New Zealand's Personal Property Securities Act - some of the difficult issues

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Introduction:

Personal property securities law reform has often been on the agenda of this conference in recent years. Previous sessions have focused on the need for reform and on the conceptual framework of proposals based ultimately on Article 9 of the American Uniform Commercial Code – the progenitor of all modern personal property securities legislation – or more immediately on the various Canadian Personal Property Security Acts.

This paper moves on from that discussion. New Zealand has personal property securities legislation that has now been in force for more than a year. The Personal Property Securities Act 1999 came into force on 1 May 2002. The remarkably brief transitional period expired 6 months later.[2] All security interests (as expansively defined by the Act) in personal property are now wholly regulated by the Personal Property Securities Act; the prior registration regimes under companies, chattels transfer and motor vehicle securities legislation are no more.[3] So in this paper I focus on the New Zealand experience in the year or so since the Act came into force. In particular, I have been asked to look at some of the difficult issues that have arisen. When the Act was first passed I provocatively suggested that it contained 100 errors. It was a nice round figure chosen with some poetic licence intended to reinforce my argument that the Act should not be brought into force until it was fixed up. I lost that argument - but at least I have plenty of material to work with for the

[2] Though some potentially untoward consequences of the transitional regime will live on for some time: see, eg, Gedye Cuming and Wood, *Personal Property Securities in New Zealand,* Brookers, Wellington, 2002 at paras 193.1 to 201.3.

[3] A few interests and regimes live on outside the Act, either specifically exempted by the Personal Property Securities Act or in co-existence with it: eg The Ship Registration Act.

purposes of this paper! Although my focus is on issues pertaining to the operation of the Act, in keeping with the historic reflections and future predictions theme of this conference, I will start by making some observations about how we got to where we are and I will finish with some comments on future possible directions.

The New Zealand Personal Property Securities Act was a long time coming. David Allan knows this better than I - he has contributed around 40 years of effort promoting a new approach to personal property security regulation in New Zealand and Australia. In 1989 the New Zealand Law Commission in its Report No. 8 strongly recommended that New Zealand adopt a Personal Property Securities Act based on the Bill that had recently been introduced in British Columbia. The objective of the reform proposals was to remedy the well-known anomalies in the existing regimes. The reforms were intended not merely to tinker with the existing legislation but to do away with it altogether and to substitute a new regime that proceeded on a quite different conceptual basis. The prior regimes dated from Victorian times and gave significant and unjustified legal consequence to fine formalistic distinctions. Also, for no good reason, incorporated debtors were treated differently to unincorporated debtors, pointless distinctions were drawn depending on the nature of the collateral and the various registration regimes were technically obsolete. Perhaps most importantly, the legal rules that determined which of two or more competing creditors secured over the same collateral was entitled to priority were obscure and at times uncertain. The new regime was intended to remedy all of these concerns in one go.

The Law Commission's 1989 draft Act and recommendation for immediate enactment languished for nearly a decade until the late 1990's. The now Ministry of Economic Development then took responsibility. However, rather than simply picking up where the Law Commission had left off, the Ministry drafted its own version of a Personal Property Securities Bill. It is at this point that a number of errors crept in, many of which were not rectified by the subsequent legislative processes.

The most significant conceptual reform wrought by the Personal Property Securities Act was the utilisation of the in substance security interest as the foundation of a comprehensive regime for the regulation of the use of personal property as collateral. By this I mean defining security interests according to the economic function of transactions rather than according to their legal form. Commentators often mistakenly say that it was the Personal Property Securities Act that introduced this concept into New Zealand law. In fact, it was first introduced as long ago as 1974 in the form of s.18A of the Chattels Transfer Act, and was also adopted by the Motor Vehicles Securities Act 1989, but its significance went largely unnoticed. In any event, it was the Personal Property Securities Act that first adopted the concept as part of a comprehensive personal property security regime and it is still the concept that lawyers and others brought up with the prior law have the greatest difficulty coming to grips with – especially its effect on the traditional concept of title. It is worth setting out the pertinent extract from the statutory definition of security interest found in s.17 of the NZ Personal Property Securities Act:

> In this Act ... security interest –
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> (a) Means an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to –
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> (i) The form of the transaction; and
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> (ii) The identity of the person who has title to the collateral; and
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> (b) ...

In this definition "substance" means economic substance. The definition is of most significance in relation to title retention financing arrangements such as conditional sales, sales secured by what are imprecisely called "Romalpa clauses", hire purchase agreements and leases. The prior law did not consistently regard such interests as security interests. Unless there were some applicable exception to the nemo dat quod non habet rule of the common law (ie only the titleholder in goods can transfer title to the goods), the owner of goods could claim them back from any third party to whom a debtor in possession of the goods had purported to give some interest. In simple terms, the Personal Property Securities Act now treats the owner as no more than a secured creditor and both the definition of security interest and s.24 make it abundantly clear that for the purposes of the Act the owner's retention of title makes no difference.[4] This leads to the outcome that many lawyers still find counter-intuitive and difficult to accept: a bailee of goods that the bailee has no contractual or other right ever to own can transfer ownership of the goods to a third party. This outcome provokes a hostile response from traditionalists, but once it is accepted that the owner's interest must be reconceptualised as a security interest, and that this interest can be protected by compliance with the provisions of the Personal Property Securities Act, the outcome follows logically and involves no inequity.

The Personal Property Securities Act does much more than just reconceptualise the nature of security interests and the relevance of title, but in this introduction I want to do no more than briefly mention three of the other significant products of the Act:

1. **A Comprehensive Priority regime.**

The Act contains priority rules that tell us who wins when more than one person claims the same item of personal property. These rules are intended to be comprehensive and so go into considerable detail; at times, arguably, to excess. Despite this, they regrettably fail to answer a relatively common priority conflict: who wins when there are two unperfected security interests over after-acquired collateral. Also, it must be remembered that the priority rules do not address priority conflicts that are beyond the scope of the Act. The rules cover conflicts between competing security interests, and between a security interest and a buyer or lessee, but the priority rules generally do not deal with conflicts between a security interest and a non-security interest (such as an implied trust recognised by equity) or between two non-security interests.

2. **A Computerised Notice Registration Regime**

   Registration under the regime is wholly electronic. Brief particulars of a debtor, a potential secured party and potential collateral are all that is registered. Because security agreements are not registered, it is possible to complete a registration before a security agreement is entered into and, conversely, a single registration may relate to more than one security agreement. The registration is no more than a warning to searchers that one or more security interests may, at the time of the search or some time in the future, cover the described collateral.

3. **Floating Charges Rendered Redundant**

The Act authorises the creation of a security interest over future circulating assets so that there is no longer any need to employ the floating charge for this purpose. One significant consequence of this that is discussed below was the necessity to

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[4] S.24 provides: The fact that title to collateral may be in the secured party rather than the debtor does

restructure the preferential creditor regime that gave certain creditors priority over floating charges.

Difficult Issues:

Before addressing some specific issues, I wish to comment briefly on whether the Personal Property Securities Act has brought greater overall certainty to this area of the law. I have long been a believer in the Personal Property Securities Act and the concepts that underpin it. The logic of treating alike all transactions that in economic substance serve as security is convincing. But as is so often the case, much of the devil is in the detail. We should not assume that the greater certainty the new legislation was intended to bring will initially result in less litigation. The Canadian experience has been the converse; even a quarter of a century after PPS legislation was first introduced there are sufficient reported cases each year to fill a volume of the specialist case series the *PPSAC's*. Even the judiciary sometimes still shows poor understanding of quite simple issues. A recent example is an Alberta Master's decision in *Cash Store Inc v Leduc Motors*.[5] A purchase money security interest ("pmsi") that had been duly perfected by registration of a financing statement within the requisite time applicable to equipment (under the NZ Act, within 10 working days of the debtor taking possession[6]) was held to be perfected too late. The Master held that to obtain pmsi super priority the security interest should have been perfected, pursuant to the equivalent of NZ s.74, prior to the debtor taking possession because the collateral was inventory *of the secured party*. This patently erroneous reasoning resulted in a general security interest taking priority over the pmsi. It is difficult to conceive how a judge from a jurisdiction that has had PPS legislation since 1988 could fail to appreciate that collateral is of course classified according to the debtor's use of the collateral, and not according to the secured party's use, so that the collateral was properly classified as equipment, had been duly registered in time and was entitled to priority over the general security interest.

As a recent adopter of PPS legislation, New Zealand should have been able to benefit from the Canadian experience by utilising Canadian case law to reduce any uncertainty in the New Zealand context. Unfortunately, the New Zealand Act

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not affect the application of any provision of this Act relating to rights, obligations, and remedies.

[5] (2003) 39 CBR (4th) 59

[6] S.73.

contains numerous departures from the Canadian precedents, both stylistic and substantive, so that it is often difficult to predict whether a particular Canadian precedent will be applied in New Zealand. Many of the uncertainties around the issues discussed below arise because of departures from the Canadian drafting. While it would be nice to think that the Personal Property Securities Act has clarified the law, we must accept that in New Zealand there will be a period of initial uncertainty until any ambiguities created by New Zealand drafting peculiarities are settled by the courts. Indeed, it is my hope that the litigation will come sooner rather than later so that issues are resolved as soon as possible. Much worse than early litigation would be long term uncertainties that could otherwise go unresolved for many years and that eventually could undermine practices that had by then become accepted. Australia should be able to avoid these growing pains if it adopts a PPSA type regime. The current draft Australian bill already appears to have avoided the worst of the New Zealand pitfalls and further refinements could be made in the light of the New Zealand experience. And despite the implementation difficulties experienced in New Zealand, I believe most stakeholders on this side of the Taman would regard the new Act as a significant improvement over the old regime.

Issue 1: Collateral Description Requirements for Non-possessory Security Interests

To create a valid and perfected non-possessory security interest under the Personal Property Securities Act it is necessary to comply with two different collateral description requirements, both of which can create problems for particular secured creditors. To create a security interest that is enforceable against third parties, it is necessary to have a security agreement acknowledged in written or electronic form that describes the collateral.[7] To perfect the security interest it is necessary to register a financing statement that describes the collateral. The collateral description in the security agreement will not necessarily take the same form as the description in the financing statement, even where it is intended to describe the same assets,[8] but difficult issues arise in relation to both.

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[7] Essentially this requires a written security agreement, though it is vaguely arguable that an oral agreement acknowledged in the requisite from would suffice.

(a) Collateral Description in the Security Agreement

The requirement to describe the collateral in a security agreement is set out in s.36. In the case of a non-possessory security interest, a security agreement is enforceable against a third party only if:

> (b) The debtor has signed, or assented to by letter [etc], a security agreement that contains –
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> (i) An adequate description of the collateral by item or kind that enables the collateral to be identified; or
>
> (ii) A statement that a security interest is taken in all of the debtor's present and after-acquired property; or
>
> (iii) …

The requirement is easily satisfied where the secured party is taking a security interest over all of the debtor's present and after-acquired personal property. Paragraph (b)(ii) expressly authorises such a description. Banks and other financiers that are used to taking comprehensive security should be well pleased with the ease at which an all assets security interest can now be documented. The documentation can be much less complex than that required for the common practice under prior law of describing which assets were subject a fixed charge and which were subject to a floating charge.

The description requirement is only marginally more onerous where a secured party is taking a security interest in all of an easily described kind or class of assets. Paragraph (b)(i) clearly permits a description such as "all of the debtor's present and after-acquired widgets." It is also permissible to refer to all of one of the categories of collateral defined in the Personal Property Securities Act. For example "all of the debtor's goods" or "all of the debtor's accounts receivable" would satisfy the collateral description requirement of s.36.[9] It requires slightly more care where the collateral is one or a few high value items and a description by item rather than by kind is given

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[8] The collateral covered by a financing statement will not necessarily be the same as the collateral covered by a particular security agreement. For example, one financing statement might cover more than one security agreement and so may describe a more extensive range of collateral.

[9] It is not sufficient to use the categories of "equipment" or "consumer goods": see s.37.

but the value of the collateral will warrant the extra care. For example, a description as "Acme brand printing press model abc serial number 123" would clearly suffice.[10]

The difficult issue that I wish to address in this context is where a security agreement is intended to cover only some of a particular kind of the debtor's after-acquired assets (particularly where they are circulating assets) or where the security agreement covers, say, one item where the debtor holds or acquires more than one such item. For example, where a security interest is taken over some of the debtor's widgets or over a particular refrigerated container and the debtor already owns, or later acquires, another identical container. Security interests such as these are extremely common. Many secured inventory supply arrangements will fall into this category. Ironically, although I now regard this as one of the most difficult issues under the Act, it was not one I listed on my top 100 hit list. It was not until I was called on to draft security agreements to cover some of a class of collateral that I appreciated how difficult it was.

Let us look at the problem through the eyes of Supplier Ltd, a wholesale supplier of golfing goods, including golf clubs and trundlers. Supplier Ltd sells many brands to many different retailers and wants each of its retailer customers to sign standard terms of supply that include a security interest over the goods. The retailers are also likely to buy golfing goods of the same brands from other suppliers. Because Supplier Ltd is not the only supplier of golfing goods to its customers, or even the only supplier of Brand X golfing goods, it cannot correctly describe the collateral as "**all** the debtor's golfing goods" or as "**all** the debtor's Brand X golfing goods". It is necessary to find an accurate description that satisfies s.36(b)(i). Simply referring to "golfing goods" is accurate, but does it "enable the collateral to be identified", as required by s.36(b)(i)?

In other words, what does "enables the collateral to be identified" mean? Subject to determining the rationale or public policy justification for the collateral description requirement, a range of plausible meanings can be suggested. At one end of the range is the possibility that a description is adequate as long as it is consistent with the collateral claimed. The s.36 requirement would then be satisifed as long as the

[10] Of course, the greater the detail in the description, the more likely a typographical or other error will creep in that could potentially invalidate the security interest. For example, if a security agreement describes collateral by an incorrect serial number, does the agreement nonetheless still cover the intended collateral if other description details are accurate?

secured party did not try to claim collateral that was outside the description. If Supplier Ltd had described the collateral as "golfing goods" it clearly could not claim that cricket gear was covered by its security agreement. But any golfing related items such as golf clubs and trundlers would be covered. At the other extreme, it can be argued that in order to satisfy s.36 it is necessary that any individual item of collateral must be identifiable solely by reference to the description in the security agreement. If so, a description as "golfing goods" would be inadequate because it would not identify whether any particular golf clubs held by the debtor were subject to the security agreement. Similarly, a description such as "all golfing goods supplied by Supplier Ltd" might not be adequate because a third party could not identify *from the security agreement* whether a particular item had been supplied by Supplier Ltd and was therefore subject to the security agreement.

The issue can be put another way. The real question that needs to be answered to determine which of the above descriptions, if any, is adequate is this: Can extrinsic evidence be used to make a description adequate for the purposes of s.36 or must the description be fully self-contained so that a third party can identify every individual item of collateral solely from the written description? If it is permissible to introduce extrinsic evidence, a description such as "all golfing goods supplied by Supplier Ltd" could suffice because it should often be a simple matter to determine who supplied what from business records or oral evidence of the parties. But the question concerning the extent to which extrinsic evidence can be resorted to for the purpose of identifying collateral is not an easy one to answer.

The collateral description requirement started life in the American Uniform Commercial Code as a Statute of Frauds type provision. The description was required for enforceability against the debtor and third parties. In this context it is plausible to argue that it should be open to the secured party to adduce extrinsic evidence to help identify the collateral. Why, it can be asked, should a debtor be able to avoid a security agreement that can easily be proven by the available evidence? No serious possibility of fraud arises in allowing the secured party to prove the precise subject matter of the security interest through extrinsic evidence, as long as the written security agreement contains a description consistent with the collateral claimed.

When PPS legislation was first enacted in Canada (in Ontario), a written collateral description was required for enforceability against third parties but was no longer needed for enforceability against the debtor. From this it can be argued that it was the protection of third parties that had by then become the principal policy justification of the requirement. There are two possible aspects to this protection. First, the requirement for a written security agreement may be intended simply to prevent the secured party and the debtor fraudulently colluding to allege the existence of a non-existent security agreement. This goal is arguably satisfied with even an extremely broad collateral description – one that is merely consistent with the collateral claimed. Secondly, the requirement may be intended to allow third parties to judge whether they are safe to deal with particular property of the debtor. If this is so, it would seem less appropriate to allow extrinsic evidence of which a third party may be unaware to supplement the collateral description given in the agreement. To achieve this goal, the third party would need to be able to identify every item of collateral from the description in the security agreement alone.

There was little in the New Zealand legislative process that indicates which policy was being pursued in New Zealand. The Law Commission at pages 107and 108 of its Report No.8 implies that a reasonably specific description is required. On the other hand, the New Zealand Act is generally based on the Saskatchewan model where a broad description is adequate. In Saskatchewan, the description must be by "item or kind" or by reference to a prescribed list of collateral types. There is no equivalent to the New Zealand requirement that the description "enable the collateral to be identified." In *GE Capital Canada Acquisitions v Dix Performance*[11] (a case on a British Columbian provision similar to the Saskatchewan provision) the court upheld a collateral description that merely referred to "shelving." The security agreement did not attempt to identify the relevant shelving further by composition, brand, model, or any other identifying data. However, the court indicated that a more onerous collateral description requirement prevailed in Ontario where the relevant section requires that the collateral description be "sufficient to enable it to be identified." The wording of the Ontario Act is obviously similar to that found in the New Zealand Act and may well be the origin of the New Zealand wording. But the court apparently failed to appreciate that these words were added into the Ontario Act to simplify the collateral description requirement rather than to make it more onerous. An earlier version of the Ontario Act simply required a "description of the collateral." Fears that

[11] [1995] 2 WWR 738.

this wording could have been interpreted as necessitating a precise and rigorous description led to the addition of the words "sufficient to enable it to be identified," which words were intended to clarify that a rigorous description was not required, merely a means of identifying the collateral.[12]

None of this provides a clear interpretation for the New Zealand provision. The New Zealand Act follows the Saskatchewan model in permitting collateral descriptions by kind, yet unlike Saskatchewan qualifies this by requiring the description to enable the collateral to be identified. The Ontario Act contains similar words, but they were apparently intended there to liberalise the description requirement and allow descriptions by kind (which are not otherwise expressly authorised in the Ontario Act). The difficulty in interpreting the New Zealand provision is compounded by the fact that in New Zealand no clear policy justification for the requirement has been articulated.

The policy behind the collateral description requirement must be one that is consistent with other policy objectives of the legislation, including the objective of simplifying the documentation requirements needed to create effective security interests. Allowing broad, generic descriptions satisfies this objective. The desire to prevent the debtor and secured creditor from fraudulently alleging the existence of a fictitious security interest is generally satisfied by requiring a written description consistent with the collateral claimed. Beyond this, it should be possible to adduce extrinsic evidence to identify the precise collateral claimed. This also seems consistent with the role that the collateral description in the security agreement plays in practice. Under the PPSA regime, the security agreement is not the principal way in which third parties are informed of security interests in the debtor's assets. Security agreements are not registered and third parties may never see them.

Third parties are initially warned of potential security interests in a debtor's assets by searching registered financing statements and it is the description in the financing statements that alerts third parties that particular assets may already be encumbered. Admittedly, a third party may then investigate further by obtaining a copy of any potentially relevant security agreements but this is rarely done and, in any event, cannot prudently be relied upon to establish a third party's rights against an original secured party. A third party cannot rely on a description in a security

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[12] See McLaren, *Secured Transactions in Personal Property in Canada* (2nd ed) Carswell, Toronto,

agreement because under the Personal Property Securities Act the priority of competing interests is principally determined by the time of registration, not by the time of documenting the security agreement or the time of attachment of the security interest. A third party who searched the register and discovered a registration that described the collateral as "golfing goods" and who then obtained from the secured party a copy of a security agreement that described the collateral as "all the debtor's golf trundlers" could not safely take a security interest in the debtor's golf clubs. The original secured party could later enter into a new security agreement that described the new collateral as golf clubs and, because the original secured party's prior registration covered "golfing goods", which includes both clubs and trundlers, take priority over the third party. At least in this sense, the collateral description requirements for financing statements are more important than those for security agreements. And they are only slightly less difficult to pin down.

In fact, neither the description in the financing statement nor the description in the security agreement should be regarded as the most reliable means for a third party to determine whether a particular item is subject to a security agreement that covers "kinds" of property. When determining how specific or self-contained either of these descriptions must be, the courts should have regard to s.177 of the Act. Under s.177(1)(c) a secured party can be required to confirm whether one or more specified items are subject to the security agreement. When s.36 is considered in conjunction with s.177, there is no need to interpret s.36 as demanding rigorous descriptions because it is under s.177 that a third party can which specific items are subject to the secured party's security interest.[13]

Sections 37 and 38 may also impinge on this issue. Section 38 appears to say that a description as "inventory" is acceptable, yet clearly this is not a self-contained description. Extrinsic evidence may be required to prove both what goods are inventory of the debtor and which of the debtor's inventory is subject to the security agreement. Similarly, by negative implication s.37 suggests that a description as a particular type of equipment (eg "printing equipment") is adequate. On the other hand, while it is certainly appropriate that **if** ss 37 and 38 permit descriptions that are not self-contained, s.36 should be similarly interpreted, it is also plausible to argue

1989 (looseleaf) at para 2.01[2].

[13] Because a secured party is only required to disclose current collateral under s.177, the section still should not be relied upon by third parties as guaranteeing that the secured party will not later take a

that **if** s.36 requires a self-contained description, then ss 37 and 38 should be interpreted to require self-contained descriptions. In other words, while the three sections should certainly be interpreted consistently, it is not entirely clear which is the chicken and which is the egg.

So far I have discussed the collateral description issue mainly with a view to determining the degree of specificity or completeness required when describing some of a particular kind of asset. But the case of a single item of collateral can provide a good illustration of some of the anomalies that could arise if a fully self-contained description were required. A description as "Acme brand printing press model xyz" would certainly satisfy s.36 where the debtor had only one such printing press. Any third party reading the security agreement would be able to identify the particular printing press that was encumbered. The security interest in the printing press would accordingly be enforceable against third parties pursuant sections 35 and 36 and would attach and be perfected in accordance with ss 40 and 41. Should the answer be any different if the debtor happened to have another identical printing press? A third party could not then identify from the security agreement which of the two printing presses was collateral. In my opinion, the description should still be valid. The third party can avail itself of s.177 or rely on extrinsic evidence if it needs to ascertain which printing press is unencumbered. A fortiori the same result will follow if the debtor had only one printing press when the original security agreement was entered into and subsequently acquired another. The unilateral act of the debtor in acquiring assets similar to those otherwise sufficiently described in a security agreement should not cause the security interest to "detach" and become unenforceable against third parties.

Where does all the above leave us? In New Zealand, there is considerable uncertainty concerning the degree of specificity required in describing collateral in security agreements. This is because the policy objective in requiring a collateral description has not been well articulated in New Zealand and the relevant New Zealand provision combines the two different approaches that are taken in the Saskatchewan and Ontario Acts without following either. However, it is my opinion, particularly having regard to the role played by the security agreement description, by the financing statement description and by s.177, that self-contained descriptions should not be required. In other words, it should be permissible to adduce extrinsic

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security interest in additional collateral: see Gedye, Cuming and Wood, *Personal Property Securities in* evidence to determine the exact items that are subject to a security agreement, as long as the collateral description in the agreement is consistent with the collateral claimed. In reaching this conclusion, I am essentially interpreting the collateral description requirement in the same way as under the Saskatchewan Act, which does not contain the additional requirement that the description "enables the collateral to be identified." It could be suggested that in reaching this conclusion I am ignoring the additional requirement that the Legislature deliberately inserted in the New Zealand Act and that as a matter of statutory interpretation this is not permitted. However, I prefer to say that I am simply interpreting the words as meaning that the description must "enable the collateral to be identified having regard to the available evidence."

Despite my conclusion, I recognise that prudence dictates at least an attempt to draft around the uncertainty until the matter is resolved by the courts. The approach I adopt in practice, having regard to the reality that in the circumstances where the issue is relevant lay persons will likely be completing the security agreement, is to use a standard form where the collateral description to be completed (often by a lay person) in each security agreement forms only part of the overall collateral description. Other clauses attempt to overcome some of the uncertainties discussed above. For example, a supplier's credit application form may constitute a security agreement because it creates a security interest in goods that will be supplied over the course of the parties' relationship. To satisfy the collateral description requirement of s.36 and at the same time be broad enough to anticipate goods of any description that may be supplied in the future, often only a broad description can be included each time a credit application is completed. This broad description is then reinforced by other printed provisions. The completed form looks something like this:

Without limiting clause (x), collateral shall include: golfing goods [this description will often be completed, perhaps inadequately, by the secured party and will be on the front of the credit application form. The printed conditions will include clause (x)]

(x) Collateral means:

- x.1 goods of the general description specified on the front of this agreement; and

New Zealand, Brookers, Wellington, 2002, paras 177.4 to 177.6.

- x.2 all goods of the general description specified on the front of this agreement supplied or financed by the Creditor to the customer; and
- x.3 all goods supplied or financed by the Creditor to the customer; and
- x.4 inventory of the customer; and
- x.5 all inventory of the customer that is supplied or financed by the Creditor; and
- x.6 all goods supplied or financed by the Creditor and further identified in any invoice issued by the Creditor to the customer, which invoices are deemed to be incorporated into and form part of this agreement; and
- x.7 all goods that are marked as having been supplied or financed by the Creditor or that are stored by the customer in a manner that enables them to be identified as having been supplied or financed by the Creditor.

The above descriptions x.1 to x.7 may overlap but each is independent of and does not limit the others.

Possibly, the handwritten description alone, or any one of the printed subclauses, may satisfy the collateral description requirement of s.36, but for the reasons canvassed above this is uncertain. To minimise this uncertainty, each subclause attempts to satisfy s.36 in a different way, the objective being that if one fails another will succeed. As long as one is successful, the security agreement will satisfy s.36. For example, x.1 refers to "goods", which is a category of personal property defined in the Act that would be a sufficient description in Saskatchewan. X.4 and x.5 attempt, in different ways, to take advantage of s.38, which appears to allow descriptions by reference to inventory. X.6 tries to incorporate other documents that might more fully describe specific items of collateral, but can a collateral description that does not exist at the time the security agreement is entered into satisfy s.36? Subsequent invoices could of course themselves be security agreements that satisfy s.36 but to do so each invoice would require written acknowledgement by the debtor. X.7 would work where the facts permit, but this may require the supplier to ensure that the debtor did not remove marks identifying the collateral and/or stored the collateral in an appropriate manner.

Finally, I would like to address a comment to financiers, such as bankers, who take a comprehensive security interest over all present and after-acquired assets. Such financiers may regard the collateral description issue as of little consequence to them because when taking a comprehensive security interest they can simply and sufficiently describe the collateral as "all assets". Nonetheless, they should not assume that because the problem does not apply to "all assets" securities, the issue is of no relevance to them. The issue actually provides general financiers with an opportunity. Financiers should not assume, just because a valid financing statement has been registered, that any underlying security interest is valid. For example, an inventory supplier may register an effective financing statement describing collateral. The inventory supplier would claim a purchase money security interest in the collateral and claim priority over a prior registered general financier such as a bank. But if the inventory supplier's underlying security agreement does not adequately describe the collateral in accordance with s.36, the supplier will not have a security interest that is enforceable against the general financier and the inventory will then fall into the general financier's all assets security.

(b) Collateral Description in Financing Statement

A security interest is normally perfected by registering a financing statement. Section 142 states that a financing statement must contain "a description of the collateral." Section 142 does not mention description by item or kind and, unlike s.36, does not require that the description "enables the collateral to be identified." This omission might suggest that the financing statement collateral description requirement is less rigorous than the description required in the security agreement. Conversely, if one looks to the history of the Ontario Act, the omission may indicate a more rigorous collateral description requirement in s.142 because in Ontario the additional words were added into a section where the Legislature wanted to clarify that a specific collateral description was not required. Most likely, the wording of s.142 simply indicates that the detail of the collateral description requirement for financing statements has been left to the Regulations.

I will stay with the issue of describing some of a class of collateral. Again, there is no difficulty where all assets securities are concerned. And where the collateral is motor vehicles or aircraft, detailed descriptions are provided for (though they do create some unique problems of their own). Unfortunately, there is uncertainty when it again comes to describing asset classes.

The general collateral description requirements for financing statements are set out in clause 8 of Schedule 1 to the Regulations. Clause 8(1) requires the registering party to select from one of 13 listed categories (ie a "tick the box" approach) and clause 8(2) requires that "A further description must be provided ...." No additional guidance is given as to how detailed this further description must be. There is no indication of where the New Zealand approach came from. In Canada there are two approaches – tick the box or give a written description. The New Zealand regulations require both. Also, the choice of listed categories has not been explained. One of the categories is "goods: livestock." This is the only place in the Act or Regulations that livestock is mentioned. Two of the other categories are "goods: motor vehicles" and "goods: other", the latter being the residual category for goods not specifically listed. Where motor vehicles are acquired by a debtor as consumer goods or equipment, the serial numbers and other identifying data must be given. This information is not required where motor vehicles are acquired as inventory.[14] However, the register itself has been set up so that serial number and other data *must* be given whenever the "goods: motor vehicles" category is selected. This means that a creditor secured over motor vehicles that are inventory of the debtor (so serial numbers are not required) has to select the "goods: other" box and then describe the collateral as motor vehicles!

Of more concern than the above oddities is the lack of detail concerning the requirements of the written description. Subclause 8(2) states that it must be a "further" description, arguably indicating that it must be more specific than the selected category. I have seen collateral descriptions where the "goods: other" box has been selected and the written description given as "goods." "Goods" would be an adequate description in Canada, but it hardly qualifies as a "further" description. At the very least, it would seem that the written description should refine the selected category, or indicate that it covers all assets of the selected category. For example, if the "goods: other" category were chosen a description as "golfing goods" would be a further description. This description is consistent with the goal of simplifying documentation and registration requirements. A description as "golfing goods" also

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[14] This is because it would impose an unreasonable burden on the registering party to continually amend or reregister financing statements to record serial numbers for inventory that was being constantly turned over.

satisfies the policy that the registration is only intended to warn third parties of potential security interests in certain kinds of a debtor's assets, so that broad collateral descriptions should be permitted. If a third party requires greater specificity, resort can again be had to s.177. However, once again "golfing goods" does not identify exactly which items of the debtor's golfing goods are potentially subject to a security interest and until the scope of the description requirement has been ruled on by the courts there will be a tendency to provide more rather than less information. Providing too much detail is not without risk – but cautious lawyers probably regard it as the lesser evil. The risk is twofold. An overly specific description risks omitting items of collateral. An overly broad description (eg "all of the debtor's golfing goods" when only some are collateral) risks antagonising the debtor and prompting the debtor to file a change demand requiring the creditor to register an amendment.

Perhaps the greatest uncertainty that I have observed in practice in relation to collateral descriptions in financing statements is in relation to describing proceeds of original collateral. Section 45 of the Act gives the secured party an automatic security interest in proceeds but it is still necessary to perfect this security interest. For some types of proceeds collateral (eg cash proceeds), perfection will also be automatic. But otherwise the original financing statement will need to describe the proceeds or an amendment registered once the description is known. A practice appears to have arisen amongst some lawyers of describing proceeds as "all present and after-acquired assets that are proceeds." This is an attempt to circumvent the difficulties involved in describing proceeds in advance of knowing exactly what they are. However, in my opinion this approach is flawed. Section 46(a) arguably requires a proceeds description by "kind" and there must be a significant risk that an all assets description is not a description by kind. Also, if such descriptions are permitted, it reduces the usefulness of the register. Anyone searching the register must assume that all assets are subject to a security interest because the searcher will have no ready means of discovering which assets are proceeds of the originally described collateral (and therefore subject to the proceeds claim) and which are not.

The most common types of proceeds (other than cash or cheques, claims to which are automatically perfected) will likely be accounts receivable and chattel paper. If the original collateral is quidditch equipment, the "goods, other" box will be selected and a written description such as "quidditch equipment supplied by the secured party" will be given. To describe proceeds, it will be necessary to add a description such as: "All present and after-acquired accounts receivable and chattel paper that are proceeds." The issue that arises here is whether this proceeds description can be included with the original collateral description against the "goods: other" box or whether it is necessary to also select the "chattel paper" and "intangibles" boxes (accounts receivable being intangibles under the statutory classifications). Most registrations I have seen simply record the proceeds description against the box selected for the original collateral but it would seem prudent to take the extra care to select the appropriate categories of proceeds and record the written descriptions against those categories.

Even if a particular collateral description or proceeds description is found not to comply with the Regulations, the registration is not necessarily invalid. An inadequate description in the *security agreement* renders the security interest unenforceable against third parties in respect of the misdescribed collateral but an inadequate description in the *financing statement* does not invalidate the financing statement with respect to the misdescribed collateral (and hence the security interest in the misdescribed collateral is still perfected) unless the description is "seriously misleading" in accordance with s.149. Even if a description as "golfing goods" is held not to comply with clause 8(2), can it be said to be seriously misleading? I would say no. In effect, the description tells a third party that some of the debtor's golfing goods may be encumbered. This may not tell the third party as much as it would like to know, but the third party is not misled, particularly as the third party can use s.177 to obtain greater precision. The reasonable third party will assume all golfing goods are potentially encumbered until proven otherwise.

Again, the proceeds description issue causes no difficulty for all assets financiers. As far as all assets financiers are concerned, any proceeds are also original collateral because they are after-acquired property to which the all assets security interest applies.

(c) Lessons for Australia

I believe the problems described above have arisen principally because in New Zealand there was no attempt to clearly articulate the objectives of requiring collateral descriptions in either security agreements or financing statements and hence the required degree of specificity in both is unclear (and potentially inconsistent with each other). By clearly specifying the objectives and by carefully drafting the legislation (including regulations) to achieve these objectives much potential uncertainty could be avoided.

Issue 2: Errors that Invalidate Financing Statements

Registration of an invalid financing statement will be potentially disastrous. The security interest that the registration is intended to perfect will remain unperfected and vulnerable to loss of priority. Because the electronic registration system by and large does not detect registration errors, invalid registrations are accepted for registration and the fatal defect may go undetected until it is too late to rectify it. The registration system places all the responsibility on the registering party to ensure that a registration does not contain any invalidating defects.

Some relief from this responsibility comes in the form of s.149. Section 149 is a curative provision: it provides that only seriously misleading defects invalidate a registration. In other words, a registration that contains a defect will be valid and will be effective to perfect a security agreement as long as the defect is not seriously misleading. Section 150 gives a little guidance on when a defect will be seriously misleading but essentially it is necessary to return to basic principles.

Defects can be of two kinds: a defect in the information that forms part of the criteria that can be searched against (ie a defect in a searchable field) and any other defect. Defects in searchable fields are the most serious. Defects in the "any other" category will rarely be fatal, with the exception of collateral misdescriptions. Inaccurate or overly narrow collateral descriptions will often be fatal. For example, a collateral description of "golfing goods" would not perfect a security interest in cricket gear and a description as "Acme brand golfing goods" would not perfect a security interest in Brand X golf clubs. On the other hand, an overly broad description, while being effective to perfect a security interest in a subclass of the described collateral, will be open to challenge by the debtor and may put the secured party to the cost and inconvenience of defending a change demand. As apparent from the previously discussed issue, there is quite an art to describing collateral.

Errors in searchable fields are widely regarded as fatal if the error prevents what I term a "properly formatted search" from disclosing the registration. Whether a properly formatted search discloses a registration largely turns on the search software employed by the register. There is also room for debate over what amounts to a "properly formatted search". In Canada, there are two main alternative search types: debtor name searches and serial number searches of prescribed goods (essentially motor vehicles and aircraft). There has been considerable debate in Canada as to whether an error in one of these search fields is fatal when the other search field is correctly recorded. If only a search on both can be regarded as properly formatted (to use my term) then an error in one will not necessarily be fatal. But if a search on only one of the fields is regarded as properly formatted, an error in either may be fatal. The most recent case on point is the well reasoned decision of the New Brunswick Court of Appeal in *GMAC Leaseco Ltd v Moncton Motor Home and Sales Inc*,[15] which is a model of analysis on this issue. The Court was strongly of the opinion that a searcher could elect to search on either field and accordingly an error in either was potentially fatal.

Whether an error in either field is in fact fatal depends on the search paradigms of the register. All of the Canadian PPS registers except Ontario allow what is known as close match searching. A search will return not only exact matches of the search criteria but also close matches. For example, a search on John Smith may return a registration against John Smyth. Even if it is the registration that is wrong, it will nonetheless be valid (as a result of the curative provision s.149) if a reasonable searcher would have identified the erroneous registration from other identifying details in the registration (such as the debtor's date of birth). On the other hand, in Ontario, only exact matches to searches are returned. Any error, however minor, in a search field will therefore invalidate the registration.[16]

The New Zealand position is influenced by two unfortunate factors. It was widely anticipated that New Zealand would adopt the close match search software of the Canadian provinces other than Ontario. Although the New Zealand Act closely resembles the legislation from these provinces, regrettably the register has followed

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[15] [2003] NBJ No. 140 (available on Quicklaw)

[16] Except where the error is in the debtor name and the collateral is prescribed goods that can be searched by serial number. Based on the unique wording of the Ontario Act, the Ontario Court of Appeal has held that a searcher needs to search on both debtor name and serial number (*Re Lambert* (1994) 119 DLR (4^{th}) 93). The relevant wording of the New Zealand Act is the same as applied in *GMAC Leasco* and in my opinion that decision would apply in New Zealand.

the Ontario model. Only exact matches of searches are disclosed. The unreasonable burden of complete accuracy that this imposes on registering parties is further compounded by the details required for the debtor's name and by s.172 of the Act. The register requires the full first, middle and last name for a debtor who is a natural person. Assuming that the compelling logic of *GMAC Leaseco Ltd v Moncton Motor Home and Sales Inc* is followed, this means that in New Zealand any error, however minor, in the debtor's first, middle or last name will invalidate a registration.

The possible consequences of s.172 could make matters even worse for registering parties. Section 172 lists 7 alternative search criteria. There is no equivalent provision in the Canadian legislation. Whereas the basic search criteria in Canada are limited to debtor name and serial number searches, and so only searches using accurate details of these criteria can be regarded as properly formatted, s.172 would seem to authorise a greater range of properly formatted searches. In effect, s.172 increases the number of search fields and so increases the number of potentially fatal registration errors. If it is accepted that any error in a search field is fatal in a system that employs exact match searching, this imposes a severe burden on the registering party to ensure complete accuracy. The relief provided by s.149 is substantially abrogated. One clause in s.172 allows searching on an incorporated debtor's incorporation number. Another clause includes the debtor's address. While it is perhaps not unreasonable to require exact accuracy in a debtor company's incorporation number (because that can be a convenient way of identifying a company) it is in my opinion wholly inappropriate to use the debtor's address as a search criteria and require complete accuracy in this field. What is more, searching based on addresses would be foolish. It is inappropriate both for the Act to create a searchable field around addresses and for searchers to search on addresses for at least three reasons: addresses can reasonably be recorded in more than one way, addresses are non-permanent and businesses may have more than one address. A recent search that I conducted where there were multiple registrations disclosed a different debtor address for every single registration. This would not matter if the register had been configured to disclose all addresses, but the exact match search protocol of the New Zealand register means that a search including a particular address will not reveal a registration using a different address, even if all other details are the same. Although a strict application of the test that I have proposed for whether a registration error is seriously misleading and therefore invalidating (ie would the registration be disclosed by a properly formatted search?) would mean that address errors would be fatal in New Zealand, this outcome is so counter-intuitive that it is to be hoped that in this case a court would decline to apply the test. Of course, this would create some uncertainty because if a court is given license to ignore the standard logic in one case, it may choose to do so elsewhere. It would be much better if s.172 were repealed (with consequential changes to the search criteria permitted by the system) and/or the register were modified to allow close match searching.

Lessons for Australia

A considered assessment should be made of the degree of accuracy expected of registering parties and the register must be designed to reflect this. The more search criteria that are permitted (to use my term, the more ways there are of carrying out a search that can be regarded as properly formatted) the greater the potential burden on a registering party to ensure complete accuracy. The burden can be lessened by designing the register to carry out close match searches so that minor errors will not invariably be fatal. My preference is for close match searching, but Ontario lawyers seem satisfied with the exact match protocols of that province (though of course there are fewer search fields in Ontario than in New Zealand).

Some Practical Thoughts Concerning Issues 1 and 2

Issue 1 concerned inadequate collateral descriptions – either in the security agreement or in the financing statement. Issue 2 dealt with financing statement errors (which could involve inadequate descriptions but more likely would involve an error in a searchable field) that could invalidate the financing statement. The possible permutations of errors can be considered as follows:

1. ineffective security agreement but valid financing statement;
2. effective security agreement but invalid financing statement; and
3. ineffective security agreement and invalid financing statement.

1. Ineffective security agreement but valid financing statement.

This first possibility requires consideration from the perspectives of both the secured party and a third party searcher. A secured party who discovers an inadequate description in a security agreement, or who has otherwise failed to comply with s.36, should take immediate steps to rectify the defect. Although the Act itself contains no express time limit for compliance with s.36, it is likely that the latest possible time would be immediately prior to enforcement procedures being taken by any secured party.[17] However, there is debate over whether it is possible to remedy a failure to comply with s.36 and restore the secured party's desired priority position after a competing security interest has arisen. In my view, it is possible to do so, both by amending a defective security agreement and by entering into a new one (possibly the safer option subject to the application of voidable preference provisions) but my Canadian co-authors would not go so far.[18] In my view, priority would then be based on time of registration and because, ex hypothesi, the financing statement is valid, the rectified security interest would take priority over any later perfected general security interests. If it is not possible to get the debtor to agree to a new security agreement or a better collateral description, consideration should be given to seizing the collateral. Although the better view is that this would not satisfy s.36,[19]until the issue is ruled on this may be one case where possession is 9/10ths of the law.

From a third party's perspective it is important to remember that for a competing security interest to take priority, both the financing statement and the underlying security agreement must be effective. It seems that many searchers do not fully appreciate the implications of this. For example, in my experience receivers will generally conduct a search of the register and act on the results of the search without further investigating whether competing secured parties have complied with s.36. A receiver appointed by a bank may search to determine which of the likely numerous claimed purchase money security interests have been duly perfected without verifying that the debtor has signed a security agreement with the purchase money claimant that complies with s.36. Having conducted a search and discovered an apparently valid purchase money security interest, many receivers seem happy to concede priority when they may not be required to do so. Obviously, receivers need to make a cost benefit assessment of the costs

[17] See Gedye Cuming and Wood, *Personal Property Securities in New Zealand,* Brookers, Wellington, 2002, at para 66.5.
[18] Ibid at para 36.4.
[19] Ibid at para 36.2.

of further investigation versus the likely returns but it is not appropriate simply to ignore the issue. The basic point is that nobody should assume that a valid financing statement alone entitles a competing claimant to priority.

2. Effective security agreement but invalid financing statement.

An effective security agreement but invalid financing statement will have allowed the security interest to attach and be enforceable but it will be vulnerable to loss of priority. This second permutation again raises issues for both the affected secured party and third parties. A secured party who has registered an invalid financing statement can attempt to rectify the problem any time before any secured party takes steps to enforce its security interest. The financing statement defect can be rectified in two ways: either by registering a financing change statement to correct the existing financing statement or by registering a wholly new financing statement. Often, the better strategy will be to register a wholly new financing rather than to amend the existing defective financing statement by way of a financing change statement. The register has been constructed to show the history of amendments so if a financing statement has been amended, it will often give away the fact that the secured party has attempted to rectify matters and draw attention to the defect. On the other hand, if a new financing statement is registered to remedy a defect, the defective financing statement can be left in place and the defect may not be obvious. Also, registering a new financing statement may more readily allow the secured party to argue that the defect was not seriously misleading than would be the case if the secured party had chosen to rectify the defect by registering a change statement. Care must also be taken not to make matters worse. A secured party who suspects that the debtor's name is recorded incorrectly in a financing statement would perhaps be wisest to leave the existing registration in place and undertake a new registration just in case the original registration turned out to be correct.

From the searching party's perspective, it is obviously necessary to carefully consider the history of registrations and to investigate whether amendments or multiple registrations might be a result of an initial defective registration. It is also important not to assume just because a search has revealed a financing statement that the financing statement is valid. In one case I was involved in, a receiver utilised the useful debtor incorporation number search facility and simply assumed that all the registrations that were returned by the search were valid. In fact, several were invalid because the debtor name had been incorrectly recorded. This was not immediately obvious to the receiver because the incorporation number had been entered correctly and the receiver's search had revealed both valid registrations and the registrations that were invalid.

3. Ineffective security agreement and invalid financing statement.

This is the worst-case scenario yet some secured parties are effectively electing this path by intentionally not complying with s.36 or registering a financing statement. I am aware of many small retention of title type suppliers who deem the time and expense of complying with the Act not warranted. Despite the risks, and possible illegality under Part 9, their approach is simply to repossess the goods they have supplied at the first hint of trouble and hope that competing financiers do not notice! There will often be a realistic prospect that competing secured parties will not know that the debtor had possession of the collateral in the first place and so will not know to challenge its repossession. For those for whom this is not the preferred approach, immediate steps should be taken to remedy the defective security agreement and financing statement using the strategies already discussed. Obviously, the double defect will compound the problems associated with any of the alternatives.

Issue 3: The Enforcement Regime

In simple terms, Part 9 of the Personal Property Securities Act deals with the enforcement of in substance security interests in collateral other than consumer goods. Because of the perceived need for additional consumer protection measures, enforcement of security interests in consumer goods is primarily regulated by the Credit Repossession Act 1997.

Part 9 has had a chequered history. There was considerable debate as to whether remedies, particularly in relation to business financing, should be regulated by the Personal Property Securities Act. The alternative was to leave the parties and the common law to provide for remedies. Even once it was decided that the Act should cover remedies, the drafting approach was revised several times, both while in Bill form and by amendment to the Act before it came into force. Despite all this attention, Part 9 remains deeply flawed.

One of the fundamental concepts underpinning the Personal Property Securities Act is that all transactions that in economic substance secure the performance of an obligation should be regulated in the same manner. This goal extends not only to rules regulating the creation, priority and registration of security interests but also to the enforcement of security interests. This is one of the justifications for regulating remedies in the Act. Unfortunately, the New Zealand Act permits contracting out of the remedies regime to such an extent that the goal is not achieved. The theory is that the equal bargaining power of the parties justifies allowing contracting out for business to business transactions. The reality is that the creditor calls the shots and there is rarely any meaningful negotiation. Not surprisingly, lawyers acting for financiers have seized the opportunity and contracting out to the maximum extent possible has become the norm. The harm this could do to the goal of a unified approach to security interests can be illustrated by a simple example. One of the most basic rights of a debtor who has given security is the right to receive any surplus on realisation of the collateral by the secured party and it is surprising that this right can be contracted away. A secured party's legitimate interest is to receive payment of principal, interest and costs. If the collateral is realised for more than that, the extra should go to the debtor (or subordinate secured parties). By allowing the debtor to contract away this right, the possibility exists of the various forms of security interest being treated differently. At common law, a retention of title supplier may, depending on the circumstances, be entitled to keep any surplus. On the other hand, a mortgagee may be compelled to account for any surplus even where the debtor has purported to contract away this right. Contrary to the intention of the Act, the form of the transaction can thus affect the way it is regulated.

However, the most serious flaw in the enforcement regime is s.109. Section 109 is unique in the PPS world. The problem with s.109 is not so much what it says but what the drafter of the section thinks it says. Section 109 says that "a secured party with priority over all other secured parties" may seize and sell the collateral. This was apparently intended by the drafter to mean that only a first ranking secured party could enforce a security interest.[20] There is a good argument that the section has not achieved this intention, but there are difficulties whether or not it has done so. If the section does do what the drafter intended, no secured party will be able to enforce a security agreement unless they are satisfied that they have first priority. There will be many cases when it is unclear who has first priority and it will serve no-one's interest to delay enforcement until the priority question has been resolved. The Act itself awards equal priority to certain component interests in finished goods; does this mean none of the equal ranking interests can enforce?

The only way in which the section can be interpreted as not limiting enforcement rights to first ranking security interests is to argue that subordinate interests can still rely on a contractual right to enforce. If a subordinate security agreement gives a right to seize and sell, it can be argued that when doing so the secured party is not enforcing under s.109 and so is not constrained by the injunction that the section only applies to first ranking security interests. The problem with this argument is that all of the subsequent sections that refer to enforcement steps "under s.109" would not then apply and the enforcing secured party would avoid the principal obligations under Part 9 (eg the obligation to sell for the best price reasonably obtainable at the time of sale).

The only sensible solution is to amend s.109 to make clear that any secured party has a right to enforce and to delete the references in the later sections to s.109 so there can be no argument that a secured party exercising a contractual right to enforce is not subject to Part 9. It is also worth noting that the intended effect of s.109 can easily be avoided by appointing a receiver. Nothing in Part 9 applies to receiverships so anyone concerned at the possible consequences of s.109 can insert in their security agreement a power to appoint a receiver, even where traditionally this would not have been the usual remedy.

Part 9 very usefully creates a voluntary foreclosure regime: ie the secured party is given the right to seize collateral and retain it in satisfaction of the obligation secured rather than sell it and apply the sale proceeds towards the obligation secured. But certain steps must be followed when exercising this right and I suspect that these steps are often ignored. The voluntary foreclosure regime is set out in ss 120 to 124 and requires that the secured party give notice to others with an interest in the

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[20] My assessment of what the drafter intended is based on discussions with officials and papers

collateral, who then have the right to object to the foreclosure. These provisions are most likely ignored by retention of title suppliers, who have enough trouble accepting that they only have a security interest in the goods they have supplied let alone understanding that they must follow the statutory procedures before they can take back the goods. Such suppliers are so used to grabbing their goods when the debtor does not pay that it probably does not occur to many of them that in doing so they are exercising enforcement rights under the Personal Property Securities Act. General financiers, and their receivers, should be aware that before they took steps to enforce, title retention suppliers may have improperly made off with goods to which the general financier had a better claim.

Lessons for Australia

There are, I believe, two lessons for Australia in view of the New Zealand experience. First, there is no reason why the right to enforce a security agreement should be limited to a first ranking security interest. There is no problem with a lower ranking interest being enforced. As a matter of practice, the holder of a lower ranking interest will need the cooperation of higher ranking interests to enable the holder of the lower ranking interest to sell the collateral and/or to avoid liability for conversion. Secondly, I believe there should be minimal contracting out of the enforcement provisions. Consumer protection policy may well justify additional provisions protecting consumer debtors but otherwise it is far better to limit the enforcement provisions to rights and obligations to which no reasonable secured party or debtor can object and to prohibit most contracting out. As soon as a general contracting out power is given, the goal of creating a unified security interest is undermined.

Issue 4: The Meaning of Ordinary Course of Business

Section 53 allows a buyer or lessee of goods sold or leased in the ordinary course of business to take free of certain security interests. Central to this provision is the meaning of "ordinary course of business." This is a seminar topic in itself and here, in view of the unfortunate history of this phrase on both sides of the Tasman, I want to make just one important point. Australian company law used to utilise, and the New Zealand Companies Act still contains, an exception to the voidable transaction provisions for transactions in the ordinary course of business. In both countries,

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obtained under the Official Information Act.

interpretation of the phrase has been variable. While I do not want to interpret the phrase exhaustively for the purposes of the Personal Property Securities Act, it is important to understand that in the context of the PPSA, the term should not be given the same meaning as under voidable preference law and the precedents where it has been interpreted for that purpose should be largely ignored. To a slightly lesser extent, the same is true for precedents that have interpreted the phrase for the purposes of floating charge law. Policy dictates that in the context of voidable transactions law, the phrase should be given a relatively limited scope whereas in the context of floating charges a broad interpretation has traditionally been given. The proper interpretation for the purposes of the PPSA lies somewhere in the middle. In the context of the PPSA, the phrase is clearly used subjectively; it is the seller's or lessor's ordinary course that is relevant not the ordinary course of business generally. This alone is enough to distinguish the voidable preference cases and it is to be hoped that New Zealand courts look to North American PPS precedents for guidance rather existing Australasian jurisprudence on voidable preferences or floating charges.

Lessons for Australia

There are as yet no reported New Zealand cases defining the ordinary course of business under s.53 of the Personal Property Securities Act. Although there is no reason to suggest that the courts will follow the wrong path, in view of the unfortunate baggage associated with the phrase in both Australia and New Zealand, drafters of an Australian PPSA might like to consider using an alternative phrase to clearly distinguish it from the voidable preference context or to further define the phrase for the purposes of the PPSA.

Issue 5: Problems with the Preferential Creditor Regime

This also is a conference topic in itself and I have written it up extensively elsewhere.[21] The New Zealand preferential creditor regime has its own peculiarities but in common with Australia, it was previously based on distinguishing between fixed charges (which did not concede priority to preferential creditors) and floating charges (which did concede priority). With the advent of a PPSA that did not distinguish between fixed and floating charges, a new approach was required and this proved to be an extremely vexing problem. In the final event, the relevant New Zealand legislation gives preferential creditors priority over some security interests in accounts receivable and inventory but not over certain other security interests. Unfortunately, these provisions are not consistent with the rules governing the priority of the various security interests relative to each other so that the potential for circular priorities arises: ie, SP1 may have priority over SP2 who has priority over the preferential creditors who have priority over SP1. It will most commonly be receivers who are called on to deal with this issue. While the courts have had to cope with circular priorities in the past, until the courts have considered the matter in this context, I would advise receivers who are confronted with the issue to seek the directions of the court rather than take the responsibility on themselves.

There are many other unresolved issues with the New Zealand preferential creditor regime of which the following is a brief sampling:

- preferential creditors are payable from accounts receivable and inventory or their proceeds. It is not clear how far back one must go to determine whether property is proceeds of accounts receivable or inventory. Presumably, it is only proceeds of accounts receivable and inventory that have been realised post receivership or liquidation that must be applied to preferential creditors;
- purchase money security interests have priority over preferential creditors but it is not clear whether this is so only if the purchase money security interest qualified for super priority under the PPSA and it is not clear whether a proceeds purchase money security interest is entitled to priority over preferential creditors;
- preferential creditors are payable from accounts receivable but not from chattel paper. This peculiarity means it is absolutely essential for receivers and others that have a statutory duty to pay preferential creditors to distinguish between chattel paper and accounts receivable. The distinction can be difficult to make and again, at least until some helpful precedents have evolved, I advise receivers to seek the coutrs' guidance and not to go it alone.

The problems associated with the preferential creditor regime in New Zealand have led me to conclude that the best solution is simply to abolish the regime. Where there is a legitimate social need to protect certain vulnerable creditors, which

[21] See the forthcoming articles in the August and November editions of the NZ Business Law Quarterly.

arguably only applies to employees, I am of the view that an insurance scheme would produce a more efficient outcome.

Lessons for Australia

Unlike New Zealand, Crown preferences have already been abolished in Australia so the issue is of slightly less significance though no less difficult to solve. It may seem a trivial issue, but the difficulty of merging the preferential creditor regime and a PPSA should not be underestimated. Several approaches were suggested in New Zealand but each had problems. If anyone can come up with a trouble free solution short of abolishing the preferential creditor regime, I would be keen to know of it.

What will the Future Hold?

The difficulties with the New Zealand Act that I have referred to in this paper are largely due to poor implementation rather than any conceptual shortcomings. Undoubtedly, Personal Property Securities legislation is conceptually more coherent than the law it replaces. Potentially, it also makes it easier to create and perfect security interests, is less costly for both secured parties and debtors and is more certain – though New Zealand is still a little way off fully achieving all of these ideals. There can, however, be no disputing that even despite implementation glitches documentation and registration procedures are in many cases more straight forwards than under the prior law and transaction costs accordingly lower. Banks and other general financiers should certainly be pleased with the ease with which all assets security interests can be taken and protected by registration. Indeed, it can be argued that the legislation is too pro-Bank. This is not a view I share; I believe the Act draws the right balance between the interests of general financiers such as banks and specialist financiers such as inventory suppliers. One goal of the new Act was to make the law more accessible and transparent and overall it has probably done so. This is not to say that a layperson picking up the Act could understand all its provisions. It is not an easy Act to read without a good understanding of the underlying principles but this understanding can be readily obtained from commentary on the legislation. Certainly, no-one could claim that the prior law was accessible or transparent and I believe the Act is a vast improvement.

New Zealand's path is clear. Drafting anomalies should be rectified. Some steps have already been taken in this direction with some miscellaneous provisions in the omnibus Business Law Reform Bill that is currently before Parliament aimed at correcting errors in the Personal Property Securities Act. Personally, I do not believe that this piecemeal approach is ideal. It will take years to address all of the outstanding issues. I would much prefer to see a comprehensive PPSA amendment bill prepared and adequately debated so that all the issues can be properly addressed at the one time.

Beyond sorting out teething problems through amending legislation, New Zealand can look forward to judicial analysis of the legislation to settle some issues. I am confident that the New Zealand courts will be well up to the task, particularly if the initial cases that come before them are soundly argued. It is incumbent on the financing industry and the legal and insolvency professions (for the latter is where many of the cases will originate) to ensure this occurs. Apart from settling outstanding issues, New Zealand will need to consider whether any substantive amendments are warranted. Thought should be given to the treatment of security interests in investment securities. There are already a number of defects in the New Zealand treatment of investment securities and rather than simply rectifying these New Zealand should consider following the American model where attachment and perfection of security interests in investment securities are based on the concept of control of investment securities. Canada appears to be going down this track and has already done considerable work that would be applicable in the New Zealand context.

Australia has yet to commit to a Personal Property Securities Act. In my opinion, it should do so. PPS legislation is conceptually sound and offers many practical advantages over the old law. With a free trade agreement with the United States on the horizon, a common secured financing regime makes good sense. Harmonisation in international commercial law is a worthwhile goal in itself and PPS legislation is rapidly spreading around the world. I understand that there is slight opposition to PPS reform from one or two of the Australian banks and I find this surprising. PPS legislation makes life easier for general financiers so I hope this opposition can be overcome.

While I have been critical of some aspects of the New Zealand Act, there are other New Zealand innovations that Australia should consider. For example, in New Zealand the purchase money super priority for inventory suppliers is not dependent on giving prior notice to general financiers. While some general financiers may disagree, I believe this is a more appropriate balance of the various competing interests and it avoids the evidential and other difficulties that arise as soon as priority turns on something other than the time of registration. New Zealand also gives priority to a buyer over an unperfected security interest where the buyer knew of the existence of the prior security interest. I believe this too is an appropriate departure from the North American model; again it eliminates the need to consider whether a buyer had actual knowledge of a prior security interest. The most radical New Zealand departure from international norm was to make unperfected security interests effective in insolvency. Although I am opposed to this approach, there are interesting arguments both ways and Australia should probably at least consider the possibility. But none of these considerations need significantly delay the Australian adoption of a comprehensive Personal Property Securities Act, applicable to both incorporated and unincorporated debtors, to all forms of security interest and to all forms of personal property.

In twenty years time, I will be retired and will not be attending the 40th anniversary of this conference to be held accountable for my prediction today.

I hope that in twenty years time, the floating charge and other Victorian financing devices, and the accompanying incoherence, will be remembered only in legal history classes. New Zealand and Australia, in common with most of the civilised world, will be basking in the golden glow of common personal property securities legislation, fleshed out by well reasoned judicial analysis. The law will be simple and certain and will facilitate international trade and financing and no-one will remember why PPS legislation was not adopted twenty years before 2003. That is my 20/20 vision – but then of course I need prescription glasses to see where I am going today.