Challenging secured creditor priority: revisiting the meaning of "accounts receivable"

"A new decision of the High Court has reignited the debate as to the true meaning of "accounts receivable"

A new decision of the High Court (*Burns & Anor v Commissioner of Inland Revenue & Ors* CIV 2010-404-7387, Associate Judge Gendall, Auckland High Court, 10 August 2011) has reignited the debate as to the true meaning of "accounts receivable" in Schedule 7 of the Companies Act 1993.

Schedule 7 is significant by virtue of the fact that it (in combination with s312) dictates which funds in liquidation must be reserved for payment of preferential claims and therefore be placed beyond the reach of secured creditors.

In recent years the only official commentary on the meaning of accounts receivable in Schedule 7 has been the decision of Associate Judge Hole in *Commissioner of Inland Revenue v North Shore Tavern Ltd* (2008) 23 NZTC 22,074. In that instance, the Court took a narrow view of the definition and concluded that, notwithstanding the broad wording of section 16 Personal Property Security Act 1999 (**PPSA**), "accounts receivable" was to be equated with traditional book debts. The *North Shore Taverns* decision has been the subject of both academic and commercial criticism but there had, until now, not been a judicial opportunity to revisit the issue.

Burns v CIR involved a competition between the Commissioner of Inland Revenue and a secured creditor (two related Strategic Finance entities) for a variety of funds held by PwC as liquidators of a failed property development company. The liquidation commenced in late November 2008 and in the months that followed the liquidators amassed funds from a variety of sources including: refunds of development contributions from a local authority; the return of deposits held by the company's former solicitors; rental recoveries from company properties; body corporate levy refunds; and certain other miscellaneous funds. The sum at stake was a little under $700,000 whereas the Commissioner and the secured creditor were each owed considerably in excess of that amount. (A separate question arose in relation to a mistaken payment by the Commissioner; however, this aspect of the case did not impact on the s16 definition.)

In light of the competing claims, and bearing in mind the contrast between the s16 definition and the narrow approach taken in *North Shore Taverns*, the liquidators applied to the Court for directions.

In reaching his conclusion, that all the funds held by the liquidators were a "monetary obligation" as set out in the s16 definition of "accounts receivable", Associate Judge Gendall clarified the following points:

1. the traditional (pre-PPSA 1999) definition of "book debts" was imprecise and often ambiguous;

2. the scheme of the PPSA is fundamentally integral to the meaning of accounts receivable; and

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3 a plain reading and construction of the expression "accounts receivable" must provide it is a broad definition given it is a monetary obligation not evidenced by chattel paper, an investment security or by a negotiable instrument. A book debt is not synonymous with an account receivable.

Despite being invited to adopt a more constrained view (either by reference to the earlier *North Shore Tavern* decision or principles of statutory interpretation), the Court declined to do so. The judge noted in particular the various iterations that the provision had been through before the present language of the section was adopted. He also placed reliance on the fact that it was modelled on Canadian legislation which does not seek to limit "account" in the manner stipulated by *North Shore Taverns*.

After giving due consideration to the various funds collected by the liquidators, Associate Judge Gendall ruled that each category constituted a "monetary obligation". The result of this finding was that the Commissioner's claim had priority pursuant to the statutory regime. The Court also confirmed that assets will only be subject to the preferential regime if they were an account receivable at the time of liquidation.

The decision will be welcomed by commentators who have repeatedly expressed the view that *North Shore Taverns* was unduly confined in its approach and not in keeping with either the wording of the PPSA or its general scheme. As the differing judgments originate from the same court, technically neither has precedence but it is suggested that the decision of *Burns v CIR* is to be preferred.

It remains to be seen how significantly the alternative wider meaning of "accounts receivable" will impact on the recovery achieved by secured creditors. The case is now also on appeal and the outcome should be known in the first quarter of 2012.

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