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PERSONAL PROPERTY SECURITIES LAW REFORM IN NEW ZEALAND : RECENT DEVELOPMENTS

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INTRODUCTION

I addressed this gathering five years ago on the subject of personal property security law reform. That was five years after the New Zealand Law Commission had published its report proposing a Personal Property Securities Act (*PPSA*) for New Zealand[1]. Despite the five year wait up till that time, I was optimistic enough to say that there was cause for hope that a PPSA reform would occur in the short term in New Zealand.

It is just as well nobody relied on my view, because another five years have gone by and we still do not have a PPSA in New Zealand. However, for those of us who favour an Article 9-type solution[2] to the quagmire of secured financing laws in New Zealand, things are now looking up. At the time of writing this paper, a Personal Property Securities Bill (the *Bill*) is before the New Zealand Parliament, has been under consideration for some months by a Select Committee and is due to be reported back to the House by the Select Committee on 28 June 1999. While the vagaries of an election year and the fragility of a coalition government with a small majority make it hard to predict with certainty what will happen to the Bill, there is a reasonable prospect that it will be passed in the next two or three months, in which case the new law would probably come into effect on 1 April 2000.

HISTORY

The introduction of the bill was a milestone at the end of a long and winding road. It started in 1987 when the Law Commission asked Professor John Farrar and me to visit Canada and the US to investigate Article 9 regimes. We prepared a

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[1] New Zealand Law Commission Report No. 8, *A Personal Property Securities Act for New Zealand*, April 1989 (referred to below as the *NZLC Report*).

[2] A statutory regime based on Article 9 of the US Uniform Commercial Code.

report[3], following which the Law Commission appointed an advisory committee consisting of John and myself, along with a number of prominent practitioners and academics. That committee prepared a report for the Commission, which the Commission then adopted and published as the NZLC Report in April 1989.

After that, the process was derailed by a number of things. First, there was the enactment of the Motor Vehicle Securities Act 1989, which created a register of motor vehicle securities and which had some of, but not all of, the features of the PPSA as well as some consumer protection provisions (but, of course, applied only to security interests in motor vehicles). Secondly, the various Australian reform proposals went off the rails, which meant that the enactment of a PPSA in New Zealand was seen as being out of step with the objective of harmonising commercial laws between the two countries. Thirdly, there were various restructurings of the Government departments responsible for commercial law reform.

Meanwhile, the Companies Act 1993 was passed without any registration of charges provisions, so that it was also necessary to pass the Companies (Registration of Charges) Act 1993 to preserve the charge registration provisions of the Companies Act 1955. When the 1955 Act was repealed on 30 June 1997, its charge registration provisions were further prolonged by the Companies (Registration of Charges) Amendment Act 1997, but this was seen as a temporary solution pending some form of reform, whether PPSA or otherwise.

ESSENTIAL FEATURES

Many of you will be familiar with the conceptual basis of PPSA. While the Bill has many imperfections, some of which are touched on later, the essential features of the North American models are replicated in the Bill. It does not, however, take account of the 1998 revision of Article 9, which is unfortunate, as the revision represents the latest thinking on a number of issues, from which New Zealand should have benefitted.

The Bill is based on the Saskatchewan Personal Property Security Act 1993, but the order and layout of the sections is quite different, and the wording of the sections is often different from the original, even where the intended outcome appears to be the same.

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[3] New Zealand Law Commission Preliminary Paper No. 6, *Reform of Personal Property Security Law*, May 1988.

The paragraphs which follow give a brief outline of the essential features of the Bill.

Replacement of Existing Laws

The Bill is drafted on the basis that it will be the only legislation dealing with security interests in personal property. It will replace:

- the Motor Vehicle Securities Act 1989
- the Chattels Transfer Act 1924, and
- the registration of charges provisions in the Industrial and Provident Societies Act 1908 and the Companies (Registration of Charges) Act 1993.

Comprehensive concept of "Security Interest"

The Bill will apply to all forms of security interests. It refers specifically to reservation of title (Romalpa) clauses, charges, mortgages, conditional sale agreements, hire purchase agreements, and consignments (among others). The term "security interest" is also extended to include a transfer of an account receivable or chattel paper, a lease for a term of more than one year and a commercial consignment (such as a dealer floor plan arrangement).

Attachment and Perfection

The Bill provides for parties with a security interest in personal property to have the means of *perfecting* that interest. Perfection occurs when the security interest has been "attached" and the steps necessary for perfection have been completed, regardless of the order in which that occurs.

Attachment occurs when:

- the debtor has rights in the collateral and gives the security interest, and
- the secured party gives value (e.g. makes an advance).

Perfection occurs when the secured party either:

- registers a financing statement in the Personal Property Securities Register to be established by the Bill (the *PPSA Register*), or

- takes possession of the collateral.[4]

New National Personal Property Securities Register

The PPSA Register will replace all existing registers relating to securities over personal property (with some minor exceptions such as the ships register). As the Bill deals only with security interests in personal property, any arrangement involving the giving of a security over land will be dealt with exclusively by the Land Transfer Act 1952. Although details relating to the PPSA Register will be contained in (yet to be drafted) regulations, the Ministry of Commerce has indicated that the PPSA Register will be on-line. Paper-based registrations will not be permitted. The on-line nature of the PPSA Register has been a subject of concern to the Privacy Commissioner, apparently because of the danger of information being misused by criminals or downloaded for marketing purposes.

Register of Details of Debtor and Collateral

The PPSA Register will be debtor-based (i.e. indexed by the *name* of the debtor granting the security interest). However, where the collateral can be identified by a serial or identification number (e.g. a motor vehicle), registration of this will also be necessary in most circumstances. This will allow the register to be searched using details concerning the collateral, rather than the debtor's name.

Fundamental Rule: 'First to File' wins

The fundamental rule in the Bill is that the security interest of the first secured party to register a financing statement complying with the prescribed requirements will take priority over any other security interest.[5] While a number of specific (and sometimes complex) rules deal with specific situations, the order of priority of security interests will be determined in most cases according to which secured party registered its financing statement first. Secured parties can agree to alter the priority position of their security interests.[6]

Exclusions

There are a number of exclusions in the Bill, mostly to cover non-consensual security interests and security interests where an alternative registry exists.[7]

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[4] The concept of "possession" is given an extended meaning in relation to certain types of collateral. See, for example, clause 96 of the Bill in relation to uncertificated investment securities.

[5] Clause 62 of the Bill.

[6] Clause 66 of the Bill. Clause 156 provides for registration of a "financing change statement" but does not make it compulsory.

[7] Clause 23 of the Bill.

Exceptions include statutory and common law liens, transfers of interests in insurance policies, assignments of accounts receivable made solely to facilitate collection and sales of accounts receivable or chattel paper as part of the sale of a business.

Notice Filing

The PPSA Register will be computerised and will provide for notice filing through the internet. This means that only a *financing statement* giving certain details of the debtor, secured party and collateral will be filed. A financing statement will lapse after 5 years.[8] It will no longer be necessary (or possible) to register copies of security agreements. However, a debtor, execution creditor or other secured party can obtain a copy of the security agreement from the secured party.[9]

Generic Registration

There will be no requirement to register individual transactions if a general security interest is granted by the debtor. For example, if a supplier to a dealer retains title until payment (i.e. has a *Romalpa* clause), then it will need to get the dealer to sign an agreement to the *Romalpa* terms and register a security interest in the relevant inventory of the dealer. Doing this would "perfect" security interests in all inventory supplied subject to the Romalpa clause to that dealer in the future.

Abolition of Floating Charge

The concept of a "floating charge" will disappear when the Bill becomes law.[10] However, the same degree of flexibility for inventory financing will exist, because the Bill will permit fixed security interests over after-acquired property and for security interests to secure future advances. It will also protect consumer purchasers of items of inventory sold in the ordinary course of business.

Purchase Money Security Interests

The Bill provides a "super priority" for a purchase money security interest (*PMSI*). For example, a *Romalpa* supplier will have priority over the interest of a bank if both have a security interest in inventory of a dealer which has been supplied by the *Romalpa* supplier. Different rules apply where the collateral is

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[8] Clause 150 of the Bill.

[9] Clause 171 of the Bill.

[10] However, clause 41(4) provides that the use of the term "floating charge" will not stop attachment occurring at the time provided for in the Bill.

not inventory, but the general principle is that a purchase money security interest will normally have priority over any other security interest if the PPSA requirements are complied with.

Consumer Goods

The PPSA makes registration of a security interest in low value consumer goods largely futile, because a buyer or lessee of consumer goods (even from a party other than a dealer) takes title free of a perfected or unperfected security interest so long as the buyer gives value and does not have knowledge of the security interest.

PROVISIONS TO NOTE IN THE BILL

The following paragraphs highlight some aspects of the Bill which are controversial or which have given rise to concern. All of these issues have been raised with the Select Committee and at least some of them will be dealt with in the Bill as reported back from the Select Committee to the House.

Purchase Money Security Interests

The Canadian PPSAs and Article 9 provide that a party seeking the super priority for a PMSI in inventory or its proceeds must give notice to any other secured party who has registered a financing statement containing a description that includes the same item or kind of collateral. The notice must state that the person giving the notice expects to acquire a PMSI in inventory of the debtor and must describe the inventory by item or kind. The notice must be given before the debtor obtains possession of the collateral.

This notice requirement is designed to put a working capital financier (such as a bank relying on a security agreement covering all of the debtor's personal property including after acquired property) on notice that another party will have a prior interest in certain types of the debtor's property. The working capital financier can then take that into account when making a decision whether or not to allow future drawdowns of a facility or make further advances.

The Bill omits this requirement, apparently because of the concern that there would be high compliance costs or widespread failure to comply and because on-line searching will make it easy to check for PMSIs. Of course, under current law *Romalpa* suppliers achieve priority over bank debentures without giving notice (or, indeed, without registering their interest on any public register).

Invalidity of Unperfected Security Interests

The Canadian PPSAs and Article 9 provide that an unperfected security interest (i.e. a security interest which has not been perfected by registration or by taking

possession of the collateral) is not effective against a liquidator or other bankruptcy agent if it was unperfected at the date of bankruptcy or the date of the liquidation order. There is a similar provision making an unperfected security interest subordinate to the interest of a judgment creditor[11].

This was not followed in the NZLC Report, which adopted the same approach as the Motor Vehicle Securities Act i.e. a failure to perfect means a loss of priority against perfected security interests but not against unsecured creditors. The Bill adopts a half-way house approach, in that it does not provide for the subordination of unperfected security interests against liquidators or other insolvency agents, but does provide that unperfected security interests are subordinated to the interests of execution creditors[12]. This is a controversial area, in which there has been a division of view in the New Zealand profession. It will be interesting to see whether the Select Committee changes the approach of the Bill in this regard[13].

Preferential claims

A number of New Zealand statutes provide for the payment of preferential claims for various taxes, wages, holiday pay and numerous other specific matters in priority to the claims of any person holding a floating charge, if the assets available for payment of general creditors are insufficient to pay them. The whole area of preferential claims is currently under consideration by the Law Commission in the context of the seemingly never ending process of insolvency law reform in New Zealand. However, the abolition of the concept of a floating charge by the Bill meant that the Bill had to try to establish a regime which made as little change as possible in practice to the current regime, pending the resolution of the substantive issues relating to preferential claims.

The language used in the Bill did not achieve that objective. The Bill provides that, when the assets available for payment of general creditors are insufficient to meet the preferential claims, the preferential claims:

> *"have priority over the claims of any person that has a security interest in respect of [the debtor's] inventory, accounts receivable, equipment and*

[11] Personal Property Security Act 1993 (Saskatchewan), section 20.

[12] Clause 102 of the Bill.

[13] For a summary of the competing arguments, see articles by D F Dugdale [1998] NZLJ 383 and D W McLauchlan [1999] NZLJ 55.

> *after acquired property, other than a purchase money security interest in that property".*[14]

It is likely that the Bill as reported back from the Select Committee will delete the references to equipment and after-acquired property, meaning that, to use the old language with which we are all familiar, only security interests in stock in trade and book debts will be subject to the preferential claim regime. In view of a recent decision in New Zealand in *Re Brumark*[15], which upheld a fixed charge over book debts, it is even arguable that a reference to accounts receivable should not be included.

The exception for purchase money security interest is designed to exclude *Romalpa* clauses (which, in the context of wholesaler/retailer relationships, will be security interests in inventory) and dealer floor plan arrangements (such as bailment plans) from the ambit of the preferential claims regime. Some of these arrangements are currently documented as floating charges and are therefore subject to the preferential claims regime. On the other hand, bailment plans and consignment arrangements are not "charges" and therefore fall outside the scope of the preferential claims regime under current law.

Chattel paper provisions

In New Zealand, most financing of retail sales is done through a transaction involving the dealer or retailer selling the goods on hire purchase terms, and then immediately assigning the dealer's rights under the relevant hire purchase agreement to a finance company. The hire purchase agreement in that situation is "chattel paper" under the Bill.

The Bill has a number of provisions dealing with the rights of chattel paper financiers, which are based on the equivalent provisions in the Personal Property Security Act 1993 (Saskatchewan)[16]. However the Saskatchewan provisions appear to be inappropriate if the objective of the Bill is not to force a substantial change in the way retail financing transactions are undertaken in New Zealand. In particular:

- there appears to be a presumption in the Bill that the return of the goods subject to the chattel paper to the dealer/assignor will terminate the chattel paper;

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[14] See for example the proposed amendment to the Seventh Schedule to the Companies Act 1993, in Schedule 1 to the Bill.

[15] High Court Auckland, M753/98, 16 February 1999, Justice Fisher.

[16] Clauses 49-52 and clauses 83-85 of the Bill.

- the Bill opens up the possibility that repossessed goods could become subject to other security interests given by the dealer/assignor;

- the effect of the Bill appears to be that a security interest given by the debtor in the goods subject to the chattel paper would prevail over the interest of the chattel paper financier;

- under the Bill, a chattel paper financier's security interest may need to be registered again if goods are returned.

All of these consequences seem to be unintended and are likely to be remedied. It may be that there has, in this case, been too close a reliance on the Saskatchewan provisions, as my understanding is that the original Article 9 provisions dealing with chattel paper would have none of those effects.

Transitional period – existing security interests and charges
The Bill provides for a transitional period of only six months, but this may be extended by the Select Committee. Even security interests registered under the Motor Vehicle Securities Act (which has a computerised registry similar to that proposed under PPSA, although the name of the debtor is not publicly available) will not be automatically reregistered on the PPSA Register. This means that finance companies will have to re-register these interests, which seems an unnecessary inconvenience. It is likely, however, that there will be either a reduced fee or a complete waiver of the registration fee for these initial re-registrations.

Commercial reasonableness
Clause 25 of the Bill requires that all rights and obligations under a security agreement or the Bill or "any other applicable law" must be exercised "in good faith and in a commercially reasonable manner". This follows the equivalent Saskatchewan provision, but does not take into account section 10 of the Credit Contracts Act 1981, which allows a court to reopen a credit contract if a party has exercised, or intends to exercise, a right or power conferred by it in an oppressive manner[17]. The apparent overlap has been drawn to the attention of the Select Committee.

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[17] Section 9 of the Credit Contracts Act defines "oppressive" as meaning "oppressive, harsh, unjustly burdensome, unconscionable or in contravention of reasonable standards of commercial practice".

Remedies

While the Canadian PPSAs and Article 9 all have substantial regimes dealing with remedies available to secured parties, the draft Bill in the NZLC Report did not include provisions dealing with remedies. The Bill does so, but there are a number of anomalies. In particular:

- the Bill contemplates that transactions involving security interests in consumer goods will be left to be dealt with under the Credit (Repossession) Act 1997, (which will be amended by the Bill). However the current linkage between the Bill and the Credit (Repossession) Act is somewhat murky.[18] For example, the situation where a financing transaction involves security being given over both consumer and non-consumer transactions is not dealt with.

- even for non-consumer transactions, the provision allowing for debtors and secured parties to contract out of the statutory remedy provisions is not as clear as it ought to be[19].

- the provisions requiring that the secured party distribute any surplus after payment of the amount it is owed[20] and the duty to obtain the best price reasonably obtainable[21] use different language than the equivalent provisions in the Receiverships Act 1993;

- providing for the extinguishment of subordinate security interests when collateral is sold and for the purchaser to receive title free of any other security interests are not expressed to apply in a receivership situation, so that there would be a potential inconsistency of treatment. This is likely to be remedied when the Bill is reported back[22];

- the Bill currently requires a secured party intending to sell collateral upon default to give 10 working days notice to the debtor, other secured parties and other parties who have given notice of an interest in the collateral. This cannot be contracted out of[23]. There seems to be a good case for limiting

[18] See clause 104 and clause 197 of the Bill.

[19] Clause 106 of the Bill.

[20] Clause 116 of the Bill.

[21] Clause 109 of the Bill.

[22] Clause 114 and clause 123 of the Bill.

[23] Clause 106 of the Bill.

this provision to a requirement for notice to be given to the debtor (and, perhaps, a guarantor), and to allow for contracting out or, alternatively, for it to be deleted altogether, given that consumer transactions will require such notice because they are governed by the Credit (Repossession) Act 1997. There are similarly inappropriate provisions dealing with a right to reinstatement[24]. However, at least it is possible to contract out of those provisions.

Hopkinson v Rolt

The Bill effectively overrides *Hopkinson v Rolt*[25]. This will increase the importance for second or lower ranking secured parties of properly documented priority agreements. The same change will not, however, be made in relation to security interests in property other than personal property, where *Hopkinson v Rolt* will continue to apply. This will mean that priority agreements applying to both real property and personal property will require some complex drafting, and will necessitate some amendments to section 80A of the Property Law Act 1952. It will be interesting to see whether the Select Committee goes the next step and makes an equivalent change for real property transactions, as the Law Commission suggested a few years ago.

CONCLUSION

As someone who has been advocating the adoption of a PPSA regime for over ten years, I welcome the introduction of the Bill and hope that it becomes law, hopefully after some improvements as a result of the Select Committee scrutiny. Once that occurs, regulations will need to be drafted, which will contain much of the detail as to how the PPSA system will work in practice – in many ways these will be as important as the Bill itself.

It is sad that the ten years between the release of the NZLC Report and the introduction of the Bill were not spent on focused and informed research on many of the hard issues which arise under PPSA regimes, many of which have never been fully thought through in New Zealand. This means that the Bill relies heavily on the Canadian models, even in circumstances that may not be appropriate, and in some cases diverges from the Canadian models without any real research as to whether that is the appropriate approach. However, for all its faults, I think that it will still represent a substantial improvement over the current quagmire of secured financing laws in New Zealand.

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[24] Clauses 131 and 132 of the Bill.

[25] Clause 68 of the Bill.