

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV2003-404-5577

BETWEEN GRANT ROBERT GRAHAM AND
BRENDON JAMES GIBSON
First Plaintiff

AND NDG PINE LIMITED (IN
RECEIVERSHIP)
Second Plaintiff

AND THE HONGKONG AND SHANGHAI
BANKING CORPORATION LIMITED
Third Plaintiff

AND PORTACOM NEW ZEALAND LIMITED
Defendant

Appearances: MJ Tingey for the Plaintiffs
PR Cogswell and GR Jaduram for the Defendant

Judgment: 17 March 2004

JUDGMENT OF RODNEY HANSEN J

Solicitors: Bell Gully, P O Box 4199, Auckland for the Plaintiffs
Hesketh Henry, Private Bag 92093, Auckland for the Defendant

Introduction

[1] The defendant (Portacom) leased portable buildings to the second plaintiff (NDG). The third plaintiff (HKSB), who held a debenture over NDG's assets, appointed the first plaintiffs as receivers and managers of NDG's assets. The receivers claim to have the right to sell the buildings. That is disputed by Portacom. As a result, the receivers seek directions, under s 34 of the Receivership Act 1993, whether they or Portacom have priority to the buildings and whether they have the power to sell them.

[2] The dispute raises for consideration (for the first time I am told by counsel) the operation of the Personal Property Securities Act 1999 (the Act). The debenture was registered under the Act but Portacom's interest in the buildings was not. The question is whether the debentureholder has priority as a result.

Further background

[3] The five buildings were delivered by Portacom to NDG between April 1998 and September 2002. It is accepted that at the material times all were leased on Portacom's standard terms and conditions of sale and hire, stated to be effective from 1 April 2002.

[4] Clause 9 of the lease provides that goods will be held at the customer's risk immediately on delivery and requires the customer to insure them. Clause 11 provides that the customer:

- Would not part with possession of the goods or sublet or sell or attempt to alienate them.
- Would be liable for any loss or damage to the goods.
- Would take proper care of the goods and maintain them in a good and clean condition.

- Not carry out any repairs without the express consent of Portacom.
- On request advise Portacom of the whereabouts of the goods.
- Give Portacom an irrevocable licence to enter its premises for the purpose of inspecting, repairing, testing or removing the goods.

[5] Clause 12 of the standard conditions dealt with the application of the Act. It provided:

“Notwithstanding clauses 10 and 11, the Customer acknowledges that:

- a) These terms create and/or provide for an interest or interests in favour of Portacom in Goods sold or hired to the Customer by Portacom which may be registrable under the Personal Properties Securities Act 1999 (“PPSA”) once the PPSA comes into force.
- b) The Customer undertakes to do such acts and provide such information as in Portacom’s opinion may be necessary or desirable to enable Portacom to perfect the interests created or provided for by these terms once the PPSA comes into force, as a first priority interest, or with such other priority as Portacom agrees in writing. The Customer shall act immediately when requested by Portacom and at the Customer’s own cost.
- c) To the fullest extent permitted by law, the Customer waives any rights it may have now or in the future to receive a copy of any verification statement or other confirmation related to the interests created or provided for by, or perfected in the manner contemplated by these terms.
- d) In particular the Customer acknowledges that Portacom takes a security interest in all such present and after-acquired goods.”

[6] The Act came into force on 1 May 2002. On 28 May 2002, HSBC registered its debenture which had been granted on 29 June 2000. Notwithstanding the terms of cl 12 of its conditions of hire, Portacom did not, however, register its interest and had not done so when, on 26 June 2003, NDG was placed in receivership.

Personal Property Securities Act and the issues in this case

[7] The Act has been described as one of the most significant pieces of commercial legislation enacted in New Zealand: Michael Gedye, *Fundamentals of*

the Personal Property Securities Act, Legal Research Foundation Seminar, (8-9 February 2000). It replaced what Mr Gedye went on to describe as a confusing hotchpotch of rules and regulations under common law and statute with a comprehensive system for registering security interest in chattels and other personal property. The Act itself helpfully contains a statement of what it is about. Section 4 provides:

"This Act mainly relates to—

- The enforceability of an interest in personal property created or provided for by a transaction that secures payment of money or performance of an obligation; the interest is called a security interest:
- How to determine the priority between security interests in the same personal property:
- How to determine the priority between a security interest and another type of interest (for example, the interest of a buyer of goods) in the same personal property."

[8] Fundamental to the operation of the Act is the concept of security interest. Section 17(1) defines a security interest as:

- "(1) In this Act, unless the context otherwise requires, the term security interest—
- (a) Means an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to—
 - (i) The form of the transaction; and
 - (ii) The identity of the person who has title to the collateral; and
 - (b) Includes an interest created or provided for by a transfer of an account receivable or chattel paper, a lease for a term of more than 1 year, and a commercial consignment (whether or not the transfer, lease, or consignment secures payment or performance of an obligation).
- (2) A person who is obligated under an account receivable may take a security interest in the account receivable under which that person is obligated.
- (3) Without limiting subsection (1), and to avoid doubt, this Act applies to a fixed charge, floating charge, chattel mortgage, conditional sale agreement (including an agreement to sell subject to retention of title), hire purchase agreement, pledge, security trust deed, trust

receipt, consignment, lease, an assignment, or a flawed asset arrangement, that secures payment or performance of an obligation.”

[9] It is to be noted that s 17(1)(b) provides that a security interest includes an interest created or provided for by a lease for a term of more than one year. A lease for more than one year (and the other interests referred to in s 17(1)(b)) are deemed security interests in that they are subject to the Act regardless of whether they secure payment or performance of an obligation. In contrast, a lease for a term of less than a year will create a security interest only if it in substance secures payment or performance of an obligation.

[10] Section 16 of the Act defines the term “lease for a term of more than 1 year” as follows:

- “(a) Means a lease or bailment of goods for a term of more than 1 year; and
- (b) Includes—
 - (i) A lease for an indefinite term, including a lease for an indefinite term that is determinable by 1 or both of the parties not later than 1 year after the date of its execution; and
 - (ii) A lease for a term of 1 year or less that is automatically renewable or that is renewable at the option of 1 of the parties for 1 or more terms, where the total of the terms, including the original term, may exceed 1 year; and
 - (iii) A lease for a term of 1 year or less where the lessee, with the consent of the lessor, retains uninterrupted or substantially uninterrupted possession of the leased goods for a period of more than 1 year after the day on which the lessee first acquired possession of them, but the lease does not become a lease for a term of more than 1 year until the lessee's possession extends for more than 1 year; but
- (c) Does not include—
 - (i) A lease by a lessor who is not regularly engaged in the business of leasing goods; or
 - (ii) 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
 - (iii) A lease of prescribed goods, regardless of the length of the lease term:

It is accepted that the arrangements between NDG and Portacom were leases for more than one year. In terms of s 16(b)(i), they were for an indefinite term. The buildings had, in any event, been in the uninterrupted possession of NDG for more than one year in terms of s 16(b)(iii). Portacom therefore had a security interest in the buildings.

[11] It is also accepted that the debenture granted by NDG to HKSB is a transaction which secures payment or performance of an obligation. It creates a security interest in any personal property which is charged by the debenture. Among the critical issues, to which I will return, are whether the leased buildings come within the charge and, if so, the nature of the interest secured.

[12] The second important concept in the Act of relevance to this case is that of perfection. It refers to the process by which the holder of a security interest obtains the optimal level of protection offered by the Act. Perfection can be achieved by registration (as in this case), by the secured party taking possession of the goods or by temporary perfection. Section 16 defines "perfection by registration" as:

"in relation to a security interest, means the security interest has attached and a financing statement has been registered in respect of the security interest."

[13] Two steps are therefore involved to achieve perfection by registration — attachment and registration. Attachment is governed by s 40 of the Act which relevantly provides:

"(1) A security interest attaches to collateral when—

- (a) Value is given by the secured party; and
- (b) The debtor has rights in the collateral; and
- (c) Except for the purpose of enforcing rights between the parties to the security agreement, the security agreement is enforceable against third parties within the meaning of section 36.

...

- (3) For the purposes of subsection (1)(b), a debtor has rights in goods that are leased to the debtor, consigned to the debtor, or sold to the debtor under a conditional sale agreement (including an agreement

to sell subject to retention of title) no later than when the debtor obtains possession of the goods.

- (4) To avoid doubt, 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 than the time specified in subsection (1)."

Registration of the financing statement on the register takes place under Part 10.

[14] It is not in issue that registration of HSBC's security interest took place in accordance with the Act. There is, however, a question as to whether attachment occurred in terms of s 40(1). It is accepted that value was given under subs (1)(a). It is also acknowledged that NDG had rights in the collateral under subs (1)(b). That is because under s 16 debtor includes a lessee under a lease for a term of more than one year and s 40(3) provides that a debtor has rights in goods it leases. As earlier mentioned, there is, however, a question as to the nature of NDG's interest in the collateral and Portacom further claims that the debenture is not enforceable against it as a third party as required by s 40(1)(c). That is another key question in this proceeding to which I will also return.

[15] Priority between security interests in the same property is determined under Part 7 of the Act. By s 66 a perfected security interest has priority over an unperfected security interest. Section 66 relevantly provides:

"Priority of security interests in same collateral when Act provides no other way of determining priority

If this Act provides no other way of determining priority between security interests in the same collateral,—

- (a) A perfected security interest has priority over an unperfected security interest in the same collateral:

Example

Person A's security interest in person B's car has been perfected by registering a financing statement.

Person C's security interest in person B's car has not been perfected.

Person A's perfected security interest in person B's car has priority over person C's unperfected security interest in person B's car."

[16] It is common ground that Portacom's security interest in the buildings had not been perfected by registration by the time receivers were appointed. HSBC's security interest will therefore have priority in terms of s 66. The receivers will have the right to sell the buildings, provided they can show that HSBC has a perfected security interest in them. Two issues arise:

- a) Whether the debenture created a security interest in the buildings;
- b) Whether the security interest attached to the buildings.

NDG's interest in the buildings

[17] Before considering these issues, it is necessary to examine more closely the way the Act deals with leased goods. Mr Cogswell argued that as NDG had only a possessory interest in the buildings, it could not, by means of the debenture, confer on HKSB a right to sell. That is incorrect and the reasons why this is so need to be explained.

[18] A lessee of goods may, by virtue of its possessory interest, grant a security interest in the goods. Section 40(3) (quoted in para [13] above) provides that a debtor has rights in goods leased to the debtor. A security interest can therefore attach to the lessee's interest in the goods: see also the discussion at para [14] above.

[19] The consequences of this to the lessor will differ according to the term of the lease. In the case of a lease for a term of more than one year, a security interest is deemed to be created by s 17(1)(b) regardless of the identity of the person who has title to the collateral. As Gedye, Cuming and Wood, *Personal Property Securities in New Zealand* (2002) at para 40.3.1 put it, the lease is treated as a security agreement and the lessee is treated as the owner of the leased goods for registration and priority purposes. If the lessor fails to register its interests, it loses priority to a perfected security interest over the leased goods: see also paras [15] and [16] above.

[20] Canadian authority and scholarship confirm this analysis. The New Zealand Act was modelled on Canadian legislation and its counterpart in the United States,

Article 9 of the Uniform Commercial Code. For a comparison of the New Zealand Act and the comparative North American regimes, see Zeigel, *Canadian Perspectives on the New Zealand Chattels Securities Act* (2001) 7 NZBQ 118. For the purpose of this case, the Canadian authorities have direct application to the New Zealand Act.

[21] The leading case is *In re Giffen* (1998) 155 DLR (4th) 332. It concerned an automobile leased to Giffen. Under the applicable British Columbia Personal Properties Security Act, the lease was for a term of more than one year which, as in New Zealand, rendered the lessor's interest a security interest. The lessor had not perfected its interest when the lessee went bankrupt. The trustee in bankruptcy claimed to be entitled to the proceeds of sale under a provision of the British Columbia Act which provides that a security interest in collateral is not effective against the trustee in bankruptcy if the security interest is unperfected at the date of bankruptcy.

[22] The Supreme Court of Canada reversed the British Columbia Court of Appeal's finding that the trustee was not entitled to the car because it was not "property of the bankrupt" in terms of the British Columbia Insolvency Act. The Court began the critical part of its analysis by explaining why the personal property securities legislation requires a fresh approach to traditional ideas of property ownership. It said at para 26:

"The Court of Appeal did not recognize that the provincial legislature, in enacting the PPSA, has set aside the traditional concepts of the title and ownership to a certain extent. T.M. Buckwood and R.C.C. Cuming, in their article "*The Personal Property Security Act and the Bankruptcy and Insolvency Act, Two Solitudes or Complementary Systems?*" (1997), 12 Banking and Finance L. Rev. 467, at pp. 469-470 underline the fact that provincial legislatures, in enacting personal property security regimes, have redefined traditional concepts of rights in property:

Simply put, the property rights of persons subject to provincial legislation are what the legislature determines them to be. While a statutory definition of rights may incorporate common law concepts in whole or in part, it is open to the legislature to redefine or revise those concepts as may be required to meet the objectives of the legislation. This was done in the provincial PPSAs, which implement a new conceptual approach to the definition and assertion of rights in and to personal property falling within their scope. The priority and realisation provisions of the Acts revolve around the central statutory concept "security interest". *The rights of the*

parties to a transaction that creates a security interest are explicitly not dependent upon either the form of the transaction or upon traditional questions of title. Rather they are defined by the Act itself. [Emphasis added.]”

The Court went on to say at para 28:

“The Court of Appeal in the present appeal did not look past the traditional concepts of title and ownership. But this dispute cannot be resolved through the determination of who has title to the car because the dispute is one of priority to the car and not ownership in it.”

[23] The Court then analysed the British Columbia legislation, the relevant parts of which are not materially distinguishable from the New Zealand Act. It also provides that a lease for a term of more than a year is deemed to create a security interest (judgment paras [30]-[31]) and that a debtor has rights in goods leased to the debtor (judgment para [36]). The Court found that the definition of “property” for the purpose of the insolvency legislation was broad enough to include a leasehold interest (judgment para [34]). It concluded this part of its analysis by discussing the effect of s 12(2) of the British Columbia Act, the equivalent of s 40(3) of the New Zealand Act. It said at paras [36] and [37]:

“[36] I note that s. 12(2) of the PPSA also recognizes that a lessee obtains a proprietary interest in leased goods. Section 12(2) states explicitly that ‘a debtor has *rights in goods* leased to the debtor ... when he obtains possession of them in accordance with the lease’ (emphasis added). Thus, s. 12 operates to ‘deem or recognize that a lessee has a proprietary interest’ (Buckwold and Cuning, *supra*, at p. 471). The Saskatchewan Court of Appeal considered a provision similar to s. 12 of the British Columbia PPSA in *International Harvester [Credit Corp of Canada v Touche Ross Limited (1986) 30, D.L.R. (4th) 387]* and held that (at p. 206) [398]:

... a trustee in bankruptcy, upon whom there devolves a chattel in the possession of bankrupt under a commercial lease for a term exceeding a year, *succeeds to the contractual or ‘possessory’ interest of the bankrupt in that chattel, as well as the bankrupt’s statutory or ‘proprietary’ interest therein as conferred upon the debtor by s 12 of the Act* [Emphasis added.]

[37] From the perspective of both the PPSA and the BIA, the bankrupt, as lessee, can be described as having a proprietary interest in the car.”

[24] A different view of the effect of the personal property securities legislation of Alberta was taken by the Alberta Court of Appeal in *Sprung Instant Structures Limited v Caswan Environmental Services Inc* [1998] 6 WWR 535. In that case,

Sprung Instant Structures Limited (Sprung) had leased two portable tents to Caswan Environmental Services Inc (Caswan). The Royal Bank of Canada (the Bank) had advanced funds to Caswan under the terms of a general security agreement. The Bank had registered its rights under the security agreement. Caswan had not registered its financing statement within the period required to achieve a "super priority". Accordingly, the Bank had priority. At first instance (at [1997] 5 WWR 280), Forsyth J held that the general security agreement executed between the Bank and Sprung granted the Bank a security interest in the structures.

[25] The Court of Appeal, in a judgment of less than a page, held that the security agreement did not cover leased goods and went on to say:

"Even if the General Security Agreement somehow does cover the lessee's interest in the lease or somehow covers the leased goods, that lessee's interest is worthless and was terminated. That lessee's interest is not what the bank seeks here. The bank seeks the reversion."

[26] The Court of Appeal's judgment was given before that of the Supreme Court in *re Giffen*. An attempt to have the decision reconsidered following the delivery of the judgment in *re Giffen* was rejected on the grounds that the earlier decision was limited to interpretation of the security agreement and did not purport to decide the security issues that were before the Supreme Court: see *Royal Bank of Canada v Sprung Instant Structures Limited*, 2000 AR LEXIS 740; 266 AR 375; 228 WAC 375.

[27] The Court of Appeal's decision offers no answer to the reasoning at first instance or to the careful analysis of the underlying principles of the personal property securities legislation in *re Giffen*. The charging clause of the General Security Agreement granted a security interest "... in all of [the lessee's] present and after-acquired personal property ...". The judgment of the Court of Appeal does not attempt to answer the finding of Forsyth J, that if the words of the general charging provision are given their natural and ordinary meaning, it is clear that ownership of the personal property is not required before a security interest will attach: see *Sprung Instant Structures Limited v Caswan Environmental Services Limited* [1997] 5 WWR 280 at 290. Its comments on the nature of the lessee's interest in the leased

goods suggest no attempt to explore the fundamental changes made to established rights of ownership by the personal property securities legislation.

[28] The rights of a lessee in leased goods referred to in s 40(3) of the Act are not therefore confined to the lessee's possessory rights. As against the lessee's secured creditors, the lessee has rights of ownership in the goods sufficient to permit a secured creditor to acquire rights in priority to those of the lessor. The conceptual basis for this is explained in an article by Bridge, Macdonald, Simmonds and Walsh, *Formalism, Functionalism and Understanding the Law of Secured Transactions* (1999) 44 McGill L.J. 567 at 602-3. The authors reject the thesis that for the purpose of Article 9 of the United States Uniform Commercial Code and the Canadian legislation, a creditor's interest in collateral attaches only to the debtor's possessory rights. They go on to say:

"The internal logic of the Article 9 and PPSA priority regime is premised on a rejection of derivative title theory in favour of registration as the principal mechanism for ranking priority both among secured creditors and as between the secured creditor and the debtor's general creditors including the trustee in bankruptcy. To give effect to this intent, 'rights in the collateral' must be understood as requiring a mere bare right to possession or a power to convey a greater interest than has the debtor, a point confirmed in PPSA jurisprudence and expressly stated in some of the more recent PPSAs. On this interpretation, ostensible ownership – in the radical sense of bare possession or control of the collateral – has effectively replaced derivative title for the purposes of determining the scope of the secured debtor's estate at the priority level. Thus, by the very act of deeming a true lease to be a PPSA security interest, ownership in the leased assets is effectively vested in the lessee as against the lessee's secured creditors and trustee in bankruptcy."

This reasoning applies with equal force to the New Zealand Act, the provisions of which are not relevantly distinguishable from North American law.

First issue – whether the debenture creates a security interest in the building

[29] NDG has therefore both a possessory interest and a proprietary interest in the buildings. The latter arises by virtue of s 40(3) which confers on NDG rights in goods which it leases. It could as a result grant a security interest in the buildings themselves, not just its leasehold interest in them. This is referred to in *International Harvester* (supra, para [23]) as the statutory or proprietary interest conferred upon a

debtor and is to be distinguished from its contractual or possessory interest. The question is whether these interests come within the charge.

[30] Clause 3.1 of the debenture defines the extent of the charge in the following terms:

“Charge: As continuing security for compliance with the Secured Obligations, the Company charges in favour of the Debentureholder all its right, title and interest (present and future, legal and equitable) in, to, under or derived from the secured assets.”

“Secured assets” are defined in cl 1.1 as:

“all assets of the Company of whatever kind and wherever situated.”

By cl 3.2, a fixed charge is created in the following terms:

“Fixed Charge: The security created by this Debenture shall be a first ranking fixed charge over all Secured Assets consisting of all present and future:

...

(k) **General:** interests in personal property not referred to above that are not normally acquired for disposal in the ordinary course of the Company’s business; and

(l) **Incidental:** all agreements evidencing the Company’s title to, right to possession of or other right or interest in, to, under or derived from any of the Secured Assets described above.”

By cl 3.3, a floating charge is created over all secured assets other than those the subject of the fixed charge.

[31] In my opinion, both the leasehold and proprietary interests of NDG in the buildings are subject to the charge. I see no reason to exclude either interest from the definition of assets. The rights to possession and to grant a security interest in the buildings are valuable ones. They fall comfortably within the definition of an asset as:

“A tangible or intangible item having economic value to its owner which may be converted into money to the owner’s benefit. An asset is available

for the payment of the debts of an individual company, or of a deceased person.”

Butterworth’s New Zealand Law Dictionary (5th ed, 2001)

[32] I agree with Mr Tingey that cl 3.2 of the debenture supports the inclusion of all rights arising under the lease of the buildings in the definition of assets. Subparagraph (k) of cl 3.2 has particular application. It specifies interests in personal property that are not normally required for disposal in the ordinary course of the Company’s business. Clause 3.1, constituting the entire charge, should be construed consistently with and no more narrowly than, cl 3.2.

[33] In terms of cl 3.1, NDG has “rights” of both a possessory and proprietary kind in the buildings. Alternatively, as Mr Tingey suggested, its proprietary rights may be characterised as having been “derived” from its leasehold interest. On either basis, NDG’s interests in the buildings come within the charge.

Second issue – whether the security interest attached to the buildings

[34] For Portacom, Mr Cogswell submitted that the debenture is not enforceable against Portacom in respect of the buildings because it does not satisfy the statutory requirements for enforceability set out in s 36 of the Act. These requirements must be met before the security interest can attach: see s 40(1)(c) quoted at para [13] above.

[35] Section 36 provides as follows:

- “(1) A security agreement is enforceable against a third party in respect of particular collateral only if—
- (a) The collateral is in the possession of the secured party; or
 - (b) The debtor has signed, or has assented to by letter, telegram, cable, telex message, facsimile, electronic mail, or other similar means of communication, a security agreement that contains—
 - (i) An adequate description of the collateral by item or kind that enables the collateral to be identified; or

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

To avoid doubt, a security agreement may be enforceable against a third party in respect of particular collateral even though the security agreement is not enforceable against a third party in respect of other collateral to which the security agreement relates.”

[36] Section 36(1)(a) is not applicable; the buildings were never in the possession of HKSB. The submission for Portacom is that the requirements of s 36(1)(b) are not satisfied because, in terms of subpara (ii), the debenture does not contain a statement that a security interest is taken in all of the debtor's present and after-acquired property.

[37] In my view, this submission cannot be sustained. The charge is over NDG's right, title and interests, present and future, in all its assets. That is clearly apt to cover all of NDG's present and after-acquired property including, as I have already found, the possessory and proprietary interests of NDG in the buildings.

Conclusion

[38] The debenture created a security interest in the buildings which was perfected on registration. It has priority over Portacom's security interest. The receivers therefore have power to sell the buildings and I make a direction accordingly.

[39] The receivers are entitled to costs on a Category 2 Band B basis.

Delivered at 3.25 p.m. on 17 March 2004.