IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2006-404-006804

IN THE MATTER OF	the Companies Act 1993
BETWEEN	THE COMMISIONER OF INLAND REVENUE Plaintiff
AND	NORTHSHORE TAVERNS LTD (IN LIQUIDATION) Defendant

Hearing: 21 July 2008

Appearances: A J Steele for Defendant
S Barker for Sure Developments Ltd

Judgment: 27 August 2008

JUDGMENT OF ASSOCIATE JUDGE HOLE

This judgment was delivered by me on 27 August 2008 at 4:00 pm pursuant to Rule 540(4) of the High Court Rules.

Registrar/Deputy Registrar

Date: ……………………….

Solicitors:
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Introduction

[1] The amended application by the liquidators (Barry Philip Jordan and Henry David Levin) of the defendant seeks directions, as follows:

a) Whether the $179,004.49 ("the fund") recovered by the liquidators from Thirty Times Two Limited ("TTTL") represent an asset of the defendant ("NTL") available for distribution to unsecured creditors and to be paid in the order of priority set out in schedule 7 to the Companies Act 1993; or alternatively

b) Whether the fund should otherwise be held or disbursed by the liquidators as the Court deems just; and

c) Whether the liquidators' costs and expenses incurred in the liquidation to date including those incurred in and incidental to this application can be deducted from the fund.

Background

[2] On 8 February 2007 the High Court at Auckland placed NTL into liquidation. The preferential and unsecured creditors' debt claims filed in the liquidation totalled $459,422.

[3] The company had started trading in October 2002 and sold its business on or about 31 August 2005. NTL's business activities had involved the operation of a licensed bar trading as "Mad Dogs and Englishmen" from premises at Wairau Park, Glenfield, North Shore City.

[4] Initially NTL acquired finance from the National Bank of New Zealand which had security over "all present and after acquired property" of NTL. NTL's indebtedness to the National Bank was subsequently refinanced through Westpac Banking Corporation. The debt to Westpac was repaid although it seems that the security documents may not have been discharged. The general security agreement

between NTL and Westpac recorded that NTL had granted to Westpac a security interest in all of its personal property and had charged to Westpac all of its non-personal property. The security interest and charge created by the general security agreement constituted a first-ranking charge.

[5] The liquidators did not adopt their usual practice and send to Westpac a notice pursuant to s 305 of the Companies Act requiring Westpac to elect between the enforcement or redemption of its security. This is because it was understood from Westpac that the security had been discharged.

[6] Subsequently, the liquidators learned that Sure Developments Ltd ("SDL") had provided funds for the repayment of part of NTL's indebtedness to Westpac. The balance of NTL's indebtedness to Westpac was satisfied from another quarter (who is not a party in this dispute). SDL did not appreciate that it might have thereby obtained rights of subrogation to the securities previously held by Westpac. Accordingly it filed with the liquidators an unsecured creditor's claim form in respect of the moneys owed to it by NTL. Thus, throughout the liquidation, SDL has acted as if it were an unsecured creditor and the liquidators have acted as if there were no outstanding secured creditors.

[7] It seems that as a result of activities undertaken by SDL, the liquidators learned that between March 2005 and September 2005 NTL's over-the-counter bar Eftpos sales receipts were transferred from NTL's Eftpos machine direct to the bank account of TTTL. The value of the sales receipts transferred amounts to $525,471.31. No documentation exists as to the reason for the transfer of the Eftpos sales receipts.

[8] The liquidators subsequently learned that TTTL had sold its business and that its solicitors were holding the sale proceeds of $179,004.49. As the liquidators considered that the fund represented a repayable on demand advance from NTL to TTTL , demand for repayment was made. Accordingly, the solicitors for TTTL paid the fund to the liquidators. The balance of the fund is available for distribution to creditors. No distribution has been made pending the outcome of the application to the Court for directions.

[9] The liquidators consider that the fund represents part of the Eftpos sales receipts transferred by NTL into TTTL's bank account. They think that its part repayment constitutes an "account receivable". "Account receivable" is defined at the end of clause 9 of schedule 7 to the Companies Act 1993. It is given the same meaning as in the Personal Property Securities Act 1999 which defines "account receivable" as: *a monetary obligation that is not evidenced by chattel paper, an investment security, or by a negotiable instrument, whether or not that obligation has been earned by performance*.

[10] The reason that the liquidators seek directions from the Court as to how the funds should be distributed is that SDL contends that because, as guarantor of NTL's indebtedness, it paid $300,000 to Westpac, it is entitled to be subrogated to Westpac's general security agreement. As such, it is entitled to claim the fund under that security.

[11] The liquidators took a neutral stance in respect of whether or not SDL was entitled to be subrogated to Westpac's general security agreement. Without wishing to show disrespect to the comprehensive submissions made on behalf of SDL, I am satisfied that SDL is entitled to be subrogated to Westpac's general security agreement. Accordingly, it is entitled to be treated as a secured creditor of NTL. Prima facie therefore, as SDL is the only secured creditor of NTL, its claim to the fund should take priority over those of other creditors when the fund is distributed.

[12] However, if the fund constitutes an "account receivable", then SDL's security must give priority to any preferential creditors. This is because clause 9(b) of schedule 7 of the Companies Act 1993 provides that where the assets of a liquidated company are insufficient to meet the claims referred to in clauses 2, 3, 4, and 5 of schedule 7, such claims take priority over the claims of any person under a security interest to the extent that the security interest is over all or any part of the company's accounts receivable.

[13] The claim of the Inland Revenue Department for $75,066.54 is a preferential claim in terms of clause 9(b). So is the liquidators' claim for costs and expenses incurred during the liquidation.

Issues

(a) An "Account Receivable"?

[14] The principal issue, therefore, is whether the fund constitutes an "account receivable".

(b) Effect of surrender of security

[15] If it is held that the fund does not constitute an "account receivable" and thus is subject to the security in favour of SDL, the question arises as to whether SDL can now claim as a secured creditor given that it surrendered its security when it lodged its unsecured creditors' claim form.

(c) Liquidator's costs

[16] If SDL can claim as a secured creditor, should the entire costs and expenses of the liquidator be paid before SDL's claim is satisfied?

(d) Equitable lien or salvage

[17] Finally, SDL claims that the sole reason that there is a fund is due to the pre-liquidation efforts of SDL in obtaining a mareva injunction over the proceeds of sale of TTTL. It was as a result of the receipt of information from SDL that the liquidators were able to recover the fund. SDL incurred substantial legal costs in the recovery of the fund and in those circumstances SDL claims it is entitled to recover those costs as a first charge over the fund on the basis of either an equitable lien or salvage.

The fund

[18] There are various ways in which one can regard the fund:

a) That it was the repayment of an authorised advance; or

b) It was the repayment of an unauthorised advance;

c) It was repayment of moneys had and received by TTTL; or

d) It was a refund of moneys held in trust by TTTL for NTL.

[19] Whilst I have considered the various ways in which the fund can be treated, at the end of the day I consider that it matters little in the end result. For reasons which will become apparent later in this judgment, the nature of the fund is irrelevant except to the extent that inherent in it was an obligation for it to be paid to the liquidators. The situation here accords with the conclusion reached by the Court of Appeal (when considering what was a "debt that is due") in *OPC Managed Rehab Ltd v Accident Compensation Corporation* [2006] 1 NZLR 778 at para 54:

> We conclude that, if a payment is received in circumstances where the recipient is obliged to repay it, whether because of a contractual or statutory provision to that effect or because the circumstances give rise to an obligation to repay on the basis of money had and received, the amount can be treated as a "debt due" for the purposes of s 289(2)(a).

"Account Receivable"

[20] As indicated previously, the definition of "account receivable" is *a monetary obligation that is not evidenced by chattel paper, an investment security, or by a negotiable instrument, whether or not that obligation has been earned by performance*.

[21] It is common ground that there was no chattel paper, investment security or negotiable instrument. Thus, in the circumstances of this case an "account receivable" is a monetary obligation.

[22] The liquidators have taken a different stance from SDL as to what an "account receivable" means.

(a) Liquidators' position

[23] Initially, the liquidators considered that it meant an obligation in the nature of a book debt or trade credit account.

[24] However, on reconsidering the matter they concluded that "monetary obligation" was capable of a wider interpretation than merely a book debt or trade credit account. To restrict the definition of "monetary obligation" to merely a book debt or trade credit account was too restrictive. Accordingly, it was submitted:

a) Section 3 of the Securities Amendment Act 2004 amended the principal Act by repealing the definition of "chattel" and substituting the following definition: "chattel includes livestock, but does not include a book debt or negotiable instrument". If the expression "book debt" was outdated or out of usage, then its use in s 3 of the Securities Amendment Act would not have occurred. It follows that "account receivable" cannot be the modern expression for "book debt".

b) The commercial understanding of what constitutes a "book debt" or "account receivable" is irrelevant because "account receivable" is defined by statute. Accordingly the Court should not take judicial notice of what the business community considers the expression "account receivable" to mean.

c) While the expression "account receivable" had replaced the more antiquated term of "book debt", that did not mean that it was restricted to mean "book debt". Enactments of various Canadian provinces and the commentaries thereon were referred to. These indicated that the expression "account receivable" was merely another name for a book debt. The commentators referred to no authority for their conclusions.

d) “Monetary obligation” appears in only two other places in the Personal Property Securities Act 1999, that is, in the “interpretation” section 16(1) to define:

“Investment security” as excluding:

> “… a writing that evidences a monetary obligation that is secured by an interest in land”.

And “Chattel paper” as:

> “… one or more writings that evidence both a monetary obligation and a security interest in, or lease of, specific goods or specific goods and accessions”.

The use of “monetary obligation” in these instances illustrate the broad nature of the obligation and its application i.e. beyond a mere book debt or trade credit account.

e) The liquidators therefore concluded that whichever way one looks at the transfer of the Eftpos receipts, an obligation to repay occurred. This constituted a “monetary obligation”. The repayment satisfied that monetary obligation. It constituted an “account receivable”. Literally, then, the fund was an “account receivable” in terms of the definition.

(b) SDL’s position

[25] SDL considers that “account receivable” is restricted to meaning “book debts”. In support of its position:

a) It adopted the reasoning by Mr Gedye and Professors Cuming and Wood in *Personal Property Securities in New Zealand* (1ed 2002) at para 16.1.2 (p 52) where the learned authors stated that the traditional

term "book debt" had been replaced by the expression "account receivable" because debts are no longer recorded in books but on computers.

b) The commentators explained that the expression "account receivable" was adopted because the business community uses that nomenclature when referring to "monetary obligations arising out of the sale of goods or services".

c) An "account receivable" could not come into existence until there is a legal relationship (for example a contract) under which the account receivable could be earned by performance.

d) The literal interpretation of the liquidators would have the effect of substantially increasing the assets of insolvent companies that are not subject to a secured creditor's security interest. There was no indication that the Companies Act intended such a wide ranging change to the law of insolvency.

e) Commercial usage is relevant and in that regard SDL referred to a number of definitions as to the commonly accepted understanding of the term:

(a) "Current assets representing amounts owed by an entity normally as the result of the sale of goods or services. Also called debtors, sundry debtors, receivables, trade debtors": Alan J Robb, *A Dictionary of Accounting Terms (2ed 1986);*

(b) "The amounts owed to an organization for goods and services that it has supplied": The Oxford Dictionary of Finance (1993, 1996 reissue);

(c) "Accounts receivable A/R) is one of a series of accounting transactions dealing with the billing of customers who owe money

to a person, company or organization for goods and services that have been provided to the customer. In most business entities this is typically done by generating an invoice and mailing or electronically delivering it to the customer, who in turn must pay it with an established timeframe called credit or payment terms": http://en.wikipedia.org/wiki/Accounts_receivable;

(d) "Money which is owed to a company by a customer for products and services provided on credit. This is treated as a current asset on a balance sheet. A specific sale is generally only treated as an account receivable after the customer is sent an invoice": http://www.investorwords.com/52/accounts_receivable.html;

(e) "Money owed by customers (individuals or corporations) to another entity in exchange for goods or services that have been delivered or used, but not yet paid for. Receivables usually come in the form of operating lines of credit and are usually due within a relatively short time period, ranging from a few days to a year. On a public company's balance sheet, accounts receivable is often recorded as an asset because this represents a legal obligation for the customer to remit cash for its short-term debts": http://www.investopedia.com/terms/a/accountsreceivable.asp;

f) The genesis of the term "account receivable" came from Report No. 8 "A Personal Property Securities Act for New Zealand" of April 1989. The report adopted the reasoning of the Canadian commentators. It contained a draft of the expression "account receivable" which is almost identical to that under discussion.

(c) Determination of "account receivable"

[26] In considering the meaning of "account receivable" in relation to the fund, the starting point is s 5 of the Interpretation Act 1999. It reads:

(1) The meaning of an enactment must be ascertained from its text and in the light of its purpose.

(2) The matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment.

(3) Examples of those indications are preambles, the analysis, a table of contents, headings to parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment.

[27] In *HIH Casualty and General Insurance (NZ) Ltd (In liquidation) v Downey & Anor* HC AK CIV 2007-404-3775 30 April 2008, Robinson AJ said of s 5 (at para 18):

> This section directs that the literal meaning of the words of a statute is not the end of the inquiry. Instead what is required is an examination of both text and purpose. Therefore, while the words of s 311(2) are indeed unambiguous, the text alone of the section is not the sole point of examination. As Fogarty J said in *Talley v Fowler* HC WN CIV 2005-485-117 18 July 2005 with regard to Counsel's submissions for a literal interpretation:
>
>> [48] … His argument was old-fashioned in the sense that he was contending for a literal interpretation whether it advanced the purpose of the statute or not. Although he cited s 5 of the Interpretation Act 1999 he also relied on the traditional proposition that if the words of a statutory provision are plain and unambiguous the Court is bound to construe them in an ordinary sense. He argued that it is only if the language of a statute is ambiguous that the policy may be taken into account.
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>> [49] The notion that the meaning of a statutory provision can be plain and unambiguous without having taken into account the purpose of the text is a dubious proposition considered linguistically. But in any event, if it was ever law, it is not now…
>>
>> [51] Section 5 of the Interpretation Act does not enable the Court to run roughshod over the text of a provision. The text still must be capable of bearing the meaning justified by its purpose…
>
> [19] It is necessary therefore to determine the purpose of s 311(2). It is in the light of that purpose and from the text that the meaning of s 311(2) is to be ascertained.

[28] At para [29] (*et seq*) he also pointed out:

> There is nothing improper with the Court reading implied limitations into the wording of a statute. As Cooke P in *R v Salmond* [1992] 3 NZLR 8, 13 said:
>
>> This Court has emphasised the importance of a practical and realistic interpretation of Acts of Parliament. In cases of ambiguity or hiatus

> they should be interpreted so as to be made to work. Gaps may be filled to cover problems not foreseen when the legislation was enacted, provided that the policy-making function is not usurped by the Courts.

And as Lord Denning in *Magor and St Mellons Rural District Council v Newport Corp* [1951] 2 All ER 839, 841 said:

> Wherever a statute comes up for consideration it must be remembered that it is not within human powers to foresee the manifold sets of facts which may arise, and, even if it were, it is not possible to provide for them in terms free from all ambiguity. It would certainly save the Judges trouble if Acts of Parliament were drafted with divine prescience and perfect clarity. In the absence of it, when a defect appears a Judge cannot simply fold his hands and blame the draftsman. He must set to work on the constructive task of finding the intention of Parliament, and he must do this not only from the language of the statute, but also from a consideration of the mischief which it was passed to remedy, and then he must supplement the written words so as to give "force and life" to the intention of the legislature.

Of course, the interpretation of statutes by reading in implied limitations must be done with restraint: *Jones v Wrotham Park Settled Estates Ltd* [1980] AC 74, 105. …

[29] Not only is the Court required to consider the text of the enactment but also its purpose. It may also consider such matters as, in this case, the expression being defined, viz. "account receivable". When one looks at the two words "account receivable" the word "account" would seem to mean a trading account. In other words, a book debt.

[30] When considering the purpose of the definition of "actual receivable", SDL submitted that the proposed broad interpretation of the liquidators would have the effect of substantially increasing the assets of insolvent companies that are not subject to a secured creditor's security interest. There is no indication that the Companies Act intended such a wide ranging change to the law of insolvency. A review of the relevant parliamentary discussion concerning the introduction of The Business Law Reform Bill divulged that there was no discussion of the definition of "account receivable". More importantly, there was no indication that Parliament intended an extensive change to this aspect of insolvency law. If the liquidator's contention is correct, then the change in terminology would have substantially increased the amount of an insolvent company's assets that were to be removed from

the security interests of secured creditors for distribution to preferential creditors. Previously that was limited to book debts.

[31] Support for this view can be gleaned from the discussion of the Law Commission in *Personal Property Securities Act for New Zealand* (NZLC R8 1989). This report considered the definition of "account receivable" and included a draft Personal Property Securities Bill. It discussed the definition of "account receivable" at page 80;

> Account receivable describes, for example, the right to payment which a supplier of goods or services becomes entitled upon performance. The term is the equivalent of the New Zealand expression "book debt". Computerised record keeping has made the adjective "book" misleading. "Receivable" more accurately describes the direction of the entitlement than does the term "debt". "Accounts receivable are a type of "intangible", the term used by the statute to describe incorporeal personal property which is not represented by either a tangible item or document".

[32] The draft definition in the report for "account receivable" is contained in p 20 of the report and reads as follows:

> A monetary obligation not evidenced by chattel paper, or by a negotiable instrument or by a security, whether or not it has been earned by performance.

[33] That wording is almost identical to the definition of "account receivable" in the Personal Property Securities Act. Plainly, the definition contained in the Act came from the report.

[34] The discussion in the report incorporates the philosophy expressed by the Canadian commentators: the expression "account receivable" updates the term "book debt"; but does not alter the essential nature of an account receivable.

[35] For these reasons, regardless of how the fund is categorised, I consider that the fund does not constitute an "account receivable". It is not a book debt or a trade credit account. No one suggested that it could be. It does constitute a secured interest in terms of the general security agreement. It is not available for the unsecured creditors.

Is SDL a secured creditor?

[36] There is no doubt that SDL is entitled to be subrogated to the interests of Westpac in respect of the general security agreement. However, through ignorance of its position, SDL failed to claim as a secured creditor and claimed, instead, as an unsecured creditor.

[37] I consider that the appropriate way of dealing with SDL's position is to act generally in accordance with the principles expressed in ss 304 and 305 of the Companies Act 1993. Section 305(10) provides that where a creditor is in the position of SDL, the secured creditor can withdraw its surrender of its charge upon such conditions as the Court or liquidator thinks fit. The qualification to subs (10), however, is that this must occur before the liquidator has realised the property charged. In this case, the liquidator has realised the property charged so, strictly speaking, s 305(10) does not apply. The liquidators have not disbursed the fund. In *Re Winefield* [1885] NZLR 394 is authority for the proposition that a creditor is not bound by his election as to whether or not his claim is as a secured or unsecured creditor if his original proof was filed as a result of a mistake and nobody is prejudiced by the change of election. When one reads *Winefield* in conjunction with the principle expressed in s 305(10), it seems appropriate that SDL should be granted leave to claim as a secured creditor. If this were done, (subject to the liquidators' costs claim) no other party has been prejudiced.

Liquidators' costs?

[38] If SDL had lodged a claim as a secured creditor, then it could have taken steps to realise its security. The liquidators would have been obliged to take no further steps in the liquidation until that had occurred. Because the liquidators were unaware that SDL was to claim as a secured creditor, they continued to act in the liquidation of the company and have incurred costs and expenses. They consider that those costs and expenses should be paid in priority to the claim by SDL and they consider that SDL is estopped from denying payment of their reasonably incurred liquidation costs expenses. Alternatively, they claim that if the Court grants leave for SDL to withdraw its surrender and permits it to rely on its security (generally in

accordance with section 305(10) of the Companies Act 1993) then the Court should impose a condition that the expenses of the liquidator throughout the liquidation should take priority.

[39] SDL considers that as the liquidators were in possession of information which indicated that it was entitled to be subrogated to Westpac's interests and therefore be treated as a secured creditor, the liquidators are estopped from claiming that their costs and expenses should be met before the claim of SDL.

[40] Normally, of course, a liquidator would not incur costs and expenses until after the claim of any secured creditor has been met. In this case, initially because the liquidators were unaware of any secured interest, costs and expenses were incurred. By 25th September 2007, at the latest, the liquidators became aware that the Westpac loan had been repaid by SDL and that accordingly SDL might be entitled to subrogation. I doubt that it can be seriously argued that the liquidators are estopped either by representation or conduct from their claim for costs and expenses up to 25th September 2007. SDL had clearly represented that it was an unsecured creditor and the liquidators had no knowledge to the contrary until 11th September 2007 at the earliest. The position after the liquidators became aware of SDL's true position is different. The liquidators, having the usual degree of skill and care implicit in their office, needed to be careful not to prejudice SDL's position as to a possible secured creditor. On the facts of this case, their knowledge, acquired as at 25th September 2007 at the latest, prevents them from continuing to rely on the estoppel created by SDL's earlier representation that it was only an unsecured creditor. In the circumstances it was no longer fair for the liquidators to continue to rely on a representation which they now doubted: *Power Beat Canada Limited v Power Beat International Limited* (HC Ham CP 6/95, 16 November 2000, Pennington J).

[41] For these reasons the estoppel defence is available to the liquidators up to 25th September 2007. Likewise they can claim to be prejudiced by the change of election by SDL unless they are otherwise protected – see para [37] supra. It follows that the liquidators' costs and expenses up to 25th September 2007 should be met out of the fund before the claims for SDL – either because of the operation of the

estoppel defence or as a condition applicable to the granting of leave to SDL to change its election to that of a secured creditor.

Equitable estoppel/salvage

[42] SDL submitted that the sole reason that there was a fund in the liquidation was due to the pre-liquidation efforts of SDL in obtaining a Mareva injunction over the proceeds of sale of TTTL. The liquidators recovered the fund following receipt of information from SDL. SDL incurred substantial legal costs in the recovery of the fund. Accordingly, SDL is entitled to recover such costs as a first charge over the fund, on the basis, if necessary, of an equitable lien or salvage.

[43] Because SDL is able to prove against the fund as a secured creditor, there is no necessity to consider this issue in detail.

[44] No authority was provided for the proposition that a creditor was entitled to preference in this regard. The cases cited referred to the position of receivers. The new schedule 7 (which would have helped SDL) came into force on 1 November 2007 which is after the date of liquidation. The old schedule 7, which applies, has no corresponding provision. It set out a statutory code for the priority of preferential payments which precludes any claim by SDL in these circumstances.

Conclusion

[45] I conclude:

a) The fund does not constitute an account receivable;

b) SDL is entitled to be subrogated to the interest of Westpac under the general security agreement;

c) Leave is granted to SDL to prove in the liquidation as a secured creditor;

d) The fund is not available for the unsecured creditors as it constitutes part of the secured interest imposed by the general security agreement;

e) The liquidators costs and expenses incurred in the liquidation up to 25 September 2007 are to be deducted from the fund in preference to the secured interest held by SDL;

f) SDL is not entitled to recover the costs of recovering the fund either ahead of IRD and the liquidators or as first charge on the fund.

g) Whilst the liquidators have lost the argument over the meaning of "account receivable", they have managed to satisfy me that most of their costs and expenses should be met out of the fund before DSL's secured claim. In order for the Court to make these rulings (sharing the spoils, as it were) the liquidators had to bring this proceeding. It is appropriate that they be awarded costs on a 3B basis (together with disbursements as approved by the Registrar) to be paid out of the fund in priority to SDL's secured claim.

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Associate Judge J D Hole