If it was, then it needed to be registered under the PPSA and the failure to register will in effect defeat the Plaintiff's claim. The parties take opposing views as to whether or not the lease was “a security interest”.

[8] At the heart of this issue was the interpretation to be placed on the following clause of the lease document:

6. The Bulbs – Lessees Obligations

6.1 The Bulbs will be at risk of the Lessee throughout the term.

6.2 Although the Lessee may use and sell the Bulbs in the ordinary course of business the Lessee will replace promptly at the Lessees expense all of the Bulbs sold with similar bulbs to the intent and purpose that the bulbs at the termination of this agreement shall be of equal numbers, condition, quality and description as the Bulbs at the beginning of this agreement. Any excess over the numbers at the beginning of this agreement shall be the property of the Lessee. All bulbs acquired or retained for the purpose of replacing the Bulbs shall be the property of the Lessors.

6.3 All proceeds from the sale of the Bulbs or of replacement bulbs will belong to the Lessee if the Lessee complies with the Lessees obligations in this agreement but will otherwise belong to the Lessors.

[9] The Judge was required to determine whether this clause created a security interest in favour of Mr and Mrs Hughes in terms of s 17 of the Act. Section 17 provides as follows:

17 Meaning of “security interest”

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

² Ibid.

- (a) Means an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to—
 - (i) The form of the transaction; and
 - (ii) The identity of the person who has title to the collateral; and
 - (b) Includes an interest created or provided for by a transfer of an account receivable or chattel paper, a lease for a term of more than 1 year, and a commercial consignment (whether or not the transfer, lease, or consignment secures payment or performance of an obligation).
- (2) A person who is obligated under an account receivable may take a security interest in the account receivable under which that person is obligated.
- (3) Without limiting subsection (1), and to avoid doubt, this Act applies to a fixed charge, floating charge, chattel mortgage, conditional sale agreement (including an agreement to sell subject to retention of title), hire purchase agreement, pledge, security trust deed, trust receipt, consignment, lease, an assignment, or a flawed asset arrangement, that secures payment or performance of an obligation.

[10] Section 16(1)(i) of the Act restricts the term “lease for more than one year” to leases involving parties who are regularly engaged in the business of leasing goods. It is common ground that Global Bulbs did not regularly engage in leasing goods. For that reason counsel agreed at the hearing in the District Court that s 17(1)(b) had no application to the present case. The lease would therefore only create a security interest in terms of the Act if it came within the definition contained in s 17(1)(a). This meant that the receivers were required to establish that, in substance, the lease gave Mr and Mrs Hughes an interest in property that secured a payment or the performance of an obligation.

[11] The Judge determined the preliminary question in the following paragraphs of his decision:³

[24] The substance of the transaction – the lease – is that not only did [Global Bulbs] get the use of the original bulbs, but also the right to use progeny, and subject to the replacement provision [Global Bulbs] would receive the increase in the number of bulbs as its own property. I am assuming here from my general horticultural (gardening) knowledge, together with Counsel’s observations on this topic, that healthy and well

³ Ibid.

maintained bulbs multiply and thereby generate progeny. Therefore part of this transaction was a vehicle for [Global Bulbs] to obtain property, ie ownership of the progeny bulbs. This was not a bailment but a form of sale.

[25] [Global Bulbs]'s obligations, at least for that part of the transaction, were to pay the defined rental and also to deliver up to the plaintiff replacement bulbs in respect of the original ones that it used for its business. So underneath the documentation this transaction was at least, in part, for the transfer of property in the progeny bulbs which were to become [Global Bulbs]' property. [Global Bulbs] had a right to deal and trade as it saw fit, not only in the progeny it became the owner of, but also in the original leased bulbs.

[26] This is quite different from in the *re Coro* case where the lessee was not entitled to trade or deal in any way with the gold other than for the specific purpose of using it for its electroplating operations.

Decision

[27] In my view, therefore, there was an obligation on [Global Bulbs] to account to the plaintiffs not only for the rental as was due throughout the lease but also at the conclusion of the lease for at least in part replacement bulbs of a like quality to the ones it had originally taken over under the lease, and which were no longer in existence. Another way of looking at this transaction is that the lease was a means whereby [Global Bulbs] became the owners of the bulbs, and the consideration was replacement of the original ones. The replacement bulbs may have been the same type but there were in fact different items.

[28] There was in my assessment an obligation on [Global Bulbs] to provide replacement bulbs. These replacement bulbs may come from the original stock, the progeny or fruit of the original bulbs, or an outside source. Therefore I resolve the issue in the defendants' favour by finding that this lease was in effect a sale, not a bailment, and did create "a security interest", and it was required to be registered under the PPSA.

Scope of appeal

[12] Mr and Mrs Hughes raise a large number of issues in support of the appeal. Principally, however, they maintain that the Judge determined an issue that did not form part of the preliminary question before him. They base this submission on the fact that the Judge concluded that the lease was caught by s 17 because it amounted in law to a sale of the bulbs to Global Bulbs.

[13] Counsel for the receivers accepts that the Judge decided the preliminary question based on an argument that neither counsel advanced during the hearing in the District Court. Both counsel had focussed their submissions in that Court on the

issue of whether or not Clause 6 of the lease gave rise to a transaction that came within the definition of a security interest in terms of the Act.

[14] Counsel for the receivers also agreed that the Judge erred in holding that, if the transaction amounted in law to a sale, it was therefore subject to the provisions of the Act. If it was a sale, ownership of the bulbs would have passed to Global Bulbs. At that point Mr and Mrs Hughes would no longer have any interest in the bulbs. For that reason a transaction amounting to a sale of the bulbs would not constitute a security interest in terms of the Act. The only way in which the Act might come into play would be for Mr and Mrs Hughes to have retained title to the bulbs until such time as they were paid for them. It is common ground, however, that the lease does not contain a provision to that effect.

[15] In those circumstances counsel agreed that this Court should re-consider afresh the issue of whether Clause 6 of the lease created a security interest in terms of s 17(1)(a) of the Act. I record, however, that the issue the Judge decided may still need to be determined if and when the proceeding is tried in the District Court.

Did Clause 6 of the lease create a security interest in terms of s 17(1)(a) of the Act?

[16] In order to establish the existence of a security interest in terms of s 17(1)(a), the receivers must prove the following elements:

- (i) the transaction gave Mr and Mrs Hughes an interest in personal property; and
- (ii) in substance that interest secured an obligation.

[17] Clause 6 relates to several different forms of personal property. First, it relates to the original bulbs that Mr and Mrs Hughes leased to Global Bulbs. Secondly, it relates to bulbs that Global Bulbs acquired in order to replace bulbs that it sold in the ordinary course of business as Clause 6.1 entitled it to do. Thirdly, it related to the proceeds of sale of such bulbs in circumstances where Global Bulbs

did not acquire bulbs to replace the bulbs that it sold. It is therefore necessary to consider whether the effect of Clause 6 was to create a security interest in relation to each of these different forms of property.

The original bulbs

[18] Mr and Mrs Hughes were the owners of the original bulbs when they entered into the lease with Global Bulbs. Nothing in the lease affected their status as owners, although Global Bulbs had the right to sell the original bulbs in the ordinary course of business provided it replaced them promptly.⁴ The lease did not bestow upon Mr and Mrs Hughes any interest in the original bulbs. Their interest as owners of the original bulbs existed prior to, and entirely independently of, the lease.

[19] For that reason the receivers cannot establish the first element necessary to demonstrate the existence of a security interest in respect of the original bulbs.

The replacement bulbs

[20] The position is different, however, so far as the replacement bulbs are concerned. Ordinarily, Global Bulbs would be the owner of any bulbs that it acquired from third parties. By virtue of the last sentence in Clause 6.2,⁵ however, Mr and Mrs Hughes would own any bulbs that Global Bulbs acquired in substitution for bulbs that it sold in the ordinary course of business. This gave Mr and Mrs Hughes an interest in property that they would not otherwise have had. The first element is therefore satisfied.

[21] The next issue is whether, in substance, the interest that Mr and Mrs Hughes acquired as owners of the replacement bulbs secured an obligation on the part of Global Bulbs. The receivers argue that it secured Global Bulbs' obligation to promptly replace all bulbs that it sold in the ordinary course of its business.

[22] As counsel for Mr and Mrs Hughes points out, however, the acquisition of replacement bulbs satisfies that particular obligation. Once Global Bulbs took the

⁴ Clause 6.2 of the lease.

⁵ Set out at [8].

required step of acquiring replacement bulbs, there remained no further obligation to secure. No further obligation would arise until such time as Global Bulbs sold more bulbs in the ordinary course of business, and thereby became obliged to replace those bulbs promptly. Nor do I consider that Mr and Mrs Hughes' ownership of the replacement bulbs secured the ongoing obligation on the part of Global Bulbs to replace bulbs that it sold in the future. Mr and Mrs Hughes became owners of replacement bulbs solely by virtue of the sale of bulbs that had already occurred.

[23] It follows that the receivers cannot establish the second element so far as the replacement bulbs are concerned.

The proceeds of sale

[24] Although this point was not argued, it is possible that Mr and Mrs Hughes may have had an equitable right to trace the proceeds of any sale of bulbs that they owned even though Global Bulbs had the contractual right to sell them in the ordinary course of business. On the other hand, given that Clause 6.2 of the lease expressly permitted Global Bulbs to sell bulbs in that way, Global Bulbs may have been entitled to retain the proceeds of sale as its own property. It is not necessary to decide that issue, however, because Clause 6.3 gave Mr and Mrs Hughes a contractual right to ownership of the proceeds of sale. That right would accrue if Global Bulbs did not comply with its obligation under the lease to promptly replace any bulbs that it sold in the ordinary course of business. As a result, the first element is satisfied. The lease gave Mr and Mrs Hughes an interest in the proceeds of sale that it would not otherwise have had.

[25] The interest in the sale proceeds that Mr and Mrs Hughes acquired in this way existed for so long as Global Bulbs failed to comply with its contractual obligation to replace the bulbs that it sold. It ceased to exist once Global Bulbs honoured that obligation. Viewed in that light, I consider that in substance Mr and Mrs Hughes' ownership of the proceeds of sale secured Global Bulbs' contractual obligation to replace any bulbs that it sold. It provided Mr and Mrs Hughes with a new asset that they could apply to offset any losses they might suffer as a result of Global Bulbs failing to honour that obligation.

[26] I therefore consider that the lease created a security interest in the proceeds of sale for the purpose of s 17(1)(a) of the Act.

Conclusion

[27] For the reasons set out above I have concluded that the lease did not create a security interest in terms of the Act in respect of the original or replacement bulbs. The lease did, however, create such an interest in respect of any proceeds of sale of bulbs in circumstances where Global Bulbs did not honour its obligation to replace those bulbs.

Result

[28] The appeal is allowed and the Judge's decision is set aside. In its place I determine the preliminary question as set out above at [27].

Costs

[29] Both parties have succeeded to some extent. For that reason my preliminary view is that costs should lie where they fall. If either party takes a different view, counsel should file brief memoranda (no more than five pages in length) addressing the issue of costs. I will then resolve that issue on the papers.

Lang J

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