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1. INTRODUCTION

1.1 At last year's conference, Pru Flacks provided some useful insights into drafting PPSA opinions and, in particular, how lawyers should properly opine to their clients on the vexed issue of priority over personal property. The thrust of those opinions has been widely adopted in the market place.

1.2 Back at 2003 conference, whilst the PPSA was still very much in its infancy, Gayatri Jaduram also touched on opinions and at a more academic level, Mike Gedye challenged us with his thoughts on some of the ambiguities under the Act. Back then, Mike identified 100 or so "problems" with the Act. What I will do today is assess whether, 3 years on, either Parliament or the Judiciary has made any headway in rectifying those problems and whether we as practitioners have made any headway in solving them ourselves.

1.3 The first part of this presentation looks to our PPSA cases to see if there is any meaningful precedent that that we can glean from them. Then I'll have a look at some of the amendments made to the Act and will consider what the effect of those amendments has been and lastly I'll share with you some of the PPSA problems I have faced and how those issues have been dealt with.

1.4 One of the most revealing things about the PPSA is the simple fact that despite all of the interesting legal issues thrown up by it, the single most important and perhaps most menial task of all is the one that appears to be continually taken for granted, or worse, overlooked. That of course, is the process of registration of financing statements on the PPSR and that is what seems to be giving rise to the majority of disputes.

2. CASE LAW – THE FAMOUS 2(.5)

2.1 An interesting statistic mentioned by Mike Gedye in his 2003 paper, was that even after 25 years of PPS law having been in force in Canada, there are still sufficient reported cases each year to fill a volume of the specialist PPS case series. New Zealand is clearly a far less litigious legal environment than Canada for although we are now 3 years on from the introduction of the PPSA, we have barely managed to muster up 3 PPSA cases let alone 3 volumes of cases, and then only because of tangential references to the PPSA in the *Building Depot* case. What I will do is examine each of those cases, and assess the extent to which they have clarified our thinking around the Act, if at all.

2.2 The famous 2.5 are reasonably well known to most of us.

2.3 They are:

(a) *Graham v Portacom New Zealand Limited*,

(b) *Agnew and Waller and SH Lock v New Zealand Bloodstock Limited and New Zealand Bloodstock Finance Limited*; and

(c) *Pardington v Fletcher Distribution Limited, Agnew and Waller and the Official Assignee.*

2.4 One common thing with these cases, is that each arose on an application by receivers to determine matters of competing priorities.

2.5 Grant Graham and Brendon Gibson were the first cab off the rank with the *Portacom* decision. The case concerned the priority of various parties to 5 portable buildings.

2.6 The next case, brought on by Richard Agnew, was the *New Zealand Bloodstock* case which concerned priority to a stallion called "Generous", and to stud fees payable in respect of Generous' performance as a stallion.

2.7 The last case, known as the *Building Depot* case which was brought on by Rod Pardington, and which can only just be classified as a PPSA case (but it does have a PPSA lesson), concerned a subsequent ranking secured creditor's claim to surplus proceeds of sale of stock in trade following a sale by the prior secured creditor's receiver. The relevance of this case is more about the effects of the realisation process selected by the secured party.

2.8 The three cases that I am going to talk about, in aggregate probably only involve amounts of $2 – 3 million. Not a large sum on any analysis. On the other hand, I know of one case where a secured creditor, for reasons which it has been unable to explain, randomly discharged financing statements over assets worth in the vicinity of $700,000. Regrettably this error only revealed itself at the time of receivership of the debtor, by which stage it was all too late and I only mention this at this point in order to give some context to the economic importance of the legal matters which, although interesting to us all as practitioners, are clearly not as important in a real sense as the day-to-day humdrum of the registration process.

Portacom

2.9 The *Portacom* case was, in one sense, a terrific first-up case to land. It reinforced what we had been told by the commentators leading up to the enactment of the PPSA – "title is irrelevant" – a proposition we all secretly refused to believe could ever be true. Well it was and is. In reality, *Portacom* merely reflected what North American commentators had been telling us, and simply confirmed what were the unambiguous words of the Act. So at that level, it was never going to sound with any great excitement around our legal market.

2.10 *Portacom* was therefore an excellent case to kick off what Hansen J in the Auckland High Court proudly acknowledged was our maiden case under the PPSA.

Material Facts

2.11 The facts of the case are quite straightforward.

- Portacom delivered 5 portable buildings to NDG Pine.

- The buildings were leased under formal lease terms for a period of more than one year (hence they constituted security interests under the PPSA). Portacom never registered these interests on the PPSR.

- NDG Pine had meanwhile granted a debenture to HSBC, which had been registered on the PPSR.

- NDG Pine was subsequently placed in receivership.

2.12 Note that Hansen J seems to have concluded that the question of priority between the claim of Portacom as lessor and HSBC as debentureholder should be decided at the time of receivership. I will come back to this point later in this paper.

2.13 Given that *Portacom* was the first case to be decided under the PPSA, the Judge seized the opportunity to recite the majority of the key principles underpinning the PPSA.

Decision

2.14 The Judge determined that HSBC's debenture created a security interest in the "portacoms" which was perfected upon registration, as was the case with the Portacom leases. The Court clearly felt that this was a case of having to decide between a perfected security interest and an unperfected security interest, in which case the perfected security interest (the case in point HSBC's debenture) would have priority.

2.15 Hansen J took the first big step in developing the New Zealand jurisprudence by assuming that the point at which you determine priority, is in the *Portacom* circumstances, the time of appointment of receivers. This in seemed to be a leap forward given that there is nothing in the PPSA which says that the time of receivership or insolvency or entry into possession by a secured party is the time at which priority is determined. This is in contrast to the Canadian position. Much has been written in Canada about this very point yet it failed to really make the line as an issue for debate.

2.16 Of most importance was the Court's decision that although a debtor does not own goods in the traditional sense of having title to those goods, it could nevertheless under the PPSA create a security interest in those rights, albeit that they might only be rights of possession. The Court then held that if HSBC had security in these rights in goods and Portacom had failed to perfect their rights, then HSBC having perfected prevailed. It effectively snuffed out the argument that the security interest that HSBC took its security over was merely the defeasible leasehold interest in those goods, and simply stated that by virtue of the operation of section 40(3) a debtor could grant a security interest in the goods (in this case, portacoms) themselves.

2.17 Interestingly, Hansen J makes reference to the British Columbia legislation which provides that a security interest is not effective against the trustee in bankruptcy if the security interest is unperfected at the date of bankruptcy. There are no equivalent provisions which determine priority around the time of bankruptcy under the New Zealand PPSA.

2.18 From *Portacom*, what we conclude is that title is irrelevant and that a debtor can grant security over an asset to which it does not have title, which in turn can confer on a security holder an ability to transfer title to a third party.

2.19 The wording of the "old world debenture" which purported to create a charge over "all assets and undertakings" is considered wide enough to capture assets in which the debtor has rights. As a first-up, this provided significant comfort to those financiers who had been unsure as to whether in fact they would need to amend their pre-PPSA security agreements (debentures so called) so that the security interest or charge attached to all assets in which the debtor "had rights" (which has now become the traditional wording). They didn't need to.

New Zealand Bloodstock

2.20 The *New Zealand Bloodstock* case was the second instance of an application for directions brought by, in this case, Richard Agnew and John Waller. The matter came before Allan J in the Auckland High Court towards the end of last year.

Material Facts

- Messrs Agnew and Waller were the receivers of Glenmorgan Farm Limited.
- The second plaintiff, being a financier called SH Lock, held a debenture over the assets of Glenmorgan which was granted in November 1999. Quite correctly, the pre-PPSA debenture was re-registered under the PPSA on 1 May 2002 so re-registration was valid.
- Glenmorgan later defaulted in its arrangements with SH Locks and the receivers were appointed under the debenture in July last year.
- After the time of creation of the Locks' debenture and in August 2001, Glenmorgan had entered into a lease to purchase agreement in respect of one of its assets being a stallion called Glenmorgan. The lease to purchase agreement was entered into with New Zealand Bloodstock. That lease was later assigned but that is not material for the purposes of this review. Subsequently the lease was re-negotiated and extended out to March 2005.
- No financing statement was ever registered by New Zealand Bloodstock in relation to its lease.
- Glenmorgan took possession of the stallion Generous in August 2001 and used him for breeding here in New Zealand and in Europe.
- Because of continuing defaults in payment by Glenmorgan, New Zealand Bloodstock also terminated its lease and took possession of Generous also in July 2004.

Decision

2.21 The questions that Messrs Agnew and Waller asked the Court to decide was (i) whether through the receivership they were entitled to possession of Generous and (ii) whether they were entitled to the stud fees earned in respect of Generous' activities.

2.22 This was another groundbreaking case that Allan J was in this case asked to decide because of course before the enacting of the PPSA, nemo dat prevailed and it was quite clear that New Zealand Bloodstock continued to own Generous.

2.23 Once again the argument was raised, as was the case in Portacom, as to whether or not this new so called "asset" being a leasehold interest could amount to an asset for the purposes of the pre-PPSA charging clause in the debenture. Allan J finally put pay to the argument that at the time leased assets were leased, it was never within the contemplation of the parties that the competing security holder might get some benefit and he essentially concluded that "property" where referred to in a debenture was not confined to property of the debtor in which the debtor had legal title or ownership, but would include all possible interests including therefore leasehold interests. On the strength of that, the charging clause was held to be sufficient.

2.24 The question then to be determined was whether or not the lease was a security interest which required to be perfected in order to obtain priority. The debenture had been perfected by reason of registration. Had the lease had been perfected though?

2.25 Perfection can of course occur either by registration or possession and New Zealand Bloodstock had taken possession of the stallion. However, possession will not necessarily be effective for perfection purposes because section 40 excludes possession where it is the result of seizure or repossession. This was the case for with New Zealand Bloodstock.

2.26 As with *Portacom*, the question that remained to be determined was the priority ranking between a perfected and an unperfected security interest. The Judge went straight to section 66 to hold that the perfected security interest granted in favour of SH Lock prevailed over the unperfected security interest held by New Zealand Bloodstock.

2.27 The Court was then asked to decide whether or not stud fees should have been paid either to SH Lock or to New Zealand Bloodstock. There was some debate as to whether or not stud fees were assets for the purposes of the SH Lock debenture. The Judge felt that it was not necessary to analyse the issue in this way as it was his view that section 45 of the PPSA, which considers the continuation of security interests and proceeds, was the relevant section. On the strength of section 45, he felt that stud fees were "proceeds" for the purposes of the Act and on that basis, should be properly payable to SH Lock.

2.28 However, it was argued by New Zealand Bloodstock that the stud fees amounted to an assignment of a single account receivable and thus fell outside the scope of the priority provisions of the PPSA. In short, New Zealand Bloodstock had taken an assignment of the stud fees payable to Glenmorgan and had issued, in compliance with section 130 of the Property Law Act, a notice of that assignment. The reality is that the accounts receivable seemed to be more than one in number and therefore not truly "single" for the purposes of the PPSA exclusion relied upon. However whilst acknowledging the argument made by *Gedye Cuming and Wood*, the Judge took the view that the assignment constituted an assignment of two separate and distinct debts arising one year apart and thus could be treated as an assignment of a single account receivable falling outside the Act.

Obiter

2.29 The Judge took the opportunity to make some policy statements. He suggested that the purpose of the exception provision was to place outside the operation of the Act isolated assignment transactions entered into, bona fide, by persons not in the business of buying or selling such obligations but who happen to do it for the genuine purpose of discharging, wholly or partly, pre-existing obligations.

2.30 This of course begs the question as to when persons might be considered not to be in the business of buying or selling such obligations. I would suggest that most assignees are not in the business of buying or selling accounts receivable as security for indebtedness which perhaps suggests that all assignments of accounts receivable fall outside the scope of the Act. This aspect of the decision is weak.

2.31 *Gedye* in a well reasoned article from February of this year criticised this aspect of the argument on four grounds. His most compelling argument was that the stud fee was more properly categorised as an expectancy than an account receivable (this because payment was uncertain). He also felt the assignment had the features of a security and thus fell clearly within the PPSA but he acknowledged that might turn on how New Zealand Bloodstock treated the receipt of stud fees in its books.

Building Depot

2.32 This is a PPSA case, at a stretch, but it is worth mentioning here.

Material Facts

- The brief facts are that the Building Depot granted in favour of ANZ a general security agreement. A financing statement in respect of this general security agreement was registered on 21 August 2003.
- The Building Depot also granted a general security deed in favour of Fletcher Distribution and a financing statement in relation to this general security deed was also registered.
- The parties entered into a deed of subordination and priority. The effect of this deed was to give ANZ first priority over all the Building Depot's present and after acquired personal property to the extent of $2.5m plus 6 months interest. Thereinafter, Fletcher Distribution was to have priority over the collateral to the extent of $5m.
- Following defaults under its general security agreement, ANZ appointed receivers on 8 September 2004. Fletcher Distribution later appointed its own receivers on 24 September 2004. After an unsuccessful attempt to sell the Building Depot as a going concern, the ANZ receivers proceeded to sell off its assets subject to ANZ's GSA. From the proceeds of the sale, ANZ's debt was paid out in full and a surplus of $2.8m remained.
- At the time of the judgment, Fletcher Distribution was owed $1.82m. The combination of the remaining secured creditors and the unsecured creditors of BDL were in the order of $5.9m.

Issue before the Court

2.33 Essentially, the issue before the Court was whether, pursuant to section 30A of the Receiverships Act 1993, Fletcher Distribution's security interest was extinguished upon the sale of the Building Depot's assets by the ANZ receivers.

2.34 Section 30A reads as follows:

> **30A Extinguishment of subordinate security interests –** If property has been disposed of by a receiver, all security interests in the property and its proceeds that are subordinate to the security interest of the person in whose interests the receiver was appointed are extinguished on the disposition of the property.

2.35 This was contrasted by counsel with sections 115 and 117 of the Personal Property Securities Act 1999 which read:

> **115 Extinguishment of subordinate security interests on sale –** If collateral has been sold under section 109, all security interests in the collateral and its proceeds that are subordinate to the security interest of the secured party who sold the collateral are extinguished on the sale of the collateral.
>
> **117 Distribution of surplus**
>
> (1) If a secured party has applied collateral under section 108 or sold collateral under section 109, as the case may be, the secured party must pay the following persons the amount of any surplus by satisfying the claims of those persons in the following order:
>
> (a) any person who has registered a financing statement in the name of the debtor over the collateral that is sold where –
>
> (i) the registration was effective immediate before the collateral was applied or sold; and
>
> (ii) the security interest relating to that registration was subordinate to the security interest of the secured party who applied or sold the collateral;
>
> (b) any other person who has given the secured party notice that the person claims an interest in the collateral that is sold and in respect of which the secured party is satisfied that the person has a legally enforceable interest in the collateral;
>
> (c) the debtor.
>
> ...
>
> (3) subsection 1 applies despite the extinguishment of a security interest under section 115.

2.36 Parliament is currently in the process of enacting an amendment to the Receiverships Act 1993 which, if passed in the current form of the Bill, will include a section in the Act substantially similar to section 117 of the PPSA. However, there is currently no such provision in the Receiverships Act. The Court heard argument from counsel as to whether section 30A could be read in a way which anticipates the amendment.

Interpretation of section 30A of the Receiverships Act 1993

2.37 Submissions for counsel for the ANZ receivers and for the Fletcher Distribution receivers were to the effect that Parliament's intention when amending the Receiverships Act contemporaneously with the enactment of the PPSA could not have been that, following sales of assets by a receiver all subordinate security interests are extinguished and the creditors holding those security interests have no claim in any surplus from such sales. This was particularly in light of the long-standing principle of law that secured interests are satisfied in priority leaving unsecured interests to share *pari passu* in any surplus, a position reflected section 117 of the PPSA.

2.38 There was much argument on matters of statutory interpretation and rectification but to no avail from Fletcher Distribution's point of view as the Court held that section 30A is a distinct regime from that contained in the PPSA and was introduced to ensure receivers were free to realise assets and purchasers to take free of subsequent security interest. On that basis, all subordinate security interests were extinguished.

Decision of the Court

2.39 The Court noted that Parliament was apprised at numerous points during the legislative process of the issue of whether sale by a receiver should extinguish all subordinate security interests. These included submissions by Parliament's Commerce Committee and the New Zealand Law Society. In addition, the Court held, noting the decision in *M & J Wetherill Co Limited v Taxation Review Authority* [2001] 3 NZLR 827, that it could not be argued in this case that there was a gap in the legislation because section 30A can be interpreted sensibly as it stands. Even applying the decision of the Court in *Northern Milk Vendors*, it could not be said that the plain words of section 30A led to absurdity. As a result, section 30A was required to be interpreted consistent with a deliberate intention on the part of Parliament to alter the way in which receivers were required to deal with funds surplus to satisfying the interests of the security holder by whom they were appointed.

2.40 This case is to be appealed which will hopefully assist those cases where subordinate security interests have been paid out in priority to unsecured creditors as it appears that Parliament does not intend its amending legislation to have retrospective effect.

Lessons learned from the cases so far

2.41 So what can we draw from the cases thus far. Regrettably, not a great deal.

2.42 The *Portacom* and *New Zealand Bloodstock* decisions tells us that a leasehold interest is an asset of a debtor for the purposes of a pre-PPSA debenture. That is good news for those secured parties with "old world" debentures.

2.43 They confirm that a perfected security interest prevails over an unperfected security interest. That is what the PPSA says. However what they do not tell us is the actual moment for determining the priority dispute, which I believe is the far more challenging issue.

2.44 The Judges have taken the opportunity to reinforce how the PPSA had significantly changed the commercial landscape in New Zealand and reaffirmed with some force the fact that nemo dat no longer rules and that title may no longer be relevant. Just as the fact of ownership was and is no defence to an owner of goods that is dispossessed under the statutory exceptions to the nemo dat rule, title affords no protection to an owner whose interest is subordinated to that of another under the PPSA.

2.45 As for *The Building Depot* decision, it tells us that as a second secured creditor and whilst s30A of the Receiverships Act remains unresolved, you would do well either to buy out the prior secured creditor or prevail on the prior creditor to exercise rights enforcement rights personally and not through its receiver and thus enjoy the benefit of the statutory priority regime set out in s117 of the PPSA.

2.46 We are told that the *Building Depot* decision is set down for appeal in September but with Parliament having now closed for its present term, the amendment to the Receiverships Act, which will remedy this obvious defect, will not now come through until the next government is formed. Although the amendment will adopt the PPSA statutory distribution regime, we are also told that the it is unlikely to be retrospective so there will continue to be quite a bit of interest in the September appeal.

3. LEGISLATIVE AMENDMENTS TO PPSA

3.1 Various amendments to the PPSA and the Distress and Replevin Act were passed and came in to force in April last year.

PPSA Amendments

3.2 27 amendments were made to the PPSA. A number of them rectified drafting errors and many of the others were minor. The three amendments which were of most interest are set out below.

Subordination Trusts

3.3 Since the PPSA came into force, there has been considerable debate in the context of financing transactions whether a subordination trust is a "security interest" under the PPSA.

3.4 A subordination trust arises most frequently when an unsecured creditor (lender) which has agreed to subordinate its claim is required to hold any funds that it receives on trust for higher ranking (senior) creditors. The circumstances of these subordination trusts vary, but the cautious view in a number of recent transactions has been that the trust is a security interest. Despite this the security interest has often not been registered on the Personal Property Securities Register for a variety of reasons, including the practical issue of who registers on behalf of the senior creditors (they might comprise all other creditors), and doubts on the benefits of registration.

3.5 The new section 17A of the PPSA provides that, for the avoidance of doubt, certain subordinated trusts are not security interests.

3.6 Essentially if a distribution of money or other personal property is made on the bankruptcy or liquidation of a debtor to a subordinated creditor which is required to hold that property on trust for a senior creditor, that senior creditor's beneficial interest is not a "security interest". It should be noted that the reverse is not true; a subordination trust falling outside those criteria, such as one arising from a payment made by the debtor when it is not bankrupt or in liquidation, will not necessarily be a security interest. Each case must be considered in terms of section 17 of the PPSA. In particular, the security interest must be *"created or provided for by a transaction that in substance secures payment or performance of an obligation ..."*.

3.7 The statutory clarification will nevertheless be helpful in most subordinated debt financing transactions. The issue would be most likely to arise in the course of an insolvency of the subordinated creditor. As with all claims made to assets relying on a trustee-beneficiary relationship, it must be fully justified. Although a trust per se is not a security interest, it could be in certain circumstances. Then the perfection of that security interest and its timing can be important.

Non-Proceeds Security Interests in Accounts Receivable

3.8 An important new priority rule has been inserted by section 75A. This is worth quoting in full:

> *"(1) A non-proceeds security interest in accounts receivable that is given for new value has priority over a purchase money security interest in the accounts receivable as proceeds of inventory if a financing statement relating to the security interest in the accounts receivable is registered before the purchase money security interest is perfected or a financing statement relating to it is registered.*
>
> *(2) In this section,* ***non-proceeds security interest*** *means a security interest in original collateral.*
>
> *(3) Sections 73 to 75 are subject to this section."*

3.9 The stated justification for this provision is that it will correct a commercial imbalance against factors which the PPSA incidentally introduced. To illustrate the point:

- a retailer is regularly supplied with whiteware by a manufacturer with payment due on normal monthly terms;
- the manufacturer's terms of trade include a security interest and/or ROT in the whiteware until it's paid for;

- the manufacturer registers its purchase money security interest (PMSI) at the PPSR, thereby obtaining super priority for all whiteware subsequently supplied by it to the retailer and not paid for (section 74 PPSA);
- the whiteware ("inventory" in the retailer's hands under the PPSA) is sold to customers and credit terms for payment are given; (Note: exclude from consideration whiteware sold by the retailer on HP – that is proceeds in the form of "chattel paper", not "accounts receivable")
- the retailer factors its book debts on an ongoing basis (that is - transfers the accounts receivable to a factoring company on payment of an agreed price);
- the factoring company registers its security interest (a transfer of accounts receivable is a deemed security interest – section 17(1)(b) PPSA).

3.10 Prior to the 2004 amendment the manufacturer's super priority extended to the accounts receivable, ahead of the factoring company which purchased them, irrespective of the order of registration of their security interests. Now, once the factoring company has registered at the PPSR, it has priority for the transferred accounts receivable except those arising from any PMSI registered earlier than the factoring company's registration.

3.11 In practice, there will often be PMSIs registered earlier. In that case, the supplier's super priority will extend to the accounts receivable as proceeds including those derived from inventory supplied after registration of the factoring company's security interest. If the factoring company requires priority for those accounts receivable, it will still, as previously, have to negotiate a suitable priority agreement with the manufacturer.

3.12 What is not so apparent is that the benefit of this provision could extend to other secured parties. In particular, banks and other lenders that hold debentures or general security agreements covering all present and after-acquired property or specific security agreements over accounts receivable also have a "non-proceeds security interest" in accounts receivable that would (usually) have been given for new value. The effect of section 75A is to increase the security value of debentures and GSAs held from debtors that sell their inventory on credit terms. In a receivership, I would suggest that the bank or other secured party will now get priority for all accounts receivable of the debtor arising from sale of inventory except those relating to a PMSI registered prior to registration of its security interest.

Financing Statements and Seriously Misleading Registrations

3.13 Section 149 of the PPSA provides that:-

> *"The validity of the registration of a financing statement is not affected by any defect, irregularity, omission, or error in the financing statement unless the defect, irregularity, omission, or error is seriously misleading."*

3.14 Section 142 lists the data that "must" be contained in a financing statement in order to register it. A new subsection (2) has been added which says that section 149 is not limited by section 142. In a nutshell, non-compliance with section 142 does not automatically mean that a registration is seriously misleading and therefore invalid. Even without this clarification there was no doubt that this was the case. I mention this but only because problems with registration of incorrect details on the PPSR have been the most talked about practical issue since the PPSA came into force.

Distress and Replevin Act Amendment

3.15 A landlord's statutory right of distraint is not a security interest under the PPSA because it arises by operation of law. (Note that a contractual right of distraint may be a security interest.)

3.16 Under section 3 of the Distress and Replevin Act 1908, a landlord can distrain only on the goods of the tenant or person in possession of the land or building for which rent is owed.

3.17 Section 4 of the Act formerly provided that chattels, the property of the tenant over which the tenant had given an instrument under the Chattels Transfer Act 1924, were deemed to be chattels of the tenant and that they could be distrained against. The Court of Appeal decided in *Metropolitan Life Assurance Co of NZ Limited v Essere Print Limited* (1991) that chattels subject to a fixed charge given by a company were not the property of the tenant for that purpose. So they could not be the subject of distraint. This created the anomalous situation that chattels charged to a lender by an individual tenant were available for distraint, yet those charged by an incorporated tenant were not, except when the charge was floating.

3.18 The Chattels Transfer Act was repealed on the PPSA coming into force. Unfortunately the reference to the Chattels Transfer Act in section 4 of the Distress and Replevin Act was not amended at the same time. This left the legal situation in doubt. It was thought more likely that a landlord would not be able to distrain on any goods subject to a security interest, whether or not perfected and irrespective of the form of legal entity of the tenant.

3.19 However, the new section 4 broadly reflects the distinction created by case law. When a motor vehicle owned by any person, or any personal property owned by a company or an incorporated society, is subject to a security interest, that property is deemed not to be the property of the tenant or person in possession of the land or building for the purposes of distress for rent. It does not matter that the security interest has not been registered.

3.20 In all other cases a landlord will be able to distrain against the chattels of the tenant or person in possession, provided they are in or on the land or building for which rent is owing at the time the distraint is made. That right will prevail over the enforcement rights of any secured party, including a receiver. This distinction, difficult in principle to justify, will be important when there is a receivership of, or other enforcement against, a debtor operating from leased premises. A lender can, of course, protect itself by obtaining a suitable waiver at the time the loan is made but experience shows many landlords are reluctant to grant waivers.

4. SOME PRACTICAL APPLICATIONS

4.1 I'll now have a look at some practical examples of where the PPSA has come sharply into focus, raising novel legal issues but where the matter, for one reason or another, was not ultimately tested in our Courts.

Significance Of "Possession" in the Sale of Goods

- Company A was placed in receivership.
- Shortly before its receivership, it had agreed to buy a large and reasonably expensive asset, being an item of inventory, from Trade Supplier.
- Company A was in the contracting business and was undertaking works at an external site.
- Trade Supplier had invoiced Company A for the asset. The asset had not been paid for but had been delivered to a space adjacent to the site where Company A was undertaking the works. The space was a public place but the asset was extremely large and heavy and could only be moved with the use of cranes and trucks.
- When the asset was delivered to the site, its delivery was receipted by the company. Furthermore, the company as a condition of the delivery, was required by Trade Supplier to use its own cranes to unload the asset.
- Company A was placed in receivership owing Trade Creditor, at that time, a significant amount of money.
- Trade Supplier had not registered a financing statement on the PPSR prior to delivery of the asset to site. Once the issue was raised, Trade Supplier immediately registered on the PPSR but the dispute did not hinge on that registration which in our view, given the item was inventory, was too late anyway to defeat the interests of the debentureholder.
- Company A had granted a security agreement to its bank and the security agreement had been perfected by registration of a financing statement.

4.2 What was the priority position? It appeared straightforward. We had a sale on reservation of title terms so a security interest under the PPSA arose. The Trade Supplier's security interest had not been perfected so the answer seemed reasonably straightforward.

4.3 Section 66 says that a perfected security interest has priority over an unperfected security interest in the same collateral. That appeared to be the end of the argument.

4.4 However, Trade Supplier elected to argue that the company's bank did not have a security interest in the asset, because the company itself never had any "rights" in the goods which it could grant security over, and title rules continued therefore to apply. This was alarming but if correct, meant that an essential ingredient for the bank's claim, being "attachment", would not have occurred.

4.5 The reasoning behind this argument is because although the asset had been delivered to what was a construction site where the debtor company was working, it had not in fact been delivered into the exclusive possession of the debtor.

4.6 Section 40 of the PPSA is relevant here. Turning to the question of whether or not there are any rights in goods which will allow a security interest to come into force, s40 of the PPSA provides that a debtor has rights in goods sold subject to a retention of title "*no later than when the debtor obtains possession of the goods*".

4.7 So the issue of "possession" appears to be reasonably crucial and Trade Supplier's lawyers argued that the asset was merely in a temporary place of storage. Arguing for the bank and its receiver, so long as we could establish possession, then we could overcome the "rights" hurdle which would then overcome any deficiencies in the security interest argument.

4.8 Nevertheless there was some weakness in our possession argument given that the asset was only adjacent to the construction site and not within it and not technically within an area that was under the "exclusive control" of the debtor, Company A.

4.9 Possession is not defined in the PPSA and in the context of section 40, there does not appear to be any Canadian material of assistance. Possession does however seem to involve a combination of both physical possession and control over the object, and for the following reasons, it would appear that the possession and therefore "attachment" test had been sufficiently met:

(a) the Equipment was "delivered to site" as noted in the delivery docket. The word 'delivery' itself implies a relinquishing of the control and possession away from Trade Supplier and towards the debtor company;

(b) there was clearly a transfer of possession because:

(i) The Equipment was so heavy that it required the debtor A to use its own hired crane to offload the Equipment from the truck - Company A offloading the Equipment was a condition of the delivery. A symbolic passing of possession at least had occurred.

(ii) Because of its weight, the debtor placed the Equipment very close to where the Equipment was to be used. That is to say, Company A had control over the placement and location of the Equipment;

(iii) The debtor signed a receipt of delivery docket;

(iv) although the site was "public land" and not fenced off at the time, the debtor clearly had some sort of control of the site (however limited) as far as the rest of the world was concerned; and

(v) the Equipment was delivered without any restrictions on use. Specifically there was no advice that it was only to go to a "temporary place of storage" – in fact all indications were to the contrary.

4.10 So, the debtor company receipting delivery of the Equipment and moving it about the site, was hardly consistent with the Equipment being in a "temporary place of storage" only, and not in the debtor's possession.

4.11 The weakness in the bank's argument was the apparent lack of exclusive control over the Equipment. Nevertheless, Company A as a contractor on the construction site obviously had some sort of possessory control – at least during the day while it was working on site.

4.12 Also the level of control required to have possession, in the case of extremely immobile objects such as we had, might be less. On a common sense level it was difficult to see what more Company A could have done in order to obtain possession of the equipment on site.

4.13 How was this resolved? Not very satisfactorily from a legal purist's perspective.

4.14 One side argued that Company A had possession and hence had sufficient "rights" to grant security over the asset to the bank. Trade Supplier's lawyers disagreed, regrettably without much substantive argument.

4.15 The sum involved was not enough to take the matter to court over and the parties reached a commercial solution.

Issues around leases for a term of more than one year

4.16 A number of commercial lawyers appear to be finding out the hard way, that a lease for a term of more than one year amounts to a security interest which requires perfection in order to preserve priority. The following is an example to be aware of.

- An outsourcing agreement was entered into by a local body with an outsourcing company.
- Under the outsourcing agreement, the local body handed over the operation and administration of one of its public amenities to a third party.
- As a part of the outsourcing arrangement, the third party was provided with access to and use of the local body's equipment necessary to run the amenity.
- The agreement provided that the outsourcing company would receive various fees but in exchange for that, it was required to maintain the equipment and pay a modest rental on it.
- The duration of the outsourcing agreement was three years, renewable.
- The agreement was signed but at the time of signing, it did not occur to the parties that bundled up within it was what amounted to a lease for a term of more than one year. The agreement amounted to a bailment of equipment.
- The outsourcing company ran into financial difficulty and as part of its file review, the local body noticed that its counterparty had granted a GSA in favour of its banker. Plainly, the local authority and its lawyers had overlooked the significance of the arrangement and any attempt at perfecting was always going to post-date the perfection of the bank's GSA.

4.17 The only realistic argument available to the local body was to apply the exclusions contained in the definition of the term "*lease for a term more than one year*" in the PPSA.

4.18 In short, the local body looked to argue that the lease was not captured on the grounds that it was "*a lease by a lessor who is not regularly engaged in the business of leasing goods*". What do those words mean? Does the lessor have to have leasing as its primary business and what does it mean to be "*regularly engaged in the business of leasing*"? Given the nature of a local authority's business and in particular its primary business, the answer seemed difficult to predict.

4.19 There is plainly no New Zealand case law on point but guidance can be obtained from the case of *National Bank of Canada v Merit Energy.* In that case, the vehicle leasing company sought to argue that it was not a lessor "*regularly engaged in a business of leasing goods*". The words considered and relied on in that case are identical to those that appear in the New Zealand PPSA.

4.20 One of the leasing company employees made an affidavit stating that leasing company was a holding company that dabbled in vehicle leasing on a small scale. In that case, the facts made interesting reading:

- The leasing company was incorporated in July 1979.
- From July 1979 until 1985 (a period of 6 years), 13 trucks only in total were rented.
- No trucks were rented from mid-1985 until 1993 (a period of 8 years).
- Trucks were rented from 1993 until 1996 and then to the debtor concerned from 1997 until 2000, being 14 units in total.
- The principle income of the leasing company from 1980 until 1995 was for consulting work.

4.21 Upon further examination, the employee revealed that:

- The majority of the leasing company's current business was the rental of trucks and this company was generally known in the oil industry to rent trucks.
- At any one time, the leasing company had been renting up to 13 trucks.

4.22 The Court held that the frequency of leasing is not determinative of whether the lessor is "*regularly engaged in the business of leasing*". The decision relied on was *David Morris Fine Cars Limited v North Sky Trading.* In that case, David Morris Fine Cars advertised that it bought, sold and leased vehicles, but it had in fact only leased 8 vehicles over a 8 year period. The Court of Appeal in that case held that the focus should be on (i) the business practice of the lessor and (ii) whether the leasing is a profit component of the lessor's business. Based on that presumption, the Court held that David Morris Fine Cars was regularly engaged in leasing.

4.23 In the *Merit Energy* example, the Court also concluded that at the material times the leasing company was in the business of leasing vehicles. It said that the fact that it did not lease vehicles in huge numbers was irrelevant, and that it was equally irrelevant that those leases were not profitable.

4.24 There is one matter alluded to which might offer the litigators something to work away at and that is that the Court said that it could not find anything which would suggest that the leasing of vehicles was "irregular". Perhaps the Court felt that irregularity would be a reason for finding that the lessor was not regularly engaged in the business of leasing goods. In any event, the Court found in the *Merit* case that the leasing company was.

4.25 Based on this analysis, the local body in the example spoken was able at the very least to make a balanced assessment of the risk of having its bailment deemed a security interest, and it negotiated its position accordingly.

Obligations of receivers to personally pay property lease rentals

4.26 Another issue that has been thrown into doubt by reason of the PPSA, is the question of whether or not the liability of a receiver to pay for rent in respect of the use of personal property for the period after the 14th day from appointment of receivers, is in any way impacted by the PPSA.

4.27 As the law currently stands, a receiver is personally liable for the payment of rent unless the receiver contracts out of that liability. However, it is interesting to ponder the situation where the obligation to pay rent is in connection with a security interest which is subordinate to that under which the receiver has been appointed. Let us consider the following example:

- Trading company granted a GSA to its bank, but also leased a PABX from a leasing house.
- Trading bank registers its financing statement on the PPSR, but the leasing company fails to do so.
- Trading company is placed in receivership by its bankers and the receivers decide to continue to trade the company for a period of time which in any event extends beyond the 14 days from the day of receivership.
- The receivers are either unable to or fail to negotiate a limitation of personal liability with the leasing company.

4.28 What is the receiver's personal liability in respect of lease payments?

4.29 On a first read of the Receiverships Act, it would appear that the receivers would be personally liable for rent. However, the Canadian Courts suggest a different outcome might ensue. In this example, it is worth considering the Canadian experience.

4.30 In the case once again of *National Bank of Canada v Merit Energy*, the Courts looked at another Canadian decision which had facts similar to those just mentioned. In that case, the parties agreed that the secured creditors could validly claim full entitlement to the proceeds of sale of leased equipment as a consequence of the lessor's failure to perfect (a position which the lessor accepted), but the lessor asserted that the receiver should still pay the lease payments while it used the equipment.

4.31 The receiver however argued the lease payments fell away with the priority to the equipment.

4.32 The Court agreed with the position adopted by the receiver but acknowledged that the PPSA, like ours, did not contemplate and govern that somewhat rare factual situation.

4.33 In the *Merit Energy* case itself, the facts were again similar although in the case in point, the assets that were used post-receivership were motor vehicles which had been leased by a vehicle leasing company.

4.34 When again asked to decide the case, the Court followed the *Skyview Hotels* decision and in summary, the Court stated that any creditor who fails to register their security interest as required by the PPSA runs the risk of losing priority to the property and the ability to enforce. In the case of a lease, certain rights accrue to the lessor, such as the right to collect lease payments. The Court concluded that the ability to enforce that right should not be available when there is an unperfected security interest. The Court said that to order otherwise, when the leasing company has failed to register its interest, would be tantamount to reviving its security and giving it priority ahead of the bank. The Court felt that this would be inconsistent with the loss of security that flows from the leasing company's lack of perfection and would be contrary to the fundamental concepts of the PPSA.

4.35 The lessor's counsel made a passing reference to the receiver, or its appointing bank, being unjustly enriched by the use of the vehicles rent free whilst Merit continued to be operated by the receiver. The Court had no sympathy for this argument and simply stated that there is a juristic reason for any "enrichment", if it arises. Quite simply, the PPSA requires that security interests be perfected at the peril of losing priority to the security to satisfy outstanding obligations of the debtor. The position would appear to be relatively cut and dry, at least based on the Canadian cases.

4.36 The *Merit* case closes with a final paragraph which will remain a hard lesson for many years to come I suspect. That paragraph states:

> "*The result of this application is unfortunate for the leasing company. However, a simple registration at the Personal Property Registry would have preserved the leasing company's position and avoided these issues.*"

4.37 Not a lot more need be said.

Acknowledgments

Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* - (Thomson Brookers)

Cynthia Hawes, *PPSA: ownership or priority* - (NZLJ – March 2005)

Mike Gedye, *Reflections on some practical issues* - ((2004) 15 JBFLP 20)