IN THE HIGH COURT OF NEW ZEALAND
TIMARU REGISTRY

CIV-2009-476-000615

BETWEEN	STEPHEN JOHN TUBBS AND COLIN ANTHONY LATHAN GOWER (AS RECEIVERS OF WAIMATE TIMBER PROCESSING LIMITED) First Plaintiff
AND	ANZ NATIONAL BANK LIMITED Second Plaintiff
AND	RUBY 2005 LIMITED Defendant

Hearing: 24 May 2011

Appearances: B Russell for Plaintiffs
D Lester for Respondents

Judgment: 27 July 2011

RESERVED JUDGMENT OF CHISHOLM J

A Judgment for the defendant.

B Costs to be resolved in accordance [78].

REASONS

Introduction

[1] Pursuant to a General Security Agreement in favour of ANZ National Bank Limited (ANZ) the plaintiffs were appointed receivers of Waimate Timber Processing Limited (Waimate). According to the plaintiffs the proceeds of timber sales during October 2009 are secured to ANZ Bank pursuant to that security. Alternatively, the plaintiffs claim that the sale proceeds are held on a constructive trust for Waimate and are thereby subject to the bank's security.

[2] These allegations are denied by the defendant (Ruby). It claims that the timber was sold to it by Waimate during the ordinary course of Waimate's business and that in terms of s 53 of the Personal Property Securities Act 1999 Ruby took the timber free of the bank's security. Ruby also denies that the proceeds of sale are held on a constructive trust in favour of Waimate.

[3] The issues arising in this proceeding have already been considered by French J in the context of the plaintiff's application for an interim injunction[1] and by the Court of Appeal on appeal from that decision.[2] Later, amended pleadings were filed. The substantive proceeding now requires determination on the basis of those pleadings and the affidavit evidence before the Court. None of the deponents were cross-examined.

[4] By consent ANZ was joined as a second plaintiff at the commencement of the hearing. Mr Russell acknowledged, however, that this joinder was out of an abundance of caution, and I am satisfied that for the purposes of this judgment the joinder does not have any significance.

[5] I am grateful to counsel for the quality of their argument.

Background

[6] Waimate was incorporated in 2001 for the purpose of operating a sawmill at Waimate and selling lumber and timber. For convenience I will collectively refer to those items as timber. Part of the funding came from ANZ which obtained a General Security Interest over Waimate's assets under the Personal Property Securities Act.

[7] From an early stage Waimate experienced financial difficulties which were primarily due to the fluctuating New Zealand dollar. The shareholders provided significant and continuing financial support until shortly before the plaintiffs were appointed receivers.

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[1] *Tubbs & Gower v Ruby 2005 Ltd* HC Timaru CIV-2009-476-000615 26 February 2010
[2] *Tubbs & Gower v Ruby 2005 Ltd* [2010] NZCA 353

[8] In 2005 the directors of Waimate established Ruby as a separate company to assist Waimate's cashflow. The objective was for Ruby to purchase timber from Waimate when Waimate needed to achieve sales. Waimate and Ruby had common shareholders and three of the four Ruby directors were directors of Waimate. Ruby was reliant on Waimate's staff.

[9] In terms of the agreement between Waimate and Ruby, Ruby would purchase timber from Waimate for cash and at market value. It had been originally intended that the timber so purchased would be moved off Waimate's site. However, this proved to be impractical and Waimate retained physical possession of Ruby's timber on its site, but with the timber being stored separately.

[10] Because Ruby did not have the necessary expertise or connections it was reliant on Waimate to find purchasers for its timber. But in terms of the agreement between the two companies Waimate was only entitled to use Ruby's timber to supply its customers when Waimate was in a position to immediately pay for the timber in cash or, alternatively, was able to immediately swap its timber with timber owned by Ruby. Thus it was never intended that Ruby would extend credit to Waimate. Sales were transacted in Waimate's name and all invoicing and freight arrangements were handled by Waimate.

[11] Until August 2007 this arrangement worked satisfactorily. Unfortunately from that time William Savage, the then manager of Waimate, failed to honour the agreement that had prevailed since 2005. Instead of paying cash or immediately replacing Ruby's stock, Waimate sold Ruby's timber and received the proceeds of sale into its trading account. At Mr Savage's instigation invoices were issued by Ruby to Waimate for the value of the timber that Waimate had taken from Ruby's stock. While the documentation indicated that Ruby had extended credit to Waimate, this was contrary to the agreement between the two companies and the directors of the companies were unaware of this unauthorised pattern of dealing.

[12] The last invoice forming part of this unauthorised pattern of dealing was issued by Ruby on 28 November 2008. By that time the invoices issued by Ruby to Waimate totalled $288,762.58 and virtually all Ruby's stock had been taken by

Waimate. The directors of Waimate and Ruby were still unaware of the unauthorised transactions.

[13] From at least 31 May 2009 Waimate was insolvent. As at that date its current liabilities exceeded its current assets by $2,429,561. Later that deficit increased to more than $3,000,000.

[14] According to the second affidavit of David Sanderson, who replaced Mr Savage as manager of Waimate in 2008, by the end of July 2009 approximately half of Ruby's stock that had been taken by Waimate had been replenished by that company. And he deposes that by the early September 2009 the balance had been replenished.

[15] Sales of timber to two overseas companies during October 2009 lie at the heart of this litigation. First, early in October 2009 Waimate agreed to sell timber to Dafaf al Wadi General Trading Co Limited (General Trading) of the United Arab Emirates and that agreement was later taken over by Ruby who received and retained the sale proceeds. Secondly, an agreement entered into by Waimate in early October 2009 to sell timber to Phu Tai Joint Stock Co (Phu Tai), Vietnam was also taken over by Ruby who received and retained the sale proceeds. Sixteen invoices relating to these transactions indicated that Waimate had sold timber worth $270,000 to Ruby.

[16] When the plaintiffs were appointed receivers of Waimate on 29 October 2009 they formed the view that Ruby had set off the proceeds of the October sales against Waimate's unsecured debt of $228,762.58 to Ruby, this was outside Waimate's ordinary course of business, and the proceeds of sale remained subject to ANZ's security interest. They also believed that in October 2009 Waimate's directors had breached their duty of care to Waimate by diverting Waimate's business opportunities to Ruby and that the proceeds of sale were impressed with a constructive trust in favour of Waimate.

[17] Correspondence between solicitors for the parties did not resolve the matter. The plaintiffs issued this proceeding on 2 February 2010.

The statutory context

[18] Section 53 of the Personal Property Securities Act lies at the heart of this matter. It provides:

> **53 Buyer or lessee of goods sold or leased in ordinary course of business takes goods free of certain security interests**
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> (1) A buyer of goods sold in the ordinary course of business of the seller, and a lessee of goods leased in the ordinary course of business of the lessor, takes the goods free of a security interest that is given by the seller or lessor or that arises under section 45, unless the buyer or lessee knows that the sale or the lease constitutes a breach of the security agreement under which the security interest was created.
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> (2) This section prevails over section 3 of the Mercantile Law Act 1908 and section 27 of the Sale of Goods Act 1908 where this section applies and either or both of those sections apply.

The critical issues are whether for the purposes of s 53(1) the relevant timber was "sold" by Waimate to Ruby and, if so, whether that sale was "in the ordinary course of business" of Waimate.

[19] Section 25 also features in the argument. It provides:

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

Given the unauthorised dealings between August 2007 and November 2008 the issue is whether the plaintiffs, as agents of Waimate, are tainted with bad faith and, if so, the implications.

[20] These provisions will be examined in greater detail later. In the meantime I will briefly summarise the decisions of French J and the Court of Appeal.

The previous decisions

French J

[21] An interim injunction was refused by French J.

[22] For the purposes of s 53 Her Honour found that there was no serious question to be tried in relation to the 2005-2008 transactions. Notwithstanding that those transactions were for the express purpose of assisting Waimate's cashflow, they were sales in the ordinary course of Waimate's business. For more than half its life Waimate had enjoyed this trading relationship with Ruby which was designed to help cashflow and this "became a habitual part of what Waimate did".[3]

[23] French J considered that "what happened in 2009 was simply the performance of those 2005-2008 sale contracts".[4] It could not be right that Waimate, and thus the receivers, were in a better position because of the manager's unlawful actions than they would have otherwise been. The manager's actions could not render invalid what would otherwise be valid or "unravel the sale contract".[5] Nor could the manager's unauthorised paperwork have the effect of changing the legal consequences of the contractual arrangements or convert Ruby into an unsecured creditor. Ruby had already purchased and paid for the timber and in October 2009 "it was only uplifting its own property that it had already paid for pursuant to a sale that was in the ordinary course of Waimate's business."[6]

[24] The plaintiff's alternative contention based on a constructive trust was also rejected by French J. She held that there was no breach of fiduciary duty by Waimate, known to Ruby, by diverting Waimate's business opportunities to Ruby. All the Waimate directors were doing was acting in accordance with Waimate's contractual obligations regarding timber that belonged to someone else. This was not a situation of one creditor being preferred over another.

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[3] At [46]
[4] At [51]
[5] At [51]
[6] At [56]

Court of Appeal

[25] The Court of Appeal allowed the appeal and granted an interim injunction which was to have effect until further order of the High Court. As a result of that decision all the proceeds from the October 2009 sales have been paid into a separate interest bearing account.

[26] With reference to the 2005-2008 transactions the Court of Appeal proceeded on the basis that for the purposes of s 53 Waimate's business was to sell timber for cash at full market value. It continued:

> [36] ... the practical effect of these transactions was that Waimate sold its timber earlier than it would otherwise have done. This was wholly in the interests of Waimate and its creditors; the transactions removed Waimate's inventory from the reach of the Bank's security, but replaced that inventory with cash. The fact that these sales were to a related party is here immaterial. There was no suggestion there was otherwise a breach of the security agreement. In these circumstances, the receivers cannot realistically impune the sales between 2005 and 2008.

The Court then went on to consider some Canadian cases that had been relied on by Mr Russell. It concluded that those cases were distinguishable because they involved sales that were below market value.

[27] The following comments of Linden J in *Fairline Boats Ltd v Leger*[7] with reference to the Ontario equivalent of s 53 were endorsed by the Court of Appeal:[8]

> The objective of this section, as I understand it, is to permit commerce to proceed expeditiously without the need for purchasers of goods to check into the titles of sellers in the ordinary course of their business. Purchasers are allowed by our law to rely on sellers using the proceeds of sale to repay any liens on the property sold. In these days inventory is almost invariably financed, and as a result is almost invariably subject to liens of one kind or another. To require searches and other measures *to protect lenders*[9] in every transaction would stultify commercial dealings, and so the Legislature exempts buyers in the ordinary course of business from these onerous provisions, even where they know that a lien is in existence.

The Court of Appeal noted that the purpose of s 53 is to limit protection of creditors

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[7] *Fairline Boats Ltd v Leger* [1980] 1 PPSAC 218 (Ont HC) at [8]
[8] At [38]
[9] This emphasis was added by the Court of Appeal

where a buyer takes goods in a specific way, but that in this case there was no need to protect the Bank because the transactions did not diminish, and quite possibly enhanced, the valuer of its security by less liquid stock being converted into cash.

[28] With reference to the 2009 transactions the Court said:

> [39] The 2009 transactions are another matter. We do not yet know what the facts are. We have noted that there has been no discovery and there is no affidavit from the former manager. If at the time the stockpile was depleted the manager acted with Ruby's express or implied approval, Ruby then waived rights against Waimate and its timber. In that event the receivers' submission that Ruby became a mere unsecured creditor is correct. If he acted without Ruby's approval he may be party to a conversion by Waimate of Ruby's property, namely the proceeds of depletion of the stockpile. Receipt of such proceeds would have given Ruby a claim for their amount against Waimate. We do not agree with the Judge ... that the events of 2009 are to be characterised as mere completion of the 2005-2008 sale contracts. Waimate was passing to Ruby title to timber belonging to Waimate and thus within the Bank's security.
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> [40] While Ruby had paid cash at full market value in the earlier transactions, this time the "sales" from Waimate to Ruby, which entailed the transfer of Waimate's inventory to Ruby's stockpile (and later to third parties who paid Ruby), were not for cash. They were in satisfaction either of Ruby's existing claim for conversion (if the manager's actions were unknown and unauthorised) or of Waimate's debt to Ruby (if Ruby's directors had known of the manager's actions). Again in contrast to the earlier sales, the 2009 transactions certainly had the effect of undermining the Bank's security. We hold they were arguably not sales and were outside the ordinary course of business, either because:
>
> (a) they were in satisfaction of Waimate's existing debt to Ruby, rather than for cash; or
>
> (b) they were to account to Ruby for Waimate's conversion, via the manager, of Ruby's stock.

On that basis the Court of Appeal accepted that there was an arguable case that the 2009 sales did not occur in the ordinary course of Waimate's business.

[29] The Court did not find it necessary to consider the alternative cause of action based on breach of fiduciary duty.

Does s 53 apply?

[30] Two primary issues need to be resolved: whether in terms of s 53(1) the timber involved in the October 2009 transactions had been "sold" and, if so, whether this was "in the ordinary course of business" of Waimate.

Plaintiff's argument

[31] The October 2009 transactions constituted a transfer of Waimate's inventory to Ruby in satisfaction of Waimate's liability to Ruby at a time when Waimate was insolvent. These transactions did not constitute a "sale" for the purposes of s 53. Alternatively, if the correct interpretation is that the transaction was to rectify a GST anomaly this would not constitute a "sale" for the purposes of s 53.

[32] Even if the October 2009 transactions constituted a sale for the purpose of s 53, they were not in the ordinary course of Waimate's business because the sales:

(a) Involved a related entity;

(b) Were in settlement of a pre-existing claim;

(c) Occurred about three weeks before the receivership;

(d) Had the effect of preferring a liability to a related entity to the general body of Waimate creditors;

(e) Occurred after an 11 month period of inactivity.

(f) Were part of a wider transaction involving diversion of sales orders from Waimate to Ruby;

(g) Involved a sale of timber that had been cut specifically for overseas orders originally placed with Waimate;

(h) Involved a situation where Ruby otherwise had no need for the timber;

(i) Did not involve a situation where payment to Ruby was required to secure an ongoing supply of raw materials or other commodities necessary for Waimate to continue operating;

(j) Amounted to the payment of a related party debt in anticipation that Waimate would be placed into some form of insolvency administration in the near future.

In all the circumstances, the plaintiffs argue, it would be artificial to suggest that Ruby "was a member of the buying public which would ordinarily be protected by s 53".

[33] The primary purpose of the transactions was the satisfaction of a pre-existing debt. There is no other plausible explanation. Consequently, the transactions had the effect of undermining the Bank's security interest in the inventory.

[34] As to the defendant's defence based on s 25, there is no evidence to support the proposition that the Bank has exercised its rights or duties otherwise than in good faith and in accordance with reasonable standards of commercial practice. The actions of the receivers do not restrict the receivers from seeking to recover assets subject to the Bank's charge. There is no evidence of any windfall benefit to the receivers who are seeking to recover in excess of $1.9m owing to the Bank.

Defendant's argument

[35] When determining whether there was a "sale" for the purposes of s 53 the touchstone is substance over form and the word "sale" should be interpreted liberally. Set-offs are included in the s 53 concept of a sale. This is apparent, amongst other things, from the passage of s 53 into law. When considering whether there is a sale the solvency of the parties is irrelevant. Virtually any transaction that is not gratuitous will be a sale and the October transactions clearly constituted a sale.

[36] Not only were the transactions "sales", they were also in the ordinary course of Waimate's business. The finding of the Court of Appeal that the 2005-2008 transactions were in the ordinary course of business is particularly significant because they indicate that the Court of Appeal accepted that the right to *exchange* timber formed a legitimate part of Waimate's business operation. That feature carried through to the October 2009 transactions.

[37] When determining Waimate's business the Court should give the words "in the ordinary course of business" a liberal interpretation. Waimate's business involved the sale of timber to whoever would purchase it. The company's financial difficulties throughout was part of the pattern of business. The company sold timber in a variety of ways and there was nothing out of the ordinary about the October 2009 sales. The frequency of sales could not dictate whether they were in the ordinary course of business.

[38] Contrary to the plaintiffs' argument the nature and place of the transaction, as well as the parties to the transactions and the prices charged, all point to the sales being in the ordinary course of Waimate's business. Even if the unauthorised dealings by the manager had not arisen, the October 2009 sales would have occurred. There was no question of any antecedent debt, and Ruby was simply taking delivery of its own timber.

[39] While the Court of Appeal disagreed as a matter of *law* that the October 2009 transactions amounted to completion of earlier transactions, as a matter of *fact* and substance that is what they were. Rather than being a reaction to a debt, the October 2009 transactions represented completion of Ruby's decision to acquire timber.

[40] Alternatively, the receivers, as agents of Waimate, are seeking to rely on the wrongful actions of Waimate to again obtain the benefits of Ruby's timber for which payment had already been made by Ruby. This is not in accordance with s 25, and it would be unjust for the plaintiffs to receive again what is effectively a windfall.

Discussion

[41] When considering whether the October 2009 transactions were within the scope of s 53(1) it is important to identify the *substance* (as opposed to the *form*) of the relevant transactions. As Rodney Hansen J observed in *Orix New Zealand Limited v Milne,*[10] the way in which transactions are accounted for in the books of buyers and sellers is essentially an internal administrative matter which does not necessarily reflect the way in which they have carried on business. So the Court needs to look behind the books and ascertain the true nature of the transaction.

[42] The first step is to determine the nature of Waimate's business. There is no issue about that. Waimate was always in the business of selling timber to both New Zealand and overseas customers. And after the formation of Ruby in mid 2005 those customers included Ruby who would in due course on-sell the timber to others.

[43] Having resolved that issue, it is now necessary to determine whether the October 2009 transactions can be construed as sales in the ordinary course of Waimate's business. Obviously that matter cannot be determined in a vacuum, and it is necessary to take Waimate's trading history into account.

[44] For present purposes that history begins in July 2005 when Ruby was incorporated. It is beyond argument that between that time and August 2007 Waimate's business included the sale of timber to Ruby at full market value. That was generally achieved by cash sales. However, on some occasions there was a swapping of timber and on yet other occasions Waimate purchased back timber that it had earlier sold to Ruby. The underlying purpose was to accelerate Waimate's cash flow. Pending sale to third parties by Ruby, its timber was stored at Waimate's premises. Because Ruby did not have the necessary expertise or connections, Waimate would locate customers and handle the sales transactions on behalf of Ruby.

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[10] *Orix New Zealand Limited v Milne* [2007] 3 NZLR 637 at [69]

[45] As the Court of Appeal noted,[11] the practical effect of the cash transactions was that Waimate was able to convert its timber into cash earlier than would otherwise have been the case, which was wholly in the interests of Waimate's creditors. The Court of Appeal also noted that the fact that these sales were to a related party was immaterial. It is also inherent in the Court of Appeal's conclusions that the fact that at all relevant times Waimate was struggling financially did not detract from the conclusion that the earlier transactions were in the ordinary course of Waimate's business.

[46] For the purposes of s 53(1) I find that this pattern of trading from mid 2005 until August 2007 reflected Waimate's ordinary course of business.

[47] A new phase began in August 2007 and continued until November 2008. This phase of trading was an aberration. It was also outside Waimate's ordinary course of business. Moreover, as is apparent from both the amended pleadings and the uncontested evidence in the defendants' affidavits, the transactions involving Ruby during this period were not known to, or authorised by, the directors of Waimate or Ruby. In other words, these transactions were in breach of the agreement between the two companies, especially to the extent that the documentation suggested that Ruby was extending credit to Waimate.

[48] Given those findings one of the issues left open by the Court of Appeal[12] (whether the transactions between August 2007 and November 2008 amounted to conversion of Ruby's timber by Waimate, or to credit transactions) can be resolved. I find that during that period Waimate unlawfully converted Ruby's timber to the value of $288,762.58. I also find that despite appearances in the companies' books, Ruby did not at any stage extend credit to Waimate.

[49] Having decided that Ruby's timber was converted by Waimate, the next issue is whether the converted timber was replenished by Waimate and, if so, the implications.

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[11] At [36]
[12] See [40]

[50] In his second affidavit sworn on 1 February 2010 David Sanderson, the manager of Waimate since April 2008, deposed:

> 3. I can confirm that by early 2009 most of Ruby's stock of timber had been used by Waimate Timber. As at the end of July 2009 approximately half of Ruby's stock had been replenished by Waimate Timber with the balance being replenished by early September 2009. Accordingly when in September 2009 the directors of Ruby wanted to uplift the timber owned by Ruby, the balance of Ruby's stock had been replenished. (Emphasis added)

Reference to the directors wanting to uplift the timber owned by Ruby is a reference to para 15 of Mr Sanderson's first affidavit in which he deposed that in order to correct the situation arising from Waimate's unlawful conversion of the timber that had come to the knowledge of the directors "it was agreed that Ruby should be in a position to uplift the timber purchased by it in early October 2009". While this passage is slightly ambiguous, I interpret it as meaning that the timber was to be *uplifted* in early October 2009, not that it was to be *purchased* in early October 2009.

[51] Mr Sanderson's second affidavit was sworn in response to a query from the plaintiff's solicitors about the "physical state" of Ruby's stock.[13] Mr Sanderson was not cross-examined and his unequivocal evidence that the stock had been replenished by early September 2009 is unchallenged. Had there been any plausible challenge to that evidence it might be expected that there would have been further affidavit evidence from the plaintiffs or, at the very least, cross-examination of Mr Sanderson. I accept Mr Sanderson's evidence that the converted timber had been fully "replenished" by early September 2009.

[52] I also accept that the replacement timber belonged to Ruby. Indeed, any suggestion that it might have belonged to Waimate would not make the slightest sense. No doubt Mr Sanderson used the word "replenished" advisedly. According to the *Collins Concise Oxford Dictionary* that word means:

> To make full or complete again by supplying what has been used up.

It is not disputed that Ruby had paid for, and was the lawful owner of, the timber that was converted by Waimate. Thus, when replacing that timber Waimate must have

[13] See para 1 of that affidavit

intended that it would belong to Ruby, not Waimate, and I so find. Effectively, Waimate was returning the timber that it had unlawfully converted.

[53] For the plaintiffs, Mr Russell claimed that the defendant's evidence concerning the replenishment of the timber is "confusing". I agree that before Mr Sanderson's second affidavit was provided that might have been the case. However, Mr Sanderson's further affidavit removed any doubt about the physical status of the timber as at September 2009. His further affidavit makes it clear that the converted timber (valued at approximately $288,000) had been replaced, the unauthorised phase of dealing had come to an end, and Waimate and Ruby were now poised to resume their normal pattern of trading. Put another way, the matter had come full circle since the timber was converted.

[54] Before leaving this matter I should add a further comment. While the earlier affidavits might have been confusing, I do not consider that they are incompatible with Mr Sanderson's second affidavit. Gary Rooney, a director of Waimate and Ruby, deposed that the timber sold in October 2009 was timber that was "due and owing to Ruby by Waimate Timber as Ruby had already paid Waimate Timber for that timber".[14] He also stated that "As at late September 2009 Ruby had not taken delivery of timber it had paid for".[15] These statements are consistent with the proposition that the converted timber had been replaced and was available for uplifting in October 2009. Mr Rooney's evidence is supported by Robin Murphy, another director of the two companies.

[55] Roslyn Pearce, the Waimate officer manager/accounts person from 2003, deposed that it was intended that the timber that had been taken by Waimate would be replaced and that the 16 invoices were only issued by Waimate to "rectify the GST situation"[16] arising from the unauthorised transactions. She deposed that the documentation misrepresented the true nature of the transactions between the two companies.[17] This is supported by Kristy Kewene who was employed by the chartered accountants acting for Waimate and Ruby. Ms Kewene confirmed that the

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[14] See para 48(e) of his affidavit
[15] See para 54 of his affidavit
[16] See para 28 of her affidavit
[17] At 19 of her affidavit

invoices were not in accordance with the arrangements between Waimate and Ruby and that they should not have been issued.[18]

[56] Nothing in the amended pleadings alters the conclusion that the timber that had been unlawfully converted by Waimate had been replenished by early September 2009 and that such timber belonged to Ruby. These are critical findings.

[57] Now, I turn to the October 2009 transactions which represented the last phase of trading between Waimate and Ruby. When that phase began Ruby owned timber to the value of approximately $288,000 which was stored at Waimate's premises. Early in October 2009 Waimate made arrangements for timber to the value of approximately $270,000 to be sold to General Trading and Phu Tai. Later in the month Ruby uplifted its timber to complete those transactions.

[58] With the benefit of those findings I come back to the two critical questions arising from s 53(1): did Waimate sell timber to Ruby; if so was this sale in the ordinary course of Waimate's business?

[59] The Act does not define "sale". M Gedye et al, *Personal Property Securities in New Zealand (2002)* states:[19]

> The transaction will meet the definition of a "sale" even if the buyer has paid half or all of the price through a trade-in or other exchange of property. Also, there is no requirement that the buyer must have paid for the goods, the section will protect a buyer on credit.

This supports Mr Lester's proposition that the word "sale" should be given a liberal interpretation in recognition of the multiple ways in which commerce is transacted. I accept that proposition. Any other interpretation is likely to undermine the purpose of s 53.

[60] Had the conversion not taken place it would have been beyond argument that Waimate had "sold" the timber involved in the October 2009 transactions to Ruby. As French J commented, it would be odd if the receivers were in a better position by virtue of the manager's unlawful action than would otherwise have been the case.

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[18] At para 8 of her affidavit
[19] At 53.5

Furthermore, given that clause 13.2 of the General Security Agreement states that the receivers are Waimate's agent it is difficult to see how the plaintiffs could enforce rights under the Security Agreement without infringing the duty of good faith imposed by s 25. Whatever way the matter is viewed they are tainted with Waimate's unlawful conversion of the timber.

[61] When reaching those conclusions I have not overlooked the Court of Appeal's view that the October 2009 transactions were "arguably" not sales because they were to account to Ruby for Waimate's conversion of its stock. That analysis was, however, in the context of an interim injunction where the Court of Appeal acknowledged "We do not yet know what the facts are".[20] One of the critical facts that count against the Court of Appeal's tentative finding is that the stock had already been replenished before October 2009 and that the replenished stock belonged to Ruby. Thus, on the facts as now determined, the October 2009 transactions did not involve Waimate's stock and Waimate was not "passing to Ruby title to timber belonging to Waimate and thus within the Bank's security".[21]

[62] I am, therefore, satisfied that the timber had been "sold" for the purposes of s 51(3). Now I turn to the question whether the October 2009 transactions were within Waimate's ordinary course of business.

[63] Two New Zealand cases involving s 53(1) are of assistance. In *Orix New Zealand Ltd* Rodney Hansen J noted that the focus is on the business of the seller and he proceeded on the basis that a liberal approach should be taken to the words "in the ordinary course of business". On the facts before him, His Honour found that although the relevant sales were infrequent and formed only a small part of the seller's business they were nevertheless within the ordinary course of the seller's business.

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[20] At [39]
[21] At [39]

[64] The other case is *Gibson & Stiassnny v Stockco Limited & Ors*.[22] In that case White J accepted that s 53 required an objective factual assessment based on all of the circumstances of the particular case. He said:

> [147] In making an objective factual assessment based on all the relevant circumstances of the particular case ... the Court will not focus on the particular sale of goods in isolation. Whether the sale is part of a deal or inextricably linked with a wider transaction the Court will look at the whole deal or wider transaction to answer the question. It is well established in commercial law that the nature, purpose and effect of a composite transaction will be determined from an examination of its constituent parts as a whole ...

White J then examined the sale of the livestock in that case and concluded that the sale was not in the ordinary course of the company's business. The circumstances were, however, well removed from this case.

[65] Once the October 2009 transactions in this case are considered within their overall context it becomes clear that they were consistent with the earlier pattern of trading between Waimate and Ruby (mid 2005 until August 2007). As with the earlier transactions, the two customers (General Trading and Phu Tai) were located by Waimate who transacted the sales to those companies on behalf of Ruby. In due course the timber required to meet the sales was uplifted from the Waimate premises and supplied to the customers. There was nothing unique or unprecedented about the transactions. I am satisfied that they were in the ordinary course of Waimate's business.

[66] At [32] I have listed a number of factors that Mr Russell advanced in support of the proposition that the October 2009 transactions were not in the ordinary course of Waimate's business. I will briefly respond to those matters.

[67] The first two matters ((a) and (b)) can be considered together. As to (a) I adopt the Court of Appeal's observation that the fact that these transactions were between related entities is immaterial.[23] These were arms-length transactions at market value. And in relation to (b) the October transactions were not in settlement of a pre-existing claim because the timber already belonged to Ruby.

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[22] *Gibson & Stiassnny v Stockco Limited & Ors* CIV 2009-404-7120 17 December 2010
[23] At [36]

[68] Points (c), (d) and (j) can also be considered together. The evidence does not suggest that these were forced sales, the directors knew receivership was imminent, or there was any attempt to defeat the legitimate claims of creditors. Throughout its life Waimate had struggled financially and there was no suggestion that the October 2009 transactions had the effect of preferring a related entity to the general body of creditors. Similar financial pressure arguments were raised and rejected in *Orix*. In effect the plaintiffs are seeking to obtain payment twice and as Karakatsanis J commented in *Bank of Nova Scotia v IPS Invoice Payment System Corporations et al,*[24] there is no compelling reason why a creditor should be able to recover a windfall by way of double recovery from the same collateral. Arguably this is reinforced in New Zealand by s 25.

[69] Although it is alleged in (e) that the October 2009 transactions occurred after an 11 month period of inactivity, that cannot be decisive: see *Orix* at [70] which cited *Alberta Pacific Leasing Inc v Petro Equipment Sales.*[25] Moreover, as White J observed in *Gibson & Stiassnny,* the whole context is relevant and it is particularly relevant in this case that during the period of inactivity the agreement between Waimate and Ruby was being breached. Again, this might bring s 25 into play.

[70] The remaining points (f) – (i) can be dealt with together. Contrary to the plaintiff's proposition that the October transactions gave rise to a diversion of sale orders from Waimate to Ruby, a more accurate description would be that, as in the past, Waimate found the customers to purchase Ruby's timber and handled those sales on behalf of Ruby. The fact that the timber had been cut specifically for overseas orders was irrelevant. Overseas orders had been satisfied through third parties in the past and there was nothing unusual or untoward about these transactions. The suggestion that Ruby otherwise had no need for the timber is bizzare. Ruby used the timber, which it owned, to fulfil the orders. Finally, the attempt to distinguish the October transactions from earlier overseas transactions is not persuasive.

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[24] *Bank of Nova Scotia v IPS Invoice Payment System Corporations et al* 318 DLR (4th) 751 at 763
[25] *Alberta Pacific Leasing Inc v Petro Equipment Sales* (1995) 10 PPSAC (2d) 69

[71] I therefore conclude that the October 2009 transactions were sales in the ordinary course of Waimate's trading and that Ruby was entitled to the protection conferred by s 53(1).

Alternative cause of action based on a constructive trust

[72] Having pleaded that the directors of Waimate owed fiduciary duties to the company not to allow a conflict of interest to arise and to exercise their powers in the best interests of Waimate (all of which is admitted), the amended statement of claim alleges:

> 40. By causing or permitting Ruby 2005 to take over the orders or the sales from Waimate Timber to General Trading and Phu Tai, the directors of Waimate Timber that are also directors of Ruby 2005 breached their fiduciary duty to Waimate Timber.
>
> 41. Ruby 2005 received proceeds from the sale of the lumber to General Trading and Phu Tai with knowledge of the breach of duty as set out in paragraph 40 herein.
>
> 42. The defendant is a constructive trustee of the proceeds of the sales to General Trading and Phu Tai and holds the proceeds on trust for the plaintiffs.

The allegations in 40 - 42 are denied by the defendant.

[73] The underlying proposition of the plaintiffs is that "by agreeing to allow Waimate to pass title in its timber to Ruby in satisfaction of Waimate's liability"[26] the directors of Waimate breached their duty. However, this proposition cannot succeed on the facts. By the time the orders were received from General Trading and Phu Tai in early October 2009, Ruby already owned sufficient timber to fulfil those orders and that timber was so used. It was not a matter of Waimate passing title to *its timber* to satisfy those orders: it was a matter of Ruby's timber being used. Thus the constructive trust allegation cannot get off the ground.

[74] Apart from that, as I have already found, the October 2009 transactions were part of Waimate's ordinary course of business pursuant to the agreement between that company and Ruby. As French J concluded, there could be no breach of a duty

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[26] Para 61 of submissions of counsel for plaintiffs

either to the company or to its creditors when the Waimate directors were simply acting in accordance with Waimate's contractual obligations regarding timber that belonged to Ruby. This is not a situation where Ruby was being preferred over Waimate's creditors.

[75] This alternative ground has not been made out.

Result

[76] The plaintiffs' claim fails and there will be judgment for the defendant. The proceeds of the October 2009 sales and the interest earned are to now be released to the defendant.

[77] My initial impression is that the defendant should receive costs on a 2B basis. However, if either party wishes to present submissions on that issue that party should do so within 21 working days of the delivery of this decision. The other party will then have a further 10 working days to reply. Submissions should not exceed two pages.

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