IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2005-404-001691

UNDER	the Personal Property Securities Act 1999
IN THE MATTER OF	KING ROBB LTD (In Liquidation)
BETWEEN	SLEEPYHEAD MANUFACTURING CO LTD Plaintiff
AND	CHRISTINE MARGARET DUNPHY AND IAIN BRUCE SHEPHARD Defendants

Hearing: 27 January 2006

Appearances: Michael Robinson for Plaintiff
Howard Thompson and Elizabeth Tobeck for Defendants

Judgment: 23 February 2006

JUDGMENT OF HARRISON J

In accordance with R540(4) I direct that the Registrar endorse this judgment with the delivery time of 3.15 p.m. on 23 February 2006

SOLICITORS
Simpson Grierson (Auckland) for Plaintiff
McMahon Butterworth (Auckland) for Defendants

Introduction

[1] This case raises two novel questions in the area of insolvency law. One concerns the nature of the relationship between a liquidator, a company and its creditors. The other concerns the relationship between a security interest under the Personal Property Securities Act 1999 (the PPSA) and a charge under the Companies Act 1993.

[2] The issues arise in this context. Sleepyhead supplied King Robb Ltd (trading as Bedworld) with beds and other goods on its ordinary written terms and conditions. Its invoices provided for retention of title in and a security interest over the goods, which it registered following the passage of the PPSA. The parties never signed a formal contract to govern their relationship. After 12 years of trading between the two entities, King Robb was placed in voluntary liquidation. The liquidators later sold the subject goods but have refused to recognise Sleepyhead's security interest or account for the proceeds of sale.

[3] Sleepyhead has claimed summary judgment on a number of grounds. The liquidators concede that the company's goods were subject to a security agreement. Nevertheless, they deny that Sleepyhead is a secured creditor on the grounds that, first, the agreement was enforceable only against King Robb and not against them and, second, in any event, they are not obliged to recognise Sleepyhead's security interest. These two defences are purely legal; there is no material dispute about the facts. Sleepyhead must be entitled to summary judgment unless either defence is made out.

Facts

[4] Sleepyhead started supplying goods to King Robb in 1992. The current terms and conditions of trade between them were imposed in Sleepyhead's invoices sent on and from 19 April 2002 as follows:

> 7. Ownership in the Goods shall remain with the Company (and the Customer shall be a bailee only in respect of the Goods) until the

Customer has paid all amounts payable by the Customer to the Company.

…

9. If the Customer:

9.1 breaches these terms and conditions of sale;

9.2 makes a default in any payment on the due date;

9.4 if an incorporated company, passes an effective resolution for its liquidation or a Court makes an order to that effect or an application is made for its liquidation;

9.6 becomes unable to pay its debts as they fall due or suspends payment to its creditors; or

9.7 if the Goods are 'at risk' (as that term is defined in the PPSA),

then:

(c) the Company may repossess and sell the Goods and may enter into any premises where the Goods may reasonably be expected to be held at any time for that purpose.

11.1 These terms and conditions create a security interest in all present and after acquired Goods as security for all the Customer's obligations to the Company, which is or will be registrable in the Personal Property Securities Registry.

[5] On 3 May 2002 Sleepyhead registered its interest in all goods supplied to King Robb on the Personal Property Securities Register. Two days earlier, on 1 May 2002, the Bank of New Zealand had registered a prior registered debenture on the same register. It is common ground that, first, the BNZ is entitled to priority over Sleepyhead's security interest in the relevant goods and, second, no other party holds a security interest in them.

[6] King Robb never signed the invoices containing the agreements on which Sleepyhead made supply. However, Mr Howard Thompson, the liquidators' counsel, accepts that the course of conduct between the parties was sufficient to create a security agreement enforceable between Sleepyhead and King Robb. For his part, Mr Michael Robinson, Sleepyhead's counsel, accepts that the agreement is not enforceable against third parties given that King Robb did not sign the

documents (s 36(1)(b) PPSA). This question of third party enforceability lies at the heart of the liquidators' defence.

[7] Between March and August 2004 Sleepyhead supplied King Robb with goods to a value of $43,354. On 19 August 2004 Ms Christine Dunphy and Mr Iain Shephard were appointed liquidators pursuant to a special resolution of King Robb's shareholders (s 241(2)(a) Companies Act). The full purchase price of the goods was then outstanding. The next day Sleepyhead asked the liquidators to return the goods. They declined and later sold them by auction for $26,225.

[8] Total stock realisations made by the liquidators amounted to $147,524. BNZ obtained priority to the extent of $39,618. Nevertheless, only $2560 remained for distribution among all other creditors including Sleepyhead. Mr Robinson was critical of the amount of the liquidators' fees of $56,504. They also incurred commission and charges of $32,011 and legal fees of $9515.

[9] The liquidators' costs appear very high in relation to a modest liquidation. Mr Thompson explained that a substantial part was incurred in attempting to arrange a sale of the business as a going concern. The appropriate time to follow that course was before liquidation. Experience shows that the prospects of a successful sale after liquidation are remote.

Sleepyhead's claim

[10] Sleepyhead originally claimed summary judgment for $43,354 on the ground of conversion. Later it added causes of action for failing to account and breach of duties as the BNZ's agents. The rationale for adding them is unclear. Mr Robinson, who argued Sleepyhead's case skilfully on short notice, focused on conversion.

[11] To succeed in conversion Sleepyhead must establish that the liquidators' conduct: (1) was inconsistent with its rights as owner entitled to possession of the goods; (2) was deliberate; and (3) was so extensive an encroachment on the company's rights as to exclude it from use or possession of the goods (*Kuwait Airways Incorporation v Iraqi Airways Co (No. 4 & 5)* [2002] 2 AC 883 per

Lord Nicholls at 1084). Mr Thompson's defence for the liquidators challenged Sleepyhead's ability to prove the first element of the tort; that is, its right to immediate possession of the goods when demand was made for their return (*Harris v Lombard NZ Ltd* [1974] 2 NZLR 161).

[12] I shall now deal with each of the two affirmative defences raised by the liquidators to Sleepyhead's claim.

(1) Were the liquidators third parties or King Robb's agents?

[13] Mr Thompson submitted that the security agreement between Sleepyhead and King Robb is unenforceable against the liquidators because they are "a third party" (s 36(1) PPSA). This question will be determined by whether or not the liquidators were acting as King Robb or its agents when selling the goods.

[14] The material provisions of the Companies Act provide the starting point for this inquiry. The commencement of liquidation vests custody and control of the company's assets in the liquidator (s 248(1)(a)). The directors remain in office but cease to have any powers, functions or duties (s 248(1)(b)). The liquidators' principal duty is to take possession of, protect, realise and distribute the company's assets or their proceeds of realisation to its creditors in a reasonable and efficient manner (s 253(a)). He or she assumes other duties, principally of an administrative or mechanical nature (ss 254-257), and is bound to have regard to the views of shareholders and creditors (s 258). Significantly, the appointee has the powers necessary to carry out the functions and duties of a liquidator including those set out in the Sixth Schedule (s 260). The liquidator's expenses and remuneration are payable out of the company's assets (s 279).

[15] The liquidators' scheduled powers include, to the extent necessary for the liquidation, to carry on the company's business; to appoint a solicitor; to sell or otherwise dispose of the company's property; to act in the name and on behalf of the company and enter into contractual relations in that capacity; to borrow money on the security of the company's assets; and to appoint an agent to do anything which the liquidator is unable to do.

[16] These statutory functions and powers, individually and collectively, point to the constitution of a relationship of agency between the company and liquidator immediately upon appointment. The power to act "on behalf of the company" is the language of agency (*Re Tuohey; Ex Parte Attorney-General for Northern Territory* (1980) 145 CLR 374, at 376). It means acting for the benefit or in the interests of the nominated party (*Re Portus; Ex Parte Federated Clerks Union of Australia* (1949) 79 CLR 428, at 438).

[17] The issue has not been determined authoritatively in New Zealand. The common law, however, supports the conclusion of agency from the company. The English Court of Appeal has held that a liquidator, whether appointed voluntarily or by order, is not personally liable for the fees of solicitors engaged by him in the winding up (*In Re Anglo-Moravian Hungarian Junction Railway Company; Ex Parte Watkin* (1875) 1 Ch D 130). That is because the liquidator is acting as the company's agent and the contract is between the company and solicitor through the liquidator's agency (per James LJ at 133). As ownership of the company's assets is not vested in him, and he is the officer who acts instead of the directors, the liquidator is no more personally liable for contracts made in that capacity than directors would be (per Mellish LJ at 134).

[18] These authoritative statements of principle find express recognition in the Companies Act. Control and custody of assets only, not ownership, are vested in the liquidator. Upon appointment he or she supplants the directors. In that capacity the liquidator assumes his or her principal power of realisation of the company's assets, which is traditionally exercised by directors.

[19] The law has long treated a director as the company's agent (*Ferguson v Wilson* (1866) LR 2 Ch App 77 per Cairns LJ at 89, approved in *Kuwait Asia Bank EC v National Mutual Life Nominees* [1990] 3 NZLR 513 (PC) at 529) with consequential fiduciary obligations relating to its property. The express juxtaposition of the liquidator's appointment and cessation of the directors' powers confirms the identity between the two functions. There could be no rational basis for the law treating the relationships of a director and a liquidator with the company differently when they perform the same power of sale.

[20] Mr Robinson also relied on a later decision of the English Court of Appeal that a covenant in a lease against assignment without the landlord's consent was equally binding on the tenant and its liquidator (*In Re Farrows Bank Ltd* (1921) 2 Ch 164). The Court was concerned with powers in the Companies (Consolidation) Act 1908 analogous to those found in the Sixth Schedule. Lord Sterndale MR was satisfied that the liquidator's acts in seeking to assign without the lessor's consent were those of the company (173-175). Accordingly, he was bound by the terms of the lease.

[21] I accept that none of the judgments delivered by the three members of the Court in *Farrow's* case are expressed in terms of agency. They simply treated the liquidator as the company. In that sense the decision provides powerful support for Mr Robinson's argument, and undermines Mr Thompson's submission that these liquidators were "a third party".

[22] The trend of authority in Australia is to the same effect. Indeed, the liquidator's status as the company's agent has apparently been accepted without serious challenge (*In Re Millingens Ltd* [1934] SASR 72, Murray CJ at 80; *Rankine v Harris* [1997] QCA (unreported) CA (Queensland), Full Court, 9 July 1997, McPherson JA at 3; *Australian Securities and Investment Commission v Rich* (2005) 53 ASCR 752, Austin J, at paras 267-271). The office of liquidator has been described as a "hybrid composite with elements of fiduciary, trustee, agent, [and] officer of the company …" (*Oakleigh Acquisitions Pty Ltd (In Liq) v Steinochr* [2005] WASA 247 per McLure JA at para 63).

[23] Mr Thompson did not address any of these authorities. He advocated a middle ground of agency for some purposes but not for others. He posited two distinct situations. One involved the liquidator stepping into the company's shoes. In the other he or she represents and is agent for its creditors.

[24] Mr Thompson submitted that the liquidators were acting in the second situation. He focused upon the duties imposed by the Companies Act, and the obligation to realise and distribute assets or their proceeds in accordance with the statutory scheme. He submitted that when a liquidator exercises custody and control

over assets and, *a fortiori*, when realising them or distributing the proceeds, he or she is not acting simply as the company's agent. Instead, he or she is acting in the capacity of liquidator, pursuant to statutory functions and other powers and duties.

[25] With respect, Mr Thompson's attempt to place a liquidator in a distinct conceptual category as the creditor's agent or representative when realising and distributing the company's assets confuses authority and duties. The liquidator is subject to express limitations when exercising the power of sale. He or she acts in the company's name, not personally. He or she is not entitled to retain the proceeds to his or her own account. He or she also assumes duties to the company while performing that function including, among other things, the obligation to act with reasonable skill and care and also as a fiduciary.

[26] The Companies Act imposes personal obligations on the liquidator in favour of third parties, principally creditors and shareholders. The common law recognised a duty of this scope but one limited in nature to liability for misfeasance and personal misconduct (*Knowles v Scott* [1891] 1 Ch 717). Now the liquidator is statutorily bound also to act in a reasonable and efficient manner and would be liable to the company's creditors for a failure to sell assets for a reasonable price. The existence of a duty of care to that class is beyond argument given the statutory obligations to "distribute … the proceeds of the realisation of the [company's] assets to its creditors" (s 253(a)) and to have regard to the creditors' views in certain circumstances (s 258(1)). A receiver, who is also the company's agent, owes analogous duties to unsecured creditors when exercising a power of sale (s 19 Receivership Act 1993).

[27] However, the existence of statutory duties to creditors, or the obligation to act for their benefit, does not create an agency between the liquidator and them. Factors counting directly against such a relationship are the liquidator's rights to disregard the creditors' views when exercising his or her duties and to payment from the company's assets. Also major legal and commercial difficulties would arise from dual agencies. How would a third party buyer know, for example, whether the liquidator was acting as agent for the company or its creditors at any stage in the sale process? And would the creditors assume vicarious liability, in accordance with

orthodox agency principles, for the liquidator's acts or omissions in exercising the power of sale?

[28] Mr Thompson sought support from authorities to the effect that a liquidator when distributing assets is not estopped by representations made by the company to a creditor without the privity or knowledge of the other creditors (see *Re Exchange Securities and Commodities Ltd (No 3)* (1987) BCLC 425). However, on analysis, those cases provide no assistance whatsoever. Their rationale is that an estoppel by representation by the company cannot be used to set up an estoppel against a statute which requires a liquidator to distribute the assets among the company's true creditors, not those among whose claims are rendered fictitious by inclusion of substantial but non-existent profits on investments and credited to accounts (see *Re Exchange Securities* at 432-435). That is not the point here.

[29] In my judgment the law is clear. The liquidators were acting as King Robb's agents, for and on its behalf, when they sold the goods subject to Sleepyhead's security interest. In this respect I endorse statements to the same effect by the text book writers, Keay, McPherson: *The Law of Company Liquidations* (286-289); *Brookers Insolvency Law*, CA260.03, and Gedye, Cuming and Wood: *Personal Property Securities in New Zealand*, para 36.9. Alternatively put, the liquidators were the company and thus the debtor for the purposes of the PPSA. They were not collectively a third party.

(2) Recognition of security interest

[30] Mr Robinson's consequential submission was that, given the validity of the security agreement, Sleepyhead's goods were subject to a purchase money security interest for the unpaid purchase price (ss 16-17 PPSA). He submitted further that the interest complied with the statutory requirements in that: (1) it attached to the collateral (defined as the personal property that is subject to a security interest (s 16)) when Sleepyhead gave value by supplying goods and granting credit (s 48(1)(a)) and (2) King Robb had rights in the collateral, in the form of rights of sale and retention of profit subject to the terms and conditions of the agreement (s 40(1)(b)).

Sleepyhead did not lose these rights simply because the company went into liquidation.

[31] Mr Thompson accepted that Sleepyhead's interest had attached to the collateral. Accordingly, at that point, the company acquired a security interest in the subject goods. Nevertheless, he argued that the interest did not constitute a charge binding on the company or its liquidators for the purposes of the Companies Act. It defines a charge as (s 2):

> … includ[ing] a right or interest in relation to property owned by a company, by virtue of which a creditor of the company is entitled to claim payment in priority to creditors entitled to be paid under [s 313] …

[32] Mr Thompson observed that, while the statutory definition is not exhaustive, in order to qualify as a charge, a security interest must confer on its holder an entitlement to be paid from the proceeds of the subject property in priority to preferential and unsecured creditors in the context of the debtor's liquidation. In this context he argued that, although a charge within the meaning of the Companies Act definition will always be a security interest under the PPSA, the converse is not necessarily true. Here, he said, Sleepyhead's security interest was not a charge because it did not attach to any collateral except for the limited purpose of enforcing rights between the immediate parties. Consequently, it conferred no right on its holder of payment in priority to preferential and unsecured creditors in a liquidation.

[33] When stripped to its core, Mr Thompson's argument was that, because Sleepyhead's security interest did not satisfy the third statutory requirement of enforceability against a third party (ss 36 and 40(1)(c)), it did not attach to the collateral in the sense of creating a right in rem or a proprietary interest in the goods; that the right was only enforceable inter partes; and that a security interest of this nature is of an inferior quality, excluding it from the category of a charge.

[34] I must say, with great respect to Mr Thompson, that the passage of time has not eased the difficulties I experienced when listening to his argument. I record his acknowledgement that, first, a security interest constitutes 'a right or interest in relation to property owned by a company' within the Companies Act definition of a charge and, second, Sleepyhead's particular interest had attached to the subject

goods. Thus value had been given, and rights acquired. Nothing more was required in the circumstances of this case. Sleepyhead was entitled to payment from the proceeds in priority to other creditors. Mr Thompson did not explain how the advent of voluntary liquidation deprived the company of that right.

[35] The Companies Act expressly recognises the right of a secured creditor to take possession of and realise a debtor's property over which that creditor has a charge (s 248(2)). The secured creditor is subject to a residual obligation to account to the liquidator for any surplus (s 305(3)(b)). I repeat again Mr Thompson's concession that Sleepyhead was a secured creditor while King Robb was not in liquidation. In the event of default under its security agreement, Sleepyhead was entitled to take possession of and realise the goods. The Companies Act recognises, as Mr Robinson emphasised, that that right remains unaltered by liquidation. Indeed, it would be anomalous, and lacking in any commercial rationale, if the act of voluntary liquidation was of itself sufficient without more to relegate Sleepyhead from the rank of secured to unsecured creditor.

[36] In terms of these goods, on these facts, Sleepyhead's security interest was perfected for the reasons that (1) the security interest had attached and (2) a financing statement had been registered some years earlier in respect of the security interest (s 41(1) PPSA). There is no doubt that the scope of the protection afforded to Sleepyhead's security interest upon perfection might have been less than if it had complied with s 36(1) PPSA; the company would have been relegated to the league of unsecured creditors if King Robb had sold the goods to a third party. But that is not the case here. Sleepyhead's security interest gave it both contractual rights against King Robb and an interest in the property itself.

[37] In my judgment neither the PPSA nor the Companies Act allows for gradations of quality. An interest is either secured, and is thus a charge, or it is not. Neither statute allows for a halfway concept, something that gives incontestable priority against a debtor before liquidation but not afterwards. I agree with Mr Robinson that Mr Thompson's argument is borne of an attempt to analyse the relevant legal principles by reference to the old statutory regime. The PPSA introduced a new concept into securities law. It rendered the element of

enforceability immaterial as a component of attachment where the creditor was not seeking to enforce its rights against a third party but against the debtor alone. Conversely, of course, the security interest would not attach for the reason of unenforceability where a third party had acquired the goods for value from the debtor. In contrast, the Companies Act did not allow for such a concept; registration was sufficient to perfect a security for a creditor against everybody.

[38] Before the PPSA's enactment, the registration of company charges over personal property was governed by a number of enactments. Among them were the Chattels Transfer Act 1924, the Motor Vehicle Securities Act 1989 and Part IV of the Companies Act 1955. Under the former regime the question of which registration system applied to a security agreement and the effect (if any) of non-registration turned on factors such as the form of the transaction (whether the agreement was expressed as being a charge, a chattel mortgage or a title-based security); the identity of the person who had legal title to the personal property; the nature of the personal property that was subject to the security interest (e.g., a motor vehicle or boat); and the status of the debtor (a corporate or non-corporate body). The PPSA replaced these miscellaneous systems with a unitary notice registration system for all security interests in personal property. Its purpose is to provide a uniformity of treatment of all consensual security interests in personal property which is not dependent upon the form of the transaction.

[39] In my judgment Sleepyhead's security interest was a right or interest relating to property owned by King Robb by virtue of which the company is entitled to claim payment of the proceeds of sale in priority to unsecured creditors. Accordingly, it is a charge within the statutory definition.

Conclusion

[40] I am satisfied that Sleepyhead had a right to immediate possession of the goods it supplied King Robb, both when it made demand for their return and when the liquidators later sold them. In particular, Sleepyhead was not then seeking to enforce its contractual rights against a third party, but against the debtor itself, and in any event its interest constituted a charge in terms of the Companies Act giving it a

right to priority to the net proceeds of sale. It follows that the liquidators have no tenable defence to Sleepyhead's claim in conversion.

[41] Sleepyhead is entitled to summary judgment against the liquidators for the sum of $43,354 together with interest at Judicature Act rates from 25 September 2004.

[42] Sleepyhead is also entitled to judgment for costs against the liquidators personally. Mr Robinson indicated that Sleepyhead would seek costs on either an indemnity or increased costs basis. Sleepyhead is entitled to apply. However, I draw the attention of both counsel to the recent decision of the Court of Appeal in *Holdfast NZ Ltd v Selleys Pty Ltd* (CA200/04, 6 December 2005). If Sleepyhead wishes to pursue a claim for costs then I direct it to file a memorandum by 10 March 2006 and the liquidators to file a memorandum in answer by 24 March 2006.

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Rhys Harrison J