THE EFFECT OF THE PERSONAL PROPERTY SECURITIES ACT ON DEBENTURE CREDITORS

ANDREW H. ABERNETHY

THE PERSONAL PROPERTY SECURITIES ACT

A. THE UNIFYING CONCEPT OF "SECURITY INTEREST"
B. THE UNIFORM REGISTRATION REGIME
C. ATTACHMENT AND PERFECTION OF SECURITY INTERESTS
D. PRIORITY RULES

THE DEBENTURE

A. CURRENT DRAFTING PRACTICE
   1. Crystallisation Events Implied by the Court
   2. Automatic Crystallisation Clauses
B. THE LAW
   1. The Fixed Charge

LLB(HONS) RESEARCH PAPER
SALES & SALES FINANCING (LAWS 527)

4. The Floating Charge and the Fixed Charge With a Licence to Deal
5. Re Masoeva Transport (in receivership): The Floating Charge

LAW FACULTY
VICTORIA UNIVERSITY OF WELLINGTON

C. THE FLOATING SECURITY INTEREST AND THE PPISA
   1. Differences Between The Floating Security Interest and The Fixed and Floating Charges
D. THE FIXED CHARGE AND THE PPISA

1993
# TABLE OF CONTENTS

**ABSTRACT**

**INTRODUCTION** ................................................................. 1

**THE PERSONAL PROPERTY SECURITIES ACT** ................................ 3

A. THE UNIFYING CONCEPT OF "SECURITY INTEREST" ...................... 3

B. THE UNIFORM REGISTRATION REGIME .................................... 4

C. ATTACHMENT AND PERFECTION OF SECURITY INTERESTS. ............ 7

   1. Attachment. ............................................................... 7

   2. Perfection ............................................................... 8

D. PRIORITY RULES. ............................................................. 10

**THE DEBENTURE** ............................................................... 11

A. CURRENT DRAFTING PRACTICE ........................................... 11

   1. Crystallisation Events Implied by the Court ....................... 15

   2. Automatic Crystallisation Clauses ................................ 16

B. THE LAW ............................................................................. 17

   1. The Fixed Charge ......................................................... 17

   2. The Floating Charge ................................................... 19

   3. Fixed Versus Floating Charge. ....................................... 24

   4. The Floating Charge and the Fixed Charge With a Licence to Deal .................................................. 25

   5. Re Manurewa Transport (in receivership): The Floating Charge in Practice: ........................................... 29

   6. Automatic Crystallisation Clauses .................................. 30

C. THE FLOATING SECURITY INTEREST AND THE PPSA ............... 32

   1. Differences Between The Floating Security Interest and The Fixed and Floating Charges ..................... 32

D. THE FIXED CHARGE AND THE PPSA .................................... 44
<table>
<thead>
<tr>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>E. THE PPSA AND THE CREDITOR'S CONTINUING SECURITY INTEREST IN COLLATERAL</td>
</tr>
<tr>
<td>F. VOIDABLE PREFERENCE</td>
</tr>
<tr>
<td>1. Should After-Acquired Property Interests Be Voidable?</td>
</tr>
<tr>
<td>2. Will Interests in After-Acquired Property be Voidable After Enactment of the PPSA?</td>
</tr>
<tr>
<td>G. SUFFICIENT DESCRIPTION OF COLLATERAL</td>
</tr>
<tr>
<td>H. FUTURE ADVANCES</td>
</tr>
<tr>
<td>1. The Common Law Position</td>
</tr>
<tr>
<td>2. Future Advances and the PPSA</td>
</tr>
<tr>
<td>I. AFTER-ACQUIRED PROPERTY AND PURCHASE MONEY SECURITY INTERESTS</td>
</tr>
<tr>
<td>1. The Current Position of Purchase Money Security Interests</td>
</tr>
<tr>
<td>2. Purchase Money Security Interests Under the PPSA</td>
</tr>
<tr>
<td>J. PREFERENTIAL PAYMENTS</td>
</tr>
<tr>
<td>1. The Current Scheme Under the Companies Act</td>
</tr>
<tr>
<td>2. The Proposed Scheme</td>
</tr>
<tr>
<td>3. Areas of Concern</td>
</tr>
<tr>
<td>CONCLUSION</td>
</tr>
</tbody>
</table>

**BIBLIOGRAPHY**

**APPENDIX A**

**APPENDIX B**
ABSTRACT

This paper considers the impact the proposed Personal Property Security Act will have on lending institutions securing advances by way of debentures. The first part of the paper examines the broad changes to chattels security law contained in the draft PPSA which has been submitted by the Law Commission to the Justice Department. The main body of the paper treats specific aspects of current debentures and assess them in the light of the proposed changes. The focus is predominantly on the relationship between specific provisions of the PPSA and specific clauses of debentures of large New Zealand lending institutions.

The paper identifies the particular areas of concern as: postponed attachment of security interests, the registration-by-serial-number rule, the voidable preference and preferential creditor rules under company law, inadvertant subordination of security interests in proceeds and transferred collateral, the wording of future advance clauses, and the purchase money security provisions of the PPSA.

The writer has suggested improvements to the PPSA and the Companies Bill (as it was at the time of writing) where appropriate.

Word Length

The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 24,000 words.
INTRODUCTION.

The "irrational assortment of rules presently governing chattel security conflicts" in New Zealand has long been recognised as requiring comprehensive reform. The draft Personal Property Securities Act submitted by the Law Commission to the Minister of Justice will, if enacted, effect this comprehensive reform. The proposed legislation is based on article 9 of the Uniform Commercial Code in the United States and its Canadian progeny- the Personal Property Securities Acts. These systems essentially regulate the rights and obligations of secured parties by focusing on the substance of the transaction intended as security rather than the form in which this intention is manifested.

The purpose of this paper is to examine what effect the enactment of the PPSA will have on creditors who secure the obligations of their debtors by way of debenture. It will become apparent in the course of this examination that debenture holders who continue to use existing documentation after the enactment of the PPSA risk compromising their security in the debtor’s collateral. In order to benefit most from a PPSA regime debenture holders need to familiarise themselves with the wording of their own documentation and the important changes effected by the PPSA.

In writing this paper I gratefully acknowledge the assistance of R Dugan, Faculty of Law at Victoria University of Wellington; and the following businesses: ANZ Banking Group (NZ) Ltd, Bank of New Zealand, Benchmark Building Supplies Ltd, Firestone Tire & Rubber Company of New Zealand Ltd, National Bank of New Zealand Ltd, New Zealand Industrial Gases Ltd, Porirua City Finance Ltd, UDC Finance Ltd, and Westpac Banking Corporation.


2. Hereafter "the PPSA" or unless the context otherwise requires "the Act". Likewise section references are, unless otherwise stated, to the PPSA. "The Companies Act" refers to the Companies Act 1955, and the "Chattels Transfer Act" refers to the Chattels Transfer Act 1924. Note that throughout this paper reference has been made to the "Companies Bill" and the "Companies (Ancillary Provisions) Bill". At the time of writing these had been enacted (September 23 1993) but had not been published as statutes. Therefore the clauses cited in this paper refer to the legislation in its Bill form.

3. A Personal Property Securities Act for New Zealand (Law Commission, Wellington, 1989) NZLC, R8. This proposal is currently with the Justice Department and is expected to be introduced as a Bill in 1994.

4. Enacted in various forms; in Saskatchewan as the Personal Property Security Act, 1989-90 (Sask), c P-6.1, in Ontario as the Personal Property Security Act 1989, RSO c 16.
This paper is in two parts. First, the broad changes to be effected by the PPSA will be outlined. Secondly, specific provisions of debentures currently used by New Zealand lending institutions will be examined in the light of the proposed changes. The paper concludes with some remarks about the desirability of adopting the PPSA.
II THE PERSONAL PROPERTY SECURITIES ACT.

This section focuses on the broad changes which enactment of the proposed PPSA would effect:

(A) The unifying concept of the "security interest"
(B) The uniform registration regime
(C) The concepts of attachment and perfection
(D) Uniform priority rules

A. THE UNIFYING CONCEPT OF "SECURITY INTEREST".

The fundamental unit in the PPSA is the "security interest". The Act reduces the array of current chattel security devices to this central concept. Parties may continue to use the various devices available but the PPSA will not distinguish between these devices on the basis of their form. Where distinctions are made they are made on a functional basis: for example whether the relevant security interest qualifies as a "purchase money security interest" depends on a number of functional considerations.

The definition of "security interest" covers every interest in personal property arising from a transaction which:

"in substance secures payment or performance of an obligation, without regard to the form of the transaction and without regard to the identity of the person who has title to the collateral".

The definition includes (and therefore subjects to the notice filing regime) chattel mortgages, charges, pledges, hire purchases, and assignments as well as devices not

---

5 Defined in s 4 which is reproduced, along with other sections in the PPSA, in Appendix A to this paper.

6 See the definition of this term; s 1 in Appendix A.

7 Section 4(1).
currently recognised by commonwealth common law as creating security interests\(^8\): leases for terms of more than a year\(^9\), retention of title clauses\(^{10}\), conditional sales\(^{11}\) and commercial consignments\(^{12}\).

The inclusion of title-based security interests within the regime will mean, for example, that suppliers will have to register financing statements in respect of goods supplied under retention of title in order to protect themselves against third parties claiming an interest in the same collateral. Currently a simple retention of title clause is not registrable because it is not an "instrument" for the purposes of the Chattels Transfer Act\(^{13}\) or a "charge" for the purposes of the Companies Act. The interest retained by the supplier will thus not be void against a subsequent bona fide mortgagee of the collateral under s 19 of the Chattels Transfer Act or against other creditors under s 103(2) of the Companies Act. Under the PPSA, priority of the supplier’s interest will depend upon the application of s 27.

B. THE UNIFORM REGISTRATION REGIME.

Under the Chattels Transfer Act the instrument creating the relevant security interest is deposited and registered at the High Court Office in the provincial district within which

---


"A security interest is a right given to one party in the asset of another party to secure payment or performance by that other party or by a third party. A security interest:

1. arises from a transaction intended as security;
2. is a right in rem;
3. is created by grant or declaration of trust, not by reservation;
4. if fixed, or specific, implies a restriction on the debtor’s dominion over the asset;
5. cannot be taken by the debtor over his own obligation to the debtor." (emphasis added)

See also: *Re Bond Worth Ltd* [1980] 1 Ch 228 at 248 per Slade J (facts cited below, n 75).

\(^{9}\)Section 4(4)(b) and leases which secure the performance of an obligation (s 4(3)(c)(ix)).

\(^{10}\)Section 4(3)(c)(ii).

\(^{11}\)Above, n 10.

\(^{12}\)Section 4(4)(c).

\(^{13}\)All transfers of chattels in the ordinary course of business of any trade or calling are excluded from the definition of "instrument" in s 2 of the Act.
the chattel is situated at the date of the instrument’s creation. The system provides for local rather than central registration and this constitutes its main disadvantage. Search of the register in a certain High Court Office only provides protection against instruments registered with respect to chattels situated in the relevant district at the time of execution of the agreement. In addition the Act requires registration of the actual instrument and a certificate in the form prescribed by Schedule 1. This approach is cumbersome.

Where a security is granted over company property the instrument may variously require registration under the Chattels Transfer Act, the Companies Act, or neither. Charges over company property must be entered on the company’s register and are registrable in the Companies Office. To complicate matters there are types of charges which need to be entered on the company’s register but not registered in the Companies Office.

The existence of a dual registration system further complicates the difficult relationship of the Companies Act and the Chattels Transfer Act. The uncertainty over where to register security interests was acknowledged by the Macarthur Committee in 1973. DW McLauglan notes, for example, that *Re Manurewa Transport Ltd* - a leading New Zealand case on the priority of the floating charge- could have been decided on a short point not raised by counsel: That the chattel mortgage in the case (since it was given over company property) was erroneously registered in the Supreme

---

14Section 5(1).

15Instruments which are not “charges” but which require registration under the Chattels Transfer Act.

16Instruments exempted from the Chattels Transfer Act or registrable under some other Act.

17Section 111(1).

18Final Report of the Special Committee to Review the Companies Act (1973) para 181: "It is common knowledge that many instruments over chattels are executed by companies and are nevertheless registered as chattel instruments in the [High] Court Office of the appropriate district and that officials of the [High] Court, deeming their duties merely ministerial, accept and register these instruments. The instrument may also be registered in the Companies Office and thus there will be dual registration, one of which is quite ineffective and unnecessary".

19DW McLaughlan "Corporate Personal Property Secured Transactions: Chattels Transfer Act, Companies Act or Neither?" (1978) NZLJ 137, 139.

Court Office at Auckland as if it were an “instrument” rather than in the Companies Office as it should have been.

The essence of registration under the PPSA is notice filing as opposed to current instrument filing. Secured parties register a financing statement which contains only the brief and necessary details of a security agreement. This notice is entered onto a computerised national register which may be searched. Experience with article 9 systems indicates that the notice filing regime is easier and less expensive to administer.

Details of the security agreement underlying the notice may be obtained by specified persons under s 13 of the PPSA. There is provision for the full recovery of legal costs incurred by an entitled party in exercising its right to disclosure.

Because the security agreement itself need not be filed, a creditor may register an interest before execution of the agreement. This is not possible under current law. Currently a creditor remains vulnerable to other security interests granted by the debtor and registered within 21 days of execution.

For example: on Day 1 David grants a chattel mortgage over his boat to Bank. On Day 2 he gives another chattel mortgage over the same property to Finance Co which registers its interest on Day 3. Bank registers its instrument on Day 4. In such a case Bank will lose priority unless he can prove that on Day 3 Finance Co had notice of Bank’s (at that point unregistered) interest.

Under the PPSA Bank could register a financing statement before advancing any sums to David. On being satisfied of the result of a search of the register Bank could advance funds being certain of the strength of its security interest.

Registration under the Companies Act endures until discharged and under the Chattels Transfer Act for five years. The PPSA provides that registration is effective

---

\(^{21}\text{Section 37(4).}\)

\(^{22}\text{Proviso to s 22 of the Chattels Transfer Act.}\)

\(^{23}\text{Section 107.}\)

\(^{24}\text{Section 14.}\)
for the period it is intended to operate as indicated on the financing statement\textsuperscript{25}. The operative period may be amended or renewed by the filing of a new financing statement.

Currently if a secured party refuses to amend or discharge a registered interest the costs of obtaining rectification by the court are borne by the debtor\textsuperscript{26}. Under the PPSA a secured party who, without reasonable excuse, fails to comply with a valid demand to amend or discharge the registration, is liable to pay the debtor’s reasonable legal costs of enforcing the demand\textsuperscript{27}.

C. ATTACHMENT AND PERFECTION OF SECURITY INTERESTS.

1. Attachment.

Attachment of the security interest determines the rights of the creditor and debtor inter partes. Without attachment a security interest is not enforceable against a debtor. Section 10 of the PPSA provides:

"(1) A security interest, including a security interest in the nature of a floating charge, attaches to collateral when
(a) value is given by the secured party; and
(b) the debtor has rights in the collateral; and
except for the purpose of enforcing rights as between the parties
(c) the security interest is enforceable against third parties within the meaning of section 9;
unless the parties agree that it shall attach at a later time, in which case it attaches in accordance with the agreement of the parties."

Attachment is important because:
(a) without it a ‘secured’ party will have no proprietary interest in the collateral. The lender will only be able to sue on the contract with the debtor;

\textsuperscript{25}The registration fee payable by the secured party will probably depend upon the duration of the notice specified by that party in its financing statement.

\textsuperscript{26}Section 45 Chattels Transfer Act, s 107 Companies Act.

\textsuperscript{27}Section 43(ii).
(b) it provides protection to the secured party against claims to the same collateral from judgement creditors and unsecured creditors; 

(c) priority between two unperfected interests is determined by the order of attachment; 

(d) the time at which the security interest attaches determines the law governing the validity and perfection of the security interest. Section 6 provides: 

"(1) The validity, perfection and the effect of perfection or non-perfection of a security interest is governed by the law of New Zealand if 

(a) at the time when the security interest attaches 

   (i) the collateral is situated in New Zealand, or 

   (ii) the collateral is situated out of New Zealand but the secured party has

   knowledge that it is intended to remove the collateral to New Zealand...."

B. Perfection.

Perfection determines the strength of the security interest as against third parties and may be effected in one of three ways: 

(a) registration of a financing statement; or 

(b) possession of the collateral; or 

(c) temporary perfection.

A perfected security interest obtains the greatest level of protection offered by the PPSA. Generally priority among perfected security interests will be determined by the order of

---

28Sections 8 and 15. 
29Section 28(1)(c). 
30Section 19. 
31Section 18. 
32Section 20.
registration or by specific provisions of the Act. A perfected interest takes priority over unperfected.

Interests cannot be perfected until attachment\(^{33}\) therefore a floating charge cannot be perfected until the after-acquired property is acquired since the debtor will not usually acquire rights in the collateral until this point. However the required financing statement can be registered before attachment and since priority between perfected security interests is determined by order of registration there is the opportunity for holders of floating charges to defeat holders of later fixed charges over the relevant property\(^{34}\).

Unperfected security interests are subordinated to the interests of buyers and lessees not acquired by way of security agreement and without knowledge of the prior interest and providing value is given. However unperfected security interests do have priority over interests acquired by third parties. This includes interests of the liquidator, Official Assignee and judgement creditors. These entities do not enjoy statutory priority\(^{35}\) over unregistered security interests.

Currently negotiable property cannot be subject to non-possessory security interests. However the PPSA allows perfection of a security interest by registration as well as possession. However the negotiability of the property is largely preserved by s 25, so a concerned creditor will still need possession of the collateral to prevent unauthorised dispositions prejudicing his or her interest. If the creditor does take possession of the negotiable property as collateral, it must have a method of realising it. Since the debtor will normally be the party entitled to payment on the face of the instrument the creditor may relinquish possession in order to enable realisation by the debtor. Section 20 allows perfection of the interest to continue for 10 working days from the date on which the property was transferred for this purpose.

Under existing law the priority of secured creditors does not depend wholly on order of attachment or perfection but also on the type of interest involved. For example

---

\(^{33}\)Section 14(a).

\(^{34}\)Subject to the super priority of purchase money security interests (s 27).

\(^{35}\)Under the Chattels Transfer Act and the Companies Act.
a registered floating charge without a clause prohibiting the creation of equally ranked interests and absent also a clause automatically crystallising the charge when an attempt is made to do this\(^{36}\) will rank behind a subsequent registered fixed charge over the collateral. Under the PPSA all security interests are treated uniformly: There is no inherent superiority of a fixed charge over a floating charge.

**D. PRIORITY RULES.**

The main priority rules in the Act are:

1. A purchase money security interest takes priority over a non-purchase money security interest.
2. Priority between perfected security interests is afforded to the first to perfect (usually being the first to register)\(^{37}\).
3. Perfected security interests take priority over unperfected interests\(^{38}\).
4. Between unperfected security interests the first to attach has priority\(^{39}\).

\(^{36}\)Which is unlikely of course.

\(^{37}\)Section 28(1)(a).

\(^{38}\)Section 28(1)(b).

\(^{39}\)Section 28(1)(c).
III THE DEBENTURE

In its broadest sense "debenture" is used simply to describe a document which creates or acknowledges a debt. Courts have encountered difficulty in trying to determine what constitutes a debenture and the definition in the Companies Act is of little assistance. However for the purposes of this paper it is unnecessary to test the scope of this term. 'Debenture' as it is used in this paper refers only to a document which evidences an agreement between a business lender and a borrowing company whereby:

(i) the lender agrees to make funds available to the borrower (usually in the form of a revolving credit or overdraft facility); and

(ii) the borrowing company grants the lender a fixed and floating charge over the whole of its property.

Other types of debenture are not within the scope of this paper.

A. CURRENT DRAFTING PRACTICE

There are certain clauses which are common to debentures. These are usually drafted so that the lender is afforded the highest degree of protection available. This section examines specific clauses taken from standard debentures used by large New Zealand lending institutions.

(1) The "Charging" Clause.

"That the charge created by this security shall be a fixed charge in respect of the following assets of the Company:

---

40 Levy v Abercorris Slate & Slab Co (1887) 37 Ch D 260 per Chitty J at 264:
"I cannot find any precise legal definition of the term, it is not either in law or commerce a strictly technical term, or what is called a term of art".

41 Section 2(1) provides:
"'Debenture' includes debenture stock, bonds and other securities of a company, whether constituting a charge on the assets of the company or not".

42 For example: debenture stock and unsecured debentures.

43 References to particular institutions contained in these clauses have been omitted.
(a) Freehold and leasehold land;
(b) Fixed plant and machinery;
(c) Patents, tradenames and all other intellectual property whatsoever;
(d) Unpaid and uncalled capital;
(e) Goodwill;
(f) All book debts and other debts now or from time to time due or owing to the company.

As regards the Company’s other property and assets the charge created by this security shall be a floating charge but so that the Company shall not be at liberty to sell or dispose of the property or assets or any part thereof covered by such floating charge except in the ordinary course of carrying on its business”.

There are two initial points that can be made with respect to this clause:
(1) two distinct charges have been created- a fixed charge and a floating charge: and
(2) the clause specifies the classes of property charged so that the intended collateral is clear to courts which may be asked to enforce the security.

(2) The "Moneys Secured" Clause.

"The words "Moneys Secured" shall mean:
(i) all loans, credits, advances, accommodation made or given, payments and the amounts of other financial assistance of whatsoever kind now heretofore of hereafter made, advanced, expended given or made available by [the Lender] to or for the Company or another at the express or implied request of the Company; and
(ii) shall further include such sum or sums as [the Lender] may expend for the better protection of its interest under this Debenture and any sums payable by virtue of any of the Clauses of the Debenture; and
(iii) shall also include interest (including interest payable by reason of default on the part of the Company) on any sum or sums secured hereunder and at the rate or rates applicable thereto.

The "moneys secured" clause specifies the obligations which the charges secure. This is typically drafted as widely as possible so that all sums, including future advances, which might fall due in the future are secured.

(3) The Crystallisation Clause.

Until crystallisation the debtor retains the power to deal with the assets subject to the floating charge on its own behalf. Upon, or immediately preceding crystallisation this power is lost and the floating charge ceases to hover over the fund of assets and attaches upon the assets in specie. While the fixed charge attaches immediately to the charged assets and to after-acquired property within the scope of the charge upon its acquisition, the floating charge does not attach upon execution or acquisition but upon crystallisation.

"Notwithstanding anything herein contained to the contrary in this Debenture the Moneys Secured shall become immediately due and payable by the Company to [the Lender] and the floating charge hereby created shall immediately attach and become affixed (without the necessity for any notice of default or demand being given by [the Lender]) in any of the following events:
(a) If the Company makes a default in the punctual payment of any of the Moneys Secured or any other moneys secured by any security issued by the Company.
(b) If a distress or execution be levied or issued against any part of the property or assets of the Company.

44See: 'Crystallisation Events Implied by the Court' below at 14.
(c) If a petition for the winding up of the Company shall be presented or if a special or extraordinary resolution be passed or an order be made for the winding up of the Company.

(d) If a receiver shall be appointed over the Company’s assets or any part thereof or if [the Lender] is requested by the Company to appoint a receiver over such assets or if any person having a charge over any of the Company’s assets shall take steps to enforce that charge.

(f) If the Company shall become insolvent.

(g) If it appears from any balance sheet of the Company that the liabilities of the Company exceed its tangible assets or if it appears to [the Lender] that the Company is not able to pay its debts as the same fall due upon expiration of any periods of credit agreed to by creditors of the Company.

(h) If the Company shall cease or threaten to cease to carry on any business or businesses of the Company or any substantial part thereof or shall stop payments to all or any of its creditors.

(i) If the Company purports or attempts to mortgage, charge, assign or encumber any of its property or assets or any part thereof without the prior and express consent of [the Lender].

(j) If the Company sells or disposes or attempts a sale or disposition of its whole undertaking or any substantial part thereof whether by a single transaction or by a number of transactions (whether related or not).

(k) If the Company shall without the prior written consent in writing of [the Lender] enter into any arrangement or composition with creditors generally.

(l) If the Company shall commit a breach of any of the provisions of any other security given by the Company to [the Lender] or to any other person whether ranking in priority to this Debenture or not.

(m) If the Company shall without the prior and express consent of [the Lender] agree to purchase any material quantity of stock-in-trade for the purposes of its business upon terms that legal and beneficial ownership
of that stock-in-trade is reserved to the seller thereof until payment by the
Company of the purchase price.

Events triggering crystallisation can be divided into those that courts have
identified as arising impliedly out of the terms of any floating charge and those which
the parties have provided for additionally by the terms of the contract.

1. **Crystallisation Events Implied by the Court**

Since the floating charge is premised on the continuing ability of the debtor to manage
his assets and trade as a going concern, anything which interferes with this freedom will
crystallise the charge. Such events include: the winding up of the Company whether this
is voluntary or involuntary, the cessation of the debtor’s business by sale of the

---

45Inclusion of which in the terms of the debenture will therefore be strictly unnecessary.

46Re Colonial Trusts Corporation (1879) 15 Ch D 465: A company engaged in buying and disposing of land
issued debentures over their "real and personal estate". A resolution was passed by the company for a voluntary
winding up. The debenture holders claimed to be entitled to a first charge over all the company’s property. Jessel MR
held that the debenture holders were entitled to obtain full payment out of the charged assets and stated at 473:
"if the appointment of a receiver in an action by the debenture holder is sufficient stoppage of the
business for the purpose of enabling the debenture holder to assert his right, a fortiori it must be
so when on the petition of the company a liquidator is appointed".

47Re Panama, New Zealand & Australia Royal Mail Co (1870) 5 Ch App 318: A steamship company issued
debentures of £100 each charging the "undertaking, and all sums of money arising therefrom". The principal was to
be repaid upon a specified date. The company was wound up before the sums became due. The property of the
company was sold by the liquidator. The debentures did not expressly empower the holders to apply the charged
property in discharge of the debts owing to them. However the court held that the debenture holders were entitled
to be paid out of the proceeds of the assets sold- notwithstanding that the debt secured by the debentures had not,
on the face of the debenture, fallen due.
undertaking or otherwise\(^{48}\), the appointment of a receiver by the debenture holder\(^{49}\), or the taking of steps by the creditor to enforce its security\(^ {50}\).

2. **Automatic Crystallisation Clauses**

Modern debentures include clauses which do not require the intervention of the secured party before the charge can crystallise\(^ {51}\). RM Goode notes that the use of these automatic crystallisation clauses has only become fashionable since the 1970's despite the absence of any:

"reported case, either here [UK] or overseas, which denies to the parties to a floating charge the freedom to determine at what point and on the occurrence of what events the debtor's authority to dispose of its assets free from the charge is come to an end"\(^ {52}\).

Note in the above clause that the events which crystallise the floating charge also cause all the moneys secured to become immediately due and payable.

\(^{48}\)Re Mobile Electric Ltd (1979) 29 CBR (NS) 204 (Ont SC).

\(^{49}\)Evans v Rival Granite Quarries Ltd [1910] 2 KB 979: A company in debt to P issued a debenture which granted a floating charge over its "undertaking, including the goodwill of its business and all its property and assets whatsoever and wheresoever both present and future". The creditor, P, was empowered to appoint a receiver after the principal moneys had fallen due. The moneys became due and P demanded payment from the debtor company- but took no other steps to enforce his security. Subsequently a judgement creditor of the debtor obtained a garnishee order nisi against the bank account of the company. P gave notice to the bank that he contested the claim of the judgement creditor to the balance due to the debtor from the bank. P demanded that the bank pay the balance in the debtor's account to himself and further opposed an application by the judgement creditor to have the garnishee order made absolute.

The Court of Appeal held that the debenture holder, P, had not done anything which had caused the floating charge to crystallise. The fact that P's power to appoint a receiver had become exercisable was not sufficient by itself. In order for the debenture holder to have acquired rights in the debtor's particular assets he needed to have crystallised the charge by appointing a receiver- thus ending the debtor's powers of management (per Vaughn Williams LJ at 986-987).

\(^{50}\)Evans, above, n 49 per Vaughn Williams LJ at 986-987 and Fletcher-Moulton LJ at 993.

\(^{51}\)For example clauses (i), (l) and (m) in the example above.

\(^{52}\)Above, n 8, 70-71.
B. THE LAW

Current chattels security law dictates the form of the debenture.

1. The Fixed Charge

A charge is an equitable security distinct from a mortgage. While a mortgage will vest the mortgagor’s legal or equitable title in the mortgagee, a charge does not transfer ownership in or title to property:

"It is merely an encumbrance attaching to the property giving the creditor, on default, a right to resort to that property to satisfy his claim"\(^\text{53}\)

Common law recognised only two types of proprietary interest in personal property: absolute ownership and possession. Since a charge conferred neither, the chargee was not recognised as having any rights in rem\(^\text{54}\).

The courts of equity however did recognise the charge and allowed the chargee to exercise certain rights over the property on the chargor’s default\(^\text{55}\). The holder of a charge therefore now has an enforceable equitable interest against subsequent claimants to the same property. Being an equitable interest however it will be extinguished by a subsequent transfer of the legal interest in the property to a person taking for value and without notice of the chargee’s equitable interest\(^\text{56}\).

A fixed charge attaches to the relevant property upon execution of the charge or when the debtor acquires rights in assets within the description of the charge- whichever occurs later. On attachment the creditor acquires an immediate equitable right in the

\(^{53}\)Above, n 19, 141.

\(^{54}\)The only remedies on default would therefore be in personam.

\(^{55}\)Above, n 8, 14.

\(^{56}\)There are two qualifications to these general statements:

(1) some charges created by statute are ‘legal’ charges (for example see the Statutory Land Charges Registration Act 1934) and the holder has a legal interest in the asset charged.

; and

(2) for the purposes of Part IV of the Companies Act “the expression ‘charge’ includes mortgage”: (s 102(11)(a) of the Companies Act).
assets. If the debtor defaults the chargee, in the absence of contractual or statutory provisions to the contrary, may apply to the court to have the charged assets applied in satisfaction of the debt or may itself appoint a receiver.\(^{57}\)

It was noted above that the chargee’s interest, being only equitable, will be defeated by a bona fide transferee of the legal interest in the collateral for value and without notice ("the BFP rule"). However charges can be registered under both the Chattels Transfer Act and the Companies Act allowing chargeholders to serve notice on the world of their interests and thereby denying the application of the BFP rule.\(^{58}\)

(a) The fixed charge and the statutory scheme.

Section 4 of the Chattels Transfer Act provides:

"(1) Save as provided in subsection (3) hereof, all persons shall be deemed to have notice of an instrument and of the contents thereof when and so soon as such instrument has been registered as provided by this Act....

(2) Save as provided in subsection (3) hereof, all persons shall be deemed to have notice of a security granted wholly or partly upon chattels by a company registered under the Companies Act 1955... and of the contents of such security, so far as it relates to chattels, immediately upon the registration of such security in the manner provided by the said Companies Act ...."

The effect of these provisions is that by registering a fixed charge the charge holder can fix third parties with notice of the charge and therefore defeat the operation of the BFP rule.

For Example:

\(^{57}\)Above, n 19, 140.

\(^{58}\)To the extent that the charge is over "chattels" as defined in s 2(1) of the Chattels Transfer Act.
Creditor ("C") takes a fixed charge over the plant of Debtor Ltd ("D Ltd") to secure the repayment of a $100 advance. Creditor registers the charge pursuant to s 102(3) of the Companies Act.

Subsequently Debtor chattel mortgages the plant to Third Party ("TP") in return for value. Third Party is without actual notice of Creditor's interest.

In this case Third Party takes the legal title to the plant encumbered with the charge in favour of Creditor. The property in the plant remains in D Ltd after the charge to C since a fixed charge is a mere encumbrance attaching to the property not a transfer of ownership or title\textsuperscript{59}. As D Ltd continues to hold the legal title it is able to mortgage this interest to TP. On ordinary principles the subsequently taken legal interest will extinguish the prior equitable interest unless the subsequent transferee has notice. Here TP has constructive notice since the charge is registered\textsuperscript{60} and he therefore takes the legal interest encumbered with C's earlier charge.

If TP sells the charged plant for $150 he will hold the first $100 of the proceeds as constructive trustee for C\textsuperscript{61}. Without registration and absent actual notice of C's charge, TP's legal interest would extinguish the equitable interest of C. TP would have only a contractual remedy in personam against D Ltd.

2. The Floating Charge.

\textsuperscript{59}DW McLaughlan "The Concept of 'Charge' in the Law of Chattels Securities" (1975) 8 VUWL 283 at 289.

\textsuperscript{60}Section 4(2) of the Chattels Transfer Act 1924.

\textsuperscript{61}"The modern doctrine of Equity as regards property disposed of by persons in a fiduciary position is a very clear and well established doctrine. You can, if the sale was rightful, take the proceeds of the sale, if you can identify them. If the sale was wrongful, you can still take the proceeds of the sale, in a sense adopting the sale for the purposes of taking the proceeds, if you can identify them. There is no distinction, therefore, between a rightful and wrongful disposition of the property, so far as regards the right of the beneficial owner to follow the proceeds": Re Hallet's Estate (1880) 13 Ch D 696, 697 per Jessel MR.

Note that in common law C would have no remedy against TP since to maintain an action in trespass, detinue or conversion the claimant must establish an immediate right to possession (which a chargeholder will lack).
A floating charge allows a creditor to encumber shifting classes of the debtor’s assets while still enabling the debtor to deal with these assets on its own behalf. Like a fixed charge it covers after-acquired property but unlike the fixed charge the debtor does not require permission to deal with the charged assets in the ordinary course of business. This is its most important advantage.

The validity of a fixed charge over after-acquired property was established in *Holroyd v Marshall*\(^2\). The charge in that case attached automatically to the new property without the need for an additional dispositive act. This decision facilitated the development of the floating charge.

While the fixed charge provides effective security over after-acquired fixed assets there are problems in using the same device to charge after-acquired shifting assets (book-debts\(^3\) and trading stock). It would be cumbersome and put undue pressure on the debtor’s trading activities to require the creditor’s consent before any shifting asset be dealt with\(^4\). This of course is not in the interests of the debtor or creditor since the both will usually anticipate repayment from the trading profits of the debtor.

\(^2\)(1862) 10 HL Cas 191; 33 CJ Ch 193; 7 CT 172; 9 Jur NS 213; 11 WR 171: 11 ER 999.

"If a vendor or mortgagor agree to sell or mortgage property, real or personal, of which he is not possessed at the time, and he receives the consideration for the contract, and afterwards becomes possessed of property answering the description in the contract there is no doubt that... the contract would in equity transfer the beneficial interest to the mortgagee or purchaser immediately on the property being acquired" (per Lord Westbury LC at 1007 (ER)).

\(^3\)Unless the debtor’s ability to collect and deal with the debts itself is not important to the contracting parties.

\(^4\)In *Holroyd v Marshall* (above, n 62, at 1007 (ER)) Lord Westbury explained:

"There is another criterion to prove that the mortgagees acquired an estate or interest in the added machinery as soon as it was brought on the mill. If afterwards the mortgagor had attempted to remove any part of the machinery, except for the purposes of substitution, the mortgagees would have been entitled to an injunction to restrain such removal, and that because of their estate in the specific property."
If a charge had already fixed on assets it would seem inconsistent to allow the
debtor to deal with the assets freely. In the United States, prior to the Uniform
Commercial Code, courts took the view that such failures to exercise reasonable
dominion over the collateral constituted a fraud on the creditor. The security interest was
illusory and void65

English courts approached provisions allowing the debtor to deal in the assets not
by voiding the security (like their United States counterparts) but by postponing the
point of attachment. The point of attachment was a matter for the parties to stipulate in
their contract. Failing such stipulation the courts would assume that the security would
attach when the debtor’s power of management over the affected assets was removed:
for example on the winding up of the company and on the appointment of a receiver.

Therefore while a fixed charge attaches immediately to the presently owned
collateral upon the execution of the charge or upon the acquisition after-acquired
collateral within the scope of the charge, a floating charge does not attach until the
debtor’s power to manage the assets is terminated. This is known as "crystallisation".
The postponed attachment of the creditor’s security enables the debtor to deal with the
assets in the interim, thus generating revenue with which to repay the creditor.

However despite its postponed attachment:
"A floating charge is not a future security; it is a present security which
presently affects all the assets of the company"66.

(a) The floating charge is a present security.

The floating charge creates a present interest in a fund of assets though the
interest does not attach to specific assets until crystallisation. What then is the distinction

65Geilfuss v Corrigan 95 Wis 651; 70 NW 306 (1897): In which a purported pledge of pig iron to a bank taking
it in good faith as collateral security for a loan, gave the bank no rights superior to judgement creditors who sold the
iron because of non-delivery of the iron.
Benedict v Ratner 268 US 354; 45 S Ct 566; 65 L Ed 991 (1925): In which an assignment by a company of its
present and future accounts receivable as security for a loan was void since the reservation of the assignor’s dominion
over chattels assigned was inconsistent with the effective disposition of title and creation of a lien (Court of Appeals-
second circuit).

66Above, n 49, at 999 per Buckley LJ.
between a floating charge and an agreement to charge upon the occurrence of some future event?

(1) The floating charge may attach without the need for some new dispositive act on the part of the debtor.
(2) The chargee’s interest is not a mere contractual right and therefore unlike an agreement to charge in the future the terms of the charge will bind third parties who purchase charged assets with the knowledge that the terms of the floating charge are being breached. This is so even though the charge has not crystallised at the date of the disposition.

For example: D gives C a floating charge over its stock-in-trade. The terms restrict dispositions other than in the ordinary course of D’s business. D sells charged assets to TP in breach of this term. TP knows of this breach. TP takes the legal title but impressed with C’s inchoate security (though typically the charge will have crystallised on the unauthorised disposition).

If the charge crystallises (either at the point of sale or subsequently) TP’s interest is subject to that of C. On the other hand if D and C had merely agreed that D would charge a class of assets in the future C could not follow property into the hands of third parties if it was disposed of before the charge was executed.

(3) The debenture holder can restrain the debtor, by injunction, from dealing with assets in breach of the debenture.
(4) The debenture holder may have a receiver appointed by the court if his security is jeopardised, notwithstanding that the charge has not crystallised.

---

67Hubbuck v Helms (1887) 56 LT 232. The plaintiff was the holder of a debenture issued by P. The debenture charged all of P’s property. P sold its entire undertaking to H—a prior mortgagee of certain assets of P. The plaintiff sought an injunction to restrain H from selling, conveying or parting with property covered by its debenture. In granting the injunction Stirling J stated: “I think the proper order will be to restrain the defendant [H] from dealing with the property comprised in the indenture otherwise than in the ordinary course of business of the company, or otherwise than in the ordinary exercise of the rights which he possesses under the mortgages subsisting at the date of the indenture”.

68Edwards v Standard Rollins Stock Syndicate [1893] 1 Ch 574: A company issued debentures creating floating charges over the whole of the company’s undertaking and property, present and future. The company covenanted with the holders of these debentures to pay the principal and interest on a specified date. Before payment became due execution had been levied on certain chattels of the company subject to the floating charge by the sheriff acting on behalf of judgement creditors. The debenture holders gave notice to the sheriff that the chattels seized were subject to a first charge in their favour. Nevertheless the sheriff indicated that he intended to proceed with a sale of the
The floating charge creates a present interest in a fund of assets but because the debtor retains the liberty to deal with the assets in the ordinary course of its business the creditor has no right to appropriate any specific asset within the class prior to crystallisation of the charge.

While the fixed charge attaches as soon as the debtor acquires rights in the assets attachment under the floating charge is a two-stage process: The debtor must acquire rights in the collateral and the charge must crystallise.

"Upon crystallisation, the fund of assets comprised in the charge solidifies, terminating the debtor company’s powers of management and converting the creditor’s security interest into a fixed interest as regards property covered by the charge in which the company then has or subsequently acquires an interest"69.

(b) Time of attachment.

Although a floating charge does not attach to the collateral until crystallisation, it operates as an effective security from the date of execution of the agreement. The date of creation is important since if the charge "is given by the company" within specified periods immediately preceding the commencement of the company’s winding up the charge may be void against the liquidator70.

chattels unless restrained by the court. With the consent of the debtor company the debenture holders applied for permission to appoint a receiver over the assets. North J held that a receiver could be appointed over the charged assets even though the debtor was not in default under the terms of the debenture.

Re London Pressed Hinge Co Ltd [1905] 1 Ch 576: A company had issued debentures of £100 each. The plaintiff held fifteen of these. The company agreed to repay the loan principal on a specified date and the interest twice yearly. The debenture created a floating charge over the company’s present and future property. Although the company was not in default under the debenture the plaintiff applied for a receiver to be appointed by the court on the grounds that its security was jeopardised by the competing claim of a judgement creditor of the company. The company consented to the application. Buckley J ordered the appointment of a receiver but referred to the result as an “injustice which is now of frequent occurrence” (at 580).


70Sections 309 and 311 of the Companies Act 1955. See below, page 49.
3. Fixed Versus Floating Charge.

RM Goode notes that the advantage of a floating charge over a fixed charge is commercial practicability:

"[I]t is not in the interests of either party to unduly fetter the company’s ability to run its own business, for it is from the income generated by the company’s trading activities that the creditor will ultimately be paid"\(^71\).

A floating charge enables the debtor to deal with its trading stock and is thereby conducive to the generation of income. The fixed charge however offers greater protection to the creditor.

(1) A floating charge is postponed in priority to the preferential creditors listed in s 308(1) of the Companies Act\(^72\) regardless of whether the charge has crystallised or not. A fixed charge is not postponed on the winding up of a company and will take priority over the creditors in s 308.

(2) While the creditor’s interest in collateral the subject of a floating charge will be extinguished by a subsequent transferee of the legal interest taking in the ordinary course of the debtor’s business, the creditor’s rights under a fixed charge can only be defeated by a bona fide purchaser for value and without notice (which will be rare since the charge is registrable).

(3) While all floating charges given by a company require registration only the classes of fixed charges within s 102(2) of the Companies Act are registrable. If the fixed charge is not over property listed in this

---

\(^71\)Above, n 8, 51.

\(^72\)See also cl 278 of, and the Seventh Schedule to, the Companies Bill.
section and would not be registrable if given by an individual under the Chattels Transfer Act 1924 the charge need not be registered\textsuperscript{73}.

\textbf{4. The Floating Charge and the Fixed Charge With a Licence to Deal}

In theory a fixed charge can be granted over shifting assets because the character of a charge is not determined by the nature of the collateral covered.

If, on the construction of the document and the conduct of the parties it appears that the debtor was not at liberty to deal with assets charged in the ordinary course of business a court is not likely to treat the security as a floating charge even if it is labelled as such by the parties.

The essential elements of a floating charge are that it is a present security in a fund of assets in which the debtor company is free to deal in the ordinary course of business\textsuperscript{74}.

\textsuperscript{73}For example if the charge was given orally there is no "instrument" in existence to register. However although the charge will not, in such a case, be void against the liquidator and creditors by virtue of s 103(2) of the Companies Act, it will, as an equitable interest, be defeated under the BFP rule by those without notice. In the absence of having actual notice of the prior equitable interest, a third party would enjoy priority.

\textsuperscript{74}Above, n 8, 49. See also: Re Yorkshire Woolcombers Association Ltd [1903] 2 Ch 284: This case turned on the question of whether a security given by the debtor company was a floating charge. The company gave security to its guarantors by purporting to assign its present and future book debts to a trustee on trust for the guarantors. The assignment provided that the trustee could at any time give notice, appoint a receiver and exercise a power of sale over the book debts. Prior to this the company had issued a debenture to other creditors comprised by a fixed charge over its land and a floating charge over all its property and assets. On November 21 the trustee appointed a receiver over all the book debts of the debtor. On November 25 a receiver was appointed by the court on behalf of the debenture holders. The two parties were contesting entitlement to the book debts. The Court of Appeal held that the trustee’s security was in reality a floating charge since the parties intended that the debtor would continue to collect and deal with its book debts. The charge was therefore void because it had not been registered under s 14(1) of the Companies Act 1948 (UK). In the course of his judgement Lord Justice Romer stated (at 295):

\textit{"I certainly do not intend to give an exact definition of the term ‘floating charge’ nor am I prepared to say that there will not be a floating charge... which does not contain all the three characteristics that I am about to mention but I certainly think that if a charge has the three... it is a floating charge. (1) If it is a charge on a class of assets of a company present and future: (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some further step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the... class of assets...".}
Conversely if it appears that a debtor has been left free to dispose of the assets in the ordinary course of business the court will treat the charge as floating notwithstanding any label employed by the parties to the contrary.\textsuperscript{75}

It is therefore conceptually possible to take a fixed charge over trading stock or book debts. The English Court of Appeal endorsed this view in \textit{Siebe Gorman & Co Ltd v Barclays Bank Ltd}\textsuperscript{76}. The facts were:

A company secured its present and future indebtedness to a bank with a fixed charge over its present and future book debts. The debtor company was to pay all the monies received in discharge of debts owing to it into the company’s account with the bank. The company undertook not to further charge or assign the debts without the bank’s written consent.

The company subsequently assigned some of its charged book debts to a third party. The bank holding the charge collected the debts (including those assigned). The third party argued that the purported fixed charge was really a floating charge and was therefore defeated by an assignment.

Slade J held that the device was not a floating charge, as the debtor lacked the essential ability to deal with the assets in the ordinary course of business. The restrictive terms of the debenture, coupled with the obligation to pay the monies into the company’s account and lack of freedom to deal with the funds once deposited with the bank negated any creation of a floating charge.\textsuperscript{77}

\textsuperscript{75}Above, n 69, 795 citing \textit{Re Bond Worth Ltd} (1979) 3 All ER 919: Seller supplied fibre to the buyer. The terms of the contract stated that the “equitable and beneficial ownership” in the fibre was to remain in Seller until payment had been made in full or until sub-sale by the buyer. In the case of sub-sale before repayment Seller was entitled to the proceeds and if the fibre was converted into other products Seller was to have equitable ownership of those products and of the proceeds of sale thereof. The buyers mixed the fibre inseparably with other products in the course of manufacturing carpet. A receiver was subsequently appointed over the buyer’s assets. The buyer owed Seller £587,000 in respect of unpaid deliveries but had a large stock of carpets in varying states of manufacture.

Slade J held that Seller’s interest in the fibre, carpet and proceeds was an equitable charge granted by the buyer rather than a retention of title. Equitable ownership had to be granted- it could not be retained. Therefore Slade J assumed that the contract of sale had transferred the whole legal interest in the fibre to the buyer- who had granted back an equitable charge. Additionally, since the buyer was free to use the fibre for its own purposes in the course of its business, the charge was of a floating rather than a fixed nature. The charge was therefore void against the debenture holder for non-registration under s 95(1) of the Companies Act 1948 (UK).

\textsuperscript{76}[1979] 2 Lloyd’s Rep 142.

\textsuperscript{77}Slade J was of the view that as long as the debenture existed the Bank need not have allowed the debtor access to its account, even if in credit. Therefore the debtor did not have control over the book debts, even when paid into their account.
In a later case *Re Brightlife Ltd*\(^7\) the debenture again purported to grant a fixed charge over the book debts of a company, the debtor was again prohibited from further disposing of the assets but the requirement to hold the receipts from the debts for the creditor was absent. Also in this case the debenture holder was not, as in *Siebe Gorman*, a bank, and therefore could not exercise practical control over the use of the debtor’s bank account. Hoffman J held that the debtor’s ability to deal with the receipts was determinative of a floating rather than a fixed charge\(^7\).

Opinions differ as to whether a debtor can grant a fixed charge over trading stock.

RM Goode notes\(^8\) that in theory since the determinant of a floating charge is the debtor’s freedom to deal with the assets in the ordinary course of its business there is nothing to prevent a fixed charge being taken over trading stock. But in practice if a debtor cannot deal with its trading stock its business is paralysed, and the time and effort that would be involved in obtaining the creditor’s consent to every disposition of trading stock makes this method of stock financing impracticable in most cases\(^8\).

Additionally:

"[a] blanket consent *in advance* would not do, for this would be incompatible with the existence of a fixed security interest and would make the charge a floating charge"\(^8\).

Goode’s view is consistent with the weight of case authority.

---

\(^7\)[1986] 3 All ER 673.

\(^7\)A plausible conclusion from these cases is therefore that:

"only a bank can take an effective general fixed charge over book debts, at least unless elaborate and restrictive provisions regarding the collection of debts are imposed, which in practice is unlikely to be commercially acceptable": CJ Hanson "Fixed and Floating Charges: *Re Brightlife Ltd*" [1987] Lloyd’s Mar & Comm LQ 147, 150.

\(^8\)Above, n 8, 54.

\(^8\)Fixed charges over trading stock would be most workable where the grantor’s business turns over inventory slowly and the value of the individual items of stock sold each account for a significant proportion of the total value of the creditor’s collateral. An example may be where a small business builds only several boats a year. The financing of motor vehicle dealers is typically structured as a retention of title rather than a charge over the assets of the dealer.

\(^8\)Above, n 8, 80.
On the other hand some cases do support the proposition that a fixed charge over stock-in-trade divesting upon the occurrence of a certain event (for example sale) is possible.

In *Joseph v Lyons*\(^3\) a jeweller by bill of sale assigned to the plaintiff, inter alia, "all the stock-in-trade...which shall or may at any time... be brought into the premises". Subsequently the jeweller pledged after-acquired inventory to the defendant who had no notice of the plaintiff’s prior interest. The plaintiff demanded the return of the jewellery pledged by the jeweller but the defendant refused, claiming it as his security.

There was therefore a priority dispute between the mortgagee and the subsequent pledgee. The pledgee won. However the route the court took in arriving at its conclusion impliedly accepts the validity of a fixed charge over trading stock.

Had it been impossible to grant a fixed charge over after-acquired stock-in-trade no priority dispute would have arisen. The court would simply have interpreted the plaintiff’s security as an uncrystallised floating charge defeated by the pledge to the defendant.

In the recent Canadian case *R in Right of BC v FBDB*\(^4\) Lambert J recognised the validity of a fixed charge over trading stock with a licence to deal.

The relevant facts were:
A Ltd granted a debenture to the defendant bank, giving the bank a floating charge over the assets of A Ltd and in addition " a fixed and specific mortgage and charge" over, inter alia, its trading stock\(^5\).
The debenture allowed A Ltd to make sales of its stock-in-trade in the ordinary course of its business until the defendant notified it to cease doing so.
Eventually the bank seized and sold A Ltd’s trading stock. The crown asserted a lien over the same due to the debtor’s non-payment of sales tax.

---

\(^3\)(1884) 15 QBD 280.


\(^5\)Appliances and equipment for use in electrical lighting systems.
The majority of the British Columbia Court of Appeal did not need to decide whether the fixed charge with a licence to deal was possible but Lambert J stated:

"A borrower and a lender may make an agreement which grants to the lender a fixed charge over the present and future stock-in-trade and inventory of the borrower but reserves to the borrower the right to make sales of the stock-in-trade and inventory in the ordinary course of his business until the lender notifies him that the sales must stop."

5. Re Manurewa Transport (in receivership): The Floating Charge in Practice:

This case illustrates how potent a floating charge can be against third parties taking an interest in the same collateral.

The facts were:

The debtor company gave GL a floating charge over all the assets of the company. There were two important terms.

1. The money secured would become payable and the charge would crystallise if the company should attempt to mortgage, charge or encumber any of its assets without the consent of the debenture holder, GL. This was the automatic crystallisation clause.

2. The company was prohibited from creating any mortgage or charge on its assets ranking in priority to the debenture holder’s security. This was the prohibition clause.

The charge was registered pursuant to s 102 of the Companies Act. Subsequently the company granted an instrument by way of security to another (WGS Ltd) over a truck, already subject to GL’s floating charge. The priority contest was between GL and WGS Ltd.

*Above, n 84, 28.

*Above, n 20.
The New Zealand Supreme Court held that the holder of the floating charge had priority for two reasons. Central to both being the fact that due to s 4(2) of the Chattels Transfer Act 1924 WGS Ltd had constructive notice of the debenture and its contents.

(1) WGS Ltd had notice that the debtor company was prohibited from making further charges; and
(2) WGS Ltd had notice that the floating charge had crystallised prior to the completion of the instrument by way of security.\(^88\)

It can therefore be seen that the protection afforded to creditors by automatic crystallisation clauses and prohibition clauses is significant. This is mainly because constructive notice can be given both of the existence and contents of a security over chattels using s 4(2) of the Chattels Transfer Act.

6. **Automatic Crystallisation Clauses.**

A floating charge may crystallise in one of two ways:

(1) By the occurrence of an event which the law recognises as generally crystallising a charge. Examples are: liquidation, cessation of trading, appointment of a receiver by the debenture holder or by the holder otherwise entering into possession of the assets charged.

(2) Contractually stipulated events of crystallisation such as: the grant of a security to another creditor (as in *Re Manurewa Transport*), debtor defaults under the terms of its other security agreements or failure to meet financial ratios. These are automatic crystallisation clauses ("ACCs").

In practice the events in group (1) above will also be stipulated in the debenture but strictly this is unnecessary.

\(^{88}\)That is, when the debtor had "attempted" to encumber the truck: cl 13(1) in the debenture.
In theory there are no limits to the scope of ACCs. Such restraints that do exist are in the nature of commercial practicability. It is possible that a lender could become over-zealous in its provision of ACCs.

For example a typical ACC will provide for crystallisation:

"if the Company shall fail to observe or perform any of the covenants on its part herein contained".

Since modern debentures typically contain a multitude of technical covenants, there is a possibility that the charge will crystallise without either party being aware of it. However easy crystallisation does not necessarily protect the lender.

If the lender is unaware the charge has crystallised it is in no position to protect the proprietary rights it acquires on crystallisation.

If the lender is aware that its charge has crystallised it may decide to allow the borrower to carry on trading if the borrower is in a healthy financial position. This may have the effect of de-crystallising the charge by estoppel89. But:

"The tacit waiver of an automatic crystallisation clause may well have a much more profound effect than to de-crystallise the charge; it may lead the court to conclude that the whole clause should be ignored as not truly reflecting the intention of the parties"90.

89RM Goode notes that there is no case authority for this proposition (above, n 8, 75) yet it is certainly possible to argue in favour of decrystallisation by estoppel:

"It is the first principle upon which all Courts of Equity proceed, that if parties who have entered into definite and distinct terms involving certain legal results...afterwards by their own act or with their own consent enter upon a course of negotiations which has the effect of leading one of the parties to suppose that the strict rights arising under the contract will not be enforced or will be kept in suspense, or held in abeyance, the person who otherwise might have enforced those rights will not be allowed to enforce them where it would be inequitable having regard to the dealings which have thus taken place between the parties": Hughes v Metropolitan Rly Co (1877) 2 App Cas 439 per Lord Cairns at 448.

90Above, n 8, 74.
C. THE FLOATING SECURITY INTEREST AND THE PPSA.

The floating charge as it is currently understood in New Zealand will exist only in name after the enactment of the PPSA. Instead the proposed Act recognises a ‘floating security interest’ but the nature of this interest differs greatly from the floating or fixed charge.

The overall effect the PPSA is likely to have on the debenture can be predicted by examining how debentures in Canada changed with the enactment of similar article 9 based systems.

The trend in Canada has been away from the conventional debenture with the fixed and floating charge. Large lending institutions have increasingly abandoned these in favour of devices more compatible with the scheme and terminology of the PPSA in the various jurisdictions. RJ Wood notes that in place of the old debenture:

"[b]anks commonly use a standard form security agreement called a ‘general security agreement’ (or g.s.a) which grants to the bank a security interest in all the debtor’s present and after-acquired personal property". 91

We will see that similar devices will, in New Zealand, be preferable to the existing debenture when the PPSA is enacted. However though the floating charge will become little more than a "quaint historical artifact" 92 in New Zealand after the enactment of the PPSA it is submitted that lenders will only gradually relinquish its use as a security device.

1. Differences Between The Floating Security Interest and The Fixed and Floating Charges.

(a) Sole traders will not have to incorporate in order to grant a floating charge over their assets. Currently it is a commercial reality that only companies can grant a floating

---

92 Above, n 91, 198.
charge. Individuals may use s 26(d) of the Chattels Transfer Act to grant security over after-acquired stock-in-trade. But the resulting security is cumbersome. Under the PPSA a debtor need not incorporate to grant a floating security interest. The Act contemplates a lender simply taking a security interest "in all of the debtor’s present and after-acquired personal property" without further description of the type of collateral covered and the interest will cover inventory. Further, the lender’s interest automatically extends to the proceeds of sale of the debtor’s stock without the need to comply with the equivalent of s 26(2)(b) of the Chattels Transfer Act.

However without incorporation by the debtor there will be no delimitation between the property of the debtor’s business and the debtor’s personal or domestic property. An unincorporated debtor using s 9(1)(b)(ii) of the PPSA will be granting an interest in all his property which may not be intended.

To avoid this result unincorporated debtors, such as sole traders and partnerships, can remove their non-business assets from the scope a floating security interest by either:

(i) specifying the type of collateral covered (s 9(1)(b)(i)); or
(ii) granting a security interest over all their present and after-acquired property "except specified items or kinds of personal property" (s 9(1)(b)(iii)).

Unlike a floating charge, which can be taken simply over "trading stock", an instrument by way of security under the Chattels Transfer Act which purports to cover the trader’s inventory:
(a) must require the debtor to hold the inventory, until disposed of, at the premises specified in the instrument; and
(b) requires the collateral to be "of such a nature" or "so described, whether by brand or trade name, or otherwise howsoever, as to be reasonably capable of identification": s 26(1)(d)(i); and
(c) will only secure proceeds from the sale of the trading stock:
"(a) To the extent that such proceeds are expressly stated in the instrument to form part of the grantee’s security; and
(b) To the extent that and so long as any such proceeds being money are kept by or on behalf of the grantor in a separate and identifiable fund": (s 26(2)).

For example: "I/we grant to Lender a security interest over all the following types of collateral situated at our place of business":
[A] security agreement that limits the collateral description to property ‘located at’ a particular address will preclude attachment of the security interest to collateral acquired by the debtor after he moves the business to another location: B Clark “Secured Transactions” (1988) 43 The Business Lawyer 1425, 1447 citing In re Tepper Indus 74 Bankr 713, 3 UCC Rep Serv 2d (Callaghan) 10909 (Bankr 9th Cir 1987).
(b) There is no crystallisation under the floating security interest. The interest attaches to the collateral immediately upon its acquisition.

In contrast to this Lord Macnaghten noted in *Illingworth v Houldsworth*:

"a floating charge... is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp".

Until crystallisation the floating charge does not attach and the chargee has no rights *in specie*.

When a floating charge is used under the PPSA no crystallisation is needed. Section 10 of the Act provides:

"(1) A security interest, including a security interest in the nature of a floating charge, attaches to collateral when

(a) value is given by the secured party; and

(b) the debtor has rights in the collateral; and

except for the purpose of enforcing rights as between the parties

(c) the security interest is enforceable against third parties within the meaning of section 9 unless the parties agree that it shall attach at a later time, in which case it attaches in accordance with the agreement of the parties.

(2) For the purposes of subsection (1), a reference in a security agreement to a floating charge is not an agreement that the security interest created by the floating charge attaches at a later time."

For example:

97(1903) 2 Ch 284, 295.

98Section 9 provides that a security interest is unenforceable against third parties unless (a) the collateral is in the possession of the secured party; or (b) the debtor has signed a security agreement containing a sufficient description of the collateral.
Appliance Ltd gives a floating charge over its trading stock to Bank on Day 1. On Day 10 Appliance Ltd purchases 10 new ovens as inventory. On Day 15, in return for an advance, Appliance Ltd grants a fixed charge over the new ovens to Finance Co. Appliance Co defaults on both the advance from Bank and Finance Co.

Currently the general position would be that Finance Co takes priority in the proceeds over Bank. This is because Bank’s interest has not attached while Finance Co takes an immediate proprietary interest in the collateral charged. In practice however Bank’s charge will crystallise when Appliance Ltd attempts to encumber the property already charged. However it has been noted above that there is a danger in the over-zealous use of automatic crystallisation clauses.

On the other hand using the same documentation under the PPSA Bank’s interest would attach to the ovens immediately upon their acquisition by Appliance Ltd. The priority issue will be determined by the extensive priority rules in the PPSA. Briefly these are:

(1) A purchase money security interest takes priority over a non-purchase money security interest.

(2) Priority between perfected security interests is afforded to the first to register.

(3) Perfected security interests take priority over unperfected.

(4) Between unperfected security interests the first to attach has priority.

In the above fact example, assuming neither party has registered a financing statement, Bank will take priority as its interest attached on Day 10 while the interest of Finance Co attached on Day 15.

Perfection determines the strength of the secured party’s interest against third parties. Perfection may be achieved in either of two main ways: by the secured party
taking possession of the collateral\textsuperscript{103} and by registration of a financing statement\textsuperscript{104} which details the nature of the security interest.

(c) There is no distinction between fixed and floating charges in the PPSA. Under the current chattels security regime the rights and obligations attaching to a given security interest are largely determined by the form of the interest. The distinction between fixed and floating charges can determine, for example, the priority positions; of preference creditors\textsuperscript{105}, of fixed and floating chargeholders inter se, and of execution creditors.

In contrast to this: "Perhaps the greatest contribution of article 9 is that it all but obliterates many of the sharp lines that distinguish between the kinds of security interests created under each of the separate security devices"\textsuperscript{106}.

While the current regime is concerned mainly with identifying the form of security device used, the PPSA focuses instead on the nature of the collateral and the character of the debtor.

The PPSA operates on "security interests". Both fixed and floating charges are within the scope of this term.

For example:

The chattels covered by the floating and fixed charges are typically mutually exclusive sets. That is, the floating charge will cover property excluded from the ambit of the fixed charge:

"As regards the Company's other property and assets the charge created by this security shall be a floating charge..."(my emphasis).

\textsuperscript{103}Section 18.

\textsuperscript{104}Section 19.

\textsuperscript{105}Sections 101 and 308 of the Companies Act. A floating charge will be deferred to these classes of creditors whether it has crystallised or not. A fixed charge will not be deferred. See below, 81.

\textsuperscript{106}PF Coogan, WF Hogan, DF Vagts \textit{Secured Transactions Under the Uniform Commercial Code} (Mathew Bender, New York, 1976) Vol 1, 217.
This presents no prima facie problems as s 10 of the Act provides that reference to a floating charge in a security agreement is not by itself evidence of postponed attachment. The holder of a floating charge over, say, trading stock is afforded the advantage of immediate attachment.

However problems may arise if the debenture specifically provides, as it typically will, that the charge will not attach until the occurrence of a later event. This will constitute contractual postponement of the immediate attachment rule contemplated by s 10(1) above. Most modern debentures expressly provide for or implicitly contemplate late attachment of the floating charge.

For example:

"Notwithstanding anything herein contained to the contrary in this Debenture the Moneys Hereby Secured shall become immediately due and payable by the Company to [the Lender] and the floating charge hereby created shall immediately attach and become affixed... in any of the following events:"

"If at any time the Bank’s floating charge shall have crystallised and attached to all or any of the Company’s property and assets then provided the Company is not in liquidation or receivership the Bank may at any time by written notice to the Company:

(a) Remove or decrystallise in whole or in part the attachment of the floating charge as a fixed charge; or

(b) Waive in whole or in part its rights to the attachment and crystallisation of the floating charge as a fixed charge and in either of such events the attachment of the floating charge in respect of the relevant property and assets shall be cancelled and removed and shall thereafter continue so as to provide the same floating charge that subsisted prior to attachment"

107 That a security interest will attach when the secured party gives value and the debtor has rights in the collateral: "unless the parties agree that it shall attach at a later time, in which case it attaches in accordance with the agreement of the parties".
However it is submitted that the mere use of the term "floating charge" is not enough to evidence an agreement to postpone attachment of the interest. In Canada the Saskatchewan Court of Appeal considering a provision similar to s 10(1) held that the mere use of a floating charge was not evidence of an intention to postpone attachment.\textsuperscript{108}

One confusing decision is that of the Ontario Court of Appeal in \textit{Re Huxley Catering Ltd}\textsuperscript{109} which described the interest of a floating chargeholder under the Ontario Personal Property Securities Act\textsuperscript{110} as "equitable". The facts were as follows:

HCL assigned to the bank "as a general and continuing... security... all debts, accounts, claims, moneys and choses in action which now are or which may at any time hereafter be due or owing to [HCL]". A proviso to the assignment read: "provided always that until default by the undersigned... or until notice by the Bank to the undersigned to cease so doing... the undersigned may continue to collect, get in, and deal with the said debts... in the ordinary course of business of the undersigned but not otherwise". HCL subsequently entered into an agreement to sell the land and premises from which it conducted its business. HCL then became bankrupt. The trustee in bankruptcy completed the sale, the bank claimed the proceeds under the assignment of book debts. The assignment had been duly registered under the Ontario PPSA.

\textsuperscript{108}Re Royal Bank of Canada (1982) 34 Sask R 195, 10 DLR (4th) (Sask CA) considering s 12 (1) of the Saskatchewan Personal Property Securities Act (RSS, c P 6.1) which provides:

"A security interest attaches when:

(a) value is given;
(b) the debtor has rights in the collateral; and
(c) except for the purposes of enforcing \textit{inter partes} rights of the parties to the security agreement, it becomes enforceable within the meaning of section 10;

unless the parties intend it to attach at a later time, in which case it attaches in accordance with the intentions of the parties."

\textsuperscript{109}(1982) 134 DLR (3d) 369, 36 OR (2d) 703 \textit{sub nom Irving A Burton Ltd v Canadian Imperial Bank of Commerce}.

\textsuperscript{110}RSO 1970, c 344 (now RSO 1989, c 16).
The trustee in bankruptcy claimed priority to the proceeds under s 22(1) of the Act which read:

"...an unperfected security interest in subordinate to
(a) the interest of a person...

(iii) who represents the creditors of the
debtor as assignee for the benefit of
creditors, trustee in bankruptcy or
receiver..."

The success of the trustee's claim depended on the Court accepting that the bank's interest had not attached prior to HCL's bankruptcy.

Weatherston JA delivered the judgement of the court. The first important finding was that the assignment of book debts with a licence to deal was in reality a floating charge. This had been established in earlier cases. His honour held that the bank had priority on either of two grounds: either the charge had attached (and was thus perfected) immediately or it had attached later upon crystallisation but still prior to bankruptcy.

There are two criticisms of this judgement.

(1) The decision that the case could be decided on alternate grounds was unnecessary. The better ground is that the parties clearly intended the charge to attach immediately to the book debts as they arose. This would have been even more clear under the

---


112"Notionally, at least, the directors of the Huxley Catering Limited had to resolve to make an assignment in bankruptcy before the assignment could be made, and when that resolution was passed, it ceased to carry on business in the ordinary course. So, at some time before the assignment in bankruptcy was made, the assignment of book debts became a specific charge..." above, n 109, 371 (OR).

113Section 12(1) of the Ontario PPSA provides:

"A security interest attaches when,
(a) the parties intend it to attach;
(b) value is given; and
(c) the debtor has rights in the collateral."

Therefore unlike the Saskatchewan PPSA and the proposed PPSA for New Zealand there is no statutory presumption that the interest attaches immediately. However the passage from Catzman Personal Property Security Law in Ontario (1976) 66 cited by Weatherston JA in Re Huxley indicates the existence of a judicial presumption that holders of floating charges intend immediate attachment:
PPSA proposed for New Zealand given the statutory presumption of immediate attachment under that Act. (2) Weatherston’s description of the secured party’s interest, whether attached or not, as "equitable" is manifestly incorrect. Neither article 9 nor the PPS regimes distinguish between legal and equitable interests. The creditor’s interest is either a "security interest" (in which case its priority is governed by the Act) or it is not.

"It would undermine the whole purpose of the Act to superimpose on it an extrastatutory regime of equitable rules and concepts often at variance with its express terms."

Even given the statutory presumption of immediate attachment in New Zealand it is clear that the continued use of some charging clauses will postpone attachment under the PPSA. The consequences of postponed attachment under the PPSA may be examined using the following example:

Appliance Ltd gives a floating charge over its trading stock to Bank. The terms of the charge indicate that the parties’ intention is to postpone attachment of the charge until the occurrence of a contractually stipulated event of default. Bank registers a financing statement. Appliance Ltd buys new ovens as inventory.

At this stage the security interest of Bank has not attached so though Bank has registered a financing statement its interest is unperfected and unattached.

114 "the form of assignment of book debts, although giving to the bank an equitable interest in present debts immediately, and in future debts as soon as they come into being, left with the customer the right or privilege to continue to collect debts in the ordinary course of business.": (above, n 109, 373 (OR)).

115 JS Ziegel, "Recent and Prospective Developments in the Personal Property Security Law Area" (1985) 10 CBLJ 131 at 151-152.

116 See text accompanying n 107, above.
Assume: Appliance Ltd is now wound up. The liquidator seeks to use the trading stock to pay unsecured creditors.

As seen above the winding up of a company is an event of crystallisation implied by the court whether the parties have provided for it or not. Bank’s interest therefore attaches to the collateral and has priority over the claims of the liquidator. Having complied with s 9 of the Act, Bank’s interest is enforceable against the liquidator. The unattached interest is only postponed to the attached or perfected security interest: (ss 28(b),(c)). Bank therefore has priority over the liquidator.

Assume: Appliance Ltd, instead of being wound up, grants a fixed charge over the same ovens to Finance Co.

Here the interest of Finance Co attaches immediately. Prima facie there are two possible outcomes:

(1) Finance Co registers a financing statement and takes priority over Bank as the holder of a perfected security interest; or

(2) Finance Co does not register a financing statement and takes priority over Bank because:

"priority among unperfected security interests is determined by the order of attachment of the security interests".

Either result is undesirable for Bank which has inadvertently postponed attachment of its security interest by using pre-PPSA standard form debentures. However in practice Bank would take priority over Finance Co in the above example. This is because Bank’s crystallisation clause will typically be drawn wide enough to precipitate attachment of the charge before another creditor can compromise its priority.

For example a typical debenture provides for crystallisation:

---

117 One interesting question is whether courts will continue to recognise and apply this floating charge jurisprudence after the enactment of the PPSA.

118 Sections 8 and 15 (though see the rules relating to preferential creditors below, 81).

119 Section 28(1)(b).

120 Section 28(1)(c).
"if the Company purports or attempts to mortgage, charge, or encumber any of its property without the prior and express consent of [the Lender].

It is difficult to envisage a situation where a debenture holder with postponed attachment of its interest is in a worse position than an immediately attaching interest.

For example assume, in the above example, Appliance Co sells the ovens to purchasers at retail:

(1) If the interest remains unattached Bank has no enforceable interest in the collateral.
(2) If the interest has attached and therefore been perfected (since we assume Bank has registered a financing statement) Bank’s interest is subordinated as well (s 24(2)).

The position will differ if the sale is not in the ordinary course of the debtor’s business. For example if Appliance Ltd needs cash and sells 10 ovens at once to a rival retailer at a reduced price:

(1) If Bank’s interest is unattached it has no enforceable interest in the collateral and the rival retailer takes free of any encumbrance.
(2) If Bank has registered a financing statement the security interest will be perfected and take priority over the buyer. Section 24 offers no protection to a buyer of inventory outside the ordinary course of business.

This would appear to be a case where the use of pre-PPSA debentures will compromise a creditor’s position. If the creditor had altered the terms of the agreement to provide for immediate attachment of the floating security it would not be defeated in priority by a third party purchasing inventory from the debtor outside the ordinary course of the debtor’s business.

However in practice the sale of the debtor’s inventory in these circumstances is likely to crystallise the floating charge anyway, thus giving Bank a perfected interest with which to defeat the purchaser.

A survey of debentures currently employed by major New Zealand lending institutions reveals charges which attach:
"If the Company disposes of any part of its Charged Property... or attempts to do or arrange ... such things contrary to the provisions of this Debenture"

[the terms of the debenture being that assets subject to the floating charge can only be disposed of in the ordinary course of the debtor’s business]

If the debtor breaches its covenant not to "sell, remove, part with or destroy all or any part of its stock-in-trade except in the ordinary course of business of the Company"

Because such clauses are invariably included in the terms of current debentures creditors continuing to use these forms would appear to be in no worse position than creditors using immediately attaching security interests. The only concern with continued use of the floating charge therefore is over-zealous employment of automatic crystallisation clauses and the effect of repeated decrystallisation by estoppel or waiver.

Also of concern is this: current debentures postpone attachment of the floating charge until crystallisation which occurs either; on a contractually stipulated event of default or on an event implied by law as crystallising the charge (liquidation etc). Usually the implied crystallising events are also expressed in the debenture but failing such specification will courts after the enactment of the PPSA continue to recognise these events as impliedly bringing about attachment ? I do not think so because: s 10 allows contractual postponement of attachment in which case the security interest attaches:

"in accordance with the agreement of the parties".

Clearly if the parties have not agreed that, say, liquidation will cause attachment the court applying s 10 should not say that they have. The PPSA abandons the concept of the floating charge and post-PPSA courts ought not to cling to it.

It is therefore possible that a creditor’s floating charge could remain unattached even after the occurrence of events which current courts recognise as impliedly crystallising the charge. As noted above however, s 10(2) of the PPSA recognises that
the mere use of a floating charge will not postpone attachment of the security interest\textsuperscript{121}.

\textbf{D. THE FIXED CHARGE AND THE PPSA.}

A debenture holder may compromise its position by failing to modify the terms of the fixed charge after the enactment of the PPSA. The fixed charge applies only to a limited class of assets. For example:

"The charge created by this Debenture shall in respect of the Company’s freehold and leasehold lands, plant, machinery, chattels, (other than stock-in-trade but including motor vehicles as defined in the Motor Vehicles Securities Act 1989) patents, trade names, licences, unpaid and uncalled capital and goodwill be a fixed and specific charge".

Therefore while the assets specified above are subject to an immediately attaching security interest the residual assets (trading stock in the above example) may not be so covered. Other debentures may also subject book debts to a floating rather than a fixed charge\textsuperscript{122}:

"As regards the Company’s book debts the charge shall be a floating charge".

Therefore if the debenture postpones attachment of the security interest then the creditor’s security over a large segment of the debtor’s available collateral (trading stock and often book debts) will be compromised in the ways outlined above. The only immediately attaching security interest will be the fixed charge, and this over a smaller class of assets.

\textsuperscript{121}Confirmed in: Re Royal Bank of Canada and G Homes Inc (1982) 10 DLR (4th) 439 (Sask CA); Euroclean Canada Inc v Forest Glade Investments Ltd (1985) 16 DLR (4th) 289 (Ont CA).

\textsuperscript{122}Note that in the above example "chattels" includes book debts: see 6(2) of the Statutes Amendment Act 1939.
E. THE PPSA AND THE CREDITOR’S CONTINUING SECURITY INTEREST IN COLLATERAL

Section 22(1) of the Act provides:
"Except as otherwise provided in this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest (a) continues in the collateral unless the secured party expressly or impliedly authorises the dealing."

Therefore where collateral is transferred by the debtor to a third party, the security interest will continue in this property allowing the secured party to seize and sell it. The section provides two important limitations:

(1) The Act may provide for the interest of the secured party to be subordinated to that of the subsequent transferee; or
(2) The secured party itself may have authorised the dealing thus extinguishing its interest in the transferred collateral.

The purpose of this part of the paper is to examine whether continued use of standard debentures after enactment of the PPSA will limit the secured party’s statutory remedies against collateral dealt with by the debtor. Phrased alternatively do the terms of current debentures give the debtor more dispositive liberty than the provisions of the PPSA?

The terms of a debenture will typically provide:

"(1) The debtor shall not mortgage, charge, or encumber any of its undertaking, property, or assets without [the Lender’s] prior and express consent in writing.

(2) The debtor shall not dispose of, remove, part with or destroy any of the assets subject to the fixed charge without the written consent of [the Lender]: except for the purpose of renewing or replacing the same with property of a similar type and value and appropriate to the debtor’s business.

(3) The debtor shall not sell, remove, part with or destroy all or any part of the assets subject to the floating charge except in the ordinary course of its business."
The circumstances in which debenture holders subordinate their interests to third party transferees of collateral otherwise subject to the debenture is thus limited to:

(a) transferees of the assets subject to the floating charge in the ordinary course of the debtor’s business;

(b) transferees of assets subject to the fixed charge where the debtor is replacing the asset transferred with another asset of a similar type and value; or

(c) transferees of assets holding the interest transferred as a purchase money security interest\textsuperscript{123}.

The circumstances in which the debenture holder’s interests are subordinated to transferees by the Act are:

(a) Section 28(1)(b). An unperfected security interest is subordinated to a perfected security interest. For example: a floating charge which has not attached due to contractual postponement or either a floating or fixed charge in respect of which no financing statement has been registered.

(b) Section 28(1)(c). An unperfected security interest is subordinated to another unperfected security interest which has attached earlier in time. For example assume: floating charges are given to two different creditors under the terms of separate debentures. Neither registers a financing statement. However the terms of the earlier debenture postpone the attachment of the charge until an event of default. The holder of the later debenture has priority since his interest has attached\textsuperscript{124}.

\textsuperscript{123}See: ‘After-Acquired Property and Purchase Money Security Interests’ below at 69.

\textsuperscript{124}However in practice this would not happen as the earlier charge would crystallise (and therefore attach) on the granting of a subsequent floating charge.
(c) Section 24(2). A perfected security interest in collateral is subordinated to the interest acquired by the buyer or lessee of the collateral in the ordinary course of the debtor’s business.

This has the same effect as a secured party, by the terms of the debenture, authorising the debtor to deal with the collateral in the ordinary course of its business. Under both s 24(2) and the standard terms of a debenture the transferee will be entitled to priority.

(d) Section 24(6) provides for the interest of the secured party to be subordinated to a transferee of fixed assets:

"...if the buyer or lessee
(a) bought or leased the goods without knowledge of the security interest:
and
(b) the goods are of a kind that are required or permitted by regulations to be described in a financing statement by serial number and were not so described in the financing statement relating to the security interest".

Therefore the conventional debenture will provide another method by which the creditors interest can be subordinated. For example:

A Ltd is a manufacturer with a fixed charge over its plant in favour of Bank. The terms of the charge allow A Ltd to dispose of the plant for the purposes of replacement. A Ltd sells some of the charged plant to Buyer but the goods have been described by their serial number in the financing statement so that the interest of Bank is not subordinated to that of Buyer pursuant to s 24(6). A Ltd does comply with the terms of the charge so that Bank’s interest is contractually subordinated to Buyer’s.

In the above example if the debenture had been silent as to the terms on which A Ltd could dispose of its fixed assets, Bank’s interest in the collateral would continue after the transfer to Buyer. Failure to amend such terms weakens Bank’s position vis-a-vis bona fide purchasers of its debtor’s fixed assets. However the terms of debentures are typically strict and it may be that Bank is, in fact, in no worse position. Recalling the
wording of a typical debenture, the creditor only authorises the disposition (and therefore subordinates its interest) where the charged asset is disposed of:

"...for the purpose of renewing or replacing the same and [where the debtor] will in such case forthwith renew or replace the same accordingly with other property of a similar type and value and appropriate to the [debtor's] business..."

Assume that A Ltd in the above example does not replace the plant sold to Buyer so that the disposition is unauthorised. Assume also that Bank’s priority is subordinated to Buyer’s under s 24(6) by failing to describe the collateral by serial number. Here the terms of the debenture favour Bank’s priority but the Act favours Buyer’s.

Bank cannot extend its interest in the collateral by contract. Bank only has the rights it is recognised as having by the provisions of the PPSA. It can waive these rights and subordinate its interests but it can not obtain better rights or stronger priorities by merely contracting with A Ltd. Therefore although disposition of fixed assets without replacement would be unauthorised under terms of the debenture this does not affect Buyer’s rights to the assets under s 24(6). Bank’s remedies will be:

(a) a charge over the proceeds of the sale since they form part of A Ltd’s property subject to the floating charge; and

(b) the unauthorised disposition will be an event of default making all sums owing immediately due and payable.

(e) Section 27 provides for the super-priority of purchase money security interests in certain circumstances. The operation of this section may postpone the priority of a debenture holder’s interest in its debtor’s collateral.

---

125 Above, 44.
126 And on the trust principles in Re Hallet’s Estate, above, n 61.
127 For example a typical crystallisation / event of default clause might provide for default:

"if the Company shall commit any breach of any of the provisions herein contained".

128 See: ‘Purchase Money Security Interests under the PPSA’ below at 72.
Sections 31 and 32 govern the priority of security interests in accessions and commingled goods. If a security interest in collateral is not perfected before that collateral loses its identity by becoming commingled with other goods the security interest will not continue into the composite product. For example:

Bank has a security interest in the raw materials used by Debtor in its manufacturing process. Debtor makes coloured T-shirts using cotton and dyes. The cotton is supplied under retention of title from Supplier. The dye is owned by Debtor. If Bank’s interest in the dye is not perfected before it is commingled—due to either non-registration or postponed attachment—its interest will not continue into the finished product (the T-shirt). Supplier’s interest will continue in the T-shirt if it has registered a financing statement.

However in practice Bank will have a floating security interest over the whole of debtor’s property so if its interest does not continue into the product it will at least attach as soon as the product is created and its priority will be determined by the date of its financing statement.

Section 31 regulates the priority contest between security interests over the whole of a chattel (for example a boat) and a security interest in an accession added to the whole (for example an engine installed in the boat). As between a security interest in an accession and a pre-existing security interest in the whole to which that accession is attached the priority is determined by the first interest to attach. When the contest is between the security interest in the accession and a security interest subsequently acquired over the whole of the asset (including the accession) priority is determined by the ‘first-to-perfect’ rule.

For example:

Trade Supplier Ltd ("TSL") is in the business of purchasing second hand concrete mixers, pneumatic drills, chainsaws and other power equipment, repairing and then reselling them. Bank holds a debenture over TSL’s assets. This comprises a floating charge over TSL’s stock-in-trade and a fixed charge over its other property. TSL buys a chainsaw and has a new engine installed in it by Repairer— who retains title to this accession until the purchase price is paid.
In the above example Repairer’s security interest in the engine supplied takes priority over that part of Bank’s interest which covers the same collateral. This is because Repairer’s interest attaches before the motor becomes an accession\textsuperscript{129}. If Bank’s interest is already perfected it may make further advances against the whole of the chainsaw and its interest in the motor takes priority over Repairer to the extent of the advance\textsuperscript{130}.

Therefore with continued use of current debentures after the enactment of the PPSA:

1. secured parties run a greater risk of subordinating their interests in collateral to third party transferees; but
2. given the strict conditions governing the disposition of fixed assets under most debentures the debenture holder’s interests will typically be subordinated only in circumstances where the strength of the creditor’s position is not compromised. The interest will attach instead to the proceeds of the disposition or to replacement collateral.

F. VOIDABLE PREFERENCE

Sections 309 and 311 of the Companies Act void certain securities given by a company within specified periods of the commencement of its winding up. Clauses 255 and 257 are the counterparts of these sections in the Companies Bill.

Section 309(1) of the Companies Act provides that every charge given by an insolvent company within two years of the commencement of the company’s winding up is voidable as against the liquidator if it is given "with a view" to giving the grantee a preference over other creditors. Subsection (1A) provides that every charge given in favour of a creditor by an insolvent company within one month of the commencement of the company’s voluntary winding up is voidable as against the liquidator.

\textsuperscript{129}Section 31(1).

\textsuperscript{130}As long as it has no actual knowledge of Repairer’s interest and Repairer has not perfected its interest: ss 31(3)(c), 31(2).
Section 311 of the Companies Act provides that every charge given by a company within 12 months immediately preceding its winding up is voidable against the liquidator unless either (i) it is proved that the company was solvent after the charge was given; or (ii) the charge was given in substitution for an existing security. Additional exceptions are contemporaneous securities and purchase money securities.

In both sections the crucial issue is determining when the charge is given— at the date of the agreement or at the date of its attachment. The rationale for these sections is that for insolvency law generally: ensuring pari passu distribution of the debtor’s assets by avoiding transactions which have the effect of depleting the fund of assets that would otherwise have been available for the general creditors. These sections aim to prevent ‘looting’ of the debtor’s coffers by creditors anticipating the debtor’s liquidation.

This section of the paper is concerned with the situation where Debtor grants a fixed and floating charge in Year 1 and it is wound up in Year 5. Debtor has of course continued to acquire property in the year immediately preceding its liquidation in order to continue trading and the fixed charge attaches as this new property is brought into the company. Are the charges attaching in Year 5 considered to be given in Year 1 or Year 5. The answer will determine whether they constitute voidable preferences or not.

Currently, where a security agreement is executed outside the suspect period but the interest created by that agreement attaches to after-acquired collateral within the period, the interest in the new collateral will not be voidable. RM Goode explains:

"A security agreement expressed to cover future property creates merely an inchoate security interest, but upon the debtor acquiring an asset within the after-acquired property clause the security interest attaches to that asset with effect from the date of the agreement unless the agreement itself evinces a contrary intention".

131 The floating charge attaches on crystallisation.


133 Above, n 69, 741.
Goode cites two cases in support of the retroactive effect of attachment\textsuperscript{134}. In \textit{Re Lind} Bankes LJ stated\textsuperscript{135}:

"It is true that the security was not enforceable until the property came into existence, but nevertheless the security was there, the assignor was the bare trustee of the assignee to receive and hold the property for him when it came into existence".

The concern with the effect of the PPSA on the voidable preference rules is stated in the Report of the Advisory Committee on Personal Property Security\textsuperscript{136}:

"It is arguable that, in the absence of any changes to sections 309 and 311, the attachment of the floating security interest to property acquired within the 12 month period could constitute a voidable preference".

The argument could be made that the PPSA abandons any notions of an inchoate security prior to attachment and that therefore the attachment of the security interest will be determinative of the time it is "given". Clearly the security will be unenforceable until the debtor acquires rights in the collateral\textsuperscript{137}. However this was recognised also in \textit{Re Lind} -a non-PPSA case. The real problem is that s 10 of the PPSA destroys the concept of an inchoate security (and therefore of retroactive attachment) by expressly providing that a security interest only attaches to collateral when:

"(a) value is given by the secured party; and
(b) the debtor has rights in the collateral..."\textsuperscript{138}

\textsuperscript{134}Tailby v Official Receiver (1888) 13 App Cas 523; Re Lind [1915] 2 Ch 345.

\textsuperscript{135}Above, n 132, 374.

\textsuperscript{136}Above, n 3, 109.

\textsuperscript{137}See: ‘Attachment’ above, 6.

\textsuperscript{138}Section 10(1).
1. Should After-Acquired Property Interests Be Voidable?

One problem with allowing after-acquired property clauses to escape the ambit of the voidable preference provisions is illustrated by the following example:

Bank has a typical debenture covering all Debtor’s present and after-acquired property. Debtor is a closely held company, the principal shareholder of which ("X") has guaranteed the loan from Bank. Debtor finds itself in financial difficulties and has few assets left which can be applied in discharging the $20,000 debt to Bank. X, aware of the fact that he has personally guaranteed the repayment of the $20,000 causes his company, Debtor, to take advantage of the large amount of unsecured credit being offered by trade suppliers. Debtor enters winding up proceedings but has acquired, immediately prior to this, $20,000 worth of new equipment and inventory on credit sales. Bank’s fixed and floating charges over after-acquired property attach to this new capital and do not constitute voidable preferences as Debtor is taken to have charged the property not when the charge attaches but when it was created.

In this example X has avoided any personal liability on his guarantee by stocking up on assets which upon which Bank’s charge can attach. The trade suppliers must wait in line with the other unsecured creditors to be paid out of what little is left of Debtor’s assets after Bank has been paid. The example need not involve a guarantee- X might have engaged in the same conduct in order to ensure that Bank would be willing to lend more money to X’s future business activities.

On the other hand to make a secured creditor’s interest in after-acquired property voidable merely because the property has been acquired:

- within one month of the commencement of the debtor’s winding up (s 309(2)); or
- within 12 months immediately preceding the commencement of the debtor’s winding up (s 311(1))

---

139Typically to pay by the 20th of the following month (and not supplied under retention of title).
is clearly a harsh result. It would also reduce the availability and affordability of credit since lenders could not rely on this after-acquired property to protect themselves in the event of the debtor’s default.

2. Will Interests in After-Acquired Property be Voidable After Enactment of the PPSA?

The answer to this question, both under the Companies Act and the proposed Companies Bill (cls 255,257) will depend on when the courts will consider a charge over after-acquired property to have been "given". Is the charge ‘given’ when it attaches to the property or when the security agreement is made? It is possible to argue in favour of both interpretations and there is little case authority on point. It is submitted that the

Clause 255(1) provides:
"In this section "transaction", in relation to a company, means-
(b) The giving of a security or charge over the property of a company..." (my emphasis).

Clause 257(1) provides:
"A charge over any property or undertaking of a company is voidable on the application of the liquidator if the charge was given within the specified period..." (my emphasis).

For example: Re Jackson & Bassford Ltd [1906] 2 Ch 467. The facts of this case were:
A company was incorporated with seven members. In order to obtain an overdraft from its bank one of the directors, WJ, was required to give a personal guarantee. By directors resolution it was decided that the company in turn would give WJ security over its assets by way of debentures or other charges for the amount for which WJ should be liable "whenever called upon by him to do so". WJ asked for his debenture on December 15, he received it on December 21 and it was registered on December 31. On January 1 a resolution for voluntary winding up was passed. The court held that as the giving of the debenture was purposely postponed until the company was insolvent, in order to preserve the destruction of its credit which would result from registration of a debenture, the postponement was evidence of an intention to give WJ a fraudulent preference, and on that ground the debenture was invalid. In the course of his judgement Buckley J noted:
"...an agreement to give security if and when desired does not necessarily leave the person who takes the security open to have it impeached as a fraudulent preference, but that he onus is on him to prove that he postponed taking it for some valid reason- valid for his own purposes- and that it was not postponed in order to protect the grantor’s credit, or, in other words, to enable the grantor to obtain credit from other persons in ignorance that he had given a promise which he might be called upon to perform".

But if the holder of the floating security interest has registered a financing statement- thus giving notice to third parties- it could not be said that the purpose of later attachment was:
"to enable the grantor to obtain credit from other persons in ignorance that he had given a promise which he might be called upon to perform".

Also note that fraudulent preference jurisprudence is not strictly applicable to ss 309 and 311 of the Companies Act.
preferable view is that a charge can be ‘given’ under the PPSA even though it has not yet attached. This involves accepting that it is possible to ‘give’ a charge without parting with any immediate proprietary interest in the collateral. Just as we can currently accept that a floating charge is given on Day 1 and yet attaches on Day 100 we should be able to accept that that a charge may be given before it attaches under the PPSA. It is not a question of retroactive attachment but of an intention to create a present rather than a merely contingent security.

At any rate it is likely that courts, when faced by this problem after the PPSA is enacted, will favour the view that a charge is given when executed due to the strong policy grounds favouring this construction. A contrary view would certainly place unwarrantable hardships on the suppliers of credit—hardships ultimately borne by the consumer.

Despite what has been said above it is submitted that the wording of the current rules and of those under the Companies Bill ought to be amended to provide certainty to business lenders:

Clause 255(1)(b) of the Companies Bill could be changed to read:

"An agreement granting a security or charge over present or after-acquired property of the company".

Clause 257(1) of the Bill could be changed to provide:

"A charge over any property or undertaking of a company is voidable on the application of the liquidator if the charge was created by an agreement made within the specified period".

Thought should also be given as to how a debtor’s acquisition of unencumbered assets while in financial difficulties in order to satisfy the secured creditor can be brought within the voidable preference scheme. Changing cl 255(1)(a) to read:

"A conveyance or transfer of property by or to the company"

may serve this purpose. Then all the acquisitions of property by the debtor within the specified period would constitute transactions having a preferential effect and therefore be voidable unless, as is provided by cl 255:

"the transaction took place in the ordinary course of business"

---

142See example above, 52.
The stockpiling of assets for which the debtor has no intent to pay, in order to benefit the debenture creditor, would clearly not be in the ordinary course of business. If the contract of sale is avoided the debtor will cease to have proprietary rights in the property supplied. The supplier’s legal title to the goods will be restored so that the charges of the debenture holder can not attach to the collateral.
G. SUFFICIENT DESCRIPTION OF COLLATERAL.

Section 9 of the PPSA requires the security agreement creating the security interest to contain a description of the collateral by item or kind sufficient to make the collateral reasonably capable of identification. Failure to comply with s 9 will render the security interest unenforceable against third parties. The purpose of this section is to determine whether the charging clauses of debentures, as currently drafted, comply with the description requirements of s 9.

A current clause may provide, for example:

"The Company hereby charges in favour of the Bank all its undertaking and all its property and assets whatsoever and wheresoever situated both present and future including its uncalled capital and called but unpaid capital as continuing security for the payment of the Secured Money and with the performance of all obligations secured by this debenture"

The property charged will then typically be broken down in subsequent clauses into property subject to the floating charge and property subject to the fixed charge:

The charge created by this debenture shall:-
(a) as regards the Company’s freehold and leasehold land, plant and machinery, vehicles, Book Debts and Other Monetary Debts, Intellectual Property Rights, unpaid and uncalled capital and goodwill be a fixed and specific charge; and
(b) as regards its other property and assets hereby charged or to which the fixed and specific charge may not attach or be fully and legally effective be a floating charge but so that the Company is not at liberty to sell or dispose of the property or assets or any part thereof covered by such floating charge except for valuable consideration in the ordinary course of carrying on its business."
Both the wording of the general charging provision\textsuperscript{143} and the floating charge do not sufficiently identify the collateral within the meaning of s 9(1)(b)(i). However the clauses are saved by sections 9(1)(b)(ii) and (iii) which extend the scope of the ‘sufficient description’ requirement by allowing:

(ii) a statement that a security interest is taken in all of the debtor’s present and after-acquired personal property; or

(iii) a statement that a security interest is taken in all of the debtor’s present and after-acquired property except specified items or kinds of personal property."

Clearly then the general charging clause will meet the description requirements under s 9(1)(b)(ii). However there are problems which can be illustrated in the following example:

Bank holds a debenture (with the same charging clauses as are reproduced above) over the property of Debtor. Bank registers a financing statement in respect of its debenture and remembers to describe the equipment covered by serial number. Financier subsequently takes a fixed charge over all of Debtor’s equipment, describing it by kind or serial number in the instrument. Financier does not perfect its interest by notice filing. A priority dispute arises between Bank and Financier.

In this example it is arguable that Financier wins. This is so even though Bank would appear to have a perfected interest and the interest of Financier is unperfected. The reason for Financier’s priority is that Bank’s security interest is unenforceable against third parties by reason of inadequate description of equipment. Section 9(2) provides:

“A description is not sufficient for the purposes of subsection (1)(b) if it describes the collateral as consumer goods or equipment without further reference to the kind of collateral”

\textsuperscript{143}“The Company hereby charges ....” clause, above.
The insufficiency of description results in unenforceability of the interest against third parties.

The argument in favour of this interpretation is that the wording of s 9(2) is clear: mere description of collateral as equipment is insufficient for the purposes of s 9(1)(b). Therefore the description of the collateral charged as "plant and machinery" (as in the above debenture) will be insufficient to enable Bank to enforce its security interest in equipment against third parties.

By way of counter argument Bank could rely on the general charging clause and s 9(1)(b)(ii). Certainly the initial words of the charging clause are wide enough to come within the protection offered by this subsection. Bank would assert that it had taken only the one security interest over all the property of Debtor and that therefore the general description was allowed by s 9(1)(b)(ii). Effectively Bank would be asserting that the distinction between fixed and floating charge collateral adopted in the subsequent clauses was redundant.

This argument is of doubtful weight. Where the debenture postpones the attachment of the floating charge, as in the current debenture, there are two security interests in existence: the immediately attaching interest over the fixed assets; and the interest over trading stock with postponed attachment. Each of these interests must satisfy the writing requirements of s 9 or it will be unenforceable against third parties. The fixed charge does not sufficiently describe the equipment used as collateral therefore Bank’s security interest in this particular collateral is unenforceable against Financier.

The above result may seem unfair given that Bank has filed a financing statement which does sufficiently describe the equipment (by serial number). However:

"[f]or the purposes of perfection against third parties, the security agreement and financing statement are "double filters" through which the secured creditor’s rights are viewed, and those rights are measured by the narrower of the two"144.

The practical effects of this rule will be that creditors must sufficiently describe the equipment charged or see the interest unenforceable. The easiest way to comply with

---

144 B Clark “Secured Transactions” (1986-87) 42 The Business Lawyer 1333, 1365.
s 9 will be for debenture holders to schedule to the debenture descriptions of the items and kinds of equipment to be treated as collateral.

What would be the position where the debenture contains only a general charging provision? An argument may be made that even statements in the debenture "that a security interest is taken in all of the debtor’s present and after-acquired personal property" are subject to the s 9(2) requirement that:

"A description is not sufficient for the purposes of s 9(1)(b) if it describes the collateral as consumer goods or equipment without further reference to the kind of collateral".

This argument can be based on the assumption that if Parliament had intended general security interests to be exempt from the description of equipment requirement in s 9(2) the opening words of s 9(2) would instead read: "A description is not sufficient for the purposes of subsection (1)(b)(i)".

On the other hand references to "sufficient description" in this section are contained only in ss 9(1)(b)(i) and 9(2). It would therefore be nonsensical to subject subparagraphs (ii) and (iii) to the same requirement since these provisions do not require "sufficient description" at all. That this is the correct interpretation is confirmed by the Advisory Committee’s clear contemplation of a security interest being phrased simply as an interest in all the debtor’s present and after-acquired property145.

145 Above, n 3, 87.
H. FUTURE ADVANCES.


The priority position of future advances at common law was determined in *West v Williams*[^146]:

"A first mortgagee, whose mortgage is taken to cover what is then due to him, and also further advances, cannot claim the benefit of his security for further advances in priority to a second mortgagee of whose mortgage he had notice before the further advances were made"[^147].

Lindley MR held that the rule was based not on any technicality of English law but on the plainest good sense and that it applied whether or not the first mortgagee had agreed to make future advances. Note that at common law the first mortgagee is given notice of the intervening interest of a third party:

"not by the hypothetical operation of an instrument registered subsequent to his, but by a reasonable communication of the fact by one who comes in under the subsequent instrument"[^148].

This common law rule is preserved by statute in New Zealand. An exception to the general rule that registration constitutes notice of the existence and contents of an instrument is provided by s 4(3) of the Chattels Transfer Act 1924:

[^146]: [1899] 1 Ch 132 (CA). The facts of this case were:
Williams was entitled, under his father’s will, to the income from his father’s estate for the remainder of his life. In 1895 he assigned this life interest to West by way of a mortgage in which he covenanted not to further deal with the interest that had been assigned. It was further agreed that West would not give notice of his interest to the trustees of Williams’ father estate until 1896. Notice was not in fact given until 1897. By a memorandum of charge of the same date as the mortgage Williams charged his interest under his father’s will to Temple. The charge was subject to the mortgage to West and the trustees were not given notice of it. On April 2, 1896, Williams further mortgaged his life interest to the defendants. The defendants agreed by way of consideration to advance a fixed sum and such further sums as may be advanced. The defendants did not receive notice of West’s mortgage until February 15 1897. West argued that his mortgage had priority over the defendant’s with respect to money advanced by the defendants after February 15. West admitted the priority of the mortgage of the defendants so far as regarded the original advance and advances up until February 15.

[^147]: Above, n 146, 143.

[^148]: Pierce v Canada Permanent Loan and Savings Company (1894) 25 OR 671, 676 (Ch D).
"Registration of any instrument to which subsection (1) or subsection (2) hereof applies shall not in itself constitute notice of the existence of that instrument or of its contents to the grantee of any prior registered instrument relating to the same chattels or to any of those chattels." (my emphasis)

2. *Future Advances and the PPSA.*

Unlike its counterpart in Ontario, the PPSA proposed for New Zealand specifically deals with the priority position of future advances\(^\text{149}\).  

The definition section of the Act provides:

"'future advances' means the payment of money, the provision of credit or the giving of value secured by a security interest, occurring after the security agreement has been executed, whether or not given pursuant to a commitment, and advances and expenditures made for the protection, maintenance, preservation or repair of the collateral"\(^\text{150}\).

Section 12 provides:

"A security agreement may *provide for future advances*" (my emphasis).

Section 28(2)(c) provides:

"a security interest has the same priority in respect of all advances, including future advances".

Three points can be made with respect to these sections. First, s 12 makes it clear that if provision is *not* made in the security agreement for future advances the secured party will not be entitled to tack future advances\(^\text{151}\). Only the subsequent advances which

---

\(^\text{149}\)In this respect it follows the Saskatchewan PPSA.

\(^\text{150}\)Section 2(1).

\(^\text{151}\)See also: s 8.
are both within the statutory definition and the terms of the security agreement are entitled to be enforced either between the parties or against third parties.

Secondly, the definition of "future advance" in s 2(1) clearly removes any distinction between advances a secured party chooses to make and those it is committed to making. The advances are treated identically by the PPSA.

Thirdly, the question of whether future advances create successive interests in the same collateral is answered by s 28(2)(c). There is only one security interest regardless of the number of future advances made. The priority of this interest is determined by the ordinary PPSA priority rules. The Act does not state whether this interest attaches at the date of the last advances or continues in existence from the time value was first given. In a priority contest between perfected security interests this would not matter as the priority will be determined by the 'first-to-file' rule. However if the security interests in contest are both unperfected the issue of when a security interest which covers future advances attaches is important. The following example will illustrate:

Retailer grants Bank a security interest in its equipment to secure the repayment of an initial loan of $5,000 "and all future advances". Bank does not register a financing statement. Retailer subsequently mortgages the same collateral to Finance Co in return for a $10,000 loan. Finance Co fails to register a financing statement as well. Subsequently Bank makes further advances pursuant to its earlier agreement with Retailer. The advances total $2000. Retailer defaults on all the loans and the collateral realises $10,000 on its sale.

If the attachment of Bank’s security interest is postponed until its provision of a final advance Finance Co will be entitled to the $10,000. Bank’s security interest will be factually eliminated merely because it has made future advances. That Bank’s earlier

152For example:
Manufacturer grants Bank a security interest in its plant. The security agreement purports to secure the repayment both of the initial advance and any subsequent advances which may be made.
In this example one view is that there is one security interest attaching at the time of the original agreement and that this interest covers all future advances: (Gilmore, Security interests in Personal Property (Little Brown & Co, Boston, 1965) Vol 2 33). The alternative view is that Bank has several distinct security interests each of which attaches at the time the successive value is given: (Coogan, "Intangibles as Collateral Under the Uniform Commercial Code" (1964) 77 Harv L Rev 997, 1019).
interest in the collateral should be subordinated because it has chosen to inject more
capital into the business is clearly undesirable on the policy grounds of fairness,
efficiency and the facilitation of commercial growth. It is submitted that this is not how
s 28(2)(c) will be interpreted given the clear intent of s 10(1).

The basic difference between the treatment of future advances under current law
and the PPSA regime is this: currently a third party can end a prior creditor’s right to
tack future advances onto its security interest by serving the creditor with actual notice
of its intervening interest. Under the PPSA a third party cannot end a creditor’s right to
tack. Future advances authorised by the original security agreement are treated by the
Act as if they formed part of the initial value furnished by the secured party. An
example will illustrate:

On Day 1 Debtor Ltd gives Creditor a chattel mortgage of certain items
of plant owned by it. The terms of the agreement state that the collateral
also secures the repayment of any future advances Creditor may make.
Creditor registers his interest and makes an initial advance of $10,000.
On Day 20 Finance Co loans Debtor Ltd $2,000 using the same
equipment as collateral. Seeing Creditor’s previously registered interest
covers future advances Finance Co ensures Creditor has actual notice of
its new interest in the same collateral. Creditor subsequently makes two
further advances totalling $2,000. Debtor Ltd defaults on both security
agreements and the collateral realises $12,000 on its sale.

Under current law Creditor has priority as to the first $10,000, and Finance Co is
entitled to the next $2,000 as it has terminated Creditor’s right to tack by serving actual
notice on the earlier creditor. Under the PPSA there is a simple priority contest between
two perfected security interests which is resolved in favour of the party which is “first-
to-file”\(^{153}\). Creditor thus has priority both as to its initial $10,000 and the later
advances totalling $2,000. The interest of Finance Co is factually eliminated though it
remains legally effective between the contracting parties.

Section 9-204(3) of the UCC provides that:

\(^{153}\)Section 28(1)(a)(i).
"[o]bligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment"

It is thus similar to its counterpart in the PPSA, s 12:

"A security agreement may provide for future advances"

Several of the issues relating to the future advances regime in the PPSA can therefore be considered in the light of article 9 jurisprudence.

(a) What language will create a security interest covering future advances?

The intent of the parties to include future advances within the obligations secured by the security agreement must be clear.

In Kitmitto v First Pennsylvania Bank, NA 154 a pledge which secured "all sums or debts now or hereafter owed to you by... the Borrower" did not clearly cover future advances because the original advance itself could be construed both as a debt "now owed" and as a debt "hereafter owed".

In Texas Kenworth Co v First National Bank 155 the Oklahoma Supreme Court considered a retention of title agreement which provided that property in the collateral would not pass until:

"all payments hereunder and all other charges required to be paid... and all other indebtedness from buyer to secured party are fully paid".

The Court held that the security interest created by the agreement did not extend to future advances because the clause did not expressly provide that the interest created was to secure future advances.

At a minimum the agreement should purport to secure payment of:

"any and all liabilities of debtor to creditor whether now existing or hereafter arising" 156.


155564 P 2d 222 (Okla 1977).

Ideally creditors should ensure the security agreement specifically covers ‘future advances’ in order to protect themselves.

The wording used in New Zealand future advance clauses is typically more complex than that suggested in relation to their counterparts in the United States. This may be enough by itself to create ambiguity though all the clauses reproduced below will arguably meet the specificity requirement.

(1) "The words "Moneys Secured" shall mean:

(i) all loans, credits, advances, accommodation made or given, payments and the amounts of other financial assistance of whatsoever kind now heretofore made, advanced, expended given or made available by [the Lender] to or for the Company or another at the express or implied request of the Company; and

(ii) shall further include such sum or sums as [the Lender] may expend for the better protection of its interest under this Debenture and any sums payable by virtue of any of the Clauses of the Debenture".

(2) "Secured Money’ means all moneys advanced credited or lent and all other banking accommodation provided by the Bank directly or indirectly to the Company... in any way whatsoever before upon or after execution of this Deed and all moneys and liabilities (whether certain or contingent) due owing or incurred by the Company to the Bank and all interest fees and expenses payable to the Bank in respect of the foregoing and without limiting the generality of the foregoing includes:-

(a) All moneys and liabilities which are or may become due owing or payable by the Company under any Loan Agreement or in respect of the bank account of the Company...

AND all moneys and liabilities described as above in this definition are in all cases to be regarded as Secured Money whether or not:-

...
(e) They were owing payable or incurred before or at the same time or at any time after the execution of this Debenture and whether or not any Loan Agreement or any other agreement or deed of guarantee was executed before at the same time as or at any time after the execution of this Debenture."

(3) "Principal Sum" means, at any time and from time to time, all sums of money... outstanding or owing or due and all liabilities of whatsoever nature whenever incurred and whether or not ascertained accrued or absolute, for which the Company... is or may become liable or responsible directly or contingently to [the lender] whether under a Facility Agreement or at law or otherwise and whether arrived at maturity or not and without limiting the generality of the foregoing includes:

(a) liabilities for payment repayment or discharge of any loans, advances, readvances, discounts, acceptances, guarantees, credits, deferred payment dispositions or any other accommodation made or made available by [the lender] ..."

If such clauses are not interpreted as creating security interests which cover future advances the lender’s position in each case will be severely compromised. On ordinary principles the subsequent advance is not supported by a security agreement and the lender will therefore be treated as an unsecured creditor in respect of the moneys advanced. Section 9 of the PPSA supports this result. Even if a court finds that a new security agreement has been created impliedly this agreement will still fail the formal requirements of s 9 (such as the presence of the debtor’s signature). The security agreement will therefore be unenforceable against third parties157.

(b) What future indebtedness is covered?

157Section 9.
A problem may arise where parties enter into a security agreement with a future advances clause but at the time a third party takes an interest in the same collateral there is no money owing between the original debtor and creditor. For example:

Bank loans Debtor $10,000 and is secured by a debenture over all of Debtor’s property with a future advances clause. Bank registers a financing statement. Debtor repays all the money owing to Bank. Finance Co then loans Debtor $10,000 and takes a security interest in the same collateral. Finance Co also registers a financing statement. Bank finally advances a further $5,000 to Debtor on the strength of its existing security agreement. Debtor defaults in paying both loans. The collateral is sold and realises only $10,000.

On the ordinary rules contained in the PPSA, Bank’s claim for $5,000 ought to have priority over Finance Co. A new security interest arises when Bank makes its future advance but it will be perfected by virtue of the earlier registration of a financing statement. Finance Co also has a perfected security interest. In this case “priority among perfected security interests is determined by the order of ...registration”\textsuperscript{158}. Bank registered first therefore it enjoys priority even though it gave value after Finance Co.

This result is inconsistent with a decision of the Florida bankruptcy court on the same issue. It is submitted that, to the extent of the inconsistency, \textit{In re Krig}\textsuperscript{159} must therefore be wrongly decided. This case concerned a priority dispute between liens covering the same equipment.

In 1980 Bank took a security interest in the debtor’s property to secure certain loans and filed a financing statement, thus perfecting its interest.

These loans were eventually paid off but bank did not file termination statements. Subsequently, in 1981, the debtor obtained a loan from F secured over the same equipment. F filed a financing statement. In 1982

\textsuperscript{158}Section 28(1)(a).

\textsuperscript{159}67 Bankr 50, 2 UCC Rep Serv 2d (Callaghan) 1434 (Bankr MD Fla 1986).
the debtor obtained additional loans from Bank secured by the same collateral that had secured Bank’s original loan (and that was securing F’s later loan).

The debtor defaulted on both loans. Bank argued that it had priority since between perfected security interests this was determined by the ‘first-to-file’ rule of section 9-312(5) (being similar to s 28(1)(a)(i) of the PPSA).

F argued that at the time it acquired its interest the debtor owed nothing to Bank and therefore there was no obligation that could support a security interest in its favour.

The Court decided in favour of F. Although recognising that it was entirely legitimate to register a financing statement before a security interest is created the Court said:

“that principle cannot operate to cut off a properly perfected security interest that attaches to collateral that is, in fact, free and clear of any lien at the time of perfection”160.

These words have a nice ring to them but they are wrong- both under article 9 and the proposed PPSA. Although it is true that Bank’s security interest was extinguished when it ceased to be owed any money it does not follow that when its new interest arose it was required to register another financing statement. The original statement was sufficient to cover the later advances since the same type of collateral was used as security. As a result the priority between the perfected interests of Bank and F ought to have been decided by the ordinary ‘first-to-file’ rule which would favour Bank. It would have made no difference even if Bank’s first loan had been after F’s - as long as it had registered a financing statement first.

If this result seems unfair to F it must be remembered that under both article 9 and the PPSA the debtor could have demanded a termination of the financing statement of Bank at the request of F161. This would give F priority under the same rule. Also without the ability to register a financing statement in respect of indebtedness contemplated in the future, creditors who frequently supply under retention of title will

---

160 Above, n 160, Bankr at 51, UCC Rep Serv 2d at 1436.

161 Section 9-404(1) of the UCC. Section 43(3) of the PPSA pursuant to which not only the debtor but also F (in the above example) could demand discharge.
be put to the inconvenience of registering a financing statement with respect to each delivery.

(ii) Regardless of how clearly lenders draft their future advance clauses there may be another limitation on the current scope of these clauses if New Zealand courts choose to rely on existing North American jurisprudence in interpreting the proposed PPSA.

The rule which could affect the scope of future advances clauses is called "the same class of indebtedness" rule and it has been recognised in various United States jurisdictions. It effectively means that some courts will not enforce a security interest purporting to cover future advances if the future advance is not of the same type as the original indebtedness.

RCC Cuming and RJ Wood cite the example of a debtor who obtains a personal loan from the bank pursuant to a security agreement with a future advances clause and under which the debtor's private car is the collateral. Later debtor arranges a business loan from the same bank secured over the debtor's business assets. They state: "In some U.S jurisdictions, the future advances clause in the consumer loan agreement would be construed as covering only future indebtedness of a personal, family or household nature, and not future indebtedness of a business or commercial nature".162

So in the example used by Cuming and Wood above if the bank made advances to the business of the debtor and these were defaulted on it would not be entitled to realise the debtor's car in order to satisfy the debt (unless the debtor had also defaulted on advances under the personal loan).

This is clearly at odds with the current position under New Zealand law. The better view is probably that our courts will not adopt this rule even after enactment of the PPSA. There are at least two reasons for this:

(a) The rule has not even been conclusively established in the United States; and

---


163 For example see: Thorp Sales Corp v Dolese Bros Corp 453 F Supp 196 (WD Okla 1978).
(b) New Zealand courts, unaccustomed as they will be to applying a functional approach to chattel securities law, will probably continue to interpret security agreements formalistically: ("If it says ‘future indebtedness’ it means ‘future indebtedness’ regardless of the nature of the obligation").

It is therefore important that debenture creditors continue to detail the types of future indebtedness that they intend to cover with the security interest. Failure to do so, on the wording of s 8, may preclude a creditor from bringing future advances within the protection of an existing perfected security interest.
I. AFTER-ACQUIRED PROPERTY AND PURCHASE MONEY SECURITY INTERESTS.

One common conflict arising in chattels security law is that between the holders of a charge over after-acquired property and the holder of a purchase money security interest ("PMSI"). For example:

Bank lends Debtor $10,000 and takes a fixed charge over all Debtor’s present and after-acquired property (except trading stock and book debts\(^{164}\)). Subsequently Debtor wishes to purchase a significant item of plant for use in its business. Finance Co lends Debtor the $20,000 required to purchase the plant in return for a charge over the plant.

Currently the determination of the priority dispute between Bank and Finance Co will depend upon the application of common law rules. The issue is not dealt with satisfactorily by statutes\(^{165}\). In terms of policy it is clear that Finance Co ought to have priority in the plant for two reasons:

1. The law should discourage monopolisation of a debtor’s credit arrangements. If the PMSI was not afforded priority a prior debenture creditor with a typical after-acquired property clause would take priority with respect to all new value introduced into the business—thus discouraging the injection of new value.
2. Allowing Bank to claim priority over the new equipment would give it a windfall it does not merit. In the example above the new capital has been financed by Finance Co not Bank.

\(^{164}\)Which would typically be subject to a floating charge.

\(^{165}\)Section 24 of the Chattels Transfer Act provides that an instrument shall be void against the persons in ss 18 and 19 in respect of after-acquired property except in the case of PMSIs. However commercial distrust of this limited provision has meant that lenders intending to take a charge over a debtor’s present and future property will invariably insist the debtor incorporates and grants the conventional fixed and floating charges. The provisions of the Companies Act (which do not recognise purchase money security interests) therefore apply instead.

In determining the priority between competing after-acquired property clauses and PMSIs the courts in England and New Zealand have applied the following approach.

If there is an agreement to encumber the asset before the debtor acquires any rights in it then the holder of the PMSI has an equitable interest in the property on its acquisition by the debtor. The after-acquired property clause can therefore only operate to effect a charge over already encumbered assets. It would not matter whether Finance Co had notice of Bank’s interest or not.

If, on the other hand, the debtor acquires an interest in the asset before the PMSI creditor (i.e., the agreement to encumber the asset is made after it is purchased by the debtor) then the debenture creditor’s charge will attach to the (as yet) unencumbered property of debtor and therefore take priority. This gap in time between the purchaser acquiring title and the PMSI creditor acquiring an interest in the collateral is called the scintilla temporis and until recently allowed the after-acquired creditor’s interest to attach to unencumbered title.

Re Connolly Bros Ltd (No 2) provides an example of a PMSI holder who takes priority over an after-acquired property clause:

Debtor issued a debenture to C1 which covered all its present and after-acquired property. Subsequently Debtor sought funds from C2 to finance the acquisition of new premises. Debtor agreed to give C2 a charge on the property when it was purchased. After acquisition Debtor deposited the title deeds with C2. The court held that the undertaking given by Debtor that it would charge its premises upon acquisition constituted an equitable charge which attached to the property as soon as Debtor acquired rights in it. Debtor therefore never had unencumbered title to the property upon which C1’s charge could attach.

---

166[1912] 2 Ch 25, 81 LJ Ch 517, 106 LT 738, 19 Mans 259, CA.
A recent House of Lords case affirms the efficacy of the purchase money security interest in English law. The decision in Abbey National Building Society v Cann\textsuperscript{167} eschews the previously strict rule that the existence of \textit{scintilla temporis} would defeat the PMSI creditor. Instead the court, clearly motivated by the policy desirability of protecting PMSI lenders, adopted a more liberal "single transaction" approach: even if the PMSI creditor did not take an interest in the collateral until after its acquisition it appears the Court will view the debtor’s acquisition of the property and the grant of an interest to the PMSI creditor as one indivisible transaction- thus still defeating the after-acquired property clause\textsuperscript{168}.

Following \textit{Abbey National} it can be said that a lender who advances purchase monies has his collateral protected from competing claims under after-acquired property clauses provided three criteria are met:

(1) The funds advanced by the lender are used to purchase the property which is to act as the collateral\textsuperscript{169}.

(2) The funds are only be advanced on the understanding that the debtor will grant the creditor a security interest in the property to be acquired\textsuperscript{170}; and

\textsuperscript{167}[1991] AC 56; [1990] 2 WLR 832.

\textsuperscript{168}The facts of the case were as follows:

Debtor applied to ANBS for a loan of £25,000 to buy a house. ANBS offered to make a loan secured by a legal charge over the property to be purchased. On August 13 completion of the transfer of the property and execution of the charge took place. Debtor eventually defaulted on its loan and ANBS commenced proceedings for possession. Debtor did not defend the proceedings but his mother ("Cann") did. Cann claimed to have a prior equitable interest in the property arising on a constructive trust. Cann argued that the legal charge could only have been effective if executed after the transfer of the legal estate to the debtor. She argued the conventional line that her equitable interest had attached in the \textit{scintilla temporis}.

The House of Lords dismissed the notion of a \textit{scintilla temporis} and the appeal by Cann failed. In finding in favour of ANBS the House based its decision on public policy grounds:

"The reality is that, in the vast majority of cases, the acquisition of the legal estate and the charge are not only precisely simultaneous but indissolubly bound together" (per Lord Oliver of Aylmerton at 92).

The "single transaction" doctrine therefore reduces the scope of the \textit{scintilla temporis} doctrine.

\textsuperscript{169}The safest course would be for the PMSI creditor to pay the vendor directly so there can be no question of how the funds were applied. In \textit{Abbey National} the purchaser’s solicitor was given the funds with directions to use them for the purchase.

\textsuperscript{170}This is likely to be an easy standard to meet as it appears from \textit{Abbey National} that the undertaking can be inferred from the circumstances of the advance:

"in \textit{Security Trust Co v Royal Bank of Canada} [1976] AC 503..., the court appeared to proceed on the basis that the only interest of the mortgagees which required to be considered was that which they acquired by virtue of the execution of the charge in their favour after the legal estate had vested in the purchaser. This, in my view was to ignore the interest which they must have
(3) The PMSI holder takes an interest in the property within a reasonable time after the debtor acquires the property.\textsuperscript{171}

2. Purchase Money Security Interests Under the PPSA.

While the current protection afforded to PMSIs is based entirely in common law,\textsuperscript{172} the PPSA accords statutory status to this device by providing for its super-priority in certain circumstances. There are two main features of the PMSI regime in the PPSA:

(i) A greater number of devices treated as PMSIs.

The definition section of the Act provides\textsuperscript{173}:

"purchase money security interest" means

(a) a security interest taken in collateral to the extent that it secures the payment of all or part of the purchase price of the collateral; or

(b) a security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire the rights; or

(c) the interest of a lessor of goods under a lease for a term of more than one year; or

acquired when they handed over the purchase price to enable completion to take place. It would be quite unrealistic to assume that the money was made available unconditionally and that only at or immediately after the moment of completion did the question of a charge in their favour arise": per Lord Jauncey of Tullichette at 101-102.

\textsuperscript{171}Failing this the "single transaction" approach of the House of Lords may not apply. In such a case a court may well identify a scintilla temporis in which the interest of an existing chargeholder can attach to the (apparently) unencumbered title of the debtor. There is no case authority for this proposition but see: J de Lacy "The Purchase Money Security Interest: a company charge conundrum" [1988] Lloyd's Mar & Comm LQ 531, 537. Also note that it would be extremely rare for a PMSI to fail on such a ground simply because it would require a huge oversight on the lender's part to fail to secure its advance.

A PMSI creditor who fails to register his charge in the debtor company's collateral will find that this interest is unenforceable against other creditors and the liquidator: s 103(2) of the Companies Act.

\textsuperscript{172}Section 24 of the Chattels Transfer Act is an exception to a prohibition rather than a protection.

\textsuperscript{173}Section 2(1).
(d) the interest of a person who delivers goods to another person under a commercial consignment;

but does not include a transaction of sale by and lease back to the seller, and, for the purposes of this definition, "purchase price" and "value" include credit charges or interest payable for the purchase or loan credit;

Subsection (a), above, includes the interest retained by a supplier under a Romapla clause, or a conditional sale. Subsections (c) and (d) include finance leases and consignments within the definition. Such interests are not currently treated as PMSIs, indeed they are not strictly treated as "security interests" at all\(^\text{174}\). However because of the current emphasis on the distinction between legal and equitable interests and the nemo dat rule these devices are given priority over competing after-acquired property clauses anyway. Such devices do not even require registration since they are not "charges" for the purposes of the Companies Act nor "instruments" within the Chattels Transfer Act. These devices are protected because current chattels security law recognises the superiority of legal title.

Under the PPSA this distinction is abandoned. The statute therefore provides other means by which the holders of title based PMSIs take priority over competing security interests.

(ii) *Super-priority of the PMSI*

Section 27 of the PPSA:

"accords special status to purchase money security interests in recognition of the new value which the associated transactions bring to a debtor's business"\(^\text{175}\)

In order to take advantage of the super-priority, PMSI holders must comply with certain formalities which differ depending on the type of collateral involved.

\(^{174}\) Above, n 8.

\(^{175}\) Above, n 3, 54.
(a) What is the Rationale Behind PMSI priority?

In the case of title-retention PMSIs (such as conditional sales) the PMSI creditor is favoured because:

"the property she is relying on for payment was previously hers...; there was never an instant when she relinquished a hold on it and she would never have parted with it at all except upon the belief and faith that if her buyer defaulted she could either recapture her property or get paid out of it."

The holder of the competing security interest over after-acquired property on the other hand:

"parted only with money in which they retained no interest whatsoever, and placed reliance for repayment of their debts in getting a security interest in other property not only never previously owned by them but not even owned by the debtor at the time the money was loaned."

The fundamental distinction is between losing an interest in property previously owned and failing to gain priority with respect to property never owned. With respect to PMSIs which involve encumbering the collateral rather than reatining title the rationale for super-priority is similar:

(a) The PMSI creditor has relied upon taking an interest in the particular property in question and but for this reliance the debtor would never have acquired the new property.

(b) Such injections of value into the debtor’s business are of benefit to the existing non-PMSI creditor even though they are deferred in priority.

\[\text{176 Nelson & Whitman Real Estate Finance Law (2 ed), West Publishing Co, St Paul, 1985) } \text{§ 9.1 at 679-80.}\]

\[\text{177 Above, n 176.}\]

\[\text{178 Most commonly used is the charge.}\]
The new property expands the debtor’s asset base from which income will be generated to pay the non-PMSI creditor as well.

(c) It is accepted that monopolisation of a debtor’s financing arrangements is not conducive to commercial health and expansion—one of the policies driving commercial law.

(b) Purchase Money Security Interest in Equipment: s 27(1)

Section 27(1) provides:

"A purchase money security interest in collateral, other than intangibles or inventory, or, subject to section 22, its proceeds, has priority over any other security interest in the same collateral given by the same debtor if the purchase money security interest is perfected not later than 10 working days after the day on which the debtor, or another person at the request of the debtor, first obtains possession of the collateral"

For example:

Bank has a charge over all of Debtor’s present and after-acquired property. Finance Co advances $1000 to Debtor on the conditions that the sum is used to buy a new item of equipment and that Debtor will grant Finance Co a charge over this equipment when it is acquired.

Currently Finance Co is recognised as having a PMSI in the new equipment. This takes priority over Bank’s earlier interest. If Debtor’s undertaking to charge the equipment (when purchased) to Finance Co was oral the equitable charge created need not be registered to enjoy priority over Bank. This is because it does not come within the scope of s 102(2) of the Companies Act. Finance Co however will invariably ensure that Debtor agrees in writing before the funds are advanced to charge the collateral once

179 It will not be "a charge created or evidenced by an instrument which, if executed by an individual, would require registration under the Chattels Transfer Act" (s 102(2)(c)) since an oral charge is not an "instrument": New Zealand Serpentine Co Ltd v Hoon Hay Quarries Ltd [1925] NZLR 73.
acquired. Such a charge will require registration within 30 days or it will be void against the liquidators and other creditors (including Bank).

Under the PPSA Bank's interest is also deferred provided Finance Co registers a financing statement within 10 working days of Debtor obtaining possession of the collateral. An important point is that Finance Co obtains no interest in the equipment which can be enforced against Bank unless Debtor has "signed a security agreement that contains... a description of the collateral by item or kind which is sufficient to make the collateral reasonably capable of identification".  

The position of debenture creditors with respect to competing PMSIs in equipment is therefore better under the PPSA. The time available for registration is reduced from 30 days to 10 working days and the debenture creditor will not be bound by a security agreement made orally.

(c) Purchase Money Security Interest in Inventory: s 27(3).

Section 27(3) provides:

"Except as otherwise provided in subsection (5) a purchase money security interest in inventory or, subject to section 22, its proceeds, has priority over any other security interest in the same collateral given by the same debtor if, before the debtor or another person at the request of the debtor first obtains possession of the collateral,

(a) the purchase money security interest in the inventory is perfected; and

(b) the secured party gives to any other secured party who, at the date of registration of a financing statement in relation to the purchase money security interest, has registered a financing statement containing a description of the collateral which includes the same item or is of the same kind, notice that the sender has acquired or expects to acquire a purchase money security interest in inventory of the debtor described by item or kind."

---

180Section 9(1)(b)(i).
It is therefore considerably more difficult to take advantage of the super-priority rule where the PMSI is in collateral held by the debtor as inventory: there is no 10 day grace period in which the PMSI creditor may perfect its interest to take priority and secured parties with possibly competing security interests in the collateral must be notified of the PMSI before the debtor obtains possession.

For example:
Bank holds a floating charge over Debtor’s present and after-acquired stock-in-trade. The charge is registered. Supplier supplies widgets under conditional sale to Debtor which Debtor holds as inventory. Bank appoints a receiver.

Currently there would be no dispute that Supplier has priority since it has retained the legal title to the widgets and there is no applicable exception to the nemo dar rule. However under the PPSA there is only one type of interest recognised: the security interest. The interest retained by Supplier is a security interest\(^{181}\) as is the interest of Bank. The priority dispute between the two is not resolved by making distinctions between legal and equitable interests but by applying the priorities regime in the Act with the following consequences:

(1) if Supplier has complied with the s 27(3) requirements of perfection before possession and actual notice to bank then it has priority.

(2) if Supplier has not registered the requisite financing statement it will lose priority to Bank under s 28(1)(a)(i). If it has there are two possible results:

(i) if Supplier registered a financing statement before Bank it takes priority under s 28(1)(a)(i). This may be the case if Debtor is an established customer of Supplier\(^{182}\).

(ii) if Supplier registers a financing statement after Bank Supplier will lose priority under s 28(1)(a)(i).

\(^{181}\)Section 4(3)(c)(ii).

\(^{182}\)Suppliers under retention of title clauses and conditional sales are likely to have established lines of supply. These suppliers will usually register a financing statement before they commence supply and the financing statement will cover all future supplies of the same type of collateral. Creditors intending to take security interests in the after-acquired property of debtors therefore need to look at the register to determine what suppliers to the debtor will take automatic priority without the need to comply with s 27(3). Note however that it is possible for such suppliers to subordinate their priority to the debenture holder by agreement (s 33).
In the above example it will not matter whether the floating charge is construed as immediately attaching or not. The charge will attach on the appointment of the receiver anyway so the priority contest will continue to be decided on the basis of competing perfected security interests.

Rationale Behind the Inventory PMSI rule:

Section 27(3) puts holders of existing non-PMSIs in after-acquired inventory in a better position than the current law.

Currently suppliers under title based securities need not register their interests to protect them. In most circumstances under the PPSA even registration before delivery will not suffice; the supplier must also actually notify prior registered creditors with interests covering the debtor’s inventory.

This section is similar to § 9-312(3) of the UCC. The Official Comment to that section states that the reason for the additional notification requirement:

"is that typically the arrangement between an inventory secured party and his debtor will require the secured party to make periodic advances against incoming inventory or periodic releases of old inventory as new inventory is received. A fraudulent debtor may apply to the secured party for advances even though he has already given a security interest in the inventory to another secured party. The notification requirement protects

---

183 Because they are not “charges” for the purposes of s 102(2) of the Companies Act and they are not considered “instruments” for the purposes of s 2(1) of the Chattels Transfer Act: see R Scragg “Romalpa Clauses and Section 2 of the Chattels Transfer Act” (1987) 3 Cant L Rev 282.

184 A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if

(a) the purchase money security interest is perfected at the time the debtor receives possession of the inventory; and

(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21 day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of Section 9-304); and

(c) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(d) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in the inventory of the debtor, describing such inventory by item or type."
the inventory financier in such a situation: if he has received notification, he will presumably not make an advance; if he has not received notification (or if the other interest does not qualify as a purchase money interest), any advance he may make will have priority. Since an arrangement for periodic advances against incoming property is unusual outside the inventory field, no notification requirement is included in the subsection [relating to PMSIs in equipment]."

This rationale has applicability in New Zealand as well. Debenture holders will most commonly make future advances to enable the debtor to acquire working capital-inventory since it is in the debenture holders' best interests to ensure its debtor continues to trade. If however the debtor requires new plant or other fixed capital the debenture holder is likely to enter into a new security agreement to enable the debtor to acquire it.

\[(d)\] Purchase Money Security Interest in Accounts Receivable: s 27(2).

Purchase money security interests in accounts receivable, trademarks, goodwill and other intangibles are treated similarly to their counterparts in equipment (s 27(1)). Section 27(2) provides:

"A purchase money security interest in an intangible\(^{185}\) or, subject to section 22, its proceeds, has priority over any other security interest in the same collateral given by the same debtor if the security interest in the intangible is perfected not later than 10 working days after the day on which it attaches to the intangible."

\(^{185}\)Section 2(1) provides:

"'Intangible' means personal property other than... (a) goods... (b) chattel paper... (c) a document of title to goods... (d) a negotiable instrument... (e) a security; or (f) money."
The PMSI may be taken either directly in the accounts receivable or arise by way of a PMSI which continues in the intangible proceeds of collateral dealt with by the debtor.\(^{186}\)

\((e)\) Competing PMSIs: ss 27(4), 27(6).

The following examples illustrate these rules:

C1 advances Debtor $1000 so that Debtor can purchase an item of equipment for its business. Debtor agrees at the time of the advance to charge the equipment in C1’s favour upon its acquisition which it does. The equipment is sold to Debtor by C2 under a conditional sale. This is a case of two competing PMSIs. If C2 registers a financing statement within 10 working days after Debtor obtains possession of the equipment C2 will have priority over C1.\(^{187}\) C2 will also take priority if it has previously registered a financing statement prior to C1: (s 28(1)(a)(i))\(^{188}\).

If the collateral is held by Debtor as inventory C2 must perfect its interest prior to Debtor obtaining possession of it.\(^{189}\)

Consider the following example:
Debtor has possession of equipment supplied by C1 under commercial consignment. Debtor sells the equipment to a retail customer and uses the cheque received to purchase replacement equipment under a conditional sale from C2.

---

\(^{186}\)See section 22. For example A has a PMSI in D’s equipment. D sell the equipment and the proceeds exist in the form of an account receivable. In this case A has a PMSI in the accounts receivable.

\(^{187}\)Section 27(4)(b).

\(^{188}\)Which it is likely to have done unless either (i) Debtor is a new client; or (ii) the collateral supplied is not of the type usually supplied (and therefore not within the description of the previous financing statement).

\(^{189}\)Section 27(4)(a).
Here C1 has a continuing PMSI in the replacement equipment\textsuperscript{190} however C2 has priority if:

(i) in the case of inventory, it perfects its interest before Debtor takes possession;\textsuperscript{191} or

(ii) in the case of collateral other than inventory C2 perfects its interest no later than 10 working days after Debtor obtains possession\textsuperscript{192}.

\textsuperscript{190}Section 2(1) provides: 
"'*proceeds' means identifiable or traceable personal property in any form derived directly or indirectly from any dealing with the collateral or the proceeds of the collateral..." (my emphasis).

Section 22(1) provides:
"...where collateral is dealt with or otherwise gives rise to proceeds, the security interest...
(b) extends to the proceeds".

\textsuperscript{191}Section 27(6)(a).

\textsuperscript{192}Section 27(6)(b).
J. PREFERENTIAL PAYMENTS.

1. The Current Scheme Under the Companies Act.

(a) Section 308.
This section specifies that in a company’s winding up certain debts shall be paid in priority to other debts. These preferential payments include wages and holiday pay owing to the company’s employees and amounts owing under the Child Support Act 1991\(^{193}\). To the extent that the unencumbered assets of the debtor are insufficient to meet them, these preferential debts may be paid out of property of the company subject to a floating charge\(^{194}\) whether or not that charge has crystallised\(^{195}\). However only those assets subject to a floating charge may be applied in satisfaction of the preferential debts. Assets subject to a fixed charge (whether or not in conjunction with a floating charge) may not be so applied\(^{196}\).

(b) Section 101:
This section applies a similar rule where the company is not in the course of being wound up but instead the debenture holder either appoints a receiver or takes possession of the charged assets itself. The section provides that the receiver (or the debenture holder in possession) must pay the preferential creditors\(^{197}\) out of assets subject to the floating charge, to the extent that repayment can not be completed by using the assets

---

\(^{193}\)Section 308(1)(a)-(d).

\(^{194}\)Section 308(4)(d).

\(^{195}\)Section 308(7)(d).

\(^{196}\)Re Lewis Merthyr Consolidated Colliers Ltd [1929] 1 Ch 498. This case concerned a dispute as to the proceeds of sale of certain inventory and equipment belonging to the debtor. The disputants were: (i) a bank holding a perfected security interest securing all present and future indebtedness; and (ii) the Commissioner of Revenue holding an intervening state tax lien. The Supreme Court of Tennessee held, per Drowota J, that the bank was entitled to rely on its future advances clause notwithstanding the fact that it had filed new financing statements and obtained additional collateral at the time of each subsequent advance.

\(^{197}\)As specified in s 308.
available to the general creditors. Again, if the asset is subject to both fixed and floating charges it cannot be applied in the discharge of preferential debts\(^{198}\).

These sections operate even to the extent that the relevant property has been acquired by the company after the floating charge has crystallised\(^{199}\).

2. The Proposed Scheme\(^{200}\).

The position under the proposed companies package is as follows:

(a) If the debtor is in liquidation.
- assets not subject to any charge may be used to pay the preferential creditors and the liquidator’s expenses to the extent and in the order of priority specified in the Seventh Schedule to the Companies Bill\(^{201}\).

- assets subject to a floating charge may be used to pay the preferential creditors specified in clauses 2, 3, and 4 of the Seventh Schedule to the Companies Bill\(^{202}\) to the extent that the unencumbered assets are insufficient to meet them\(^{203}\).

- assets subject to charges (fixed or floating) which have been surrendered or redeemed in accordance with cl 268 of the Companies Bill may be used to pay the expenses, fees and claims in the Seventh Schedule (which includes both the liquidator’s expenses and the other preferential debts).

---

\(^{198}\) Above, n 196.

\(^{199}\) *Inland Revenue Commissioners v Goldblatt* [1972] 1 Ch 498.

\(^{200}\) See: the Companies Bill, and the Companies (Ancillary Provisions) Bill. These ‘Bills’ were in fact enacted on September 20 1993- after this paper was written.

\(^{201}\) Clause 275(1) of the Companies Bill.

\(^{202}\) Which excludes the liquidator’s costs and expenses (cl (1)).

\(^{203}\) Clause 9(b) of the Seventh Schedule to the Companies Bill.
(b) If the debtor is in receivership\textsuperscript{204}.

- "The receiver... must apply property in receivership that is subject to a charge\textsuperscript{205} that, at the time it was created, applied to property of the grantor as well as property or the proceeds of the sale of property acquired subsequently by the grantor and that was subject to that charge when he or she was appointed-

  (a) First, to reimburse the receiver for his or her expenses and remuneration, to the extent that full reimbursement cannot be made out of other assets forming part of the property in receivership; and

  (b) Secondly, to pay preferential claims to the extent and in the order of priority specified in the Seventh Schedule to the Companies Act 1990 (except clause 1 of that Schedule) to the extent that those claims cannot be paid out of other property in receivership-

  before paying any claim of the person entitled to the security."

What is immediately noticeable about the proposed preferential creditor regime is that while in liquidation only floating charges can be subordinated to preferential creditors, if the debtor is in receivership only any charge with an after-acquired property clause may be subordinated. For example:

Lender holds a typical debenture over "all the undertaking and all the property and assets of Debtor, whatsoever and wheresoever situate, both present and future" and the security is composed of a floating charge

\textsuperscript{204} And is not in liquidation as well (cl 158(1) of the Companies (Ancillary Provisions) Bill).

\textsuperscript{205} Defined both in the Companies Bill (cl 2(1)) and in the Companies (Ancillary Provisions) Bill (cl 118(2)) as including:

"... a right or interest in relation to property owned by a company, by virtue of which a creditor of the company is entitled to claim payment in priority to creditors entitled to be paid under section 276 of this Act".

87
over Debtor’s stock-in-trade and a fixed charge over the remainder of the property.

If Debtor encounters financial difficulties the extent to which Lender’s interest in the assets is subordinated to the preferential creditors will depend upon whether Lender chooses liquidation or receivership as the method to collect the debt owing to it.

If Debtor is put into liquidation cl 275 of the Companies Bill will apply. Unless Lender has surrendered its charge\(^{206}\) (which is unlikely assuming Lender is concerned about being repaid) the only assets of Debtor which may be used to pay the preferential debts are those subject to the floating charge- the trading stock in this example- and only to the extent that free assets are not available out of which to pay these debts\(^{207}\).

If however Debtor is not put into liquidation and Lender appoints a receiver instead then the same preferential debts can be paid out of all of Debtor’s charged assets \textit{except} those:

(a) subject only to a fixed charge with no after-acquired property clause\(^{208}\), and

(b) acquired by Debtor after receiver is appointed\(^{209}\).

Since the fixed charge component of a debenture will typically extend to after-acquired property as well it appears that the preference creditors can be paid out of substantially the whole of Debtor’s assets\(^{210}\).

On such an analysis it is clearly more desirable for Lender to have a liquidator appointed than to appoint a receiver or enter into possession itself.

\(^{206}\text{Pursuant to cl 268 of the Companies Bill.}\)

\(^{207}\text{In practice unencumbered assets are likely to be scarce since debentures will typically collateralise the whole of the debtor’s property and assets.}\)

\(^{208}\text{Clause 158(2) of the Companies (Ancillary Provisions) Bill.}\)

\(^{209}\text{Clause 158(2) of the Companies (Ancillary Provisions) Bill.}\)

\(^{210}\text{Some of Debtor’s property will also be subject to specific fixed charges and mortgages evidenced by other documents (for example the land). This property will not be open to subordination to preferential creditors as it will not meet the cl 58(2) requirements of an after-acquired property charge.}\)
3. Areas of Concern.

The limitation of cl 9(b) of the Seventh Schedule of the Companies Bill to “floating charges” is troublesome in two respects.

1. The retention of this terminology is inconsistent with the scheme of the PPSA which abandons the floating charge in favour of an immediately attaching floating security interest. Lenders continuing to use floating charge terminology in their debentures will subject themselves to cl 275 of the Companies Bill while those lenders employing the floating security interest contemplated by the PPSA will avoid the preferential creditors rules in liquidation.

2. There is clearly a huge discrepancy between the types of assets subject to the preferential debts in liquidation and those subject to the same debts in receivership. There is no legal or economic justification for this. It is submitted that cl 9(b) of the Seventh Schedule be amended to bring it into line with cl 158(2) of the Companies (Ancillary Provisions) Bill.

Is the scope of cl 158(2) of the Companies (Ancillary Provisions) Bill too broad? For example it covers equipment owned by the debtor at the date of the charge and that continues to be owned by the debtor until receivership merely because the same charge also purports to cover after-acquired property (which may never even be acquired by the debtor). The counterpart sections proposed in the report of the Advisory Committee on Personal Property Securities provided that preferential debts could only be paid out of:

"collateral in the form of proceeds or after-acquired property\(^{211}\)."

In these cases it would be a question of determining whether the relevant asset was owned by the debtor at the date of the charge. If it was then it could not be used to discharge preferential debts. On the other hand under the Companies Bill and Companies (Ancillary Provisions) Bill property owned by the debtor at the date of the charge will be used to pay preferential debts if the charge also purported to cover after-acquired

\(^{211}\)Above, n 3, 77.
property. The solution for lenders however is simply, by separate security agreements, to take security interest in the present property of the debtor and then the after-acquired property of the debtor.

Nevertheless it may be argued that the scope of the preferential payment rules under the companies reform package is still too wide.

As typical fixed charges in current debentures will do.
IV CONCLUSION.

This paper has examined the likely effect of the proposed PPSA on a certain type of debenture creditor. These effects will vary depending on the exact wording employed in the debenture and the steps taken by the creditors to perfect their interests in collateral. Consequences will also vary depending on the application of specific priority rules and the nature of the collateral in the hands of the debtor.

Specific areas to which debenture creditors must turn their attention, and which are explained above, include: unnecessary postponement of attachment, the equipment-financing/registration-by-serial-number rule, the voidable preference and preferential creditor rules, inadvertent subordination of security interests in proceeds and transferred collateral, future advance provisions in the debenture, and the purchase money security provisions.

There are both bonuses and pitfalls for debenture creditors in the PPSA. However while the pitfalls can be avoided by competent lenders the advantages of the regime will endure. On the whole the PPSA puts holders of floating security interests in a safer and more certain position than they currently enjoy.\textsuperscript{213}

A broader question, and one not addressed by this paper, is whether the PPSA ought to be adopted at all. The clear answer is "Yes". Present chattels security law in New Zealand is a "quagmire".\textsuperscript{214} The artificial distinctions upon which the regime is based result in a complex web of rules from which it is often hard to extract unifying principles. This uncertainty and inefficiency results in unnecessary costs in administrating the system and higher transaction costs for parties engaged in secured financing.

The more coherent and less expensive PPSA is also fairer. To take one example-bona fide purchasers from companies currently take subject to any registered security interest in the collateral\textsuperscript{215} whereas the same purchaser taking from an unincorporated

\textsuperscript{213}Given the erosion of the floating charge by unregistered retention of title agreements and the preferential creditor rules in the Companies Act.

\textsuperscript{214}SA Reisenfeld "The Quagmire of Chattels Security in New Zealand" (Legal Research Foundation, Auckland, 1970).

\textsuperscript{215}Except where the property transferred is a motor vehicle (see: Motor Vehicle Securities Act 1989).
trader will be protected by s 18(A)(2) of the Chattels Transfer Act. The PPSA protects buyers and lessees whether the disponor is a company or not\(^2\).  

In reviewing the state of Commonwealth law in this area RM Goode and LCB Gower stated:

"What the Commonwealth jurisdictions require is a rational system of personal property security regulation based on function rather than form, in which the law is tailored to modern commercial requirements instead of being a straight-jacket into which business transactions have to be moulded regardless of the resulting inconvenience and artificiality\(^2\)."

It is submitted that the PPSA proposed for New Zealand can meet these requirements and although some issues arising from the draft PPSA need to be addressed before its enactment\(^2\) there is no reason to think that this will not be done.

\(^{216}\)Section 24.

\(^{217}\)RM Goode and LCB Gower "Is Article 9 of the Uniform Commercial Code Exportable?: An English Reaction" in JS Zeigel and WS Foster Aspects of Comparative Commercial Law: sales, consumer credit, and secured transactions (Institute of Foreign and Comparative Law, Montreal, 1968) ch 22, 298 at 323.

\(^{218}\)For example: the absence of any remedy provisions in the Act, the exclusion of statutory charges and liens from the ambit of the Act (s 4(5)(a)), and the priority of unperfected security interests over judgement creditors, the Official Assignee, and company liquidators (ss 8 and 15). With regard to this last point the Advisory Committee to the Law Commission were of the opinion that only two classes of creditor could be misled by the failure of a secured party to register a financing statement: buyers and lessees (who are protected anyway by s 24) and creditors actually advancing money against (apparently) unencumbered assets of the debtor (in which case the lender can protect itself by registering a financing statement). Other affected parties such as unsecured trade creditors: "are generally either not concerned about the presence of outstanding interests or assume that such interests exist" (Above, n 3, 115).
BIBLIOGRAPHY

Books:

5. DW McLaughlan "Corporate Personal Property Secured Transactions-Chattels Transfer Act, Companies Act or Neither ?" (1978) NZLJ 137.
<table>
<thead>
<tr>
<th>Part</th>
<th>Title</th>
<th>Sections</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Short title and commencement</td>
<td>1-15</td>
</tr>
<tr>
<td>2</td>
<td>Definition</td>
<td>16-18</td>
</tr>
<tr>
<td>3</td>
<td>Interpretation and application</td>
<td>19-23</td>
</tr>
<tr>
<td>4</td>
<td>Validation of security agreements and rights of parties</td>
<td>24-35</td>
</tr>
<tr>
<td>5</td>
<td>Perfection and priorities</td>
<td>36-48</td>
</tr>
<tr>
<td>6</td>
<td>Registration</td>
<td>49-50</td>
</tr>
<tr>
<td>7</td>
<td>Miscellaneous</td>
<td>51-55</td>
</tr>
<tr>
<td>8</td>
<td>Repeals, transitional</td>
<td>56-57</td>
</tr>
</tbody>
</table>

**PART 1: INTERPRETATION AND APPLICATION**

- 1. Short title and commencement
- 2. Interpretation
- 3. Notice and knowledge
- 4. Meaning of security interest
- 5. Application of Act
- 6. Conflict of laws
- 7. Act to bind the Crown

**PART 2: VALIDITY OF SECURITY AGREEMENTS AND RIGHTS OF PARTIES**

- 8. Effectiveness of a security agreement
- 9. Writing requirements for security agreements
- 10. Attachment of security interests
- 11. Security interests in after-acquired property
- 12. Future advances
- 13. Second parties to supply information

**PART 3: PERFECTION AND PRIORITIES**

- 14. When security interests perfected
- 15. Subordination of certain security interests
- 16. Protection of auctioneers, etc.
- 17. Continuity of perfection
- 18. Perfection by possession of collateral
- 19. Perfection by registration
- 20. Temporary perfection where collateral delivered or available to the debtor
- 21. Perfection where goods in hands of bailee
- 22. Security interests in proceeds
- 23. Security interests in returned or repossessed goods
- 24. Protection of buyer or lessee of goods
- 25. Protection of transferees of negotiable and quasi-negotiable collateral
- 26. Priority of liens
- 27. Purchase money security interests
- 28. Residual priority rules
- 29. Security interests in fixtures
- 30. Security interests in crops
- 31. Security interests in accessions
- 32. Security interests in processed or commingled goods
- 33. Postponement of priority of security interests

**PART 4: REGISTRATION**

- 34. Appointment of Registrar
- 35. Register of Personal Property Securities
- 36. Power of Registrar to delegate
- 37. Registration of financing statements
- 38. Duration of, amendments to, and discharge of registrations

**PART 5: MISCELLANEOUS**

- 52. Entitlement to damages for breach of obligations
- 53. Regulations

**PART 6: REPEALS, TRANSITIONAL**

- 54. Enactments amended
- 55. Enactments repealed
- 56. Transition: applicable law
- 57. Transition: registrations

**SCHEDULES**

- 1. Fixtures remaining goods after being
- 2. Enactments amended
- 3. Enactments repealed
- 4. Regulations and Orders revoked
PERSONAL PROPERTY SECURITIES ACT (1)

(Enacting words)

An Act to reform the law relating to security interests in personal property and to repeal and replace the Chattels Transfer Act 1924, and Part IV of the Companies Act 1955, and Part II of the Industrial and Provident Societies Amendment Act 1952.

1 Short title and commencement
(1) This Act may be cited as the Personal Property Securities Act 1989.
(2) This Act comes into force on 1 January 1990.

PART I
INTERPRETATION AND APPLICATION

2 Interpretation
(1) In this Act unless the context otherwise requires
"accessions" means goods that are installed in or fixed to other goods;
"account receivable" means a monetary obligation not evidenced by chattel paper, or by a negotiable instrument or by a security, whether or not it has been earned by performance;
"cash proceeds" means proceeds in the form of money, cheques, drafts, and deposit accounts in deposit-taking institutions;
"chattel paper" means one or more writings that evidence both a monetary obligation and a security interest in, or a lease of, specific goods or specific goods and accessions;
"collateral" means personal property that is subject to a security interest;
"commercial consignment" means a transaction where
(a) a consignor delivers goods to a consignee for the purpose of sale, lease or other disposition on terms reserving an interest in the goods to the consignor; and
(b) both the consignor and the consignee deal in the ordinary course of business in goods of that description;
but does not include an agreement under which goods are delivered to an auctioneer for the purpose of sale;
"consumer goods" means goods that a debtor uses or acquires for use primarily for personal, family or household purposes;
"court" means a District Court;
"crops" means crops, whether matured or otherwise, and whether naturally grown or planted, attached to land by roots or forming part of trees or plants attached to land, but does not include trees;
"debtor" means
(a) a person who owes payment or performance of an obligation secured, whether or not that person owns or has other rights in the collateral; or
(b) a person who receives goods from another person under a commercial consignment; or
(c) a lessee under a lease for a term of more than one year; or
(d) a transferor of an account receivable or chattel paper; or
(e) in sections 9, 23, 27, 28(3), 28(6), 32 and 37, a transferee or successor to the interest of a person referred to in paragraphs (a) to (d);
and if the person referred to in paragraph (a) and the owner of the collateral are not the same person, includes
(f) an owner of the collateral, where the term debtor is used in a provision of this Act dealing with the collateral;
(a) the obligor, where the term debtor is used in a provision of this Act dealing with the obligation; and
(b) both the owner and the obligor, where the context so requires;
"document of title" means a writing issued by or addressed to a bailee relating to goods in the bailee's possession that are identified or are fungible portions of an identified mass, and in which it is stated that the goods identified in it will be delivered to a named person or the transferee of a named person or to bearer or to the order of a named person;
"equipment" means goods that a debtor holds otherwise than as inventory or as consumer goods;
“financing change statement” means a writing in prescribed form relating to a registered financing statement;

“financing statement” means a writing in prescribed form relating to a security interest or proposed security interest and required or permitted to be registered under this Act and, where the context requires, includes a financing change statement and a security agreement registered under any other Act before the date this Act comes into force;

“future advance” means the payment of money, the provision of credit or the giving of value secured by a security interest, occurring after the security agreement has been executed, whether or not given pursuant to a commitment, and advances and expenditures made for the protection, maintenance, preservation or repair of the collateral;

“goods” means tangible personal property other than
(a) chattel paper; or
(b) a document of title to goods; or
(c) a negotiable instrument; or
(d) a security; or
(c) money;

and includes crops and the unborn young of animals, but does not include trees until they are severed or petroleum or minerals until they are extracted;

“intangible” means personal property other than
(a) goods; or
(b) chattel paper; or
(c) a document of title to goods; or
(d) a negotiable instrument; or
(e) a security; or
(f) money;

“inventory” means goods that
(a) are held by a person for sale or lease, or that have been leased; or
(b) are to be furnished or have been furnished under a contract of service; or
(c) are raw materials or work in progress; or

(d) are materials used or consumed in a business;

“land” includes all estates and interests, whether freehold or chattel, in real property and a licence to occupy any real property;

[New; of NZ PLA]

“lease for a term of more than one year” means a lease or bailment of goods for more than one year and includes
(a) a lease for an indefinite term even though the lease is determinable by one or both of the parties not later than one year from the date of its execution; and
(b) a lease for a term of one year or less that is automatically renewable or that is renewable at the option of one of the parties or by agreement for one or more terms, the total of which may exceed one year; and
(c) a lease for a term of one year or less where the lessee retains uninterrupted or substantially uninterrupted possession of the goods leased for a period in excess of one year after the day the lessee first acquired possession of them, but the lease does not become a lease for a term of more than one year until the lessee’s possession extends for more than one year

but does not include
(d) a lease by a lessor who is not regularly engaged in the business of leasing; or
(e) a lease of household furnishings or appliances as part of a lease of land where the use of the goods is incidental to the use and enjoyment of the land; or
(f) a lease of prescribed goods, regardless of the length of the term;

“money” means currency authorised as a medium of exchange by the law of New Zealand or of any other country;

“negotiable instrument” means
(a) a bill of exchange, note or cheque within the meaning of the Bills of Exchange Act 1908; or
(b) any other writing that evidences a right to payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment; or
(c) a letter of credit if the letter of credit states on it that it must be presented on claiming payment;
but does not include chattel paper, a document of title to goods or a security;

[cf “instrument” in BC PPSB]

“non-cash proceeds” means proceeds that are not cash proceeds;
“non-purchase money security interest” means a security interest which is not a purchase money security interest;
“other goods” means goods in which an accession is installed or to which it is fixed;
“prescribed” means prescribed by regulations made under this Act;
[New]

“prior law” means the law in force immediately before the coming into force of this Act;
“prior security interest” means a security interest created or provided for by a security agreement or other transaction that
(a) was made or entered into before this Act comes into force; and
(b) has not been terminated before this Act comes into force;
but does not include any such a security interest which is renewed, extended or consolidated by a security agreement or other transaction made or entered into after this Act comes into force.
[cf BC PPSB s 76]

“proceeds” means identifiable or traceable personal property in any form derived directly or indirectly from any dealing with the collateral or proceeds of the collateral, and includes
(a) a right to an insurance payment or any other payment as indemnity or compensation for loss or damage to the collateral or proceeds, and
(b) a payment made in total or partial discharge or redemption of an intangible, a negotiable instrument, a security or chattel paper;

“purchase” means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, issue, reissue, gift or any other consensual transaction creating an interest in property;
“purchase money security interest” means
(a) a security interest taken in collateral to the extent that it secures payment of all or part of the purchase price of the collateral; or
(b) a security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire the rights; or
(c) the interest of a lessor of goods under a lease for a term of more than one year; or
(d) the interest of a person who delivers goods to another person under a commercial consignment;

but does not include a transaction of sale by and lease back to the seller, and, for the purposes of this definition, “purchase price” and “value” include credit charges or interest payable for the purchase or loan credit;

“register” means the Register of Personal Property Securities set up under section 35;

“Registrar” means the Registrar of Personal Property Securities appointed under section 34, and includes any person to whom all or any of the Registrar’s functions, duties or powers have been delegated under section 36;

“registry” means the registry established under section 35 for the purpose of keeping the register;

“secured party” means a person who holds a security interest for the person’s own benefit or for the benefit of any other person and includes a trustee where the holders of obligations issued, guaranteed or provided for under a security agreement are represented by a trustee as the holder of the security interest;

“security” means
(a) a share, stock, warrant, bond, debenture or similar document
(i) that is in a form recognised in the place in which it is issued or dealt with as evidence of a share, participation or other interest in property or an enterprise; or
(ii) that is evidence of an obligation of the issuer and that in the ordinary course of business is transferred by delivery together with any necessary endorsement, assignment, or registration in the records of the issuer or agent for the issuer, or compliance with any conditions restricting transfer; and

(b) an uncertificated security.

[cf BC PPSB]
"security agreement" means an agreement that创创 creates or provides for a security interest, and, if the context permits, includes a writing that evidences a security agreement;

"security interest" has the meaning assigned to it by section 4 of this Act;

"security trust deed" means a deed or other document by the terms of which a person issues or guarantees or provides for the issue or guarantee of obligations secured by a security interest, and in which another person is appointed as trustee for the holders of the obligations;

[cf "trust indenture", BC PPSB]

"specific goods" means goods identified at the time an agreement in respect of those goods is made;

"the whole" means an accession together with the goods in which the accession is installed or to which it is fixed;

"uncertificated security" means a security which is not evidenced by a security certificate, and the issue and any transfer of which is registered or recorded in records maintained for that purpose by or on behalf of the issuer.

[cf Ont Bus Corp Act, s 53(1)(aa)]

"value" means any consideration sufficient to support a simple contract, and includes an antecedent debt or liability;

"working day" means any day of the week other than:
(a) Saturday, Sunday; or
(b) Good Friday, Easter Monday, Anzac Day, the Sovereign's Birthday, Labour Day, and Waitangi Day; or
(c) A day in the period 25 December—2 January.

[cf Credit Contracts Act 1981]

(2) For the purposes of this Act, fungible goods and fungible securities are goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit, and includes unlike units to the extent that they are treated as equivalents under a security agreement.

(3) For the purposes of this Act, a secured party does not have possession of collateral that is in the actual or apparent possession or control of the debtor or the debtor's agent.

(4) Unless otherwise provided in this Act, the determination whether goods are consumer goods, inventory or equipment for the purposes of a security interest is made as at the time when the security interest in the goods attaches.

(5) The fact that title to collateral may be in the secured party rather than the debtor does not affect the application of any provision of this Act relating to rights, obligations and remedies.

[cf UCC 9-202]

3 Notice and knowledge

(1) For the purposes of this Act

(a) a natural person "knows" or has "knowledge" of a fact in relation to a particular transaction when that person
   (i) has actual knowledge of the fact; or
   (ii) receives a notice stating the fact.

(b) an organisation knows or has knowledge of a fact in relation to a particular transaction when
   (i) the person within the organisation who is conducting the transaction has actual knowledge of the fact; or
   (ii) the organisation receives a notice stating the fact; or
   (iii) the fact is communicated to the organisation in such a way that it would have been brought to the attention of the person conducting the transaction if the organisation had exercised reasonable care.

(c) a person receives a notice, demand or other document permitted or required to be given or made under this Act when
   (i) it is delivered to that person or to the place of business through which the security agreement was made or to any other place held out by that person as the place for the receipt of such communications; or
   (ii) it is delivered to any address at which it may be left or to which it may be posted or is given to any person to whom it may be given under subsections (4)—(10).

(d) a demand, notice or other document is made or given to a person
   (i) by taking the steps reasonably required to inform the other person in the ordinary course, or
(ii) by delivering, leaving or posting it in accordance with subsections (4)–(10), whether or not the person acquires actual knowledge of it;

(2) For the purposes of subsection (1(b)

(a) “organisation” includes the Crown, a body corporate, a government department or other governmental agency, a local authority, an estate, trust, partnership or other association of two or more persons having a joint or common interest, or any other legal or commercial entity;

(b) an organisation exercises reasonable care if it takes the steps reasonably required to ensure that significant information is brought to the attention of the person within the organisation conducting a particular transaction, but nothing in this paragraph requires a person acting on behalf of the organisation to communicate information unless such communication is part of that person’s regular duties or unless the person has reason to know of the transaction and that the transaction would be materially affected by the information.

[cf US UCC, 1–201 (25)—(28)]

(3) For the purposes of this Act, registration of a financing statement is not constructive notice of knowledge of its existence or contents to third parties.

[cf BC PPSB s 47]

(4) Any demand, notice or other document required or authorised by this Act to be made or given to any person must be in writing, must, in the case of a demand made under section 13, contain an address for reply, and is sufficiently made or given if

(a) in the case of a secured party named in a financing statement or financing change statement, it is delivered to that person or is left at that person’s address as specified in the financing statement or financing change statement or is posted in a letter addressed to that person by name at that address, or

(b) in the case of any other person, it is delivered to that person or is left at that person’s usual or last known place of residence or business or at an address specified for that purpose in any document creating the security interest, or if it is posted in a letter addressed to that person by name at that place of residence or business or address.

(5) If the person is absent from New Zealand, the notice, demand or other document may be given to that person’s agent in New Zealand. If the person is deceased, it may be given to that person’s personal representative.

(6) If the person is absent from New Zealand and has no known agent in New Zealand, or is deceased and has no personal representative, or the identity or whereabouts of the person are not known, the demand, notice or other document may be made or given in such manner as is directed by an order of the court.

(7) If any such demand, notice or other document is posted to any person by registered letter it is deemed to have been delivered to that person on the fourth day after the day on which it was posted, and in proving the delivery it is sufficient to prove that the letter was properly addressed and posted.

(8) Notwithstanding anything in subsections (4), (5), (6) and (7), the court may in any case make an order directing the manner in which any demand, notice or other document is to be made or given, or dispensing with the making or giving thereof.

(9) Subsections (4)–(8) do not apply to notices or other documents given or served in any proceedings in any court.

(10) Subsections (4)–(8) do not apply to the giving of any notice where another procedure is specified in the security agreement for the giving of notices, and a notice given in accordance with that procedure is sufficiently given for the purposes of this Act.

[cf PLA, s 152(7)]

[cf MVSB, s 56]

(11) The provisions of section 37 concerning the effect of a defect, irregularity, omission or error in a financing statement or in the execution or registration of it apply, with any necessary modifications, to a defect, irregularity, omission or error in a notice, demand or other document required or authorised to be given or made to any person by this Act.

4 Meaning of security interest

(1) Subject to subsection (4), for the purposes of this Act the expression “security interest” means an interest in

(a) goods; or

(b) a document of title to goods; or
(c) a security; or
(d) chattel paper; or
(e) a negotiable instrument; or
(f) money; or
(g) an intangible; created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to the form of the transaction and without regard to the identity of the person who has title to the collateral.

(2) For the purposes of this Act, the reservation of title by a secured party or a seller of goods notwithstanding shipment or delivery is limited in effect to the reservation of a security interest.

[cf UCC 1–201(37)]

(3) Without limiting the generality of subsections (1) and (2), the expression "security interest" includes
(a) a fixed charge; or
(b) a floating charge; or
(c) any interest created or provided for by
   (i) a chattel mortgage; or
   (ii) a conditional sale agreement (including an agreement to sell subject to retention of title); or
   (iii) a hire purchase agreement; or
   (iv) a pledge; or
   (v) a security trust deed; or
   (vi) a trust receipt; or
   (vii) an assignment; or
   (viii) a consignment; or
   (ix) a lease; or
   (x) a transfer of chattel paper;

which secures payment or performance of an obligation.

(4) The meaning of the expression "security interest" extends to include an interest created or provided for by

(a) a transfer of an account receivable or chattel paper; or
(b) a lease for a term of more than one year; or
(c) a commercial consignment;

even if the transfer, lease or consignment does not secure payment or performance of an obligation;

but does not extend to include the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or the equivalent to the order of the seller or to the order of an agent of the seller, unless the parties have otherwise evidenced an intention to create or provide for a security interest in the goods.

(5) For the purposes of this Act the expression "security interest" does not include
(a) a lien, charge or other interest created by any other Act or rule of law; or
(b) any interest created or provided for by any of the following transactions:
   (i) a transfer of an interest or claim in or under a contract of annuity or policy of insurance, except as provided by this Act with respect to proceeds and priorities in proceeds;
   (ii) a transfer of an unearned right to payment under a contract to a person who is to perform the transferor's obligations under the contract;
   (iii) the creation or transfer of an interest in land;
   (iv) an assignment of accounts receivable made solely to facilitate the collection of the accounts receivable on behalf of the person making the assignment;
   (v) an assignment for the general benefit of creditors of the person making the assignment;
   (vi) a transfer of present or future wages, salary, pay, commission or any other compensation for labour or personal services;
   (vii) a transfer of a right to damages in tort;
   (viii) a transfer or assignment or mortgage or assignment of a mortgage of any ship or vessel or any share of any ship or vessel if at the time of execution the ship or vessel is registered or required to be registered under the provisions of Part XII of the Shipping and Seamen Act 1952;
(ix) a transfer of a right to payment that arises in connection with an interest in land, including a transfer of rental payments payable under a lease of or licence to occupy land unless the right to payment is evidenced by a security;

(x) a sale of accounts receivable or chattel paper as part of a sale of a business out of which they arose unless the vendor remains in apparent control of the business after the sale;

whether or not the interest would otherwise be a security interest.

[cf BC PPSA ss 2, 4]

(6) The registration of a financing statement relating to any interest in personal property does not create a presumption that the interest is a security interest for the purposes of this Act.

5 Application of Act

This Act applies to

(a) every security interest created or provided for after the coming into force of this Act; and

(b) every security interest created or provided for before the coming into force of this Act if it has been renewed, extended or consolidated after the coming into force of this Act; and

(c) every prior security interest to the extent provided in sections 56 and 57.

6 Conflict of laws

(1) The validity, perfection and effect of perfection or non-perfection of a security interest is governed by the law of New Zealand if

(a) at the time when the security interest attaches

(i) the collateral is situated in New Zealand, or

(ii) the collateral is situated out of New Zealand but the secured party has knowledge that it is intended to remove the collateral to New Zealand, or

(b) the security agreement provides that New Zealand law is its proper law, or

(c) in any other case New Zealand law applies.

(2) An intangible is deemed to be situated at the debtor's place of business, or at the debtor's chief executive office if the debtor has more than one place of business, or at the debtor's principal residence if the debtor has no place of business.

[New]

(3) Where a security interest to which New Zealand law does not apply under subsection (1) has attached to collateral before the collateral is removed to New Zealand, the security interest is deemed to be perfected by registration under section 19 if the secured party has complied with the requirements for enforceability of the security interest against third parties in the jurisdiction where the security interest attaches.

7 Act to bind the Crown

This Act binds the Crown.

[cf MVSB s 3]
394 SECURITY AGREEMENT: FORM AND CONTENT Ch. 11

3. Will insure the Collateral against all hazards requested by Bank in form and amount satisfactory to Bank. If Debtor fails to obtain insurance, Bank shall have the right to obtain it at Debtor's expense. Debtor assigns to Bank all right to receive proceeds of insurance not exceeding the unpaid balance under the note, directs any insurer to pay all proceeds directly to Bank, and authorizes Bank to endorse any draft for the proceeds.

4. Will keep the Collateral in good condition and repair, reasonable wear and tear excepted, and will permit Bank and its agents to inspect the Collateral at any time.

5. Will pay as part of the debt hereby secured all amounts, including attorneys' fees, with interest thereon, paid by Bank (a) for taxes, levies, insurance, repairs to, or maintenance of the Collateral, and (b) in taking possession of, disposing of or preserving the Collateral after any default hereinafter described.

6. Will not permit any of the Collateral to be removed from the above-mentioned location without the prior written consent of the Bank.

7. Will immediately advise Bank in writing of any change in any of Debtor's places of business, or the opening of any new place of business.

8. Will not (a) permit any lien or security interests (other than Bank's security interest) to attach to any of the Collateral; (b) permit any of the Collateral to be levied upon under any legal process; (c) dispose of any of the Collateral without the prior written consent of Bank; (d) permit anything to be done that may impair the value of any of the Collateral or the security intended to be afforded by this agreement; or (e) permit the Collateral to become an accession to other goods.

9. Bank is hereby appointed Debtor's attorney-in-fact to do all acts and things which Bank may deem necessary to perfect and continue perfected the security interest created by this security agreement and to protect the Collateral.

Until default Debtor may retain possession of the Collateral and use it in any lawful manner not inconsistent with the agreements herein, or with the terms and conditions of any policy of insurance thereon.

Sec. 11-9

Comments

9. Upon default by Debtor in the performance of any covenant or agreement herein or in the discharge of any liability to Bank, or if any warranty should prove untrue, Bank shall have all of the rights and remedies of a secured party under the Uniform Commercial Code or other applicable law and all rights provided herein, in the notes mentioned above, or in any other applicable security or loan agreement, all of which rights and remedies shall, to the full extent permitted by law, be cumulative. Bank may require Debtor to assemble the Collateral and make it available to Bank at a place to be designated by Bank which is reasonably convenient to Bank and Debtor. Any notice of sale, disposition or other intended action by Bank, sent to Debtor at the address specified above, or such other address of Debtor as may from time to time be shown on Bank's records, at least five days prior to such action, shall constitute reasonable notice to Debtor. The waiver of any default hereunder shall not be a waiver of any subsequent default.

10. All rights of Bank hereunder shall inure to the benefit of its successors and assigns, and all obligations of Debtor shall bind its heirs, executors, administrators, successors and assigns. If there be more than one Debtor, their obligations hereunder shall be joint and several.

11. This agreement is executed on ___________.

12. 

By

[Debtor]

Title:
A Fine According to Library Regulations is charged on Overdue Books.
Abernethy, Andrew H

The effect of the Personal Property Securities Act on debenture