IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2007-485-1563

IN THE MATTER OF	the Receiverships Act 1993
AND	
IN THE MATTER OF	SERVICE FOODS MANAWATU LIMITED (IN RECEIVERSHIP AND LIQUIDATION)
BETWEEN	NEW ZEALAND ASSOCIATED REFRIGERATED FOOD DISTRIBUTORS LIMITED Applicant
AND	RICHARD GRANT SIMPSON AND RONALD WALTON Respondents

CIV-2005-485-1820

IN THE MATTER OF	the Receiverships Act 1993
AND	
IN THE MATTER OF	SERVICE FOODS MANAWATU LIMITED (IN RECEIVERSHIP AND LIQUIDATION)
AND	
IN THE MATTER OF	an application for directions
BETWEEN	RICHARD GRANT SIMPSON AND RONALD WALTON AS RECEIVERS OF SERVICE FOODS MANAWATU LIMITED (IN RECEIVERSHIP AND LIQUIDATION) Applicants

Hearing: 13 March 2008

Counsel: G J Toebes & P J Niven for the receivers of Service Foods Manawatu Ltd (in receivership and liquidation)
B Gustafson & D M Hughes for NZ Associated Refrigerated Food Distributors Ltd

Judgment: 28 April 2008

JUDGMENT OF DOBSON J

Introduction

[1] In the earlier of these two proceedings commenced in 2005, Messrs Simpson and Walton as receivers of Service Foods Manawatu Limited ("Service Foods") applied for directions on how to allocate the proceeds of sale of Service Foods' assets between the appointing creditor, Westpac Bank, which held a General Security Agreement ("GSA"), and New Zealand Associated Refrigerated Food Distributors Limited ("NZARFD") which held a Purchase Money Security Interest ("PMSI") under the Personal Property Securities Act 1999 ("PPSA").

[2] For its part, NZARFD applied in its own, 2007 proceedings, under s 301 of the Companies Act 1993 and ss 34 and 37 of the Receiverships Act 1993 for distribution of certain Service Foods' assets in which NZARFD claims a security interest. It also applied for removal of the receivers.

[3] In the end, the argument focused on the extent of NZARFD's entitlement to monies being held by the receivers, pending resolution of this argument. As distribution in accordance with this judgment ought to be the last substantive step required of the receivers, no argument was addressed to grounds for their removal.

Background

[4] The incorporation of Service Foods was registered on 14 February 2003. Its business involved purchasing foodstuffs from wholesalers such as NZARFD and selling them to retailers. NZARFD became a supplier to Service Foods in mid 2004. A trading account was established on 19 November and terms of trade were agreed to on 15 December 2004 which granted NZARFD a PMSI in terms of s 16 of the PPSA. It was registered on the Personal Property Securities Register and perfected on 23 December 2004. The specific term was cast as a usual retention of title provision, so that property in goods supplied did not pass until they were paid for in full. It was expressed as follows:

> Prior to the buyer paying in full for all goods supplied to the buyer by the Company, [NZARFD] ownership of any such goods will remain with the Company.

[5] On 8 June 2005, NZARFD attempted to re-take possession of stock it had supplied, but Service Foods' employees refused access to the stock. Later on the same day, Service Foods was placed into liquidation and the liquidators also refused access. Westpac, in reliance on its GSA over all Service Foods' assets, appointed the receivers on 13 June 2005. The receivers also refused NZARFD access to the stock it had supplied. The liquidators began to sell stock after this date, with all remaining assets of Service Foods being sold as a going concern by the receivers on 23 June 2005. NZARFD issued proceedings against the liquidators following this sale of stock.

[6] NZARFD was to issue proceedings against the receivers also, but the receivers filed an originating application in this Court for directions on 3 October 2005. The directions sought included a determination as to whether NZARFD had perfected its PMSI, what priority that PMSI had as against Westpac's GSA and, if superior, the method the receivers should employ when determining the value of the PMSI. In a judgment on 30 January 2006, Goddard J confirmed that NZARFD had perfected its PMSI and that it is was in priority to Westpac's GSA, but Her Honour also held that the Court was ill-equipped to direct a methodology for determining the PMSI's value. Her Honour recorded:

> …I understand from counsel that a co-operative approach to ascertaining the value of the security covered would be adopted in the event that I reached the conclusions that I have.

Alas, not so.

[7] The receivers appealed that decision, but Goddard J's judgment was upheld in the Court of Appeal ((2007) 10 NZCLC 264,263). Under the heading "What is covered by a perfected security interest?", the Court of Appeal observed:

> [35] This is a non-issue as Mr Toebes accepted before us. The answer self-evidently is only what is covered by the security agreement. Registration does not create any interest different from that which exists in the security interest itself. The collateral is only about goods supplied and not paid for, and the proceeds thereof. NZARFD's security interest is confined to goods supplied and not paid for, and any traceable proceeds of sale of those goods.

The current proceedings

[8] Following the judgments of this Court and the Court of Appeal, the receivers have, in effect, contended that it is too difficult to identify a process for determining the extent of NZARFD's PMSI, and apply to this Court for final directions in this regard. Specifically, their further application in July 2007 sought a direction that the value of NZARFD's collateral (to be paid to them out of the receivership) "is the sum of $0".

[9] That application foreshadowed argument that the onus was on NZARFD to identify the stock it had supplied that had not been paid for, that it was impossible to establish that on an individually itemised basis, and that the security was accordingly worthless.

[10] For its part, NZARFD sought enforcement of Goddard J's judgment, which it says amounts to orders pursuant to s 37(4)(b) of the Receivers Act 1993 that the receivers pay NZARFD:

(a) $134,781.66, amounting to the NZARFD stock on hand at time of liquidation; and

(b) $178.795.54, amounting to the proceeds of the NZARFD stock already sold (ie the accounts receivable).

[11] NZARFD's grounds for such orders are twofold. First, NZARFD argues that the receivers are issue estopped in terms of (a) – the stock on hand at time of liquidation – because of an admission by the receivers made earlier in the proceedings. Secondly, if this argument does not succeed, then the stock was a commingled mass and NZARFD has a PMSI over that mass. NZARFD had a PMSI in the accounts receivable for the same reason; it is impossible to distinguish which goods were supplied by NZARFD from those supplied by others.

[12] NZARFD contends that the best way to deal with the issue (i.e. its recommendations for directions should the Court provide them) is to pro-rate the proceeds of the liquidation and receivership using the proportion of NZARFD goods out of the total goods supplied to Service Foods in its last six months of trading (agreed at 57%). NZARFD also alleges the receivers breached their duties by not marshalling certain accounts, which, if they had done so, would have avoided the present proceedings because Westpac would have been fully paid out of the proceeds of realisations other than of the stock.

[13] There were two problems in dealing with this contest between general and specific security holders. The first was that their competing claims were advanced from very different propositions, so that there was not the usual contrast of opposing arguments on the same points. On several issues, the competing cases steered past each other. The second problem was that the accounting evidence was confused and in some respects inconsistent. The receivers' stance on this was that the onus to establish the value of the PMSI rested squarely on NZARFD, and if it could not prove, item by item, the relevant collateral, then the PMSI was worthless. However, in the present circumstances that is both an inadequate and inappropriate approach to adopt.

[14] Before addressing a quantification of the collateral covered by the PMSI in terms of paragraph [35] of the Court of Appeal decision, it is necessary to clear away certain preliminary issues.

Issue Estoppel

[15] NZARFD seeks to hold the receivers to what is characterised as an admission made by one of them in an affidavit filed before the argument which was determined by Goddard J. Mr Simpson deposed:

> "If it is determined in accordance with the application for directions that NZARFD has a perfected money security interest in respect of the collateral [defined as the invoiced cost of NZARFD's supplied stock that was on hand at the time of liquidation, regardless if it is paid for or not] then that sum plus the resale proceeds obtained by the receivers will be paid to NZARFD"

[16] NZARFD argued that this admission by the receiver, combined with Goddard J's judgment requires Service Foods to pay the value of all NZARFD's stock that was in the premises of Service Foods at the date of the receivership. NZARFD relies on the definition of issue estoppel, enunciated by Lord Diplock in *Thoday v Thoday* [1964] 1 All ER 341 at 352:

> If in litigation on one such cause of action any of such separate issues whether a particular condition has been fulfilled is determined by a court of competent jurisdiction, either on evidence or on admission by a party to the litigation, neither party can, in subsequent litigation between them on any cause of action which depends on the fulfilment of the identical condition, assert that the condition was fulfilled if the court has in the first litigation determined that it was not, or deny that it was fulfilled if the court in the first litigation determined that it was.

[17] A first difficulty is that the extent of NZARFD's PMSI (viz only those goods not paid for) is different to the extent NZARFD relies upon for their argument of issue estoppel. This reliance on *Thoday* suggests that NZARFD have interpreted the concept of issue estoppel in the opposite sequence. Goddard J's determination was not conditional on Mr Simpson's admission – rather the admission was conditional on the determination, which is the reverse of the requirements outlined by Lord Diplock above. However, even if issue estoppel would work if a condition in the admission above was met so that the Court determined NZARFD had a PMSI in the collateral as defined by Mr Simpson, it still would not succeed. The Court did not make the requisite determination. The Court and Mr Simpson's respective definitions of 'collateral' do not reconcile. In short, NZARFD does not have a PMSI in all of its stock that Service Foods had on hand, but rather only that stock supplied under the terms of the PMSI that Service Foods had not paid for – a different

determination to that required in the admission. The total value of the stock on hand supplied under the PMSI, and the value of the stock on hand not paid for, will be very different, and so the admission cannot work to estop the issue; it must be capable of argument; the dictum in *Thoday* does not apply.

[18] In any case, an issue estoppel can only be founded on the determinations which are fundamental to the earlier decision and without which it cannot stand: *Talyancich v Index Developments Ltd* [1992] 3 NZLR 28. There was never any determination about the admission made by Mr Simpson in Goddard J's judgment, so it cannot be fundamental to the proceedings, and moreover, the only determination that Goddard J made, namely whether NZARFD had a perfected PMSI is not being re-litigated in these proceedings; it has been accepted by Service Foods. Accordingly, Service Foods are not issue estopped on the argument as to the extent of the value of collateral covered by NZARFD's PMSI.

Commingling

[19] NZARFD argued that s 82 of the PPSA applies. It provides:

> 82 **Continuation of security interests in goods that become part of processed or commingled goods**
>
> A security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled, or commingled that their identity is lost in the product or mass.

[20] In determining the value of the PMSI in situations covered by s 82, it is appropriate to take a pro-rata assessment of the total mass of commingled goods, which NZARFD proposes the Court should do in this instance. Unlike the issue estoppel argument, commingling covers both the NZARFD stock on hand and the proceeds thereof.

[21] There is no New Zealand case law on point, but in his article 'Rights for Suppliers of Inventory Under the Personal Property Securities Act 1999" ((2002) 8(3) NZBLQ 266), Barry Allan relies on identical British Columbian legislation to state s 82 "…only deals with the situation of goods being combined with other goods

to form some third product (such as sugar and milk to make ice cream)" (275). This approach would exclude the goods supplied by NZARFD; they have not been combined in the same way as the sugar or milk have in the example above.

[22] NZARFD relied on *In the Matter of San Juan Packers Inc, Peoples State Bank v San Juan Packers* 696 F. 2d 707. That case dealt with a vegetable processing plant where three different farmers provided vegetables for canning. This is clearly akin to the ice cream example, and similarly distinguishable from the present case. A more liberal reading could include such products supplied by NZARFD, but only so long as they had become unidentifiable. NZARFD claim that their products became part of an indistinguishable mass, but also acknowledge that they can identify the individual product lines they supplied to Service Foods. On the basis of the latter proposition, the commingling provisions cannot apply. Accordingly, I find that the goods supplied to Service Foods have not been commingled for the purposes of s 82. NZARFD's argument for pro rata division must fail, for such a direction only applies to those commingled PMSI claims.

[23] For similar reasons, the subsidiary argument advanced by NZARFD, that the stock sold and now in the form of accounts receivable has been "commingled" is an incorrect interpretation of the commingling provisions in the PPSA. When stock has been sold, the commingling provisions lose their effect; NZARFD must rely on proceeds/tracing provisions with respect to the accounts receivable.

The determination of the value of NZARFD's PMSI

[24] That brings the dispute to the core issue of determining the value of NZARFD's PMSI. That value will be equivalent to the value of those goods supplied by NZARFD after 23 December 2004 and not paid for by Service Foods, or the proceeds of sale of such goods. The method of determining this value is the crux of these proceedings.

[25] There is a range of means by which the value of goods supplied by NZARFD, and the part of those deemed not to be paid for, might be quantified. The

lack of direct contest between the parties means that the range of outcomes is even more "at large" than it would otherwise be.

[26] The total extent of indebtedness to NZARFD on appointment of the liquidator in June 2004 was $579,732.65. That amount is not contested by the receivers. Rather, because a large measure of it will not be secured in priority to Westpac, the total appears to be a matter of indifference to them.

[27] An early affidavit for the receivers analysed that $890,249.92 of goods were supplied by NZARFD between 23 December 2004 and 7 June 2005, and payments made or credits given of $816,817.77. If prior indebtedness was ignored, that would leave a shortfall of only $73,432.15. Yet another calculation was reflected in submissions for the receivers. Relying on a more recent affidavit for NZARFD that annexed all of that company's invoices for supplies to Service Foods after 23 December 2004, the unpaid balance of those invoices was calculated for the receivers at $157,791.61.

[28] Very substantial work was done for NZARFD in an attempt to relate the stock supplied after 23 December 2004, to the amounts remaining owing to NZARFD. The receivers were not able to provide copies of the invoices issued by Service Foods, which might have identified the stock lines supplied by NZARFD that were being on-sold. The analysis of what was available quantified $134,781.66 (exclusive of GST) as the cost price of stock supplied after the PMSI was perfected on 23 December 2004, and remaining on hand for inclusion in the liquidator's stock-take as at 8 June 2005. A separate and entirely unrelated analysis calculated that sales of all NZARFD products to Service Foods between 1 May 2005 and 22 June 2005 totalled $431,625.01. This was intended to demonstrate how much trading there was towards the end of the period up to liquidation.

[29] The amount of $134,781.66 is described in the affidavit producing the analysis as the loss that NZARFD suffered from being denied the right to repossess the stock by the receivers. For the receivers, Mr Toebes argued that any breach of NZARFD's right to repossess had not caused any loss at all, in essence because even at the time, they could not have discharged an obligation to identify stock supplied

but not paid for. I do not accept that argument. The right to retake possession was an important aspect of the contractual terms, and a prompt stock-take focused on NZARFD's contractual rights would inevitably have advanced their interests by enabling at least a stock-take reflecting what had been supplied, in light of NZARFD's contractual terms.

[30] Mr Toebes sought to distance the receivers' participation in obstructing NZARFD's access to the stock it had supplied by suggesting there was no evidence whether the receivers were acting as agents for the company. Given that the receivers have taken the formal step of applying for directions, the withholding from the Court of any material information in their possession which might help arguments for the appointing creditor, hardly seems appropriate in the present circumstances. Ultimately, it does not affect the outcome because NZARFD is not suing for breach of this provision in the contract. However, when pressed, Mr Toebes was inclined to acknowledge that the receivers were indeed acting as agents for the company.

Goods supplied after 23 December 2004

[31] NZARFD cannot identify the goods it supplied to Service Foods after 23 December 2004 on an individual basis. However, in argument, counsel for NZARFD stated that Service Foods had not proffered any evidence to suggest that any of the relevant stock had been supplied prior to this date. It seems most unlikely that any of the stock on hand at 8 June would have been supplied before 23 December 2004; the expiry date of the goods supplied is probably less than six months, and it is likely that Service Foods on-sold oldest stock first. Without any positive evidence in rebuttal, the inference of NZARFD that all stock on hand was supplied after 23 December 2004 is a reasonable one to make. Whilst the onus to identify the relevant stock rests on NZARFD, the standard of proof required has to take account of their being deprived of the opportunity to conduct a stock-take. In these particular circumstances, the receivers cannot complain that this very reasonable inference is relied on in finding that, on the balance of probabilities, all stock on hand was supplied after the PMSI was perfected.

Goods supplied but not paid for

[32] Service Foods argues that the onus is upon NZARFD to determine which goods supplied by it to Service Foods were paid for and which were not paid for. They argue that the party seeking to enforce a security interest must be the party to establish the property subject to that security. Mr Toebes cited a pre-PPSA regime decision relating to retention of title provisions. In *Geal Investments Limited v Ivil Hotels* (HC HAM CP 195/91, 27 May 1992) per Master Kennedy-Grant at page 22:

> In my view, identification of the stock as not having been paid for is necessary under the contract. Taking the clause as a whole, the payment referred to in the passage quoted above is payment for the goods supplied on a particular occasion not payments for all goods. It follows that it is necessary to identify the stock over which it is sought to assert a reservation of title as being stock supplied on an invoice which has not been paid for.

[33] NZARFD argued that counsel for Service Foods was "stuck in the old retention of title law" and that the same law does not apply under the PPSA so that the ruling in *Geal* does not apply. I do not consider that the PPSA has made a material change that requires the approach in *Geal* to be distinguished. That approach merely reflects the structure of contractual arrangements in that case, and also in this one. If the parties wished to strike a bargain on different terms, such as that the security extends until the buyer has established full payment for particular goods, then it would be open to them to contract on that basis. Retention of title provisions do come within the definition of "security interest" with which the PPSA is concerned, by the terms of the definition of that phrase in s 17(3). The Act does not require, for its own sake, a recasting of the contractual effect. That only arises if insolvency provisions in the Companies Act 1993 intrude in regulating the relationship. That effect is discussed below.

[34] Dealing then just with the application of the contract, this was a quite usual supplier/wholesaler relationship, where the wholesaler appears to have paid rounded amounts as and when it could. The pattern was that Service Foods were in arrears, and that applied to the relationship both before the PMSI was perfected, and in the six months between that time and the appointment of liquidators and receivers. In the absence of any other agreed terms about how payments made were to be

appropriated, I consider it appropriate to infer that, if asked, the parties would have both volunteered that oldest debts (i.e. for stock supplied first) would be paid for first. Acceptance of that as the default position goes back to *Clayton's Case (Devaynes v Noble, Clayton's Case* (1861) MER 529) and would fit logically into this type of trading relationship.

[35] It was argued for the receivers that if this usual presumption was applied, there would need to be a "ruling off" of the indebtedness as it existed on the date the PMSI was perfected, so that thereafter all payments received would have to be applied to liabilities incurred after that date. This argument invites an analogy with s 293(4) and (5) of the Companies Act 1993. Those provisions relevantly provide:

> (4) Nothing in subsection (1) [providing for voidable charges] applies to a charge given by a company that secures the unpaid purchase price of property, whether or not the charge is given over that property, if the instrument creating the charge is executed not later than 30 days after the sale of the property or, in the case of the sale of an estate or interest in land, not later than 30 days after the final settlement of the sale.
>
> (5) For the purposes of … subsection (4), where any charge was given by the company within the period specified in subsection (1), all payments received by the grantee of the charge after it was given shall be deemed to have been appropriated so far as may be necessary –
>
> …
>
> (b) towards payment of the actual price or value of property sold by the grantee to the company on or after the giving of the charge;

[36] The period cross-referenced in subs (5) as specified in subs (1) is one year, so the provision would apply in the present case, if the security had been granted in respect of assets belonging to Service Foods. In contractual terms, goods not paid for are not the property of Service Foods. The provision quoted in [4] above means that until paid for, they remain in the ownership of NZARFD. On that basis, s 293 would not apply.

[37] However, post-PPSA jurisprudence has been influenced by the need to achieve symmetry in the way that Act and the Companies Act operate. The Court of Appeal in *Dunphy v Sleepyhead Manufacturing Co Ltd* [2007] 3 NZLR 602

recognised the need to treat goods in the possession of the buyer, but subject to a retention of title provision in favour of the seller, as "owned" by the buyer for the purposes of regulating security interest. Substituting the parties in the present case for those in that one, its reasoning was as follows:

> [37] In pre-PPSA terms, the goods supplied by **[NZARFD]** would not have been "owned" by **[Service Foods]**– they would have been wholly outside the liquidation because title remained with **[NZARFD]**. Now that the PPSA governs the method by which creditors obtain security, "owned" must be read in a manner that is consistent with the PPSA, which means that **[Service Foods]**' interest in the goods must be treated as sufficient for them to be "owned" by **[Service Foods]** for the purposes of this definition (*Graham v Portacom New Zealand Ltd* [2004] 2 NZLR 528 at para [28] and *Waller v New Zealand Bloodstock Ltd* [2006] 3 NZLR 629 (CA) at para [89]). As **[NZARFD]** has a security interest which has attached for the purpose of enforcing its rights against **[Service Foods]** (and its liquidators), it is entitled to claim payment in priority to unsecured creditors. Its security interest is, therefore, a "charge" and **[NZARFD]** is a "secured creditor" as defined in s 2(1) of the Companies Act.

[38] In *Graham*, the earlier of the two cases cited in that paragraph, the Court treated the lessee of portable buildings, which subsequently passed into receivership, as having a sufficient interest for them to be the subject of a general security interest, and consistently that the lessors had a registrable interest under the PPSA. The judgment cites a North American academic article which includes these comments:

> …On this interpretation, ostensible ownership – in the radical sense of bare possession or control of the collateral – has effectively replaced derivative title for the purposes of determining the scope of the secured debtor's estate at the priority level. Thus, by the very act of deeming a true lease to be a PPSA security interest, ownership in the leased assets is effectively vested in the lessee as against the lessee's secured creditors and trustee in bankruptcy. (see para [28])

[39] Once this extended definition applies for any purposes under the Companies Act 1993, then consistency requires it to be applied for all purposes, including the application of s 293. I have real reservations about this conclusion for two reasons. First, because I did not have the benefit of any argument on the point, and secondly because it produces a result which I do not consider reflects the competing merits of the respective positions. However, the PPSA regime is intended to promote commercial certainty, so it would be difficult to justify exceptions to a reasoned rule.

[40] Accordingly, it requires the "ruling off" that Mr Toebes argued for. All payments after 23 December must be treated as paying for the stock supplied from that date, on the basis of "first supplied, first paid for". I consider the simple calculation of cost of sales to Service Foods in the period in which the security was in place, less amounts paid in that period, as set out in para [27] effects that calculation on this basis – ie $73,432.15.

[41] It becomes immaterial in present circumstances to analyse whether this amount is reflected in stock on hand and sold by the receivers, or the proceeds of stock sold earlier. The sequence in which the stock left Service Foods is a matter of indifference after adoption of this approach to measuring the sequence in which it is paid for after it comes in.

[42] It also renders irrelevant two further inquiries.

[43] First, whether NZARFD has a claim for damages from the receivers for breach of NZARFD's contractual right at least to inspect and arguably to re-take possession of stock not paid for. If there was such a right, the damage for its breach could only be quantified at the value of the stock supplied and not paid for, which must necessarily be quantified by the method directed in s 293(5) of the Companies Act.

[44] Secondly, in proposing an analysis of oldest stock being paid for first (per *Clayton's case*) but not acknowledging that a clean slate had to apply from the date the PMSI was perfected, counsel for NZARFD felt obliged to acknowledge certain exceptions where specific amounts appeared to have been paid to meet specific invoices for more recent supplies. That exercise is overtaken by the rule stipulated in s 293(5), so it does not have to be considered.

[45] This outcome is an unsatisfactory one for the holders of PMSIs. Unless a material distinction can be drawn from the circumstances in this case, it will likely mean that amounts outstanding in an existing supply relationship at the time a PMSI is taken can only be recovered after there has been full payment for goods supplied after the PMSI is perfected, if the purchaser becomes insolvent within one year of

the security being in place. It seems unlikely that NZARFD appreciated that limitation on the utility of its retention of title provision when they agreed it with Service Foods.

[46] Suppliers in the same situation may be forced to stipulate for a PMSI from the very outset of the trading relationship. Where there is a history of unsecured supplies, suppliers will have to devise other strategies to recover, or secure payment of, the debt outstanding at the time a PMSI is put in place.

[47] Counsel requested that I defer the issue of costs, and I do so. Memoranda may be filed if necessary.

Dobson J

Solicitors:
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