IN THE COURT OF APPEAL OF NEW ZEALAND

CA434/2015
[2015] NZCA 487

BETWEEN		MANDEEP PALA First Appellant
		INDERJIT LUTHERA Second Appellant
AND		BTC GROUP LIMITED Respondent

Hearing: 22 September 2015

Court: Harrison, Dobson, Gilbert JJ

Counsel: M C Black for Appellants
S A Woods and J P Bell-Connell for Respondent

Judgment: 19 October 2015 at 10.30 am

JUDGMENT OF THE COURT

A The appeal is allowed to the extent that the judgment entered against the defendants in the sum of USD 467,699.62 is reduced by USD 72,816.80 to USD 394,882.82.

B In all other respects, the appeal is dismissed.

C Messrs Pala and Luthera are to pay 75 per cent of the respondent's costs for a standard appeal on a band A basis and usual disbursements.

REASONS OF THE COURT

(Given by Gilbert J)

Introduction

[1] This is an appeal against a decision of Christiansen AJ in the High Court at Auckland granting summary judgment against the appellants, Mandeep Pala and Inderjit Luthera, under their guarantee of amounts due by Shanton Fashions Ltd to BTC Group Ltd for the manufacture and supply of garments.[1]

[2] Messrs Pala and Luthera contend that they have arguable defences to BTC's claim based on the following propositions:[2]

(a) After Shanton was placed in voluntary administration, BTC took possession of the garments in exercise of its rights under a purchase money security interest (PMSI).

(b) BTC appointed the administrator of Shanton as BTC's agent to sell the garments that were the subject of the PMSI.

(c) The administrator did not account to BTC for the full amount of its secured entitlement following sale. BTC must nevertheless give credit to Messrs Pala and Luthera for the shortfall because the administrator received the proceeds of sale as BTC's agent.

(d) The administrator failed to obtain the best price reasonably obtainable for the garments. BTC is liable for this failure because the administrator acted as its agent in selling the garments and this limits the amount that BTC can claim under the guarantee.

[3] There is no dispute about the applicable legal principles. A creditor exercising its right to sell collateral owes a duty to the debtor and any guarantors to obtain the best price reasonably obtainable at the time of sale and must account for the proceeds of sale. The critical issue is whether the Associate Judge was correct to conclude that there was no evidential foundation to support Messrs Pala and

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1 *BTC Group Ltd v Pala* [2015] NZHC 1561.

2 Messrs Pala and Luthera contended in the High Court that they were not personally liable under the guarantee. The Associate Judge rightly rejected this contention and it is not pursued on appeal.

Luthera's claim that BTC took possession of the garments and appointed the administrator to sell them as its agent.

[4] Although not raised in its notice of opposition filed in the High Court, or developed in submissions filed in this Court, an issue nevertheless arises about whether BTC is entitled to be paid for one of the consignments because it did not deliver it.

Is it arguable that the administrator acted as BTC's agent in selling the garments?

(a) Background

[5] Messrs Pala and Luthera are the directors of Shanton, a fashion retailer which formerly operated 37 stores nationwide. BTC is a clothing manufacturer based in Hong Kong.

[6] Shanton and BTC entered into a written agreement in December 2012 for BTC to manufacture and supply garments in accordance with Shanton's requirements. Shanton agreed to pay the purchase price applicable at the time of delivery rather than the date the order was placed. The price was payable in three instalments, being 20 per cent on acceptance of the order, 50 per cent on shipment and the balance 30 days after invoice. The agreement contained a retention of title clause which provided that property would not pass until payment of the invoice had been made in full. Shanton granted BTC a PMSI over the garments and proceeds of sale. This was perfected by BTC registering a financing statement before the goods were supplied. Messrs Pala and Luthera guaranteed Shanton's obligations to BTC under the agreement.

[7] In August 2013, at Messrs Pala and Luthera' request, BTC agreed to amend the payment terms for future orders by removing the requirement for the first and second instalments so that the full purchase price would be payable 30 days after invoice.

[8] From September to November 2014, BTC supplied garments to Shanton in accordance with the agreement for which it issued seven invoices totalling USD 596,470. Shanton did not pay these invoices on the due date. It paid the sum of USD 101,760 towards the first invoice but nothing towards the other six. Taking into account a credit note issued in the sum of USD 622.35, the balance outstanding as at 10 December 2014 was USD 494,087.65.

[9] BTC manufactured further garments ordered by Shanton and issued an invoice for these on 2 January 2015 in the sum of USD 72,816.80. However, because the earlier invoices had not been paid, BTC did not deliver these garments to Shanton. This invoice is nevertheless included in the amount for which summary judgment was entered.

[10] Mr Pala deposes that sales were very slow in the last quarter of 2014, partly because Shanton was unable to secure seasonal funding from its bank to pay for stock and operations, including advertising and marketing during the lead up to the Christmas and New Year trading period.

(b) Appointment of administrator

[11] By January 2015, Shanton was in a precarious financial position. It was unable to pay its creditors and Messrs Pala and Luthera were unable to secure continued lines of credit with Shanton's bank. Messrs Pala and Luthera placed Shanton in voluntary administration on 11 January 2015 and appointed Bryan Williams as administrator.

[12] The administrator continued to trade the company with the aim of selling the business. BTC advised the administrator that its secured rights under its PMSI extended to the proceeds of sale of the garments it had supplied and demanded payment of this amount.

[13] On 30 January 2015, the administrator offered to pay BTC the sum of NZD 350,000 in full and final settlement of all Shanton's outstanding obligations. BTC promptly rejected this offer and repeated its demand for immediate payment of the FOB value of the stock already sold, which it estimated to be USD 64,000. BTC

also demanded that the administrator account weekly for the FOB value of all future stock sales. The administrator replied that day saying that this was not acceptable and sent a copy of the email chain to Messrs Pala and Luthera:

> This will not work for me Suzanne. I accept that you may wish to reserve your position against the guarantors but I need settlement against the Company or I will have to stop selling the product and arrange for you to pick it up. Please urgently advise.

[14] On 2 February 2015, BTC's solicitors wrote to the administrator demanding immediate payment of the FOB value of stock sold by the administrator between 11 and 27 January 2015 in the sum of USD 64,704.83. The solicitors reminded the administrator that BTC's rights under its PMSI extended to the proceeds of sale of the stock and repeated BTC's demand for weekly payments of the FOB value of all future sales.

[15] The administrator replied that, subject to receiving confirmation from his legal advisors that the PMSI was enforceable, he would pay the amount due for stock sales to date and he offered NZD 100,000 for the remaining stock on hand. While acknowledging that this was a significant discount against the book value, he advised that he did not expect the stock to sell unless it was heavily discounted and urged BTC to consider the practicalities of the situation:

> Your … correspondence presume[s] Shanton wants the stock and perceives there to be a market to clear it. Please appreciate that the Administrator has no obligation to sell the stock and even less obligation to be forced to clear it at heavily discounted prices and pay BTC full book value for it. Please urgently advise BTC's position on this matter. I will be as helpful as I can but I will not allow Shanton to be a clearing house for old stock at a cost to Shanton. If the stock is owned by BTC, as we are expecting to be confirmed, then they are entitled to pick it up.
>
> …
>
> I look forward to your urgent response to the SOH issue. Tomorrow morning I intend to instruct staff to stop selling BTC's stock until the SOH matter is resolved. If it cannot be resolved BTC will have to go to each of the 37 stores and uplift their inventory.

[16] Mr Black realistically acknowledges that no agency existed between the administrator and BTC at this stage.

(c) Allegation of agency

[17] The administrator's threat to stop selling BTC's stock brought a strong response from BTC's solicitors the following day:

> … To be clear, our client is simply clarifying its legal right that the proceeds of any BTC stock sold is paid to them in a timely manner. Our client does not intend influencing day to day operational decisions, provided your decisions and actions are in accordance with your duties as administrator. …
>
> … there is no justification for your decision to instruct Shanton staff to stop selling BTC's stock, and your claim to do so is very concerning. Any such action will be viewed by our client as contrary to your duties to act in the interests of Shanton and to not unfairly harm the interests of creditors. Instructing staff to cease selling BTC's stock would be unsettling to trading, result in unfairly harming BTC, and be viewed as favouring some creditors over others. The fact BTC has a secured right of repossession does not mean you can choose to cease selling BTC stock in preference to the stock of other creditors.
>
> Accordingly, please urgently confirm that you have not taken this action. If we do not receive these assurances by 1.00pm today, we will assume you have taken this action and start considering our client's legal options against the administrator, the directors and/or Shanton in the event our client suffers loss as a consequence.

[18] Mr Black relies on this email to support his contention that BTC appointed the administrator to act as its agent in continuing to sell its stock. For the reasons set out below, we are unable to see any room for this interpretation.

[19] BTC did not exercise its right to take possession of the stock. This was not a practical option given that BTC was based in Hong Kong and the garments, which were spread across 37 stores nationwide, had been manufactured to Shanton's specific requirements and were labelled with Shanton's licensed trademark. This is why BTC did not give any notice of sale as would have been required under s 114 of the Personal Property Securities Act 1999 if it had taken possession of the collateral with intent to sell it. Instead, BTC chose to leave the stock in Shanton's possession so that the administrator, as Shanton's agent, would be obliged to endeavour to sell it for the best price reasonably obtainable in the interests of the creditors as a whole and account to BTC for its full entitlement under the PMSI. This had the advantage for BTC that the administrator would have to incur the costs of sale but be unable to

recover these costs from the proceeds payable to BTC. This is because the administrator's right of indemnity did not extend to these proceeds.[3]

[20] The administrator was Shanton's agent.[4] In carrying out this role, he owed duties to Shanton's creditors as a whole. He was required to avoid any conflict of interest or duty. The correspondence demonstrates that he did not agree to act as BTC's agent. This would have required him to serve BTC's interests, potentially at the expense of other creditors and in conflict with his duty to them.

[21] The administrator negotiated with BTC and its solicitors at arm's length in his attempt to purchase its stock at a significantly discounted price. He attempted to capitalise on the impracticality of BTC taking possession of the stock and attempting to on-sell it. He went as far as threatening to stop selling BTC's stock if it would not agree to his proposals. The response from BTC's solicitors made it clear that BTC did not seek to influence the administrator's day to day operational decisions but simply wanted to ensure that he complied with his obligations as administrator. They threatened legal recourse against the administrator if he implemented his threat because they considered that ceasing to sell stock would be a breach of those obligations. There is nothing in the solicitors' response to suggest that BTC was appointing the administrator to act as its agent, as contended by Mr Black. Nor is there any evidence to suggest that the administrator agreed to this. The subsequent events confirm that no agency existed.

(d) Subsequent events

[22] On 10 February 2015, the administrator duly paid USD 64,704.83, the full amount to which BTC was entitled, for stock sold between 12 and 27 January 2015. The administrator received no payment or other consideration from BTC in return for selling this stock.

[23] On 19 February 2015, the administrator sent BTC a sales report covering the period from 12 January to 15 February 2015. This showed that the FOB value of BTC's stock sold in that period was USD 131,789.97. BTC demanded payment of

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3 Companies Act 1993, ss 239ADL and 239ADM and sch 7, cl 2.
4 Companies Act, s 239W.

the full balance outstanding of USD 67,085.14, taking into account the earlier payment.

[24] The administrator responded the following day asking BTC to agree to a margin being deducted to offset the costs of these sales:

> Since producing the report provided to you we have analysed the sales value achieved for the Book Value of $196,330 (net of GST) (NZD). The items sold have been discounted to achieve the sales outcome. The average Gross Profit earned is 34.60% with a gross sales value of $300,131 (net of GST) (NZD). I will ask Emjay to forward a copy of that report to you.
>
> I have flagged on quite a few occasions that this matter needs to be addressed and that we cannot account to you for book value without having due consideration to the sales and marketing effort undertaken by Shanton to achieve the sales outcome. I propose that we agree on a GP to be earned by Shanton and that the sales figure achieved drives the amount to be accounted to BTC. I would be grateful if you could give some consideration to this method as well as proposing a GP percentage.

[25] This email is inconsistent with an existing agency agreement because this would have specified the consideration payable for the agency services.

[26] BTC's solicitors sought clarification of the administrator's proposal and said that they expected that any such proposal would be made to all creditors, or at least through the creditors' committee. In the meantime, the solicitors repeated BTC's demand for payment of the amount outstanding for existing sales.

[27] The administrator replied on 24 February 2015 firming up the proposal and saying that it did not concern the other creditors or the creditors' committee. He recited the background in terms that are wholly inconsistent with BTC having taken possession of the stock or having appointed him as its agent to sell it:

> 1. BTC have supplied inventory in respect of which a PMSI interest exists. That security interest has been acknowledged.
> 2. Inventory existed in the possession of the Administrator on the commencement date of the Administration and that detail has been provided.
> 3. BTC has allowed that inventory to be sold provided the Administrator accounts to BTC from traceable proceeds.
> 4. I have made it clear on quite a few occasions that for Shanton to make sales it has had to discount the product in its possession. I have also made it clear that Shanton cannot account to BTC for full book value if it is going to incur the time and cost of the sales process.

5. The ability to remove the inventory owned by BTC from 37 stores across the country would be an enormous task. Accordingly both Shanton and BTC were left with little other option than to sell the inventory through the market at the best price reasonably able to be obtained in all the circumstances.
6. However when it comes to accounting to BTC for the value of the realised item sold BTC will need to discount its interest in the inventory so that Shanton can recover its cost of creating the sale.
7. I have proposed that the amount paid to BTC is [a] percentage of the sale price achieved. Although I was not explicit on the amount of the discount, I had in my mind that a GP of 50% would be appropriate. That means that every dollar of realisation (less GST, duty and into store costs) is divided equally between BTC and Shanton.

[28] The administrator again wrote to BTC on 13 March 2015 advising that he had met with the secured creditors, being interests associated with Messrs Pala and Luthera who held a general security agreement, and that they required him to reach a settlement with BTC before they would be prepared to settle their claims against Shanton:

> … I have met with the secured creditors and now have their position clear. I now need to settle with BTC as a pre-condition of settlement with the secured creditors. I will set that out in an email but I would much rather do that face to face as already discussed.

[29] On 17 March 2015, the administrator made a payment of USD 34,500 on account of the amount owing to BTC. He wrote to BTC the following day, again proposing settlement either by purchasing the stock at a discounted price or by agreeing on a margin being deducted to offset sale costs:

> PMSI product is being sold but at heavily discounted prices so that it will clear. Much of it is old stock and we are now in a season change. We have discussed on many occasions that there needs to be some equity with regard to the margin that Shanton will achieve in marketing and selling that product. I did propose 50% GP but I am not sure that is enough looking at the costs that Shanton is incurring to clear the stock.
>
> We now need to decide what involvement you expect from me; the two options are to just keep selling the product (but at an agreed transfer price) or to work toward full and final settlement. It is not easy to discuss either by email but I am happy to try.
>
> I have already said on more than one occasion that it is not my desire to push back on BTC but it does make sense to consider settlement if it will produce certainty and mitigate against the cost and risk of litigation that will be inevitable if you fight it out with the guarantors. While your security interest may be rock solid that does not easily or quickly turn to money in the bank.

> If you were inclined to follow this path then I would think that 50 to 60 cents in the dollar would be where it will finally settle. If Shanton has to pay that amount then it will have to do that out of cash flow. I know that if you consider this course of action then it will cause a large write-off but I suspect you will be writing off a fairly large sum anyway in one way or another. It is worth mentioning that there are all sorts of dirty tricks that the secondary debtors (guarantors) can play to push away payment notwithstanding their black letter law obligation
>
> The alternative is to settle with me for the PMSI stock at an agreed price and then leave your options open against the guarantors once Shanton has paid you out for the PMSI stock. If this option is elected then we will need to agree on a price for all the stock that existed on the commencement date of the administration and a payment plan for settlement of the remaining amount. Simpson Western have rightfully expressed caution around settling with me for the PMSI stock – I am guessing that their concern is that settling with me at less than 100 cents in the dollar may provide for the argument by the gtors that their obligation goes down correspondingly.
>
> …

[30] If an agency agreement had already been reached, the administrator would not be seeking agreement on a "transfer price" for "selling the product" or "agree[ing] on a price for all the stock that existed on the commencement date of the administration". Nor would he be "work[ing] toward full and final settlement" or offering a reassurance that "it is not my desire to push back on BTC". It is clear from the administrator's email that BTC's solicitors had declined to reach any compromise arrangement concerning the PMSI stock because they did not wish to prejudice BTC's claim against the guarantors.

[31] BTC wrote to the Administrator on 26 March 2015 declining these proposals and insisting on payment of its full entitlement.

[32] Shanton's creditors did not approve the execution of a deed of company arrangement at the watershed meeting on 30 March 2015.[5] Control of the company was passed back to Messrs Pala and Luthera.

(e) Conclusion

[33] It is clear that at no stage did BTC take possession of the stock or appoint the administrator to sell it as its agent. It did not agree to compromise its rights to

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5 A meeting of creditors convened by the administrator pursuant to s 239AT of the Act.

payment under the PMSI. To the extent that the administrator did not account for the full amount to which BTC was entitled, that was a failure that benefitted Shanton and for which it is liable. When the administration terminated, Messrs Pala and Luthera, as directors of Shanton, were responsible for ensuring that Shanton met its obligations to account for these monies. The fact that Shanton has not done so is not something that Messrs Pala and Luthera can rely on in answer to BTC's claim against them under the guarantee. Further, because the administrator was not BTC's agent in selling the stock, Messrs Pala and Luthera are not able to argue that BTC failed to obtain the best price reasonably obtainable for it. The Associate Judge was correct to find that there is no evidential foundation for these grounds of defence.

Do Messrs Pala and Luthera have an arguable defence to BTC's claim for the price of the garments that it did not supply?

[34] BTC relies on s 50(2) of the Sale of Goods Act 1908 in support of its contention that it is entitled to be paid for the consignment of garments that it did not deliver:

> **50 Action for price**
>
> …
>
> (2) Where, under a contract of sale, the price is payable on a day certain irrespective of delivery, and the buyer wrongfully neglects or refused to pay such price, the seller may maintain an action for the price, although the property in the goods has not passed, and the goods have not been appropriated to the contract.

[35] BTC claims that payment was due 30 days following invoice and this is dated 2 January 2015.

[36] We consider that the guarantors have an arguable defence to this part of the claim, amounting to USD 72,816.80. It is at least arguable on the evidence available that this payment was not due "irrespective of delivery" in terms of s 50(2). The original terms of the agreement required that the second instalment of the purchase price would be paid "on shipment" and the balance "30 days after invoice". This indicates that the goods would be shipped prior to payment of the invoice. When the terms of payment were relaxed, full payment was due "30 days after invoice" but there is nothing to indicate that the parties intended a change to the sequence, namely, an invoice being raised at the time of shipment and payment being made

30 days later. As noted, the price was that applicable at the time of delivery, not at the time of the order. This indicates that no price could be set until delivery and therefore no invoice could be raised until that time.

[37] We do not need to finally determine this issue. There may be further evidence that is relevant to it. However, we consider that Messrs Pala and Luthera have an arguable defence to this part of the claim based on the evidence currently before the Court.

Result

[38] The appeal is allowed to the extent that the judgment entered against the defendants in the sum of USD 467,699.62 is reduced by USD 72,816.80 to USD 394,882.82.

[39] In all other respects, the appeal is dismissed.

[40] The fact that the appeal has been substantially unsuccessful should be reflected in our costs award. Messrs Pala and Luthera are to pay 75 per cent of the respondent's costs for a standard appeal on a band A basis and usual disbursements.

Solicitors:
Smith and Partners, Auckland for Appellants
Wynn Williams, Christchurch for Respondent