IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV 2008-404-001978

BETWEEN	NZ ASSOCIATED REFRIGERATED FOOD DISTRIBUTORS LIMITED Plaintiff
AND	ROBERT FREDERICK DONLEY First Defendant
AND	LAURA DONLEY Second Defendant
AND	R & L DONLEY PROPERTIES LIMITED Third Defendant

Hearing: 26 November 2008

Counsel: B D Gustafson/J R F Cochrane for plaintiff
H L Thompson for defendants

Judgment: 30 October 2009 at 5:00pm

JUDGMENT OF ASSOCIATE JUDGE ABBOTT

This judgment was delivered by me on 30 October 2009 at 5:00pm,
Pursuant to Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Solicitors:
Kensington Swan, Private Bag 92101, Auckland 1142 for plaintiff
McMahon Butterworth Thompson, PO Box 106073, Auckland 1142 for defendants

[1] This application for summary judgment arises out of the failure of a food distribution business, Fresh and Frozen Food Distributors Limited (in liquidation and in receivership) (FFFD).

[2] The plaintiff (NZARFD) carries on business as a food distribution co-operative. FFFD was a member of the co-operative and purchased substantial amounts of stock through NZARFD. The first and second defendants, Mr and Mrs Donley, were directors of FFFD at material times. They guaranteed FFFD's debts to NZARFD. The third defendant, R & L Donley Properties Limited (RLDP) is a related company (Mr Donley is its director and shareholder).

[3] Mr Donley put FFFD into liquidation on 1 April 2008. It owed substantial debts, including approximately $1.65 million to NZARFD. NZARFD put FFFD into receivership. Money recovered in the receivership has been applied in reduction of the debt. NZARFD is seeking summary judgment against the Donleys, pursuant to their guarantees, for the outstanding balance of FFFD's debt, being $620,321.71 (at the date of the hearing).

[4] The Donleys do not challenge their liability under the guarantees, but say that NZARFD has failed to prove that there is any balance of debt due by FFFD to it. They also say that there is further money to collect, and that NZARFD owes FFFD money under a discount scheme, and that these sums will offset any remaining balance.

[5] The day before FFFD went into liquidation Mr Donley transferred $268,647.72 from a bank account used to receive payments from FFFD's customers to a loan account in the name of RLDP, discharging RLDP's indebtedness under the loan. NZARFD says that this money was impressed with a trust in its favour. It claims the money back from RLDP on the grounds that RLDP received it with knowledge of that trust and in breach of fiduciary duty.

[6] RLDP acknowledges that FFFD paid the money to the credit of its loan account but says that this was pursuant to a cross guarantee given by FFFD of that obligation. It says that NZARFD has failed to show that there is any breach of fiduciary obligation, or any entitlement to trace the funds into RLDP's assets.

Factual background

[7] NZARFD is a co-operative of 19 food distribution entities operating throughout New Zealand. Some of these entities are shareholders in NZARFD. NZARFD negotiates terms of supply of food products, and other commercial opportunities, for the benefit of its members. Members of the co-operative order direct from the suppliers, but the supplier invoices NZARFD which in turn pays the supplier and invoices the member.

[8] NZARFD operates a system of trading discounts for members. The system was established pursuant to s 55 of the Companies Act 1993 and under NZARFD's constitution. Under this system, at the end of each trading year, the directors determine an amount to be returned to members from the year's trading as a rebate on purchases. The amount is allocated to a retained discount account (RDA) held by NZARFD and members are given vouchers that show the discount allocated to them for that year. The directors also determine when the vouchers are payable, and can defer payment if NZARFD's financial position requires it (for example, if there is a difficulty with cashflow).

[9] FFFD became a shareholder in NZARFD and a member of the cooperative in 2001 when the Donleys purchased the shares in FFFD. Those shares are now held by the trustees of a family trust. As part of the membership arrangement NZARFD provided credit to FFFD, secured by a debenture over all of FFFD's assets. The debenture was registered under the Personal Property Securities Act 1999 (PPSA) at a later date.

[10] FFFD purchased approximately 40% of its stock from NZARFD. On 30 March 2006 FFFD entered into a further trading account agreement with NZARFD, incorporating NZARFD's standard terms of trade. The application was made by FFFD trading as Total Food Services. The terms included a reservation of title in the stock purchased from NZARFD and the proceeds of its sale, until NZARFD was paid. In accordance with those terms the Donleys gave personal guarantees of all FFFD's obligations to NZARFD and FFFD gave NZARFD a purchase money security interest (PMSI) over all stock supplied pursuant to the terms of trade. The terms of trade (incorporating the PMSI) were registered under the PPSA in April 2006.

[11] The Donleys' guarantee is to be found in clause 17 of the Terms of Trade which reads:

> In consideration of the Company agreeing to supply the above named Buyer with goods the Guarantor HEREBY JOINTLY AND SEVERALLY agrees with the Company as follows:
>
> The Guarantor shall be responsible (as primary obligor and not merely as surety) for the due payment, performance, fulfilment and observance of all of the obligations of the Buyer to the Company.
>
> The Guarantor personally guarantees payment of all amounts owing by the Buyer to the Company and acknowledges that no indulgence, granting of time, waiver or forbearance to sue, or winding up or bankruptcy will release the Guarantor from liability hereunder.
>
> This guarantee shall be a continuing guarantee to the Company for all debts and obligations whatsoever and whensoever contracted by the Buyer with the Company in respect of goods supplied and this guarantee shall remain in force until all moneys hereby secured are paid.

[12] NZARFD started having concerns about FFFD's account towards the end of 2006. A dispute arose in early 2007 when FFFD said that it intended to stop supply to a major customer (that contract having been negotiated by NZARFD). The dispute was settled in May 2007. The terms of settlement required FFFD to make substantial monthly payments in reduction of what was by then a very substantial trading debt (approximately $2.4 million).

[13] By September 2007 NZARFD was again concerned about FFFD's financial position. It exercised a power under the debenture to appoint KordaMentha (an accountancy firm specialising in receiverships and insolvency) to undertake a formal review of FFFD. This created tension between NZARFD and FFFD, with FFFD resisting provision of some information sought as part of the review.

[14] From approximately September 2007 the Donleys starting issuing invoices to some of FFFD's customers under the name Total Food Services Limited (TFSL). TFSL was a shelf company which Mr Donley had acquired in March 2003 but, at least to that time, had never traded in its own right. Conversely, FFFD had been trading as Total Food Services and continued to issue statements to customers after September 2007 in that manner. Customers received a letter from FFFD with the statements requesting payment to an account in the name of TFSL. After funds were received they were transferred to FFFD.

[15] Mr Donley has given evidence that he wished to run TFSL separately from FFFD because of the souring of the relationship between NZARFD and FFFD. He has produced an application for credit made by TFSL in mid 2007 to a third party supplier. However, no steps were taken to establish the business separately other than the invoicing. TFSL did not create separate ledgers or obtain a separate GST number. There is no evidence that it acquired its own inventory. TFSL is now in liquidation. Mr Donley has acknowledged that he was "insufficiently careful to keep them separate".

[16] FFFD made seven payments to NZARFD under the settlement agreement, several of which were late. It was in default of the May 2007 settlement agreement by March 2008, and at that point all of its indebtedness to NZARFD had become due.

[17] On 31 March 2008 $268,647.72 was transferred from the account into which FFFD's customers were paying money to RLDP's loan account with ANZ National Bank. The money was used to clear that account, and allowed release of a mortgage over a property owned by RLDP.

[18] Mr Donley put FFFD into liquidation on 1 April 2008. The following day NZARFD exercised its powers under its debenture to appoint Mr G R Graham and Mr B J Gibson of KordaMentha as receivers of FFFD.

[19] It is not in dispute that FFFD owed a substantial amount to NZARFD at the point that it went into liquidation or that that sum has been reduced by recoveries by the receivers. The Donleys take issue, however, with NZARFD's claim that there is still a sum of $620,321.71 outstanding. They say that NZARFD has not proved what was due or has been recovered.

[20] Similarly it is not in dispute that there is a sum standing to the credit of FFFD in NZARFD's retained discount account (although the Donleys take issue with NZARFD as to the amount) or that NZARFD's Board determined prior to FFFD's liquidation that the vouchers issued to record this entitlement would not become payable at all until 2011, and would then be paid incrementally to 2016.

Amendment to application

[21] At the outset of the hearing counsel for NZARFD sought leave to file an amended application for summary judgment, to include an application against RLDP. The claim against RLDP had been brought in the plaintiff's amended statement of claim filed on 18 April 2008, but did not file and serve its amended application until 11 November 2008 (hence also requiring abridgement of time). The plaintiff relied on the same evidence adduced in respect of the application against the Donleys, and noted that the third defendant had been aware of the claim since April 2008.

[22] The defendants did not oppose leave being granted, and were able to file notice of opposition to the amended application (including opposition to the claim against the third defendant) on 20 November 2008. In those circumstances I granted leave to the plaintiff and an abridgement of time, but reserved leave to the defendants to raise any difficulties that they had in advancing any aspect of their defences by reason of the delay and abridgement: *Permanent Nominees Limited v McIntyre* (1992) 6 PRNZ 339. They did not have need to do so.

Principles – summary judgment

[23] Counsel did not dispute the principles that the Court should apply in determining an application for summary judgment. They are well understood and can be found in the leading cases *Pemberton v Chappell* [1987] 1 NZLR 1, *Bilbie Dymock Corp. v Patel* (1987) 1 PRNZ 84 (CA), and more recently *Jowada Holdings Limited v Cullen Investments Limited* CA 248/02 5 June 2003. The essential principles of relevance to this application are that:

a) the onus is on the plaintiff seeking summary judgment to show the necessary facts and legal basis to establish its claim, and that there is no arguable defence: the Court must be left without any real doubt or uncertainty on the matter;

b) the Court will decide questions of law where appropriate;

c) the Court will not attempt to resolve genuine conflicts of material facts, or to assess the credibility of statements in affidavits;

d) in determining whether there is a genuine and relevant conflict of fact, the Court is entitled to examine and reject spurious defences or plainly contrived factual conflicts; and

e) in weighing these matters, the Court will take a robust approach and enter judgment even where there may be differences on certain factual matters if the lack of a tenable defence is plain on the material before the Court.

[24] It must also be borne in mind that summary judgment will be inappropriate where material facts need to be ascertained by the Court, and the ultimate determination depends on a judgment only able to be properly arrived at after a full hearing of the evidence: *Westpac Banking Corporation v MM Kembla (New Zealand) Ltd* [2001] 2 NZLR 298 at [62].

[25] Further, it must be noted that the defendant in a claim for summary judgment must provide some evidential foundation for defences relied upon: *Cegami Investments v AMP Financial Corporation (NZ) Ltd* [1990] 2 NZLR 308, 313. Otherwise, the plaintiff's verification of its claim stands unchallenged and ought to be accepted unless patently wrong: *Australian Guarantee Corporation (NZ) Ltd v McBeth* [1992] 3 NZLR 54 at 59.

The guarantee claim against the Donleys

The plaintiff's claim

[26] NZARFD seeks judgment for the full amount of the debt owed by FFFD on the basis that the Donleys are liable jointly and severally under their guarantees as primary debtors rather than as sureties for FFFD. The sum for which summary judgment is sought is $620,371.71.

The plaintiff's arguments

[27] Counsel for NZARFD submitted that NZARFD had established its case both on liability and quantum. He argued that although the Donleys were contesting the amount of the unpaid balance, they had not provided any evidence to challenge NZARFD's evidence, and that NZARFD's evidence ought to be accepted by the Court as it was not patently wrong: *Australian Guarantee Corporation (NZ) v McBeth*.

[28] Counsel also submitted that the Donleys could not claim the benefit of a set-off of the money standing to the credit of FFFD in NZARFD's retained discount account because NZARFD's obligation to pay that credit had not crystallised, and would not do so until NZARFD's directors determined that the RDA vouchers were to be paid. He referred to the evidence of both Mr Bradley and Mr Pickup that the directors had determined that the discounts were not to be paid until 2011 at earliest, and contended that there was currently no certainty that payment would be made at that time (it would depend on NZARFD's financial circumstances, and under

clause 8 of NZARFD's constitution the directors could decide to defer payment at any time before 2011).

[29] On that basis he argued that the credit was not a debt due for payment at the time of FFFD's liquidation, for the purpose of s 310 of the Companies Act 1993 (which provides for mutual credits and set-off for a company in liquidation).

The defendants' arguments

[30] The Donleys accept that they are bound by the guarantees. However, they say NZARFD has not shown that there is any existing obligation under the guarantees because it has not proved that there is a debt remaining owing by FFFD to NZARFD:

a) First, they say that there are a number of discrepancies in NZARFD's evidence, and the true state of the account between NZARFD and FFFD has not been established (notwithstanding requests made for a comprehensive accounting).

b) Secondly, they say that NZARFD had an obligation to pay the sum credited to FFFD in the retained discount account from the time that the money was allocated to the account, and accordingly it was a debt that existed before the liquidation. They say that it can be set-off even though it was not due for payment until after the liquidation, as under NZARFD's constitution, the directors' discretion is limited to the manner of payment. They also say that references in NZARFD's constitution to discounts being "credited" to members, and to "entitlements" of members support the characterisation of the discount as debt. They say that there would be no purpose to the provisions for a set-off between discount entitlements and sums payable to NZARFD if the discounts, once allocated, were payable only at the discretion of the directors.

c) They also dispute the sum credited to FFFD's account. Mr Donley says that it is his recall that the account was near to $450,000. He contends that NZARFD should have produced copies of the relevant vouchers and a breakdown of the amount in the account.

The issues

[31] The Donleys' primary argument is that NZARFD has not proved that FFFD still owes the sum that NZARFD is claiming from them. This raises two issues. The first is whether the Court can determine that there is an unpaid debt and, if so, of what amount, on the evidence before the Court. The second is whether the sum held to FFFD's credit in the retained discount account can be set-off against the debt and, if so, whether the amount of any set-off can be determined on the evidence before the Court and whether it extinguishes the debt.

Analysis

[32] In its original statement of claim NZARFD sought judgment for an approximate sum of $1.65 million, but said that full details of the debt would be supplied before the hearing. In an affidavit sworn on 12 August 2008 by its chief executive officer at that time, Mr S J Bradley, the indebtedness was shown to be $828,865.30 as at 31 July 2008, exclusive of an advance to the receivers of $50,000 (for working capital), plus interest and costs. In an updating affidavit filed in the week before the hearing, NZARFD's chairman and interim chief executive officer Mr D L Pickup stated that the balance then was $834,321.71 but acknowledged that credit had to be given for a further $214,000 which the receivers had collected but had not paid to NZARFD at that point.

[33] Mr Pickup also stated that the debt could reduce further as recovery action was still being taken to collect FFFD's remaining debtors (totalling $146,369) and if NZARFD's claim to recover the pre-liquidation payments to RLDP ($268,647.72) was successful. He added that FFFD had a sum of $374,104 standing to its credit in NZARFD's retained discount account, but said that that sum had not been taken into

account because it was not payable until at least 2011, and there was no certainty that it would be paid even then.

[34] I accept the sum of $834,321.71 as the starting point for calculating the sum due by FFFD. It is not clear whether this is inclusive or exclusive of the additional $50,000 that Mr Bradley had added to the debt as at 31 July 2008. Counsel for NZARFD sought to clarify this after the hearing, and to file a further affidavit if necessary. That was opposed by counsel for the Donleys. I consider that the Donleys should be given the benefit of the doubt on this, and will treat Mr Pickup's figure as an inclusive figure for the purposes of this summary judgment application. Apart from that I find that there is no evidential basis for the Donleys' assertion that not all money has been brought to account.

[35] Counsel for the Donleys submitted, nevertheless, that Mr Pickup's figure could not be relied upon for two reasons. First, he said that there was no evidence from the receivers as to the sum that had been collected. However, the critical evidence must be what money has been received by NZARFD, rather than what money the receivers collected for FFFD. One of the receivers, Mr G R Graham, has given evidence that there was an agreement between the liquidators and the receivers under which the receivers were to realise assets and account to the liquidators for an agreed percentage. In doing so, as a matter of law, the receivers were acting as agents for FFFD (not NZARFD): s 31(2)(b) Receiverships Act 1993. Both Mr Bradley and Mr Pickup have given evidence that the debt claimed is net of sums NZARFD has received in reduction of the debt.

[36] The second aspect of challenge concerns the sum of $214,000 which Mr Pickup said had been collected by the receivers but had still to be paid to NZARFD. Counsel for the Donleys submitted that this evidence was objectionable as hearsay, particularly in light of the Donleys' unmet request for a comprehensive accounting. He also submitted that the true amount of the remaining debt was not proven, as the figure of $214,000 was clearly an approximation, and it was unclear what further amounts were likely to be recoverable (referring particularly to the uncollected debts totalling $146,369).

[37] There is no merit to the objection to the hearsay aspect of Mr Pickup's evidence as to the money still to be paid to NZARFD by the receiver. The Court can accept hearsay evidence on an interlocutory application, even if it should do so cautiously on an application for summary judgment. I consider that it should be allowed as it works in favour of the Donleys by reducing the amount of debt that is otherwise established on NZARFD's evidence.

[38] I also reject the defence that the quantum of the debt cannot be determined at this point because the sum still to be received from the receivers may differ from the approximate figure given by Mr Pickup or because there may still be assets to collect. The Donleys are liable as primary debtors. The debt has been established. If more has been paid to NZARFD since the hearing, NZARFD will have to give a credit for that when executing the judgment. If FFFD has assets which have not been realised the Donleys will be entitled to be subrogated to NZARFD's claim and to obtain the benefit of any further realisations.

[39] I find that NZARFD has proved a debt still owing by FFFD to NZARFD in the sum of $620,371.71 (as at date of hearing). I turn now to consider whether the Donleys can claim the benefit of a set-off of the money in the retained discount account.

[40] The Donleys' claim to the benefit of a set-off of the retained discount account is based on s 310 of the Companies Act 1993:

> **310 Mutual credit and set-off**
>
> (1) Where there have been mutual credits, mutual debts, or other mutual dealings between a company and a person who seeks or, but for the operation of this section, would seek to have a claim admitted in the liquidation of the company,—
>
> (a) An account must be taken of what is due from the one party to the other in respect of those credits, debts, or dealings; and
>
> (b) An amount due from one party must be set off against an amount due from the other party; and
>
> (c) Only the balance of the account may be claimed in the liquidation, or is payable to the company, as the case may be.

[41] Counsel were agreed that the set-off applies only to debts (or credits) that are in existence at the date of liquidation: *Paganini v The Official Assignee* CA 308/98, 22 March 1999. They differed, however, as to whether the credit in the retained discount account could be regarded as an amount due by NZARFD to FFFD when it was not immediately payable and (as NZARFD contends) might never be payable.

[42] Both counsel relied on *Paganini*. Counsel for NZARFD said that it supported its argument that the debt or obligation claimed as set-off had to be payable at time of liquidation. Counsel for the Donleys relied on it for the proposition that the debt or obligation was available as set-off if it existed at the time of liquidation, even if it did not become payable until later.

[43] In *Paganini* a landlord had an option under a lease to purchase the tenant's chattels and plant on termination of the lease. The tenant went into liquidation owing the landlord a substantial amount for arrears of rent and other obligation under the lease. The lease was terminated upon liquidation. The following day the liquidator agreed to sell the chattels and plant to the landlord. The landlord claimed a set-off of the purchase price against the unpaid rent. The Court of Appeal upheld the Judge at first instance in disallowing the set-off on the ground that there was no mutuality at time of liquidation as the landlord's obligation to pay the purchase price arose after the commencement of the liquidation. The significant reasoning, applicable to the present case is to be found in the following passages:

> [13] In this case the landlords must establish that their interest (to choose a neutral word) in the option qualified, at the time of the liquidation, as a "debt" or an aspect of "other mutual dealings" between them and their tenant. We do not see how they can possibly do that. Under the option they had the power in certain circumstances to require the tenant to sell. At the time of liquidation they had not exercised that power. Had they done so, but, for instance, the valuation had not been completed there would have been a compelling argument that they were indebted at the critical time and the fact that quantification had not been completed did not defeat the claim, eg In *Re City Life Assurance Co Ltd* [1926] Ch 191 CA and the *Rushworth* case discussed in the next paragraph. But in this case they had not taken that step and accordingly they could not be said to owe the debt to the company or to have engaged in mutual dealings with it. Nor could the power under the option be read as coming within the provisions of s 303 on admissible claims: the power is simply not a "debt" or "liability".
>
> [14] The significance of the nature of the landlord's interest in this case is highlighted by the critical difference between that interest and the landlords'

> interest in a case on which Mr James, as their counsel, placed great reliance, *Re Rushworth, ex parte J R Holmes and Sons* (1906) 95 LT 807 DC. In that case the lease (for a public house) required the landlords to find an incoming tenant to pay a fair and just valuation for the fixtures, fittings and stock in trade; in default the landlords would have to pay that amount. The Court held that the landlords could set off their debt under that provision against the pre-liquidation debt owed to them by the bankrupt tenant. As the Court made clear, this was a plain case of mutual credit existing *from the date of the lease* and continuing till the end of the tenancy; it was not affected by the bankruptcy. That is to say the landlords had always had an obligation, which could be quantified and taken into account under the set off provision.

[44] The principle to be taken from *Paganini* is that a set-off will apply if an enforceable obligation exists at the date of liquidation. This will be decided on the circumstances of the case. However, neither the Court in *Paganini* nor the Court in the earlier case of *Re Rushworth* referred to in *Paganini* explicitly addressed the essential issue in this case, namely the requirement in s 310 that the amount to be set-off is "due" at time of liquidation.

[45] Counsel for the Donleys argued that an obligation capable of being set-off under s 310 (whether it is termed a credit or a debit) came into existence when the discounts were allocated and a voucher evidencing FFFD's entitlement was issued. He said that the debt arose or was "due" at that point. This contention has to be considered in light of the provisions of NZARFD's constitution in relation to the discounts. The relevant provisions read:

> VII PROFITS DIVIDENDS AND DISCOUNTS
>
> 8 1 Each year out of the net tax paid profits of the Company and after making due provision for the running and management of the Company and such other matters as the Board deems advisable the Board shall recommend to the Annual General Meeting the making of the following provision out of the funds available as a result of the last concluded financial year
>
> ...
>
> (ii) a discount that shall be carried to the Retained Discount Account, such discount to be calculated in respect of each member who qualifies on the basis of the discount formula
>
> 8 3 The said discounts so earned to the Retained Discount Account shall henceforth each year be supported by a Voucher. The first Voucher shall show the accumulated creditors in that account as well as that year's discount and each succeeding Voucher shall show the amount of discount in that year allocated to the particular member

> 8 4 The amount allocated to each member in the Retained Discount Account and each Voucher shall be subject to set-off and the entitlement of each member shall be the net figure after taking into account any set-off whether the same arises out of unpaid purchase moneys for merchandise or arising howsoever ... and each member acknowledges that the net figure only is payable out of the Retained Discount Account and by virtue of any Voucher and each Voucher issued by [NZARFD] shall have endorsed thereon a provision that the discount shown on the face of the Voucher is subject to set-off and [NZARFD] shall only be liable to pay when the Voucher matures the net amount after taking into account any set-off whenever and howsoever arising ....
>
> 8 5 Subject as aforesaid Vouchers shall be payable to each member entitled in a manner to be determined by the Board from time to time. Notwithstanding the foregoing the vouchers shall be immediately due and payable should [NZARFD] go into liquidation or be placed in receivership
>
> 8 6 The Board shall, if in doubt, consult the Auditors as to the amount to be credited to any member, the amount of any set-off, the entitlement to payment and the time of payment of any voucher and any matters arising out of or in any way pertaining to the Retained Discount Account and the Vouchers and a certificate from the Auditors on any such matters shall be final and binding and conclusive as between the company and the member and any person claiming under that member
>
> 8 7 The dividends and discounts each year shall be fixed at the Annual General Meeting but so that neither shall exceed the amount recommended by the Board

[46] A debt is "due" when it is payable: Stroud's Judicial Dictionary, 6th ed, citing *Re European Life Assurance*, LR 9 Eq. 122. NZARFD's constitution prescribes when the money held in the retained discount account becomes payable:

a) The constitution provides a mechanism for payment in the form of the vouchers (clause 8 3).

b) NZARFD's obligation to pay the allocated credit arises "when the voucher matures" (clause 8 4).

c) The vouchers "shall be payable ... in a manner to be determined by the Board" (clause 8 5).

d) There are two circumstances in which the vouchers are payable other than as determined by the directors. The first is when the Board obtains an auditor's report because of uncertainty on various matters

including entitlement to payment and timing of payment (clause 8 6). In this circumstance the voucher will be payable as certified by the auditor (who can certify both as to entitlement and as to timing of payment of any voucher). The second is if NZARFD went into liquidation or was placed in receivership (clause 8 5). In that event all amounts are payable immediately.

[47] Mr Bradley has referred to the way in which these provisions have been applied:

> 14 The RDA is an entry in the plaintiff's accounts that records a rebate from previous years' trading that can be paid to members at a future date specified by the directors. The directors can defer payment of these rebates if they deem that to be expedient. For instance, cash flow difficulties in any given year see rebates scheduled to be paid in that financial year deferred.
>
> 15 The Fresh & Frozen RDA is currently recorded as $285,678. This amount is not scheduled to become payable at all until 31 August 2011, and is then scheduled to be paid incrementally to 31 August 2016. All of these payments are contingent upon there being sufficient cash flow available in the business for payments to be made. If it is deemed that there is an insufficient cash flow, or there is any other reason why the directors believe a distribution should not be made, then payment will be deferred.

[48] The Donleys have not disputed that the board has determined the vouchers are not payable until 2011, and the other two circumstances under which the vouchers are payable do not apply. Counsel for the Donleys argued, in effect, that this determination by the directors could not change the fact that FFFD's claim to the credit existed at time of liquidation. However, that is not the test under s 310, or a matter of quantification of an existing claim (as in *Paganini* and *Re Rushworth*). FFFD's credits are not "due" until the date determined by the board. The effect of treating the credits as an enforceable obligation at the suit of FFFD at the time of liquidation, even though they were not payable for at least three years (and potentially might never be), would give a benefit to a member going into liquidation which was not available to those who did not (and presumably continued to pay for merchandise purchased without the benefit of that credit). Such an interpretation would be inconsistent with the policy underlying these schemes, set out in s 55 of the Companies Act 1993, that all members were to be treated equally.

[49] In light of this finding that the set-off is not available, I do not have to consider the Donleys' argument that NZARFD has failed to prove the quantum of FFFD's credit in the retained discount account. I note, however, that the Donleys will be entitled to be subrogated to the claim that NZARFD would otherwise have had in the liquidation, and eventually to share in the credit if and when it becomes payable.

The knowing receipt claim

The plaintiff's arguments

[50] NZARFD's case against RLDP is that RLDP received the $268,647.72, transferred the night before FFFD was put into liquidation, knowing that the money was transferred in breach of fiduciary duties arising out of the security interests which FFFD had granted to NZARFD, and the trust arising out of the terms of trade.

[51] In a carefully developed argument, counsel for NZARFD submitted that:

a) the money comprised the proceeds of sale by FFFD of stock that was subject to NZARFD's security interest under the GSA or the PMSI (RLDP having accepted that NZARFD had a perfected security interest in FFFD's stock inventory), notwithstanding that the account from which the money was transferred was under the name of Total Food Services Limited and was owned by R & L Donley Transport Limited;

b) RLDP's argument that the money comprised (at least in part) proceeds of sale by Total Food Services Limited did not assist RLDP as stock acquired by TFSL from FFFD remained subject to NZARFD's security interests because the sale was not in the ordinary course of FFFD's business (s 53 PPSA) and the security interests extended to the proceeds of sale (s 45(1)(b) PPSA);

c) NZARFD's security interests in the proceeds of sale (whether the sale was by FFFD or TFSL) were not extinguished by the transfer of money to RLDP's loan account because RLDP had received the money with knowledge of NZARFD's security interest (s 94(a) PPSA) and there was no evidence that RLDP became a holder for value (s 94(b) PPSA*);*

d) RLDP had this knowledge imputed to it through Mr Donley who, as common director, was the mind and will of FFFD, R & L Donley Transport Limited, and RLDP, and knew that the transfer was defeating the interests of NZARFD and FFFD; and

e) RLDP is liable to account on the basis of the principle of knowing receipt, in that it received and obtained benefit from the money, knowing that it was traceable to a breach of fiduciary duty by both FFFD and Mr Donley (as director of FFFD): *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685; *Equiticorp Industries Limited (In Statutory Management) v The Crown* [1998] 2 NZLR 481.

RLDP's arguments

[52] Counsel for the defendants' first submission was that NZARFD could not trace its security interests into the hands of RLDP under the PPSA because the definition of "proceeds" was limited to personal property, and the transfer of money did not produce a fund or other personal property (it was common ground that the effect of the transfer was to discharge RLDP's indebtedness to its bank). As NZARFD has not pleaded its case in this way, nor advanced argument on it, there is no need to deal with this further.

[53] The primary argument advanced by counsel for the defendants was that NZARFD had not established one of the principle elements of its claim for knowing receipt (as identified in *El Ajou* and *Equiticorp*, namely breach of a fiduciary duty. Counsel submitted that:

a) the relationship between FFFD and NZARFD under the GSA was that of mortgagor and mortgagee, and under the terms of trade was that of debtor and creditor, rather than fiduciary;

b) NZARFD's interests under both the GSA and the PMSI were security interests as defined by s 17 of the PPSA, created to secure the payment or performance of obligations; and

c) the source of any right that NZARFD might have to the proceeds of sale of FFFD's inventory was the PPSA, rather than an implied fiduciary obligation (arising out of the provision for a trust in the proceeds of sale in clause 5 of the terms of trade) and the trust clause should not be used to circumvent or frustrate the legislative interest of the PPSA: Geyde et al, *Personal Property Securities in New Zealand*, 2002 para 17.5; *Stiassney v Dunedin City Council* HC AK CIV 2007-404-003463 30 May 2008 Winkelmann J, particularly at paras 28, 38-39.

[54] Counsel submitted that there were further difficulties with allowing a "trust" claim to be brought outside the framework of the PPSA making it difficult to ascertain what purpose the trust created by clause 5 had other than to secure performance of FFFD's obligations to NZARFD:

a) Clause 5 purports to give FFFD an interest as beneficiary in part of the proceeds of sale, but it is impossible to ascertain from the wording of the clause what that interest is, (and hence the parties' respective interests), rendering the trust void by reason of uncertainty: *Boyce v Boyce* 60 ER 959;

b) There was lack of certainty as to the subject matter of the fund because trust property was not kept separate from other property: the trust applied only to stock supplied by NZARFD, which comprised only 40% of the stock supplied, and proceeds of sale were

commingled in the account: *Stiassney v Dunedin City Council* at paras 24 and 25;

c) General principles of equity (*Re Hallett's Estate* (1879) 13 Ch D 696) could result in the entire commingled fund being deemed to be trust property. At least one other supplier supplied goods on terms of sale with a trust proceeds clause, potentially also giving it a claim to the entire fund also. This would create the confusion and uncertainty which the PPSA was intended to avoid.

[55] Counsel also submitted that even if the Court concluded that there was a breach of trust by FFFD, summary judgment was inappropriate as NZARFD had failed to show the loss that it has suffered as a result of any breach (the outcome of the receivership, and hence the extent of any deficiency, was still unclear).

Analysis

[56] Before turning to the primary argument for RLDP, I will consider whether NZARFD has established a case for summary judgment apart from that primary argument. The first matter to consider is whether the money transferred comprised proceeds of sale by FFFD of stock that was subject to NZARFD's security interests. RLDP argued that at least part of the money in the account comprised the proceeds of sales by TFSL. In my view it is doubtful that there were in fact separate sales by TFSL:

a) It is clear that FFFD used Total Foods Services (TFS) as a trading name from an early stage (prior to giving the debenture to NZARFD) and at least until September 2007.

b) The detail of Mr Graham's evidence that TFSL did not trade separately was not challenged by Mr Donley. TFSL did not have premises, staff or vehicles of its own, and did not have a GST numbers.

c) Although TFSL appears to have started issuing invoices in about September 2007 it used FFFD's GST number and no ledgers or other accounting records were set up to record transactions separate from FFFD.

d) There is no evidence before the Court of any purchases of stock by TFSL separate from FFFD. Mr Donley produced a credit application form in respect of one supplier (signed in June 2007) which was made in the trading name of Total Food Services Limited, but the provision for registered company name was not completed and FFFD's name was shown after the description "food distributor" alongside the nature of the business.

e) There is no evidence of any sales by TFSL to persons who were not previously, or were not also, customers of FFFD.

f) The combined delivery docket and invoice sent to customers with goods was in the name of TFSL but bore FFFD's GST number, and was followed by a weekly statement from FFFD trading as Total Food Services that recorded the individual invoices. The remittance advice on these statements similarly referred to FFFD trading as Total Food Services. There was a separate letter from FFFD enclosed, asking for payments to be made to an account in the name of TFSL. It is accepted that that account had been established by R & L Donley Transport Limited. It is not disputed that after receipt money was transferred to FFFD.

[57] Mr Donley has conceded that FFFD used TFS as a trading name, and that disillusionment with NZARFD had led him start trading TFSL separately. He says that TFSL's affairs became intertwined with FFFD, but has not attempted to explain why he took no steps to create separate records, including obtaining a separate GST number. As TFSL is also in liquidation, I accept that its documents will now be held by the liquidator. Nevertheless, there is no suggestion that Mr Donley has attempted to obtain any documents to support RLDP's case for the separate trading by TFSL,

which gives rise to an inference that he did not do so because they would not establish more than I have set out in the preceding paragraph.

[58] In the circumstances, Mr Donley's assertion that TFSL trading separately does not seem to pass the threshold of credibility. However, it is not necessary to determine that as NZARFD would appear to have retained a security interest in any stock that might be found to have been sold by TFSL because sales of stock by FFFD to TFSL were outside the ordinary course of FFFD's business (*Orix New Zealand Ltd v Milne* HC AK CIV 2005-404-4394, 17 May 2007, Rodney Hansen J):

a) It is accepted by RLDP that NZARFD had a perfected security interest in all FFFD's stock (whether it was obtained from NZARFD or other suppliers).

b) There is no evidence that TFSL acquired any stock directly from suppliers as distinct from through FFFD (although Mr Donley appears to assert that TFSL acquired stock independently, there is no evidence to support this assertion, and it is difficult to see how that could occur given that TFSL did not have a separate GST number).

c) FFFD's ordinary course of business was to trade as TFS, to supply customers directly, and to receive the proceeds of those sales.

d) The decision to trade through TFSL was a deliberate decision taken by Mr Donley to move trade away from that usual course (and, by inference, to avoid the security interests).

e) If FFFD did sell to TFSL as Mr Donley contends, that comprised a diversion of a substantial part of FFFD's business in breach of the debenture and terms of trade, again outside the ordinary course of business.

[59] In the circumstances, NZARFD's security interests were not extinguished (s 53 PPSA) and, after sale of the stock by TFSL, extended to the proceeds of sale in TFSL's hands (s 45(1)(b) PPSA).

[60] Finally, I accept that NZARFD's security interests in the proceeds were not extinguished by transfer of the money to RLDP because RLDP received the money with knowledge of the security interests (s 94(a) PPSA) by reason of the common directorships of Mr Donley. There is no evidence that RLDP was a holder of that money for value (so s 94(b) PPSA does not apply).

[61] This brings me to RLDP's primary ground for defence, namely that NZARFD cannot make out a claim based on knowing receipt because it could not satisfy the requirement to show a breach of a fiduciary duty.

[62] The elements which must be established for a claim for knowing receipt were set out succinctly in the judgment of Hoffmann LJ in the decision of the English Court of Appeal in *El Ajou* (at p 700):

> This is a claim to enforce a constructive trust on the basis of knowing receipt. For this purpose the plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty

[63] These elements have been accepted as representing the law in New Zealand in *Equiticorp* and, more recently, *Kings Wharf Coldstore Limited (in receivership and in liquidation) v Wilson* (HC WN CIV 2001-485-954, 24 November 2005, Miller J).

[64] Counsel for NZARFD submitted that fiduciary duties were owed both by FFFD (to NZARFD) and by Mr Donley (both to FFFD and to NZARFD) in relation to NZARFD's security interests. He submitted that these fiduciary duties were not in conflict with (and therefore could stand alongside) the statutory regime applicable to security interests under the PPSA. He referred to Blanchard and Gedye, *Private Receivers of Companies in New Zealand* at para 1.04 where the nature of security interest was discussed and the authors recognised that an equitable interest that was

not a security interest could come into competition with a security interest. I did not understand counsel for RLDP to challenge this proposition, but rather to say that the security interests claimed by NZARFD did not also give rise to a fiduciary relationship. That may or may not answer NZARFD's argument. It is necessary to consider the alleged fiduciary duties and then determine whether it is arguable that they can coexist as counsel for NZARFD contends.

[65] In his written argument counsel for NZARFD focussed on FFFD's obligation under the terms of trade to hold the proceeds of sale of secured stock on trust for NZARFD. The relationship between a trustee and beneficiary is a well settled category of fiduciary relationship. In his oral argument, no doubt in response to the argument for RLDP that there were difficulties with the trust proceeds clause, counsel for NZRFD argued also that the fiduciary duty owed by the giver of a charge to the recipient of a charge, pre introduction of the PPSA, in relation to dealings with property subject to the charge still applied notwithstanding introduction of the PPSA. He argued that the transfer of the money the night before liquidation was a breach of that duty as well as a breach of the trust arising out of the terms of trade (as it defeated the interests of NZARFD as holder of an equitable interest under the debenture and as a beneficiary of the trust under the terms of trade).

[66] Counsel for NZARFD also argued that there was clear law that Mr Donley owed a fiduciary duty both of good faith both to FFFD and to its creditors not to dispose of its funds in absence of a legal compulsion or duty, citing *Equiticorp* (at p 549):

> It is, of course, trite law that directors are effectively trustees of the company's assets and owe duties of good faith, not only to the company and its shareholders, but also to its creditors. The obligation to creditors is especially importance when the company is facing financial difficulties.

[67] He also argued that Mr Donley also had a duty (acting as agent for FFFD) not to act inconsistently with the known terms of the trust proceeds clause even if he genuinely believed he was entitled to transfer the money (because he was to be regarded as a *trustee de son tort*: Dal Pont & Chalmers, *Equity and Trusts in Australia*, 4th ed p 989).

[68] These arguments raise complex issues which make the claim unsuited for determination by summary judgment:

a) Counsel for NZARFD did not fully develop his argument that NZARFD had an equitable interest in the proceeds of sale under the debenture which could stand separately to the security interests under the PPSA. I consider that it is at least arguable that the legislative intent of the PPSA was that that interest would be subsumed by the regimes of the PPSA, in which case there may not be room for a fiduciary as distinct from the debtor/creditor relationship.

b) Although the trust proceeds clause speaks of FFFD holding the proceeds on trust for NZARFD, there is strength in the argument that that clause should be construed as "an arrangement to provide security for payment of invoiced amounts, grafted onto a relationship which is fundamentally that of debtor/creditor" (*Stiassney v Dunedin City Council* at para [28]) and not giving rise to an implied fiduciary obligation: Gedye, *Personal Property Securities in New Zealand* at para 17.5.

c) Even if it was to be found that the parties intended a trust relationship, the language of the clause makes it difficult to establish the parties' respective beneficial interests. The relevant part of the clause reads:

> If the Buyer on-sells any goods (supplied by the Company) before ownership has passed to the Buyer, the proceeds of such sale shall be received and held by the Buyer in trust for both the Company and the Buyer. The Buyer's interest as beneficiary under that Trust shall be that portion of the proceeds which does not exceed the Buyer's indebtedness to the Company.

I accept the submission of counsel for RLDP that although it appears that FFFD only had an interest in proceeds in excess of its indebtedness to NZARFD at the material time, that is not what the clause says.

d) Although the above issues are primarily matters of law, I do not consider that they should be determined at this point. The Court will be better able to determine them with the benefit of examination of surrounding factual circumstances and more detailed and focussed legal submissions. Even more significantly, for the purposes of summary judgment, it is not possible to determine now whether there has in fact been any commingling of funds in the TSF account (which may be relevant if a fiduciary relationship is found to exist under the trust clause, but not in respect of the debenture). In that event there will need to be a determination of the source of the funds and an assessment of competing claims.

e) Lastly, RLDP will only be liable if there is a deficiency as a result of any breach of fiduciary duty. That will require further evidence as to the outcome of the receivership and the extent of the loss suffered.

Decision

[69] For the reasons set out in this judgment, I find that NZARFD has established that the Donleys do not have an arguable defence to its claim under the guarantee for the unpaid debt due by FFFD to NZARFD. I order summary judgment in favour of NZARFD (the plaintiff) against the Donleys (the first and second defendants) in the sum of $620,321.71.

[70] I find that NZARFD has not established its claim against RLDP (the third defendant) for the purpose of summary judgment. I dismiss the application for summary judgment against the third defendant.

[71] The Registrar is to list NZARFD's claim against RDLP for a case management conference to give directions for its future conduct.

[72] As the successful party in its claim against the Donleys, NZARFD would ordinarily be entitled to costs against them. As it did not succeed against RLDP (at least at this stage) I would ordinarily reserve costs on that claim until it has been

determined in the ordinary course. This raises an issue as to how to apportion costs between the different parts of the claim. My provisional view is that NZARFD is entitled to costs against the Donleys in respect of the commencement of the proceeding (leaving aside the costs of amendment to the statement of claim, as they apply to RLDP) together with 50% of the costs of preparing for and appearing on the application for summary judgment (approximately the same time was spent on each aspect of the case). I also see no reason, on the material before me, to depart from costs on a 2B basis. If counsel cannot resolve costs on the basis of this indication, counsel for NZARFD is to file a memorandum within 15 workings days, and counsel for the Donleys is to respond within a further 5 working days. Costs as between NZARFD and RLDP are reserved.

Associate Judge Abbott