Who is winning the race?

The Status of Unperfected Security Interests in Insolvency Proceedings

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Introduction

This dissertation seeks to determine the appropriate treatment of unperfected personal property security interests in insolvency proceedings. Publication of security interests is a central feature of any personal property securities system. Publication is vital, serving to inform third parties that a debtor does not have unencumbered title to its assets. Failure to satisfy the publication requirement usually means a secured party’s rights in property will be vulnerable against perfected security interests, execution creditors, purchasers and lessees for value, and insolvency administrators. In New Zealand however, unperfected security interests are effective against liquidators and Official Assignees. Curiously, this position is a departure from all of the North American models upon which our Personal Property Securities Act 1999 (PPSA) is based. Further, this stance seems to diminish the role of notice-filing upon which traditional chattel securities systems placed great emphasis. This paper will critically assess this unique position occupied by New Zealand which has been thought of as the most controversial aspect of the PPSA.¹

This dissertation is broadly divided into two parts. Part I evaluates whether there is a call for legislative reform in New Zealand in its treatment of unperfected security interests in insolvency proceedings. Chapter I will explore the origins of public notice obligations and examine its relationship with property rights. An overview of the legislative development in this area will be provided along with a comparison of the current regime in New Zealand with the North American approach. Chapter II will outline the supporting rationales underlying the contrasting positions before concluding that none of the existing rationales can properly defend the positions they propose to. The discussion will demonstrate that the North American position can be justified by notions of information maximisation and market efficiency. These considerations are pivotal to chattel securities schemes. I will suggest there is a need for reform in New Zealand to adopt a rule which invalidates unperfected security interests in insolvency proceedings.

Part II looks at how the reform proposed in Part I can best be implemented in New Zealand. Chapter III begins the analysis by looking to the North American and Australian models for guidance. Recommendations for New Zealand are then made drawing from these international

¹ M Geyde The New Personal Property Securities Act (Institute of Chartered Accountants of New Zealand, Wellington, 2001) at 51.
experiences. The provisions proposed give primacy to key objectives of uniformity and certainty with a view to increase the value of secured credit and promote the expediency of the credit industry. This outcome is aligned with the vision held by the New Zealand reformers when they enacted the Personal Property Securities Act.
Part I: The Status of Unperfected Security Interests in Insolvency Proceedings

Chapter I: The Role of Notice-Filing in Secured Transactions

A. Overview

Property rights are inextricably linked to public notice obligations. Thus, notice-filing has long been seen as the centre pole which holds up the personal property securities system. Understanding this assertion is vital to determining the fate of unperfected security interests in insolvency proceedings. Therefore, this chapter will examine the role of notice-filing in the world of chattel securities.

Part B of this chapter will demonstrate that historically protection for third parties was the justification for public notice obligations. Part C will show that this was the policy underlying the early registration statutes in New Zealand. Specifically, Part C will focus on the implication of this for unperfected security interests. Part D will outline the current New Zealand regime for unperfected security interests in insolvency proceedings. A comparison will be made between the New Zealand approach and that of North America.

B. Signalling property rights in personal property

The efficacy of the credit industry relies on legal rules which govern information about property. In general, information about a debtor’s property is important to all creditors who propose to deal with the debtor. A prospective secured creditor is interested in the debtor’s property because he or she needs to be certain that his or her interest is in fact superior to that of other creditors. A prospective unsecured creditor is interested in the debtor’s property because he or she relies on sharing pari passu in the debtor’s residual property in the event of bankruptcy or liquidation. The availability of reliable information about the debtor’s property increases the efficiency of the credit market as it enables creditors to make informed lending decisions and negotiate terms appropriate for their prospective transactions. Legal rules governing the dissemination of such property rights in personal property are thus crucial to the functioning of the credit market.

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information should provide incentives to increase the amount of information available where cost is justified and ensure the reliability of that information.³

(i) Possession as signal

The legal system’s original method of providing information regarding ownership of property was to give primacy to possession.⁴ Since *Twyne’s Case*,⁵ possession was considered to be the best available source of information concerning “ownership” of physical forms of personal property. At common law, a debtor’s possession of personal property assured a prospective creditor that the debtor could give him an unencumbered interest in that property.⁶ At the same time, the assets available to a bankrupt’s creditors were not only those which he owned, but also chattels in his possession in such circumstances that he appeared to be their owner.⁷ Separation of ownership and possession was viewed as a source of mischief towards third parties and, for that reason, as fraudulent.⁸ By attaching property rights to possession, the system ensured that the information available to the market could be relied upon by creditors in their decision to extend credit. If any creditor should disrupt the informational efficiency in the market by taking a secret interest, their property rights would be extinguished. Possession achieves the publication objective of disseminating information to the market about property and eliminates the risk arising from ostensible ownership. That is, the risk that creditors might make credit decisions in reliance of the misleading appearance that the debtor has rights in property by virtue of physical possession. Possession was property. Or, perhaps more accurately, the signal sent by possession

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⁵ There, a Hampshire farmer named Pierce conveyed his sheep to his creditor Twyne to satisfy a pre-existing debt. Pierce, however, was allowed to remain in possession of his sheep, which gave the impression that the sheep were his own. When a sheriff tried to seize the sheep under a writ of execution on behalf of another creditor, Twyne resisted, claiming that the sheep were his. Edward Coke, then attorney general, brought a criminal action against Twyne in the Star Chamber. That court held that because the transfer to Twyne was secret it was fraudulent and therefore void. *Twyne’s Case*, 3 Coke Rep 80b, 76 Eng Rep 809 (KB 1601).
⁷ Known as the “reputed ownership clause”, which had been a feature of the English bankruptcy law since 1623. New Zealand bankruptcy law contained a reputed ownership clause until the Bankruptcy Act 1908, s61(c) was repealed and not replaced by the Insolvency Act 1967.
⁸ Baird and Jackson, above n 4, at 180.
was said to justify the conclusion that the possessor had “proprietary interest” in the thing possessed.\(^9\)

While a system in which possession is the sole source of information (and hence of rights) can provide certainty for market participants at a low direct cost, it has enormous indirect costs. A possession-based rule is commercially disruptive as it cannot accommodate dynamic uses of collateral. If true to form, the debtor could not possess or make use of property held by the secured creditor. As a result, the debtor is prevented from using collateralised property to generate income to repay the secured party. Further, the inability to transfer possession of certain intangible personal property limits the ability of the debtor to use them as collateral. This meant equipments of manufacturers, inventories of traders, future interests and intangible rights could not act as collaterals for loans.\(^{10}\) The possessory rule thus became a speed bump on the road to increasingly complex, disaggregated property rights.\(^{11}\) Consequently, the rule threatened to limit the value of assets and impair the growth of the economy.

(ii) Notice as signal

As the economy grew in depth, breadth and complexity, possessory based rules became neither useful nor appealing to those engaged in increasingly sophisticated mercantile transactions.\(^{12}\) Two competing policy considerations came into play: (i) the need to facilitate non-possessory secured lending; and (ii) the need to protect third parties.\(^{13}\) Given the need to balance these policy considerations, it is not surprising pressure developed to find an alternative way to convey information about interests in property. Most chattel security systems of the past 200 years have modified possession based rules to allow for the publication objective to be achieved by registration. The practice of registration allows creditors, in lieu of possession of collateral, to make a public filing that gives others notice of his interest. Registration systems enable interested parties to obtain relevant information by checking what is in the debtor’s possession and by referring to the filing system. A filing system places fewer restrictions on the use of

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\(^{10}\) Lipson, above n 9, at 16.

\(^{11}\) Lipson, above n 9, at 16.

\(^{12}\) Lipson, above n 9, at 16.

\(^{13}\) Anthony Duggan “A PPSA Registration Primer” [2011] 35 MelbULawRw 865 at 867.
collateral than does a possession-based rule, yet it still achieves the publication objective by providing useful information that allows creditors to avoid some of the uncertainty caused by the separation of possession and ownership.\textsuperscript{14}

The giving of notice, much like possession, serves the purpose of providing information to the market about interests in property. A non-possessor security interest, if not publicised, will have adverse consequences on third parties proposing to deal with the debtor. Such threat and uncertainty is incompatible with a functional and efficient credit market. Thus, publicity has long been seen as an important element of secured transactions. It follows that, without possession, a secured party must publicise his or her interest in order to assert rights in the property. Both public recording files and possession share one central feature: information about competing property interests is concrete and trustworthy. It is trustworthy because the information is conveyed by events – making filing or taking possession – that themselves determine legal rights.\textsuperscript{15} Preservation of this feature is vital to the integrity of any secured transactions system.

C. Legislative development in New Zealand

In New Zealand, prior to the adoption of an article 9 type regime, the law relating to security over personal property was artificially divided into two zones. This was a faithful adoption of the English system under which the Bills of Sale legislation and Companies Acts operated in parallel and governed separately securities in personal property created by individuals and companies.\textsuperscript{16}

The operative statutes in New Zealand were the Chattels Transfer Act 1924 and the Companies Act 1955. The need to provide information in order to protect third parties was clearly an important policy consideration underlying these early registration statutes. Not surprisingly, this meant that unpublicised interests were generally invalid.

(i) Chattels Transfer Act

The major piece of relevant legislation prior to the introduction of the PPSA in New Zealand was the Chattels Transfer Act, based on the Bills of Sale Act 1854. Section 18 of the Chattels

\textsuperscript{14} Baird and Jackson, above n 4, at 183.
\textsuperscript{15} Baird and Jackson, above n 4, at 183.
\textsuperscript{16} SA Riesenfeld \textit{The Quagmire of Chattels Security in New Zealand} (Legal Research Foundation School of Law, Auckland, 1970) at 1.
Transfer Act, following the Bills of Sale Act,\textsuperscript{17} rendered an instrument void against the Official Assignee insofar as it related to goods which at the time of the bankruptcy remained in the possession (and apparent possession) of the person giving the instrument, unless the instrument was registered within 21 days of its creation. The policy of the Bills of Sale Act was to protect general creditors. This was made explicit in the preamble:\textsuperscript{18}

Where frauds are frequently committed upon creditors by secret Bills of Sale of personal chattels, whereby persons are enabled to keep up the appearance of being in good circumstances and possessed of property and the Grantees or Holders of such Bills of Sale have the Power of taking possession of the Property of such Persons to the Exclusion of the rest of their creditors...

The purpose of the registration requirement under the Chattels Transfer Act\textsuperscript{19} was thus clearly to protect general creditors who may have extended credit under a false impression of the debtor’s prosperity. This provision remained effective until the system was replaced by the PPSA.

(ii) Companies Act

Prior to the enactment of a PPSA in New Zealand, the Companies Act 1955 governed the sphere of registrable company charges.\textsuperscript{20} Under the 1955 Act, failure to register within 21 days after the execution of the instrument creating a charge resulted in invalidity of the security against third parties, which included the liquidator of the company.\textsuperscript{21} This was initially copied from the Companies Act 1900.\textsuperscript{22} The requirement to register with the Registrar of Companies details of certain charges created by a company was first introduced in 1900 following the recommendations of the Davey Committee on Company Law Amendments.\textsuperscript{23} Protection for

\textsuperscript{17} Bills of Sale Act 1854 (UK), s1. This provision was initially adopted in the Bills of Sale statute 1856 (NZ).
\textsuperscript{18} Bills of Sale Act 1854 (UK), preamble.
\textsuperscript{19} Chattels Transfer Act 1924, s18.
\textsuperscript{20} Companies Act 1955, Part IV Registration of Charges.
\textsuperscript{21} Companies Act 1955, s103(2). First adopted in s130(1) of the Companies Act 1903 and remained in this form through successive Companies Acts: Companies Act 1908 (8 Edw 7 No 26), s26; Companies Act 1933 (24 Geo 5 No 29), ss. 89 (2) and (11), and 90 (2); Companies Act 1955 (4 Eliz 2 No 63, ss102 (2) and (11).
\textsuperscript{22} Companies Act 1900 (UK), s14.
\textsuperscript{23} Great Britain. Board of Trade. Committee on Company Law Amendment Report of the departmental committee appointed by the Board of Trade to inquire what amendments are necessary in the acts relating to joint stock companies incorporated with limited liability under the Companies acts, 1862 to
general creditors was the principal motive behind the requirement of notice. This policy was evident in the prefatory comments to the Companies Bill 1900 when it was introduced in the House of Commons by the President of the Board of Trade, Mr. Ritchie. He said, *a propos* the registration provision:

*Another evil which at present exists is that when it comes to the winding up of some companies it is found that the whole of the available assets of the company are mortgaged, and there is nothing at all to divide amongst the unhappy creditors. The only remedy which can be applied to this particular evil is to take care that publicity is given to any mortgages which exist. It is therefore provided that any mortgages shall be registered with the Registrar of Joint Stock Companies and be open to public inspection, and that any mortgages not so registered shall be invalid.*

This policy enjoyed overwhelming judicial support in the 20th century. The judiciary readily acceded to the idea that the register serves an important public function providing information to those who propose to deal with the company. In *Re Yolland Husson and Birkett Ltd.*, Cozens-Hardy M.R. noted that the purpose of the Act of Parliament, in requiring registration of securities on the company’s property is “for the protection of the general creditors of the company or of persons desiring to trade with the company”. Section 103 Companies Act 1955 remained effective until it was repealed by the introduction of the PPSA in New Zealand.

(iii)  **Showing a way forward – Motor Vehicle Securities Act 1989**

Prior to 1999, a third piece of legislation which concurrently governed the area of security interests in personal property with the Companies Act and the Chattels Transfer Act was the Motor Vehicle Securities Act. The 1989 Act was a pragmatic attempt by Parliament to address the public concern about unwary purchasers having cars repossessed by sellers’ finance

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24 (1900) 84 GBPD HC 1143.


26 *Re Yolland*, above n 25, at 156.
companies.\textsuperscript{27} The 1989 Act dealt with only security interests in motor vehicles and carried with it a heavy consumer protection undertone.\textsuperscript{28}

The 1989 Act introduced many features into the area of motor vehicle securities law that did not exist in the Companies Act or the Chattels Transfer Act.\textsuperscript{29} The most relevant feature for present purposes was the absence of any sanction for non-registration in the event of insolvency or intervention by creditor representatives. This created two curious results. First, while the validity of an unregistered security interest in a motor vehicle would be undisturbed in the debtor’s insolvency, the same security interest would be void if the subject matter was instead, say, a boat.\textsuperscript{30} A further anomaly arose in situations in relation to motor vehicle securities involving a company debtor. An unregistered mortgage or charge granted by a company in respect of a motor vehicle was void against the liquidator regardless of whether it was registered under the Motor Vehicle Securities Act.\textsuperscript{31} This meant, whilst an unregistered company charge of a motor vehicle was void on insolvency of the debtor, precisely the same security was unaffected when the debtor happened to be a firm or private individual. No justification was provided by the reformers for departing from the position of the two major pieces of chattel securities legislations. This confusing duplication compounded the “complexity and irrationality”\textsuperscript{32} of the law of chattel securities in New Zealand.

D. Current regime – Personal Property Securities Act

The chattel securities system in New Zealand underwent its most significant reform in 1999 with the introduction of the Personal Property Securities Act 1999.\textsuperscript{33} The law commission held the view that there should be a new law for security interests to replace the multitude of different rules which concurrently operated at the time. A uniform set of rules, it was thought, would enhance efficiency of the credit industry by bringing more clarity, certainty and predictability

\begin{flushleft}
\textsuperscript{28} See generally, J Garrow and R Fenton Law of Personal Property in New Zealand (6\textsuperscript{th} ed, Butterworths, Wellington, 1998), ch 8.  
\textsuperscript{29} For a detailed discussion see David McLauchlan “Motor vehicle securities: the quagmire deepens” [1989] NZLJ 211.  
\textsuperscript{30} McLauchlan, above n 29, at 213.  
\textsuperscript{31} Companies Act 1955, s103.  
\textsuperscript{32} McLauchlan, above n 29, at 211.  
\textsuperscript{33} Personal Property Securities Act 1999 came into force 1 May 2002.
\end{flushleft}
into the system.\textsuperscript{34} The reformers strongly believed that the best models for personal property security law reform in New Zealand were provided by Article 9 of the Uniform Commercial Code (UCC) and the legislative regimes based on Article 9 that had been adopted in most Canadian\textsuperscript{35} provincial jurisdictions.\textsuperscript{36}

Among other things, the reformers had to decide the fate of unregistered security interests in the event of bankruptcy and liquidation. The British Columbia legislation, which closely followed the United States enactments in this regard, renders the unperfected security interest ineffective against the liquidator and trustees in bankruptcy.\textsuperscript{37} In New Zealand the same result had followed directly from s 18 of the Chattels Transfer Act 1924 and s 103(2) of the Companies Act.

The Law Commission’s Advisory Committee was divided on whether failure to perfect by registration should invalidate a security interest against liquidators and Official Assignees.\textsuperscript{38} Existing law was far from consistent in its treatment of security interests in respect of which a creditor has not taken the step necessary to provide perfection. Failure to register rendered a chattel mortgage or a charge unenforceable against a wide range of third parties.\textsuperscript{39} However, other types of security arrangements particularly those based upon title, such as hire purchase and title retention devices were effective against third parties without registration and despite the debtor being in possession. The Motor Vehicle Securities Bill, then before parliament, also did not invalidate an unregistered security interest in the event of bankruptcy and liquidation.\textsuperscript{40} The Commission decided that unperfected security interests should remain enforceable against third

\begin{itemize}
\item \textsuperscript{34} (8 December 1998) 574 NZPD 14424.
\item \textsuperscript{35} The nine provinces are: Ontario (RSO 1990, cP-10); Manitoba (SM 1993, c14); Saskatchewan (SS 1993, cP-6.2); Yukon Territory (RSY 1986, c130); Alberta (SA 1988, cP-4.05); British Columbia (RSBC 1996, c359); New Brunswick (SNB 1993, cP-7.1); Nova Scotia (SNS 1995-96, c13); Prince Edward Island (SPEI 1997, c33); and Newfoundland (SN 1998, cP-7.1).
\item \textsuperscript{36} Law Commission \textit{A Personal Property Securities Act for New Zealand} (NZLC R8, 1989) at 8.
\item \textsuperscript{37} Personal Property Security Act, RSBC 1996, c359, s20(b); Uniform Commercial Code § 9-301(1)(b), (3).
\item \textsuperscript{38} Brown, above n 27, at 338.
\item \textsuperscript{39} See Law Commission, above n 36, at 114; see also Chattels Transfer Act 1924, s18 and Companies Act 1955, s103.
\item \textsuperscript{40} Law Commission, above n 36, at 12: The draft [Personal Property Securities] Bill proceeds on the assumption that the adoption of a Personal Property Securities Act in New Zealand would render the Motor Vehicle Securities Bill unnecessary, and that this legislation would therefore not proceed or, if passed, be repealed.
\end{itemize}
parties. Thus, the provisions of the Chattels Transfer Act\(^{41}\) and Companies Act\(^{42}\) which rendered unregistered charges void against a liquidator or Official Assignee were not adopted into the PPSA.\(^{43}\) The policy considerations the Commission provided for choosing this position will be considered in detail below in Chapter II.

E. A comparison

It is perhaps helpful at the outset to illustrate the practical implications of New Zealand’s departure from the North American model. The analysis below is a comparison of the two approaches using facts from the leading Canadian case on this point.

(i) \textit{Re Giffen}\(^{44}\)

The leading case on this point in Canada is \textit{Re Giffen}. It concerned a motor vehicle leased to Giffen. Under the applicable British Columbia Personal Property Securities Act,\(^{45}\) the lease was for a term of more than one year which, as in New Zealand, rendered the lessor’s interest a security interest.\(^{46}\) The lessor had not perfected its interest when the lessee went into bankruptcy. The trustee in bankruptcy claimed to be entitled to the proceeds of sale under s 20(b)(i) 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.\(^{47}\) Iacobucci J held that s 20(b)(i) represents a policy choice of the provincial legislature that “an unsecured creditor’s position, as represented by the trustee, is more meritorious than the unperfected security interest of a secured creditor.” Accordingly, the trustee prevailed over the lessor. The court concluded that the trustee “succeeds to the contractual or ‘possessor’ interest

\(^{41}\) Chattels Transfer Act 1924, s18.  
\(^{42}\) Companies Act 1955, s103.  
\(^{43}\) Law Commission, above n 36, at 115.  
\(^{44}\) \textit{Re Giffen} [1998] SCR 91.  
\(^{45}\) Personal Property Securities Act, RSBC 1996, c 359.  
\(^{46}\) Personal Property Security Act, SBC 1989, c36, s3 provides that the Act applies to a lease for a term of more than one year even though the lease does not secure payment or performance of an obligation. Similarly Personal Property Securities Act 1999, s17(1)(b) provides that security interest includes an interest created or provided for by a lease for a term of more than 1 year whether or not the lease secures payment or performance of an obligation.  
\(^{47}\) Personal Property Security Act, SBC 1989, c36, s20(b)(i); see also corresponding provisions in all other Canadian Provincial PPSAs: (NWT, Nu, O, PEI) s20(1); M s20(b); (NZ, S) s20(2); A s20(a); NL s21(2); NS s21(2); Y s19(1); Aus PPSA s.267; Uniform Commercial Code § 9-301
of the bankrupt in that chattel, as well as the bankrupt’s statutory or ‘proprietary’ interest therein as conferred upon the debtor by s12 of the Act”. The intricacies of the Supreme Court’s property analysis will be discussed in depth below in Chapter III. For present purposes, what is relevant is the outcome that the lessor was relegated to the status of an unsecured creditor. This meant the lessor shared equally with Giffen’s general creditors in the proceeds from the sale of the motor vehicle which it had leased to Giffen.

(ii) A New Zealand Giffen

The PPSA does not include within it a rule that invalidates an unperfected security interest against the debtor’s liquidator or trustee in bankruptcy. The omission of this rule was deliberate and the Law Commission’s rationale will be discussed in detail in Chapter II. The implication of such omission is that unperfected security interests prevail over liquidators and Official Assignees and thus remain effective in the debtor’s insolvency. As such, in New Zealand, the lessor in Re Giffen would still have a valid security interest in bankruptcy that is enforceable against third parties so long as the requirements of s 36 are complied with. The lessor would be entitled to the full value of the leased goods in the absence of claims asserted by perfected secured parties.

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48 Re Giffen, above n 44, at [36]; Personal Property Security Act, SBC 1989, c36, s12(2) is the equivalent of Personal Property Securities Act 1999, s40(3)
Chapter II: Policy Considerations behind the Fate of Unperfected Security Interests

A. Overview

This chapter will critically assess whether reform is needed in New Zealand in relation to treatment of unperfected security interests in insolvency proceedings. Parts B and C will evaluate the strengths of the underlying rationales supporting the contrasting positions before concluding that the existing rationales are largely unsatisfactory and cannot properly defend the positions they claim to support. Part D will then demonstrate the invalidation of unperfected security interests in insolvency proceedings is defensible in terms of information maximisation and efficiency. The discussion cautions against losing sight of these considerations as they are integral to any registration systems. This chapter concludes with the recommendation that reform should take place in New Zealand to invalidate unperfected security interests in insolvency proceedings so that creditors with unperfected security interests should be given no preference over unsecured creditors.

B. New Zealand rationale

The New Zealand reformers elected to omit from the PPSA a provision equivalent to the North American provisions which invalidate unperfected security interests in bankruptcy and liquidation. The decision was made on the basis that the policy underlying the North American provisions was not sound. The starting point for the reformers was that the North American reforms were based on a policy against secret liens.\textsuperscript{49} It was thought that a policy against secret liens is only appropriate if it is seriously believed that without it prospective creditors in making their decisions to grant credit will be deceived.\textsuperscript{50} The reformers did not believe such deception was an issue.

\textsuperscript{49} DF Dugdale “The Proposed PPSA” [1998] NZLJ 383 at 383 cited paragraph 9 of the Official Comment on Art 9-301 of the Uniform Commercial Code:

The rule for the subordination of unperfected security interests have a purpose – in common with similar rules in all filing and recording systems – to impose sanctions for not adhering to filing or registering requirements. Such rules are necessary to make the system effective and enforce the policy against secret liens.

\textsuperscript{50} Dugdale, above n 49, at 384; see also discussion on the problem of ostensible ownership in Part B, Chapter I.
The position against mandatory registration, which prevailed, was based on the belief that prospective creditors are not prejudiced by non-registration of security interest. This belief contradicts the rationale which justifies the existence of registration systems.\(^{51}\) The Commission concluded that prospective secured creditors are already protected by the scheme as s 66 of the Act enables them to protect themselves by registering a financing statement to establish their priority over unregistered interests.\(^{52}\) In relation to prospective unsecured creditors, the Committee held the view that they are similarly unaffected by unregistered interests as “creditors who supply goods or funds on an unsecured basis are generally either not concerned about the presence of outstanding interests, or assume that such interests exist”\(^{53}\). Further, it was thought that such creditors should not rely on the register as it cannot provide any meaningful information to them. It is important to distinguish the two separate claims in respect to unsecured creditors. The initial claim is about usage of the register, while the latter is about usefulness of the register.

The latter claim is essentially that an unsecured creditor should not use the register as he cannot rely on a search of the register that discloses no encumbrances on the debtor’s property.\(^{54}\) The assertion is that PPSA registration has a number of features that make it an unreliable source of information about the state of encumbrance of the debtor’s assets. Firstly, the PPSA allows a secured party to register subsequent to the security agreement. In such cases, the secured party has the benefit of perfection in relation to competing interests that arise after the date of perfection. This means that even if a security interest is unperfected at the time the unsecured creditor searches the register, it will still be effective in the debtor’s bankruptcy or liquidation, provided the secured party registers a financing statement before the bankruptcy or liquidation commences. Secondly, a register search will not protect an unsecured creditor against the risk that the debtor may create a security interest at some time after the unsecured creditor has made the loan. Any subsequent encumbrances of existing property will also have priority over the

\(^{51}\) Recall from Chapter I that registration systems came into existence in order to balance the need for protection of third parties and for dynamic uses of property.
\(^{52}\) Law Commission, above n 36, at 115.
\(^{53}\) Law Commission, above n 36, at 115.
\(^{54}\) Gedye, above n 1, at 52.
unsecured creditor.\textsuperscript{55} In short, the argument is that if the PPSA cannot facilitate unsecured lending at large, protection of unsecured creditors cannot be the justification for making unperfected security interests ineffective in bankruptcy. However, the following discussion will demonstrate the claim that the register is of no practical use for unsecured creditors cannot be substantiated.

The argument that the register cannot protect unsecured creditors as it allows subsequent registration of existing security interests is related to the concern that the register may not be kept up to date. The fear is that there may be looming unregistered security interests at the time of the search which will then subsequently be registered and effective at bankruptcy. The concern is that it would be incongruous to sanction an unregistered interest but not a registered interest in circumstances where both security interests may have been unregistered at the time the unsecured creditor conducted the search. However, it is unlikely in practice secured creditors would intentionally delay registration as there are adequate incentives in place for prompt registration. Firstly, a secured party who does not promptly perfect is vulnerable to a security interest which is created later but perfected first.\textsuperscript{56} Secondly, an unperfected security interest is vulnerable to the interest of a buyer or lessee for value.\textsuperscript{57} Finally, an execution creditor also takes priority over a security interest that is unperfected at the time of execution.\textsuperscript{58} Those vulnerabilities would adequately incentivise timely filing for the honest secured party.\textsuperscript{59} Of course, it cannot be expected that at any one time there would be no unregistered security interests that would be subsequently registered. However, it is likely in practice there will be few. The priority rule would ensure at any one time there are not an abundance of looming unregistered security interests that will be subsequently registered prior to bankruptcy. Thus, the claim that general creditors cannot properly rely on the register due to looming unregistered security interests is not a real concern in practice.

\textsuperscript{56} Personal Property Securities Act 1999, s66.
\textsuperscript{57} Personal Property Securities Act 1999, s52.
\textsuperscript{58} Personal Property Securities Act 1999, s103.
The argument that the register cannot protect unsecured creditors as it cannot reveal subsequent encumbrances is related to the risk that the debtor may assume additional secured debt. The concern is that the pool of assets available for distribution among unsecured creditors at bankruptcy may be less than what the debtor had at the time the unsecured creditor decided to extend credit. This is a risk that is inherent in every commercial transaction. Whenever a lender extends credit unsecured they face the risk that their debtor’s financial circumstances may subsequently deteriorate which in turn will see the debtor assume additional debt. No public register can safeguard an investor from such risks as these risks cannot be avoided in the business world. The ability of the register to facilitate unsecured lending at large cannot be denied based on its inability to reveal the debtor’s future encumbrances. In other words, usefulness of the register cannot be measured by its ability to reflect the debtor’s future encumbrances; rather, it should be measured by its ability to reflect the debtor’s current encumbrances. Of course, the latter can be improved by the legislature through enacting rules which provide incentives for prompt registration.

For the reasons outlined above, the claim that the register cannot be properly relied on by unsecured creditors is unpersuasive. Thus, the argument that protection of unsecured creditors cannot be a policy justification because of the PPSA’s inability to facilitate unsecured lending at large cannot be substantiated. This still leaves the assertion that unsecured creditors do not use the register and thus protection of unsecured creditors cannot be the justification for making unperfected security interests ineffective in bankruptcy. This claim is essentially one about creditor behaviour. Its credibility will be examined closely below in Part D.

C. North American rationale

Curiously, commentators in North America seem to be in agreement with New Zealand law reformers in terms of unsecured creditors being indifferent about the information provided by the register. However, they do not accept this as a sound basis for rejecting the rule which

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invalidates unperfected security interests against insolvency administrators. This rule, they maintain, is not based on the conclusion that failure to give public disclosure of the existence of a security interest results in unsecured creditors being induced to give credit. Thus, they conclude New Zealand’s departure from the North American approach is based on a “misunderstanding” of the central purpose behind the provision. Further, they assert that there is a compelling policy reason in support of the North American position which relates to the “representative capacity of a trustee in bankruptcy”.

In Re Giffen, Iacobucci J., writing for a unanimous Supreme Court of Canada, expounded that the policy basis of the provision can be found in the “representative capacity of the trustee and the effect of bankruptcy on the enforcement rights of unsecured creditors”. Liquidators and trustees in bankruptcy are in some sense agents of the creditors as they are appointed for the benefit of the creditors generally. In their representative capacity, they must assert the rights and entitlements held by these creditors. Prior to a bankruptcy, unsecured creditors can make claims against the debtor through judgment enforcement measures. Those which have reached a certain stage in their enforcement will rank prior to unperfected security interests. However, once a debtor becomes bankrupt or is liquidated, unsecured creditors will no longer be entitled to exercise enforcement rights (that is, commence or continue execution). In effect, the judgment enforcement rights of the unsecured creditors are merged into the bankruptcy proceedings and the unsecured creditors must look to the trustee or liquidator to assert their claims.

Invalidating the security interest against the trustee has thus been described as a kind of “quid pro quo”. The provision is to compensate execution creditors for the loss of their priority by giving a corresponding priority to the trustee in the trustee’s capacity as the creditors’

62 Re Giffen, above n 44, at [38].
63 Australian Law Reform Commission Personal Property Securities (ALRC R64, 1993) at 112; see also Dunphy and Shepherd v Sleepyhead [2007] NZCA 241, CA 63/06 in which the court concluded liquidators were agents for the secured creditor.
64 UCC§ 9-301(1)(b); PPSA: NZ, s103; Aus, s74; (NWT, NU, O, S) s20(1); (BC, M) s20(a); NL s21(1); NS s21(2); Y s19.
65 11 United States Code § 362; Insolvency Act 2006, s.30; Bankruptcy and Insolvency Act (RSC 1985, cB-3), s69.
66 Cuming, above n 60, at 29.
representative. In essence, the provision allows “the unsecured creditors to maintain, through the person of the trustee, the same status vis-à-vis secured creditors who have not perfected their security interest which they enjoyed prior to the bankruptcy of the debtor.” Iacobucci J justified the rule on the grounds of fairness; the execution creditor’s loss of priority upon the bankruptcy or liquidation of the debtor is offset by giving priority to the trustee. It is worth mentioning that this rationale is not unheard of; it has received wide recognition and is reflected in the drafting of Article 9 of the UCC. Re Giffen has been hailed as a significant decision as it clarifies what is known as a widely misunderstood issue.

From the outset, Iacobucci J’s rationale seems easy to dismantle. If one should view the race as between an unperfected secured creditor on one side, and an unsecured creditor without a judgment order on the other, it logically follows that the secured creditor should have priority. The secured creditor has at least taken a security interest, and by hypothesis the unsecured creditor has not. The perverse effect of the provision is thus to reverse the nonbankruptcy priority rather than preserve the status quo. To suggest the true competitor is an execution creditor rather than an unsecured creditor without a judgment order is to ignore today’s reality in which execution creditors are few and bankruptcies are many. The unresolved “race” outside

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68 Re Giffen, above n 44, at [40], quoting with approval from International Harvester Credit Corp of Canada Ltd v Bell’s Dairy Ltd (Trustee of) (1986) 61 CBR 193 at 206.
69 Re Giffen, above n 44, at [42].
70 Re Giffen, above n 44, at [42].
72 UCC § 9-301 provides that “A security interest is subordinate to the rights of a person that becomes a lien creditor before the security is perfected.” The term “lien creditor” is defined in § 9-301(3) to include a trustee in bankruptcy.
73 Duggan and Ziegel, above n 55, at 230; see also discussion in Craig Wappett, Laurie Mayne & Professor Anthony Duggan Review of the Law on Personal Property Securities: An international comparison of Personal Property Securities Legislation (July 2006) at 24.
74 See White, above n 60; McCoid, above n 59; compare Thomas Jackson The Logic and Limits of Bankruptcy Law (Harvard University Press, Cambridge, 1986) at 70-79.
bankruptcy cannot be logically resolved. The question essentially boils down to one of fairness for which there is room for legitimate differences in opinion. The North American approach is indefensible when the vision of the underlying rationale is restricted to the restoration of rights to execution creditors. Iacobucci J’s reasoning for the provision raises the question – Is there a justification for effectively giving the debtor’s general unsecured creditors the benefit of the rights of an execution creditor when none of those creditors in fact has actually become an execution creditor by the time of the bankruptcy filing? Common wisdom would suggest unsecured creditors who are not execution creditors would gain a windfall. In any event, the provision would seem to be a radical response to the alleged loss of rights by a group of creditors (execution creditors) who may only exist in small numbers in bankruptcy if at all. Any sensible provision, targeted at the restoration of rights to execution creditors, should have its scope limited to members of that group rather than unsecured creditors at large. The “representative capacity of trustee” rationale cannot properly defend a provision that invalidates all unperfected security interests as against liquidators and trustees in bankruptcy.

North American commentators maintain that New Zealand’s departure from the North American approach was based on a “misunderstanding” of the central purpose behind the provision. While this may be conceivable, the common policy justification expounded to defend the North American approach is itself largely unsatisfactory and cannot properly defend the invalidation rule. It seems those accusing the New Zealand reformers of “misunderstanding” have been grappling with the real purpose behind the rule themselves. As will be demonstrated in the

75 Compare the views on the nonbankruptcy “race” expressed by John McCoid and Thomas Jackson. John McCoid expresses the view that the unperfected secured creditor is the “winner” of the “race”. The view is that when bankruptcy or liquidation interrupts the race, the unperfected secured party is ahead of the unsecured party by the fact of having a security. An unperfected secured creditor would thus prevail over the unsecured creditor if the “race” were to end then and there. This is the view which I find most convincing. See McCoid, above n 59, at 175.

Another view of the race is possible. Professor Jackson points out that there is no “winner” the moment before bankruptcy because neither party has in fact taken the step that assures the ultimate victory. Which party would have taken the final step first is unknown the moment before bankruptcy. The winner would be the first party to take the required action to perfect: if the unperfected secured creditor perfected before any unsecured creditor obtained a judicial lien, the secured creditor would win but if the unsecured creditor became a lien creditor before the secured party perfected by registration or possession, the lien creditor would win. Thus, to relegate unperfected secured creditors to the status of unsecured creditors is essentially declaring a “tie” to the unresolved race outside bankruptcy. See Jackson, above n 74, at 70-79.
following discussion, the true defence of the North American position is one that has been
discarded by reformers in all jurisdictions. That is, failure to register will prejudice general
creditors.

D. Discussion

Though the reformers are clearly at odds about the central purpose of the invalidation rule, they
seem to agree on one thing—that is, protection for unsecured creditors cannot be the basis of the
rule as unsecured creditors are generally indifferent to the information provided by the register.
This claim commands closer analysis as it challenges the deeply held intuition about the
connection between property rights and notice filing obligations. This connection, as established
in Chapter I, is integral to the secured transactions system as a whole as it justifies the existence
of a registration system.

Professor James White has recognised that an effective filing system is the centre pole that holds
up the personal property security tent.  

The filing system is an integral part of the most sophisticated secured lending known to mankind.
Only by effective filing system can a secured lender know of other lenders and only by it can later
secured lenders and unsecured lenders be encouraged to lend. Without such a system, lenders
would grow wary, commerce would be hobbled, and the manifold commercial ends that are met by
commercial lenders would be stunted, rendered more costly, or stymied altogether. Every day
thousands or tens of thousands of unsecured and secured lenders search the files and act in reliance
on the information found there.

The following discussion will critically assess the claim that protection for general creditors
cannot be the basis for the North American model. Three arguments will be put forward. First,
there is a lack of empirical evidence that is supportive of this claim about creditor behaviour.
Second, general creditors in today’s commercial world at least indirectly utilises the register if
not directly. Finally, the claim is disingenuous and arises from a misguided sympathy for secured
creditors. The following discussion will demonstrate that this sympathy should be displaced as
failure to register on the part of secured creditors adversely interferes with the rights of
unsecured creditors.

76 White, above n 2, at 530.
(i) Lack of empirical evidence

Arguments against mandatory registration in bankruptcy (and liquidation) based on who does (or does not) rely on the register are curious and troublesome as these are often empirical claims about actual behaviour, in the real world. As such it would seem possible to test them. These claim have not, to date, been tested, at least in any rigorous and public way.\(^77\) There was no evidence cited by the Commission to suggest that no creditors rely on the fact or absence of registration. The claim that general creditors do not use the register seems to contradict the thinking behind enacting s 173 which permits searches by anyone for the purposes of deciding whether to advance credit to the person searched. Further, there is reasonably good anecdotal evidence suggesting that many in fact do use the system.\(^78\) The claim that the register is of no use to unsecured creditors is a serious one as it questions the efficacy of the notice filing obligation that is at the heart of the secured transactions system. Thus, it would perhaps be sensible to first test the theory before determining the rights of general creditors upon this basis.

(ii) An indirect informational source

The fact an unsecured creditor does not look to any particular piece of collateral to satisfy his debt should not automatically lead to the conclusion that he is indifferent to the information provided by the register. The information generated by the register can be valuable to general creditors even if they do not closely monitor the register or conduct any searches on it. The register is in the public domain\(^79\) and serves a useful function in providing general information regarding the credit worthiness of the debtor to the market. In general, the more complete the register is, the more accurate is the information in the market place.

Responsible general creditors often consult credit reporting services in decisions to extend credit. These services provide information on individual debtors’ asset positions, existing lines of credit, payment records, and registered security interests. Public databases form an essential component

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\(^77\) Lipson, above n 9, at 50 <http://law.bepress.com/expresso/eps/314>.

\(^78\) See Paul Shupack “Preferred Capital Structures and the Question of Filing” (1995) 79 Minn L Rev 787at 803- 807 Paul Shupack expressed that in certain contexts, trade creditors rely on a clean record in deciding whether to ship to a debtor who has promised not to encumber its inventory. Then at 806 Shupack suggests trade creditors might “view the debtor’s use of inventory as security as a public statement of the debtor’s financial distress, particularly if the debtor had not previously done so.”

\(^79\) The Personal Property Securities Register is largely in the public domain with nominal privacy controls.
of these credit bureaux’ analyses.\textsuperscript{80} This was recognised by the Law Commission of England and Wales: “the register of company charges is consulted by credit rating agencies and others on whose information unsecured creditors rely.”\textsuperscript{81} Dun & Bradstreet, New Zealand’s leading credit reporting agency, recognises the PPSR as one of their most valuable objective informational source.\textsuperscript{82} Veda, another credit bureau in New Zealand, also draws on the PPSR heavily when conducting credit analyses.\textsuperscript{83} Thus, even if most unsecured creditors do not directly rely on the public record, the services upon which they rely for information do. The PPSR consequently forms a critical part of the informational foundation upon which all creditors may indirectly rely when making credit decisions.

The information provided by the PPSR correlates with the general financial health of the debtor. Such information is often the basis upon which general creditors make their lending decisions. The accessible nature of the PPSR means that information within it is often disseminated widely to the public via intermediaries. Consequently, even when general creditors do not actively search the register, they indirectly access the information through financial service providers. As such, it is not sensible to form a policy decision tolerating unregistered security interests on the basis that general creditors do not make use of the register.

(iii) Sympathy for secured creditors

(a) The concern – the unfulfilled bargain

Perhaps the greatest reason to challenge the view that creditors are indifferent is that it is disingenuous. That is, the real concern of those who complain about the notice-filing system is not that creditors ignore it, but that the penalty for failing to comply with it is excessive.

\textsuperscript{80} See Diamond, above n 23, at [21.2] discussing the function of the register: “There is the provision of information for persons proposing to deal with the company so that they can assess its credit worthiness; this information is of course particularly relied on by credit reference agencies. The information may similarly be of use to financial analysts and to persons considering whether to invest in the company”; see also McCormack, above n 23, at 25.

\textsuperscript{81} Law Commission for England and Wales \textit{Company Security Interests} (Law Com R No. 296, 2005) at [3.77].

\textsuperscript{82} See Dun & Bradstreet New Zealand “Credit Risk Businesses” Dun & Bradstreet \url{http://dnb.co.nz/Credit_Reporting/Learn_more_about_credit_reporting/Credit_risk_-businesses/Information_resources/index.aspx#PPSR}.

\textsuperscript{83} See Vida New Zealand “Commercial Check Report” Veda \url{https://services.nz.vedaadvantage.com/public/cgi/baynet}. 

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Professor Bowers, in the context of the “strong-arm” power under the Bankruptcy Code,\(^\text{84}\) writes “there is good reason to believe that bankruptcy legislation is intended mainly to chisel secured creditors out of their bargain.”\(^\text{85}\) This statement follows the attitude that the secured creditor should be able to retain the legal rights for which he bargained when it counts the most— that is, in the debtor’s insolvency. This stance has been evident in some Canadian cases in circumstances where the status of the unperfected security interest is in dispute.

In Canada, although unperfected security interests are ineffective as against liquidators and trustees in bankruptcy, the status of an unperfected security interest remains unclear in Companies’ Creditors Arrangement Act\(^\text{86}\) (CCAA) proceedings, Bankruptcy and Insolvency Act\(^\text{87}\) (BIA) commercial and consumer proposal proceedings and receiverships. The uncertainty regarding the status of unperfected security interests in these proceedings often see contests arise between unperfected security interest holders and insolvency administrators. In these circumstances, the tendency of courts to sympathise with the holder of unperfected security interests blinds them to the competing interests. In \textit{TRG Services Inc. (Re)}, C.Campbell J. said that, “while the CCAA is a statute that permits a wide latitude for the exercise of discretion, I do not think that the discretion should be exercised to defeat the legal rights of a creditor in the position of Cisco”\(^\text{88}\) and that “unsecured creditors should not in my view, through the mechanism of the CCAA, displace the security of another creditor simply because that security is unperfected”\(^\text{89}\). Likewise, in \textit{Brookside Capital Partners Inc v RSM Richter}, Lo Vecchio J, said that, “this is not a case of a creditor trying to gain an advantage but rather simply (sic) a creditor trying to hold on to an advantage it had already negotiated”.\(^\text{90}\) Precisely the same statements could be made about the fate of an unperfected security interest in straight liquidation and bankruptcy proceedings.

There is no question that the North American approach imposes certain costs on unperfected secured parties. The question is whether, from a policy point of view, the efficiency gains to the

\(^{84}\) 11 United States Code § 544(a).
\(^{85}\) Bowers, above n 60, at 732.
\(^{86}\) Companies’ Creditors Arrangement Act, RSC1985, cC-36.
\(^{87}\) Bankruptcy and Insolvency Act, RSC 1985, cC-36.
\(^{88}\) \textit{TRG Services Inc. (Re)} (2006) 26 CBR (5th) 203 at [59].
\(^{89}\) at [71]
\(^{90}\) \textit{Brookside Capital Partners Inc v RSM Ritcher} (2006) 25 CBR (5th) 273 at [36].
credit market from a more complete register justify the imposition of the consequences of not complying with the registration requirements. For the reasons outlined in the discussion below, I would answer this question in the affirmative.

(b) Perfecting in an imperfect market

At first blush, it may seem excessively harsh to rid secured parties of good legal rights for which they bargained on the premise that they neglected to file a financing statement. The position is seemingly contradictory to a system that hinges on the ability of the law to uphold the private agreements between the debtor and his creditors. Indeed, the importance of freedom of contract was recognised by Hon Max Bradford in his prefatory comment to the Personal Property Securities Bill as he acknowledged “the Bill will strike a blow for freedom and for much reduce regulation in the private section” and that it will “give borrowers more flexibility to choose what they borrow against”. However, the rights to freedom and flexibility are not absolute; they are means of achieving the ultimate objective of the Bill – that is, to enhance the overall efficiency of the credit industry. The Australian Law Reform Commission spoke of laws affecting personal property securities as having the key goal of information maximisation. The Commission said:

An efficiently functioning commercial system depends on those who make decisions within it being able to assess accurately the risks involved. The availability of information about whether assets are being used as security, who holds the security and the rights the lenders has will determine how accurate their assessments are... Having more relevant information will tend to increase the potential for accurate risk assessments, and thus the efficiency of lending and borrowing decisions...

Thus, in the realm of secured transactions law, principles of freedom and sanctity of contract should only be upheld if doing so would be consistent with achieving an informed and efficient credit market. The invalidation rule can be justified on the premise that failure on

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91 (8 December 1998) 574 NZPD 14424.
92 (8 December 1998) 574 NZPD 14424.
93 (8 December 1998) 574 NZPD 14424.
the part of the secured creditor to give notice disrupts the informational efficiency in the credit market. Such disruption threatens to bring the whole secured transactions system into disrepute as it interferes with the ability of the market participants to make informed credit decisions.

The law permits a debtor to make a private contract with one creditor that demotes the claims of other creditors from the initial position of parity to one of subordination. This ability of the debtor to prefer some creditors over others is contrary to the cardinal principle of insolvency law that the claims of creditors shall rank pari passu. When a debtor grants a security interest, he reduces the bundle of assets available to satisfy the claims of unsecured creditors and in turn increases the riskiness of their claims by reducing their expected value in bankruptcy. It is a fair assumption, however, that unsecured creditors will be aware of this risk and will insist on a premium for lending on an unsecured basis. In general, whatever level of risk he faces, if his transaction with the debtor is a voluntary one, a creditor may be expected to adjust his interest rate accordingly and to take whatever risk-reducing precautions he deems appropriate. Thus, the efficacy of the system is unaffected by the priority of secured creditors so long as general creditors remain able to set appropriate terms upon which they will lend. The ability of general creditors to do so, however, is hugely dependent on sufficient information being available in the market.

Failure to give notice on the part of the secured creditor hinders the information flow of the market and in turn upsets the ability of general creditors to accurately ascertain the risk of prospective transactions. As previously mentioned, the register serves an important function providing information about the general financial health of the debtor. Further, the information generated by the register is at least indirectly taken into account by general creditors. A register which inaccurately reflects the extent of the debtor’s indebtedness will hinder the ability of a general creditor to negotiate a premium appropriate for the level of risk he assumes. The priority of a secured creditor can no longer be justified if, by failing to

96 Thomas Jackson and Anthony Kronman “Secured Financing and Priorities Among Creditors” (1979) 88 Yale LJ 1143 at 1147.
97 Jackson and Kronman, above n 96, at 1147.
perfect, he has contributed to informational inefficiencies in the market and in turn interfered with the rights of other creditors. Professor Goode has suggested that the justification for the priority of the secured creditor has traditionally rested on three principles: bargain, value and notice.98 According to this reasoning, the secured creditor is entitled to look to the debtor’s assets in preference to other creditors because he bargained for that right. If, he argues, another creditor chooses to lend money or supply goods unsecured, that is his affair, but he has no right to complain of being subordinated.99 This theory is predicated on the assumption that creditors remain informed and free to set the terms on which they will lend. Failure on the part of the secured creditor to fulfil the element of “notice” will deprive general creditors of the necessary information to bargain appropriate terms. Accordingly, failure to fulfil the notice-filing obligation can see the priority bargained by the secured party justifiably extinguished in the event of insolvency.

The integrity of the system of secured transactions is predicated on the existence of an efficient market with informed creditors freely bargaining their own terms. Indeed, this was recognised by Hon Max Bradford in his prefatory comments to the Personal Property Securities Bill when he indicated the effect of the Bill would be that “lenders will have a better idea about the financial position of customers and will be able to make better lending decisions”.100 To the extent this is true; the law should seek to uphold the private agreements between debtors and their creditors. However, where the ability to make an informed lending decision is hindered in the market, the law should seek to correct it. In instances where non-registration in insolvency has deterred the flow of information in the market, the appropriate correction measure would be to extinguish the security interest.

E. Conclusion

It has been widely accepted that nowadays unsecured credit is seldom granted on the strength of apparent ownership resulting from possession of assets. While this may be true, it does not

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98 RM Goode “Is the Law Too Favourable to Secured Creditors?” (1983-84) 8 Can Bus LJ 53 at 57. “Value” here refers to new value. “Notice” means actual notice by secured creditors that security has been given or constructive notice through the secured party’s possession of the collateral or through compliance with a registration requirement in a publicly accessible register.
99 Goode, above 98, at 57.
100 (8 December 1998) 574 NZPD 14424.
necessarily follow that general creditors do not rely at all on the information provided by the personal property securities register. The analysis above demonstrates that the register serves an important public function providing general information to the market. Such information is factored into account by general creditors albeit in some circumstances only indirectly. Failure to register on the part of the secured creditor will impair the ability of general creditors to accurately assess their potential risk exposure and in turn create inefficiencies in the market. The sanction of invalidity can thus be justified on the ground that failure to give notice is inconsistent with the information maximisation goal of secured transactions law. This rationale is consistent with the deeply held intuition about the connection between property rights and notice obligations which has been pertinent in the law of chattel securities since its inception. This intuition should not be lightly discarded in favour of a misguided sympathy for secured creditors.

I would recommend for New Zealand to introduce the sanction of invalidity – that is, to invalidate an unperfected security interest against the liquidator and Official Assignee. This approach is consistent with principles of information maximisation and market efficiency which are fundamental to secured transactions law.
Part II: Reform for New Zealand

Chapter III: Implementing the Invalidation Rule

A. Overview

The focus of Part II is to find an appropriate mechanism for New Zealand to implement the sanction of invalidation. The analysis will be developed through two steps. First, this chapter will critically assess the mechanisms chosen to effect the rule in Canada, United States, and Australia. Second, the discussion will draw from the valuable experiences of those jurisdictions and recommend how the rule can be implemented in New Zealand to best achieve the underlying policy objectives.

B. An international comparative overview

   (i) United States

      (a) Primary provision

In the United States, a trustee in bankruptcy prevails over unperfected security interests on the date of bankruptcy. The so-called “strong-arm” power under § 544(a) of the Bankruptcy Code,101 which governs both corporate and individual debtors, confers “hypothetical lien creditor” status on the trustee. By virtue of § 544(a), the trustee has the same avoiding power with respect to “transfers” of the debtor’s property as does an execution creditor.102 The “hypothetical” nature of these rights means that such a creditor need not in fact exist for a trustee to invoke the “strong-arm” clause. The power to “avoid” an unperfected security interest is not contained in the Bankruptcy Code, it resides in Rev. § 9-317 of the UCC. Section 9-317 (a) expressly provides that an unperfected security interest is subordinate to the rights of a “lien creditor” who attains that status prior to perfection. The term “lien creditor” is further defined in § 9-201(a)(52) to include the trustee in bankruptcy from the moment the petition is filed. Therefore, the combined effect of these Article 9 provisions and the “strong-arm” clause is that the trustee would defeat any security interest that is unperfected at the date of the filing.

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101 11 United States Code § 544(a).
102 McCoid, above n 59, at 178.
drafting of these provisions make explicit the “representative capacity of trustee” as it reinforces the connection between execution creditors and the trustee in bankruptcy.

(b) Hypothetical lien creditor status

The “hypothetical lien creditor” status suggests a connection between the “strong-arm” powers of the trustee and the loss of rights by execution creditors upon bankruptcy. However, as discussed in Chapter II, restoration of rights to execution creditors cannot be the defending rationale underlying the sanction of invalidation as the rule confers rights upon all unsecured creditors. Thus, the use of statutory language that is reflective of such rationale has been largely problematic. The US courts have long struggled with the identity of this “hypothetical lien creditor”. Judges seem to be at odds over what “hypothetical circumstances” should be attributed to the trustee in his capacity as a hypothetical creditor. The elusive concept that is the “hypothetical lien creditor” leaves the fate of claimants vulnerable to judicial ingenuity. Ultimately, the powers and rights exercisable by the trustee are dependent on the hypothetical circumstances constructed by the courts. The “hypothetical lien creditor” concept raises the question – just how hypothetical is hypothetical?

Traditionally, courts have struggled to define the precise time at which this “hypothetical lien creditor” supposedly came into existence. In Constance v Harvey, the Second Circuit held that the trustee could assume the role of a hypothetical lien creditor whose interest arose before bankruptcy and would have prevailed over a security interest that was not immediately perfected. Such a conclusion meant that an Article 9 secured party would never be safe in bankruptcy unless it filed a financing statement before extending credit. Constance v Harvey was overruled by Lewis v Manufacturers National Bank which involved a secured creditor who waited four days to perfect. A lien creditor would have prevailed over the secured creditor during the four day gap. The trustee argued, under § 70(c) of the Bankruptcy Act 1898, that it could

103 The rationale expounded by North American courts and commentators. See discussion in Part C, Chapter II.
104 Duggan and Ziegel, above n 55, at 232.
105 Recall from Chapter II, the invalidation rule purports to confer on all unsecured creditors the status of execution creditors, which goes beyond mere restoration of rights lost at bankruptcy.
assume the status of such a gap creditor, even though no such creditor ever existed. The US Supreme Court held against the trustee, concluding that the trustee’s status as a hypothetical creditor under § 70(c) must be determined as of the date of bankruptcy, not at an anterior time.\textsuperscript{109} The \textit{Lewis} decision was encoded in § 544(a)(1) with the specification that the trustee’s lien creditor status is measured “as of the commencement of the case”. This seems to support the “representative capacity of trustee rationale”\textsuperscript{110} which focuses on the effect of the automatic stay provision on the enforcement rights of unsecured creditors at the moment bankruptcy proceedings commence.\textsuperscript{111}

If restoration of rights for execution creditors should be the focus, what if no such right was affected by the commencement of bankruptcy? In \textit{Pacific Fin Corp v Edwards},\textsuperscript{112} the Ninth Circuit held that the trustee cannot invalidate a security interest, unless it can prove that an actual unsecured creditor exists who could have become a lien creditor but did not do so. Where a security interest was vulnerable to such a lien creditor, but no such creditor came into existence before bankruptcy, the security interest was held not subject to § 70(c).\textsuperscript{113} The US reformers cured the confusion in \textit{Edwards} by amending § 544(a)(1) to include the phrase “whether or not such a creditor exists”. However, failure on the part of the drafters to shift the wording away from the concept of the “hypothetical lien creditor” has seen the courts continue to grapple with the provision. On the one hand, the statutory wording makes implicit the connection between execution creditors and the trustee in bankruptcy. On the other, the section suggests the trustee’s powers are independent of the enforcement rights of execution creditors. \textit{In re Baek}\textsuperscript{114} the court held that a creditor who failed to perfect its security interest in business assets could still file a secured claim because there was no intervening creditor who would be prejudiced by the failure to perfect. Although the court recognised that an unperfected security interest is subordinate to the rights of intervening creditors, it thought that absence of such intervening interests meant that failure to perfect did not affect the lien rights between the parties. The court opined that it has

\textsuperscript{109} James Arthur Kern “The Trustee’s Status Under Section 70 (c) of the Bankruptcy Act - Constance v. Harvey Overruled” (1961) 44 Marq L Rev 566.
\textsuperscript{110} See above discussion in Chapter II.
\textsuperscript{111} The rationale as expounded in \textit{Re Giffen}, above n 44, at [38].
\textsuperscript{112} \textit{Pacific Fin Corp v Edwards} 304 F2d 224 (9th Cir 1962).
\textsuperscript{114} \textit{In re Baek} 240 BR 633, 42 UCC Rep. 2d 831 (MD Fla 1999).
been well established that “although an unperfected security interest is subordinate to the rights of intervening creditors, the security agreement is valid and enforceable as between the parties”\textsuperscript{115}. The court is right to that extent, however, the strong-arm power of the trustee cannot be ignored in the context of bankruptcy. These curious decisions can be attributed to the continuing use of statutory language which reinforces the misconceived relationship between execution creditors and trustees in bankruptcy.

The wording of the US provisions reflects the concept of the trustee being a “hypothetical lien creditor”. The elusiveness of this concept has seen the judiciary go on frolics in search for the identity of the “hypothetical lien creditor”. The problem with attaching such concept to the provision is that when a lien creditor does not exist in fact, the provision is turned on its head as the sense of purpose is lost. Further, the hypothetical nature of the concept creates opportunities for the courts to engender certain outcomes through manipulating the hypothetical circumstances. This is the case even after various amendments were made by the US reformers to eliminate doubt. Failure to disassociate the provision from the “hypothetical lien creditor” concept will see continuing uncertainty surrounding the provision. If the trustee is truly a representation of execution creditors, the scope of the protection should be limited to those deserving creditors. If the trustee is there to represent unsecured creditors at large, any language implying “hypothetical lien creditor” status should be avoided.

(c) Notable features

(1) Retroactive perfection for PMSIs

An interesting feature of Article 9 is that it makes certain allowances for security interests unperfected at the date of bankruptcy. Rev. § 9-317(e) allows a 20 day grace period for perfection of purchase money security interests. If the PMSI is perfected within the grace period

\textsuperscript{115} Bank of Green Cove Springs v Brooker (In re Brooker) 36 BR 839 (Bankr MD Fla 1984) at 841; Mercury Fin Co of Ga v Muto (In re Muto) 124 BF 610 (Bank MD Fla 1991); Gator Office Supply & Furniture Inc v AmSouth Bank of Fla., 705 So. 2d 1039, 1040 (Fla 2d Dist Ct App 1998). It is worth noting that none of the cases cited by the court challenged a trustee’s avoiding power in bankruptcy. See In re Brooker 36 BR 839 (Bankr MF Fla 1984) the court expressly recognised the “strong-armed” power of the trustee in bankruptcy (“Section 544(a)(1) of the Bankruptcy Code places the trustee in the position of a judicial lien creditor. Cases decided under the section with respect to unperfected security interests have uniformly held that holders of those interests are in a position inferior to that of the trustee and that their liens are thus avoidable by the trustee”).

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as proscribed, the perfection is retroactive as against the trustee.\textsuperscript{116} This is facilitated by § 362(b)(3) of the Bankruptcy Code\textsuperscript{117} which provides the automatic stay provision does not apply to post-bankruptcy perfection.

(2) Leased goods

A true lease is not considered a security interest subject to the rules of Article 9.\textsuperscript{118} The lessor under a true lease thus need not file a financing statement to protect its reversionary interest in the property from competing third party interests.\textsuperscript{119} The debtor’s general creditors cannot levy execution upon goods subject to a bona fide lease and subsequently these goods are out of the reach of the trustee in bankruptcy. The drafters of Article 9 might have required the filing of a financing statement by every equipment lessor, on the ground that the lessee’s apparent ownership is misleading to third parties without public notice. But such is not the statutory mandate.\textsuperscript{120} In insolvency proceedings, the exclusion of true leases has seen trustees attempt to

\textsuperscript{116} UCC § 9-317 (c) provides “Except as otherwise provided in Sections 9-320 and 9-321, if a person files a financing statement with respect to a purchase-money security interest before or within 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of a buyer, lessee, or lien creditor which arise between the time the security interest attaches and the time of filing.”
\textsuperscript{117} 11 United States Code § 362(b)(3).
\textsuperscript{118} The most important guideline in the UCC on this matter is not found in Article 9 at all, but in the definition of “security interest” under UCC § 1-201(37) which distinguishes between a true lease and a disguised secured transaction.

In order for a transaction to qualify as a security interest and therefore fall within the scope of Article 9, the obligation to pay rents must extend for the entire term of the lease and must not be subject to termination by the lessee. Once this threshold criterion is met, a transaction dressed up as a lease will be treated as a secured loan if any of the following four standards are met:

1. The original term of the lease is equal to or greater than the remaining economic life of the goods
2. The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods
3. The lessee has an option to renew the lease for the remaining economic life of the goods for no or nominal consideration
4. The lessee has an option to become the owner of the goods for no or nominal consideration.

\textsuperscript{119} See, e.g., Wang Labs Inc. v Manufacturers Hanover Trust Co., 20 UCC Rep 1035 (NY Sup Ct 1976) (computer equipment in hands of bailee to be programmed for use of bailor’s customers; no need to file UCC financing statement). By comparison, if a lender is financing the operations of the lessor and wants to retain a security interest in the lessor’s reversionary rights to the equipment, it will be necessary for the lender to perfect as to both the lease (chattel paper) and the underlying equipment (inventory). See In re Leasing Consultant, Inc 486 F2d 367, 13 UCC Rep 189 (2d Cir 1973).

\textsuperscript{120} Whether or not true leases should be subject to Article 9 has been the subject of much academic debate. For detailed discussion see Mooney “The Mystery and Myth of ‘Ostensible Ownership’ and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases” (1988) 39 Ala L Rev 683.
grab property by insisting certain leases are in fact disguised secured transactions. The amount of unnecessary litigation in this area has been scrutinised by commentators.

(ii) Canada

(a) Primary provision

The sanction of invalidity for non-registration is a rule common to all the provincial Personal Property Security Acts in Canada. The Canadian provincial legislations are all drafted in much the same way, so that the relevant provisions render unperfected security interests “ineffective” against a liquidator or trustee in bankruptcy.

Section 20 of the Personal Property Security Act, S.B.C. provides:

20. A security interest

... (b) in collateral is not effective against

(i) a trustee in bankruptcy if the security interest is unperfected at the date of the bankruptcy, or;

121 The following are some of the reported cases found by Professor James White on LEXIS. These are cases in which the trustee used § 544(a) to challenge the validity of a lease. For the full list of cases, see White, above n 60, at 837 (footnote 21):

In the following cases, the parties disputed whether the creditor possessed an unperfected security interest or a lessor’s interest that would be superior to the trustee’s interest without filing. The trustee won (unperfected secured interest): Pacific Express, Inc. v. Teknekron Infoswitch Corp. (In re Pacific Express, Inc.), 780 F2d 1482 (9th Cir 1986); Towne Realty, Inc. v. A-i Hydro Mechanics Corp. (In re A-I Hydro Mechanics Corp.), No. 87-00881, 1989 US Dist LEXIS 12215 (D Haw Sept 13, 1989); Woodson v. Ford Motor Credit Co. (In re Thompson), 101 BR 658 (Bankr ND Okla 1989), rev’d, 114 BR 278 (ND Okla 1990); Communications Co. of Am. v. Mitel, Inc. (In re Communications Co of Am), 84 BR 822 (Bankr MD Fla 1988); Woodson v. GMAC (In re Harvey), 80 BR 533 (Bankr ND Okla 1987).

In the following cases, the trustee lost (lease or absolute title retained by creditor): Wall Tire Distrb., Inc. v. Wright (In re Wall Tire Distrb., Inc.), 116 BR 867 (Bankr MD Ga 1990); General Microcomputer, Inc. v. Crow Williams #11 (In re General Microcomputer, Inc.), 118 BR 96 (Bankr ND Ind 1989); Woodson v. Ford Motor Credit Co. (In re Cole), 100 B.R. 561 (Bankr ND Okla 1989), aff’d, 114 BR 278 (ND Okla 1990); Novack v. Business Credit Leasing, Inc. (In re Novack), 88 BR 353 (Bankr ND Okla 1988).

122 For detailed discussion see White, above n 60.

123 PPSAs: (NWT, Nu, O, PEI) s20(1); (BC, M) s20(b); (NZ, S) s20(2); A s20(a); NL s21(2); NS s21(2); Y s19(1).

124 Personal Property Security Act, SBC 1989, c36, s20(b).
(ii) a liquidator appointed under the Winding up and Restructuring Act (Canada) if the security interest is unperfected at the date that the winding up order is made

(b) The debtor as the owner – Re Giffen

Canadian courts have experienced considerable difficulties with the conceptual and operational inconsistencies between the s 20(b) equivalents and bankruptcy law. These inconsistencies were highlighted in Re Giffen\(^{125}\) in which the Supreme Court had to reconcile s 20(b)(i) of the British Columbia PPSA with the principle that only the “property of the bankrupt” shall vest in the trustee\(^{126}\) and be distributed among the bankrupt’s creditors\(^{127}\). Where a true security interest is involved, the bankruptcy principle creates no difficulty since the debtor owns the collateral. However, the principle is problematic in situations involving “deemed” security interests where the traditional “legal title” of the property does not belong to the debtor.

(1) Bailors, consignors, and lessors

In Re Giffen, the lessor argued s 20(b)(i) violates provisions in the BIA\(^{128}\) as it purports to vest in the trustee property that was not property of the bankrupt at the date of bankruptcy. This is a conceptual gap in the law. Though s 20(b)(i) operates to prevent the unperfected secured parties from exercising rights against the trustee, it does not grant title or any other proprietary interest to the trustee.\(^{129}\) In Re Giffen, Iacobucci J bridged this gap in the law by concluding that the bankrupt’s right to use and possession of the car constitutes “property” for the purposes of the BIA and the trustee succeeds to this proprietary right by virtue of s 71(2).\(^{130}\) His Honour expressed the view that s 12(2) of the British Columbia PPSA\(^{131}\) operates to “deem or recognise that a lessee has a proprietary interests”\(^{132}\) as it explicitly provides that “a debtor has rights in

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\(^{125}\) Re Giffen, above n 44.

\(^{126}\) Bankruptcy and Insolvency Act, R.S.C., 1985, c.B-3, s71(2).

\(^{127}\) Bankruptcy and Insolvency Act, R.S.C., 1985, c.B-3, s67(1).

\(^{128}\) Bankruptcy and Insolvency Act 1985 (CA), ss71(2), 67(1).

\(^{129}\) Re Giffen, above n 44, at [44].

\(^{130}\) Re Giffen, above n 44, at [34] Iacobucci J finds support for this conclusion in Pacaar Financial Services Ltd, above n 71, where the Saskatchewan Court of Appeal held that “property” as it is used in the BIA is “broad enough to include a leasehold interest” (at 494, citing Re Cadieux and Jas. A. Ogilvy’s Ltd. (1952) 33 C.B.R. 15 (Que Sup Ct) at 16).

\(^{131}\) Personal Property Securities Act 1999, s40(3).

goods leased to the debtor ... when he obtains possession of them in accordance with the lease”. 133 Iacobucci J held that for the purposes of the PPSA, the rights of the parties are explicitly “not dependent upon either the form of the transaction or upon traditional concept of title” 134 thus it is necessary to “look past traditional concepts of title and ownership”. 135 The court was right to that extent, though the use of the “refined concept of rights in property” is troublesome.

The PPSA creates unique statutory rights that are independent of conventional property rights. The drafters of Article 9 of the UCC “sought nothing less than to detach the legal entailments of security from conventional property analysis”. 136 Thus, locus of title is irrelevant for the purposes of determining rights in personal property under the Act. 137 Since the PPSA does not purport to rely on location of title, terminology focusing on ownership should be abandoned. 138 Property analysis cannot logically resolve contests under the PPSA as it imports in notions that are conceptually incompatible with the Act. As will be demonstrated below, the Re Giffen property analysis sits uncomfortably with another Canadian PPSA decision.

The decision of Re Giffen has been influential in New Zealand. In Graham v Portacom 139 Rodney Hansen J found that the effect of s 40(3) was that the debtor had not just a possessory interest in the building, but also a proprietary one. His Honour expressed that if the lease is a security agreement, “the lessee is treated as the owner of the leased goods for registration and priority purposes”. 140 On this view, the lessee not only has possessory rights, but also “rights of ownership in the goods” 141 transferable to the Official Assignee. While the results in both Re Giffen and Portacom are undeniably correct, it is unnecessarily cumbersome to classify the lessees’ interest as proprietary. Arguably, the Canadian Supreme Court had to import in property

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133 Re Giffen, above n 44, at [36].
135 Re Giffen, above n 44, at [28].
137 Sections 17(1)(a)(ii) and 24 both make the location of title irrelevant to the operation of s40.
139 Graham v Portacom, above n 139, at [19].
140 Graham v Portacom, above n 139, at [28].
notions to bridge the conceptual gap between the PPSA and the BIA. However, there was no need for the Court in *Portacom* to do the same.

(2) Transfers of accounts and chattel paper

The principle that only property of the bankrupt shall vest in the trustee has also been seen as a source of difficulty in situations involving non-security assignments of accounts and transfers of chattel paper. These transactions are deemed security interests\(^\text{142}\) even where they involve the sale and absolute transfer of the debtor’s interest to the buyer with the result that there is no property interest left in the transferor to vest in the trustee of the transferor.\(^\text{143}\) In two Ontario decisions the courts held that an unregistered sale of an account receivable was not effective against the assignor’s trustee in bankruptcy as a result of s 20(1)(b) of the OPPSA.\(^\text{144}\) In *Agent’s Equity Inc v Hope (Trustee of)*,\(^\text{145}\) Feldman J expressed that the effect of s 20(1)(b) in the context of transferred accounts is to void that security interest against the trustee at the date of bankruptcy. His Honour thus held that “as of that date, the property in the accounts or the right to the commissions is not transferred to Agent’s Equity but is property of the bankrupt again and can therefore pass to the trustee.”\(^\text{146}\) The approach adopted by Feldman J has been referred to as the “bootstrap” analysis.\(^\text{147}\)

The Ontario courts did not have the benefit of *Re Giffen* at the time they decided on the cases mentioned above. The *Re Giffen* property analysis can also be applied in those cases to yield an outcome in favour of the trustee in bankruptcy. Transfers of account or chattel paper are deemed “security interests” for the purposes of the PPSA. If a security interest is in the nature of a “hypothec”, conceptually one party is the owner of the collateral and the other party is the secured party.\(^\text{148}\) As recognised in *Re Giffen*, by deeming such a transfer as a security interest, the PPSA is implicitly deeming the transferors to have ownership of that account or chattel

\(^{142}\) Personal Property Securities Act 1999, s17(1)(b).
\(^{143}\) Cuming et al, above n 61, at 445.
\(^{144}\) *Agent’s Equity Inc v Hope (Trustee of)* (1996) 40 CBR (3d) 310 (Ont Ct Gen Div); TCE Capital Corp v Kolenc (1999) 8 CBR (4th) 165 (Ont Div Ct).
\(^{145}\) *Agent’s Equity Inc v Hope*, above n 144.
\(^{146}\) *Agent’s Equity Inc v Hope*, above n 144, at 315.
\(^{147}\) Cuming et al, above n 61, at 445.
\(^{148}\) Cuming et al, above n 61, at 446
paper that is deemed to be the subject of the security interest. This deemed ownership qualifies as property vesting in the trustee in bankruptcy under the relevant bankruptcy legislation. According to Re Giffen, the effect of the PPSA is to reclassify the transferred account or chattel paper as “property of the bankrupt” capable of vesting in the trustee in bankruptcy.

(c) Secured creditor as the owner – Sparrow Electric

The “conceptual gap” issue has arisen in a separate context at the interface of the PPSA and federal Income Tax Act. In Royal Bank of Canada v Sparrow Electric Corporation, the court had to bridge the conceptual gap between the PPSA and s 227(5) of the Income Tax Act which allows the tax department to have claims over “property which lawfully belongs to the debtor.” Section 227(5) transfers title in the property from the debtor to the tax department in order to satisfy the debtor’s outstanding unremitted payroll obligations. Similar to s 71(2) of the BIA, while s227(5) permits the tax department to attach its beneficial interest to property of the debtor upon liquidation, it does not permit the expropriation of property which may belong to a third party creditor. Gonthier J engaged in a property analysis, similar to that as seen in Re Giffen, and concluded that the holder of the general security agreement acquired title to the collateral through the fixed charge and thus became the “legal owner” of the collateral as it came into possession of the debtor. This decision was not referred to in Re Giffen, however, it does seem to provide as much authority for the secured creditor becoming the legal owner of the property as Re Giffen does for the debtor.

(d) An unsatisfactory outcome – whose property is it anyway?

The proposition that s 20(b)(i) prevents the holder of an unperfected security interest, including a lessor, from asserting his or her interest against the debtor’s trustee in bankruptcy does not in

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149 In Re Giffen, it was the lessee or transferee who was deemed to have ownership because the lessor was the secured party. Applying the Re Giffen rationale to a sale of an account, the seller or transferor is deemed to have ownership because the buyer or transferee is now the deemed secured party.

150 Income Tax Act, RSC, 1985


152 Income Tax Act, RSC, 1985, s.227(5).

153 Sparrow Electric, above n 151, at [40].

154 Sparrow Electric, above n 151, at [64].

155 Allan, above n 138, at 318.
itself explicitly respond to the question of how the trustee can effect the transfer of title required to distribute the collateral or its proceeds under the bankruptcy proceedings. This has seen courts, in an attempt to fill the void, revive the notion of “ownership” which the PPSA was supposed to remove. This solution is unsatisfactory for two reasons. First, it merges the idea of property and priority. Second, it does not bring clarity and certainty to the law and cannot be consistently applied across the board as has been demonstrated by the two Canadian cases. According to Re Giffen, the debtor was the owner of the collateral. According to Sparrow Electric, the effect of the attachment is to transfer a proprietary interest to the secured creditor. Neither of these decisions can provide a satisfactory answer for a situation in which there are multiple secured party claimants. The combined effect of these two decisions suggest that all secured parties as well as the debtor would have a proprietary claim in the property, a result that is “inconsistent with the indivisible nature of a proprietary interest”. 156

The operation of s 20(b)(i) has seen difficulties as the Canadian drafters did not properly bridge the gap between provincial secured transactions law and federal bankruptcy law. While s 20(b)(i) operates to make an unperfected security interest unenforceable, it fails to effect the transfer to the liquidator or trustee in bankruptcy. This lapse in the law is troublesome as it has seen courts struggle to reconcile the inconsistency between bankruptcy law which relies on traditional concepts of property and the PPSA which has discarded property in favour of priority. This conceptual gap must be bridged in order to achieve better clarity, certainty and elegance in the law.

(iii)Australia

(a) Primary provisions

It is interesting to reflect on the mechanism chosen by the Australian reformers to effect the unenforceability of unperfected security interests on an insolvency event. Although the substantial core of the Australian provision is much the same as its Canadian counterpart, the wording of the section arguably overcomes the conceptual difficulties experienced by the Canadian provisions.

156 Allan, above n 138, at 318.
(1) Duplication

The primary provision in the Personal Property Securities Act 2009 (PPSA(Aus)), s 267, introduces the concept of unperfected security interests “vesting” in the grantor in the critical event of bankruptcy, winding-up or administration, or Execution of a Deed of Company agreement. The word “vest” appears in different property law contexts as meaning “the creation of an absolute present or future right to the enjoyment of property”. It is not the secured collateral which directly vests in the grantor, because in terms of title, the grantor may have already had title to the secured collateral. It is the security interest which vest in the grantor, and the effect of this is to allow the insolvency administrator to take control of the collateral in the case where title to the underlying collateral was not in the grantor. The provision thus not only invalidates unperfected security interests, but goes further to facilitate the transfer to the insolvency administrators by conveying the security interest to the grantor. The effect of the wording of the statute is to give the insolvency administrator power to confer title free from the unperfected security interest. In this respect, the Australian provision has overcome the difficulties faced by its Canadian counterpart. The Explanatory Memorandum to the Bill did not expound the reasons behind the choice of language. It is likely the drafters took into account the operational and conceptual issues faced by the Canadian courts.

A corresponding provision was enacted in the Corporations Act 2001 to operate in conjunction with s 267 and govern corporate debtors. Section 588FL “largely replicates” the wording of its counterpart in the PPSA(Aus) and proscribes the circumstances under which a security interest would vest in the corporate grantor. Section 588FL repealed s266 which used the more straightforward concept of “voidness” as against the liquidator or administrator where the notice

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157 A Deed of Company Arrangement (DOCA) is the method of achieving a creditor compromise or arrangement as an outcome of the Voluntary Administration process (Part 5.3A Corporations Act 2001).
158 David Brown “Insolvency Law in a PPS World” (paper presented to INSOL Academics Programme, Singapore, March 2011) at 17.
159 It is worth observing that s267 was not drafted in its current form from the outset. Both the Bond Bill 2002 and the Personal Property Securities Bill 2008 used the more straightforward concept of “voidness” against liquidator or administrator etc. However, when the Bill was tabled in Parliament in 2009 the language was revised to its current form.
162 Corporations Act 2001 (Aus), s588FL.
of the charge was not lodged within the requisite time periods.\textsuperscript{163} A significant feature of s588FL is that it vests in the company, with certain exclusions, security interests registered within 6 months prior to the critical event.\textsuperscript{164} The PPSA(Aus) insolvency provision does not have any time limits, but merely vests immediately before the insolvency event if not perfected. The parallel existence of s267 of the PPSA(Aus) and s588FL of the Corporations Act means whilst a late registered security interest would vest in a corporate grantor at the time of the critical event, precisely the same security would be unaffected if the grantor happened to be a firm or private individual governed solely by s267 of the PPSA(Aus).

The duplication of s588FL of the Corporations Act and s267 of the PPSA(Aus) has been subjected to much criticism.\textsuperscript{165} Critics contend that it is not wholly appropriate for the 2 pieces of legislation to deal with exactly the same issue in contradictory ways.\textsuperscript{166} However, the claim that these provisions deal with “exactly the same issue” is somewhat misconceived. Section 588FL is part of the voidable preference provisions of the Corporations Act.\textsuperscript{167} In a sense, the Australian reformers has put belated registration on the same footing as an undervalue transaction or preference.\textsuperscript{168} This approach is in line with the practice in North America where belated perfection within the preference period can be subject to avoidance by the trustee in bankruptcy.\textsuperscript{169} While this explains the time limitation imposed by s588FL, it does not explain why belated registration should only be viewed as a mischief when the debtor is an incorporated entity. Whether or not belated perfection should be the subject of a voidable preference is a matter of policy, whatever the policy choice may be, there is no immediate reason why incorporated and unincorporated entities should not be treated uniformly in this regard. Indeed,

\begin{itemize}
\item \textsuperscript{163} Corporations Act 2001 (Aus), s266.
\item \textsuperscript{164} Company security interests which are not either registered within 20 days of creation, or registered in the six months prior to liquidation or administration, will be rendered ineffective.
\item \textsuperscript{165} See submissions to the Senate Committee on Personal Property Securities (Corporations and other Amendments) Bill 2010 \texttt{<http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=legcon_ctte/pps_corps_and_other_amends_2010/submissions.htm>}. 
\item \textsuperscript{166} Clayton Utz “Submission to the Senate Committee on the Personal Property Securities (Corporations and Other Amendments) Bill 2010” at [2].
\item \textsuperscript{167} Corporations Act 2001 (Aus), Part 5.7B Recovering property or compensation for the benefit of creditors of insolvent company. See The Attorney General Department “Submission to the Senate Committee on the Personal Property Securities (Corporations and Other Amendments) Bill 2010” at [4].
\item \textsuperscript{168} Brown, above n 158, at 18.
\item \textsuperscript{169} 11 USC §547(e)(1)(a).
\end{itemize}
in North America, creditors of both incorporated and unincorporated debtors are subject to the
constraint of belated perfection as a voidable transaction. Mr. Loxton, a representative for
various law firms, expressed to the Senate Committee that “[t]here should just be one regime for
registration of charges – one regime that applies on insolvency and not two regimes and two
statutes that may have overlapping roles in the Corporations Act and the PPSA.”
The New Zealand reformers had similarly envisioned that the PPSA would provide a unified set of rules
governing the registration of chattel securities, regardless whether the grantor is unincorporated
or a company.

(2) The efficacy of security over future property

Section 267A provides that an unregistered security interest that attaches to the collateral after
the critical event will vest in the grantor in the same way as security interests that had attached
before the relevant time. This section was inserted into the Bill in 2010 as a response to the
concerns regarding the effect s267 has on the efficacy of security over future property.

However, the function of s267A is immediately questionable as s267 already provides that such
a security interest would vest in the grantor. As identified by many law firms in the consultation
process, the real concern with s267 is not that after-acquired property will never vest in the
grantor, but rather that it will always vests in the grantor. That is, the wording of s267 brings
the efficacy of security over after acquired property into disrepute as it arguably prevents an all-
asset security from attaching to assets acquired after the critical event. By definition, a security
interest over property cannot be perfected until it is attached and it cannot attach until the grantor
acquires “rights in” the property. So if attachment involves an interest in the vesting of the
security there is a risk that the after acquired property, purportedly the subject of the present and

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170 11 USC §547(e)(1)(a).
171 Senate Hansard (Inquiry into Personal Property Securities Bill 2009, Thursday 6 August 2009.
172 Riesenfeld, above n 16, at 24.
173 Inserted as part of the inquiry into the Personal Property Securities (Corporations and Other
Amendments) Bill 2010.
174 See Legal and Constitutional Affairs Legislation Committee “Report on Personal Property Securities
(Consequential Amendments) Bill 2009” at 27; Arthur Robinson, Blake Dawson, Freehills Lawyers and
Mallesons Stephen Jaques “Submission to the Senate Committee on the Personal Property Securities
(Consequential Amendments) Bill 2009” at 9.
175 Identified by various law firms in the consultation process. See Clayton Utz Submission, above n 166;
Allens Arthur Robinson, Blake Dawson, Freehills Lawyers and Mallesons Stephen Jaques “Submission to
the Senate Committee on the Personal Property Securities (Corporations and Other Amendments) Bill
2010”.

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after acquired security, will not come within the umbrella of that security. The technical defects in s267 threaten to disrupt the orderly conduct of liquidation processes and weaken the value of security in after acquired assets.

(b) Exemptions

Section 268 sets out certain interests which are exempted from the operation of the vesting rule as provided for in s267. The interests exempted include transfers of account or chattel paper, certain short term PPS leases and commercial consignments not securing payment or performance. The exemption provision is unique to the Australian Act. Broadly, the interests excluded are “deemed” rather than “in-substance” security interests, however, not all such “deemed” transactions are excluded by s268.

The justifications behind exempting these certain interests are not entirely persuasive. In the case of a pure transfer of account or chattel paper, the concern is that otherwise general creditors would gain a windfall as the grantor would be allowed the benefit of both the transferred account and the consideration he has already received for them. In terms of a short term PPS lease or a consignment, the reasoning is that it would be unduly harsh to require registration as the interest


178 Allens Submission, above n 174, at 1.

179 A lease of goods described by serial number for a term of 90 days or more and less than 1 year.

180 Personal Property Securities Act 2009 (Aus), s268.

181 It is worth mentioning that s105 of Personal Property Securities Act 1999 essentially provides that a competing creditor cannot enforce his rights against transferee of chattel paper or account receivable or non-security lessors, bailors and consignors. Many provincial Canadian PPSAs have also exempted non-security lessors, bailors and consignors from the enforcement powers of competing creditors—see for example PSA NB, BC, S s55- however, they have not included the same exemption as against liquidators and trustees in bankruptcy.

holder may not be aware of the application of the Act.\textsuperscript{183} The thinking is that it is one thing to require these parties to be perfected in order to achieve priority over other functional security interests, but it would be quite another to subject them to extinguishment of their previously held property-based claims on liquidation or bankruptcy.\textsuperscript{184}

The basis for exclusion contradicts two key notions underlying the PPSA. First, non-perfection causes certain inefficiencies in the market and thus justifies the extinguishment of a security interest.\textsuperscript{185} Second, exempting certain categories violates the goal of the PPSA to treat like transactions alike and reintroduces a focus on the form of the transaction. These transactions have been intentionally included within the realm of the PPSA presumably because the legislature saw the substance of such transactions as being consistent with the functional core of security interests. Thus, to turn around and exempt these transactions from the operation of s267 would raise the question of whether these transactions should be within the Act at all. There is no corresponding concession attaching to the other priority rules. It is hard to see why these exempted parties need protection in one context, but not the other. These parties either deserve protection across the board or not at all.\textsuperscript{186} If they deserve protection across the board then, of course, they should not be made subject to the statute in the first place. But if they do not deserve protection at all, then the exemption provision is ill advised.\textsuperscript{187}

(c) Compensation for affected parties

Under the Australian PPSA, a secured party whose security interest has vested in the grantor is entitled to participate in the grantor’s insolvency.\textsuperscript{188} Section 269 provides that if a lessor, bailor or consignor’s interest is affected by the operation of s267, the secured party is taken to have suffered loss or damage immediately before the critical event.\textsuperscript{189} The amount recoverable by the secured party is the greater of either the amount owed under the lease, bailment or consignment

\textsuperscript{183} Personal Property Securities Bill 2008 (Exposure draft) at 59.
\textsuperscript{184} Brown, above n 158, at 16.
\textsuperscript{185} For a detailed discussion see chapter II above.
\textsuperscript{186} Anthony Duggan “Submission to the Senate Committee on the Personal Property Securities Bill 2008 (exposure draft)” at 24.
\textsuperscript{187} The same confusion is reflected in the Revised Commentary which, on the one hand suggests that “requiring the registration of short term PPS leases… would be onerous” but at the same time defends “subjecting the short term PPS lease to the priority rules” at [11.53].
\textsuperscript{188} Personal Property Securities Act 2009 (Aus), s269.
\textsuperscript{189} Personal Property Securities Act 2009 (Aus), s269(2)(a).
or an amount equal to the market value of the leased, bailed or consigned property.\textsuperscript{190} Section 269 ensures that lessors, bailors and consignors do not lose title to the operation of s267 without appropriate compensation being in place.\textsuperscript{191}

To qualify for a share in the distribution of the bankrupt’s assets, “a person must have a provable claim which, in turn, presupposes a debt owing by the debtor to the claimant”.\textsuperscript{192} This is a fundamental principle of bankruptcy law. A lessor, bailor or consignor affected by the operation of s267 may have lost value which exceeds the amount that is secured to them. In such a case, the affected secured party will not be able to establish an amount owed by the debtor equal to the value of their collateral unless otherwise provided by the Act. The purpose of the provision is thus not to hold the grantor accountable for the loss of the secured party,\textsuperscript{193} rather, it is to give certain security interest holders a provable claim that is truly representative of their loss in the grantor’s insolvency proceedings. The consequence of omitting a statutory compensation provision is that the other unsecured creditors will gain a windfall as the lessor, bailor or consignor is unable to assert a claim that is equal to the full amount of their loss. This is the outcome in Ontario Canada where the compensation provision has been omitted from the Act.\textsuperscript{194}

Critics of the compensation provision argue that it is wrong in principle to establish a mechanism for giving the lessor, consignor or bailor a claim in the insolvency proceedings. Professor Anthony Duggan expressed in his submission to the Senate Committee that “allowing a person who is not a creditor to share in the bankruptcy distribution seems contrary to the principles of the bankruptcy law”.\textsuperscript{195} This criticism is misconceived. The most fundamental feature of the PPSA is its ability to confer unique statutory rights on parties to transactions deemed by the Act to be secured transactions. The legislature has made a conscious policy choice to include transfers of account receivable or chattel paper, leases, bailments and consignments into the regime via the deeming provision even when those transactions do not in substance secure

\textsuperscript{190} Personal Property Securities Act 2009 (Aus), s269(2)(b).
\textsuperscript{191} Senate Hansard (Inquiry into Personal Property Securities Bill 2009, Thursday 6 August 2009).
\textsuperscript{192} Duggan Submission, above n 186, at 25.
\textsuperscript{193} Duggan Submission, above n 186, at 26.
\textsuperscript{194} Personal Property Security Act, RSO 1990, c P10.
\textsuperscript{195} Duggan Submission, above n 186, at 26.
payment or obligation. In doing so, the legislature has conferred the status of a creditor upon these included parties. The result is that these affected parties must comply with the requirements proscribed by the law in order to perfect their interest. Diligent compliance with the Act would see these parties enjoy the same level of protection afforded to perfected secured creditors. On the other hand, failure to comply would see them suffer the same penalties as unperfected secured creditors. To then turn around and deny them the status of a creditor when it counts the most – in the debtor’s insolvency, would be inconsistent with what the legislation is trying to achieve. Whether or not a transferee of account, lessor, bailor or consignor should be treated as a creditor in the context of personal property securities is a matter of policy for the legislature. Since the legislature has quite clearly already made this choice, it would be contradictory to legislative intent to deny these parties of the status of a creditor.

C. Recommendations

(i) Primary provision – A hybrid Canadian- Australian approach

The proposed sanction of invalidity envisages that a security interest will be invalid against the insolvency administrator if such security interest was not perfected within a specified period. The result is that any collateral subject to the invalidated security interest will be subsumed under the control of the insolvency administrator and be distributed amongst general creditors of the debtor. As seen from international experiences, a successful provision must not only invalidate the security interest, but also effect the transfer to the insolvency administrator. In order to achieve this, the statutory language must bridge the conceptual gap which arises at the interface of the PPSA and insolvency legislations.

The spirit of the primary provision suggested for New Zealand will more closely align with that of the Canadian provisions. However, elements of the Australian statutory language will be borrowed to effect the transfer to the insolvency administrator. The result is that the proposed New Zealand provision will enjoy the substance of the Canadian provisions while avoid the

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196 Personal Property Securities Act 2009 (Aus), s12; Personal Property Securities Act 1999, s17(1)(a), (b).
197 The term “insolvency administrator” is used as an umbrella term for liquidator, Official Assignee, receivers and the like.
198 Recall the difficulties faced by the Canadian provincial legislations which technically do not effect the transfer to the liquidator or trustee in bankruptcy. As a result, the courts had to adopt curious refined concepts of “property”. For a detailed discussion see above Part C, Chapter II.
conceptual difficulties. At the same time, the proposed provision will enjoy the coherency of the Australian approach while avoid the confusing and cumbersome nature of those provisions.\textsuperscript{199} Specifically, the proposed provision will adopt the more straightforward concept of “ineffective” against the insolvency administrator to invalidate the security interest but go one step further and effect the transfer with the “vesting” concept seen in the Australian provisions. This mixed Canadian- Australian approach enjoys the benefit of being simple yet comprehensive.

The proposed primary provision will govern both individual and corporate debtors. The provision will comprehensively outline the circumstances under which a security interest will be invalidated. Thus, no supplementary provision will be inserted into the insolvency legislations to further proscribe time limits for registration.\textsuperscript{200} The result is that there will never be a situation in which the validity of a security interest would depend on whether the grantor was an incorporated or unincorporated entity. I do not propose to discuss the merits or deficiencies of having separate regimes for personal bankruptcy and corporate liquidations. My contention is simply that there should be a unified set of rules governing the registration of all security interests. There is no compelling policy reason why this should not be the case.\textsuperscript{201} Indeed, the PPSA was enacted in 1999 with the view that it is preferable to have unified rules governing chattel transactions, regardless whether the debtor is unincorporated or a company.\textsuperscript{202} Further, I can see little benefit of having rules governing registration of security interests feature in multiple insolvency legislations. It makes sense for these rules to reside in the PPSA, which sets out to comprehensively govern rules on registration of security interests. Consolidating these rules in the PPSA will further promote the fundamental objectives of clarity and simplicity.

(ii) Relief for affected parties

Imposing a new sanction of invalidity on secured creditors for failure to perfect weakens the position of secured creditors under the regime. The matter to be addressed then is whether the balance should be somewhat redressed in favour of secured creditors. In the context of

\textsuperscript{199} See discussion above in Part D, Chapter II.
\textsuperscript{200} Unlike the approach taken in Australian law under which s588FL of the Corporations Act 2001 (Aus) provides a time period within which security interests must be registered; see discussion above Part D, Chapter II.
\textsuperscript{201} As recognized by Clayton Utz in the consultation process for Personal Property Securities (Corporation and other amendments) 2010. See Clayton Utz Submission, above n 166.
\textsuperscript{202} Riesenfeld, above n 16, at 24.
registration of company charges, the Steering Committee in the United Kingdom advised that affected parties be given the right to apply to a court for relief from invalidity. The Steering Committee held the view that this will not lead to uncertainty if the court were not able to change the relative priority of charges. It thus recommended that while the court should be able to validate the charges against the liquidator or administrator and any future secured creditor, it should not be able to disadvantage the holder of a competing charge that has been registered. This view ignores the consideration that unperfected security interests bring uncertainty for general creditors at large due to the informational inefficiencies it generates. Further, it is difficult to envisage any situations in which lack of opportunity to seek relief will result in serious injustice. I do not completely deny there may be circumstances which a secured creditor may deserve relief, but those circumstances are likely to be few. The value of secured credit hinges on certainty in the law of secured transactions. As such, the integrity of the secured transactions system should be not undermined for justice in those few rare occasions. Finally, allowing the courts to freely determine relative creditor rights according to their sympathy will see inconsistent outcomes and open the floodgate to wasteful litigation. However, lack of ability to seek relief from courts will not see affected parties completely without redress. As will be outlined below, a statutory compensation provision will be available to ensure affected parties can make provable claims in the debtor’s insolvency proceedings.

(iii) Time limitations

(a) No time limit for registration

One important matter to be considered is whether there should be any time limit for filing from the time of creation of the security interest after which the security interest would be ineffective against the insolvency administrator. Under the current system in New Zealand, registration of financing statement is voluntary and can be done at any time. A secured party need not register a financing statement within a certain time in order to have an enforceable security interest against third parties. To impose a time limit for validity against insolvency administrators would thus create a circular priority problem. Specifically, it would create a situation where a secured party
who registered beyond the time limit would have priority over another secured party by prior registration but not an insolvency administrator, while the second secured party who registered within the specified time limit will be effective against the insolvency administrator but not the first secured party.

A possible solution to the circular priority problem is to impose a limitation period across the board. This was the practice in New Zealand pre-dating the PPSA and is the current practice in the United Kingdom in relation to company charges. In the United Kingdom, this practice has long been the subject of vigorous debates. The Crowther report in 1971 criticised that setting a time limit caused inconvenience and expense and did not appear to serve any useful purpose since "subsequent encumbrances are adequately protected by the rule giving them priority over a previous unregistered interest". This view was shared by the Diamond Report in 1989, the Steering Committee in 2001, and the Law Commission in 2002. However, the Working Party expressed a contrasting viewpoint in 1986. The Working Party thought it largely unsatisfactory that the Crowther Committee narrowly focused on subsequent security holders and did not take into account the value of a “complete and up-to-date register to trade creditors generally". This view was clearly favoured by the United Kingdom reformers in 2006 as the limitation period was retained in s870 of the Companies Act 2006.

The question boils down to whether the benefits realisable from having a time limitation would outweigh the costs. This is to ask, in essence, whether the imposition of a limitation period would result in a more up-to-date record system. In answering this question, it is helpful to consider the likely behaviour of creditors. In terms of registration behaviour, secured creditors

206 Chattels Transfer Act 1924, s18; Companies Act 1955, s103(2).
207 Companies Act 2006 (UK), s870.
208 Board of Trade Report of the Committee Presented to Parliament by the Secretary of State for Trade and Industry by Command of Her Majesty (November 1971) at [5.7.54].
209 Diamond, above n 23, at [11.3.7].
210 Steering Group, above n 203, at [12.11- 12.19].
211 Law Commission for England and Wales Registration of Security Interests: Company Charges and Property Other than Land (Law Com CP No. 164, 2002) at [4.75].
213 Though as a whole the company charge provisions were an almost carbon copy of their predecessor sections from Part 12 of the Companies Act 1985. For a discussion see John De Lacy “The Evolution and Regulation of Security Interests over Personal Property in English Law” in John De Lacy (ed) The reform of UK Personal Property Security Law (Routledge- Cavendish, Oxon, 2010) 1 at 77.
can be separated into three categories: 1) secured creditors who intend on perfecting; 2) secured creditors who intend on concealing the security interest until the eve of bankruptcy or until they realise the debtor is in trouble; and 3) secured creditors who will not perfect at all for whatever reason (either indifference or ignorance). The behaviour of the first class of creditors will not be affected by a time limitation rule as there are many existing incentives in place to ensure honest creditors with intention of filing would do so promptly. The behaviour of the third class of creditors will not be affected by the imposition of any kind of rules. This leaves the second class of secured creditors only. The imposition of a time limit rule will mean creditors can no longer rely on last minute registration to be effective and thus narrow the scope for secured parties to conceal security interests until insolvency is likely. As a result, secured creditors of this second class will be incentivised to promptly register. The question is then whether this result is most suitably achieved via the imposition of a time limit for registration. Intentional concealment of security interests is a matter that can be addressed by preference law which is designed specifically to deter creditors from gaining advantage over other creditors through last minute anti-collective behaviour. Voidable preference law should be preferred over the time limitation rule as the mechanism to correct the behaviour of these last-minute secured creditors as it specifically targets this kind of behaviour and thus is less cumbersome on secured creditors at large. The less draconian approach will also allow the secured party to decide for himself whether the commercial advantages of omitting filing for certain classes of transactions outweigh the risk of subordination to other parties. This outcome will be more consistent with the policy choice made by New Zealand reformers to make filing optional and the freedom of contract principles underlying secured transactions law.

(b) Belated perfection

Voidable preference law seeks to prevent creditors from trying to change their existing position vis-à-vis other creditors in anticipation of bankruptcy’s collective proceedings. Specifically, the “anti-tardy” perfection policy invalidates last-minute registrations and is common to many Article 9 jurisdictions. Under the Corporations Act in Australia, a security interest is invalid if

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214 A secured party who does not promptly perfect is vulnerable to security interests created later but perfected first, buyers or lessees for value, and execution creditors. See discussion above in Part B, Chapter II.
215 Diamond, above n 23, at [11.3.4.].
not registered within a specified time within 6 months prior to any of the critical events proscribed by s267. The Crowther report suggested that a security interest registered within three months of the debtor becoming insolvent should be void against the insolvency administrator. Whether a mere 3 months would be adequate was questioned by Professor Diamond who expressed “[i]f the company’s finances deteriorate it might be thought possible to predict three month or more ahead, and the risk of late filing might be taken. But prediction for a longer period is more difficult”. In New Zealand, the current voidable preference sections stipulate a restricted period of 6 months within which transactions entered into will be presumed to be a preference transaction. I recommend this 6 months restricted period should be applied to belated perfections however I do not propose to assess whether a 6 months window is appropriate as a matter of policy. As a result, security interests registered within 6 months prior to the debtor entering into insolvency should be invalidated against the insolvency administrator.

A derivative issue on the matter of belated perfection is that security interests which only came into existence within the 6 months period will automatically fall into the hands of the insolvency administrator as it would not have been perfected outside the 6 months window. This technical defect will bring the voidable preference regimes into disrepute as security interests that are not within the scope of “voidable charges” would still be invalid due to ineffective registration. A “grace period” should thus be stipulated within which these security interests can be registered without being automatically invalidated. In Australia, the period allowed is 20 days. The appropriate period for New Zealand is 15 days. This is compatible with the time allowed by the Act for re-perfection after a secured party becomes knowledgeable of a transfer of collateral to

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216 “Anti-tardy” perfection curiously only applies to corporate debtors in Australia (s588FL Corporations Act 2001). See discussion above in Part D, Chapter III.
217 Crowther report, above n 208, at [5.7.55].
218 Diamond, above n 23, at [11.3.8.].
219 Companies Act 1993, s293(4A).
220 Section 293 of Companies Act 1993 voids, with exclusions, security interests which came into existence within 6 months of liquidation if the company is insolvent. The relevant security interests we are concerned with here are those security interests excluded from the operation of s293. For example, a secured creditor who has given new value or a secured creditor within s296(3).
221 Corporations Act 2001 (Aus), s588FL.
another debtor. Presumably the legislature is of the view that, as a matter of policy, a 15 day window is reasonably sufficient for registration.

(iv) Security over future property

A technical deficiency of the proposed provision, as identified above, is that it brings into doubt the efficacy and value of security interests over after-acquired property. Under the proposed primary provision, property acquired after the specified time will always disappear into the hands of the insolvency administrator as perfection cannot be achieved until attachment upon possession. This outcome is despite the all asset security being registered before the specified time. While s267A of the Australian PPSA misconceives the real issue with all asset securities, the spirit of the provision can be borrowed to address the concern. In other words, the defect should be remedied with a provision which provides that a security interest does not vest in the grantor if at the time the debtor entered into insolvency there is a registration on the PPS register that would perfect the security interest when it attached and that attachment occurred after the debtor entered into insolvency.

(v) Exempted categories

No transaction will be exempt from the application of the primary provision. That is, deemed security interests which do not in substance secure payment or obligation will be subjected to the sanction of invalidity if unperfected at the specified time. The legislature has recognised as a matter of policy that these transactions are in substance consistent with the core function of security interests. As such, given the fundamental goal of the PPSA to treat like transactions alike, carving out exemptions will be inconsistent with the core function of the Act. Further, excluding these transactions is likely to induce wasteful litigations over matters of whether a transaction is a “deemed” or “in-substance” security. This has been seen in the United States in the context of true leases which are excluded from the operation of Article 9. An exemption provision will thus not be recommended with the proposed amendments. Subjecting “deemed”

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222 Personal Property Securities Act 1999, s88.
223 See discussion above Part D, Chapter III.
224 As recommended by Clayton Utz in their submission to the Senate Committee; see Diamond, above n 23, at 10.
225 Compare Personal Property Securities Act 2009 (Aus), s268. See discussion in Part D, Chapter III.
226 See White, above n 60; see also Part B, Chapter III.
security interests to the operation of s267 may appear to conflict with the policy behind s105 which protects “deemed” security interest holders from the enforcement rights of competing creditors. However, s105 is about protecting these “deemed” secured creditors from other secured creditors. Whatever the justification may be for the s105 protection, it is irrelevant to the relationship between these “deemed” security interest holders and unsecured creditors who they disadvantage through non-registration. Indeed, many provincial Canadian PPSAs protect “deemed” security interest holders from the enforcement rights of other creditors yet make their interests vulnerable to trustees and liquidators in insolvency proceedings.

(vi) Compensation for affected parties

A statutory compensation provision will be enacted to ensure that lessors, bailors and consignors do not lose title to the operation of the primary provision with no avenue of seeking adequate compensation for their lost value. As discussed previously, lessors, bailors and consignors are parties deserving of protection as they may have lost value that exceeds the amount that is secured to them. Under such circumstances, unless otherwise provided by the statute, they will be unable to make a provable claim for an amount that is truly representative of their loss. Consequently, other creditors would gain a windfall. There are sound reasons for allowing a lessor, bailor or consignor to make a claim for the full value of their loss in these circumstances. The legislature has decided that as a matter of policy, leases, bailments and consignments should be deemed security interests for the purposes of the PPSA whether or not these transactions in substance secure payment or performance. As such, every element of these transactions should be viewed through the lens of a security interest. That is to say, lessors, bailors and consignors should be treated as creditors and be entitled to participate in the debtor’s insolvency. The appropriate amount of their claims should, as the case may be with any other creditor, equate the amount receivable from the lessee, bailee or consignee outside insolvency. In the case where the leased, bailed or consigned property would have been repossessed at the expiry of the lease,

227 Personal Property Securities Act 1999, s105. The provision exempts from Part 9 of the Act (i) a transfer of an account receivable or chattel paper; (ii) a lease for a term of more than 1 year that does not secure payment or performance; and (iii) a commercial consignment that does not secure payment or performance.

228 Recall from Chapter II above, invalidation of security interest is justified as the informational deficiencies brought about by non-registration disadvantages unsecured creditors.

229 See for example PPSAs: (NB, S, BC): s55.

230 Personal Property Securities Act, s17(1)(b).
bailment or consignment, the value of the property can be seen as an amount that was receivable and owing by the debtor. Thus, any lessor, bailor or consignor affected by the operation of the primary provision should be able to recover an amount equal to the greater of either the market value of the leased, bailed or consigned property or an amount determined in accordance with the lease, bailment or consignment.

(vii) Terminology in related statutes

For purpose of coherency, terminology amendments should be made to the Companies Act and Insolvency Act. As discussed in Chapter II, conceptual problems are imminent at the interface of the PPSA and insolvency legislations as the separate branches of law rely on different concepts of “property”. As such, the scope of “property” must be broadened in these related legislations to match the more “functional” terminology that is reflected in the PPSA. This will hopefully eliminate the need for courts to exercise judicial ingenuity to refine the concept of property. Further, out- dated concepts should be discarded in favour of broader terms which are consistent with the functional approach of the PPSA. It is thus recommended that the concept of “security interest” should be introduced to replace “charge”, and the concept of “secured creditor” should be broadened to include PPSA secured creditors. There is a need to substitute the out- dated concepts with the new for the purposes of distributing the property of the insolvent debtor. These terms will help to more clearly define the property distributable among general creditors and ensure orderly liquidation processes.

D. Conclusion

Implementing the sanction of invalidity for unperfected security interests in insolvency proceedings is an intricate task. The rules operate at the functional interface of secured transactions law and insolvency law thus they must bridge the conceptual lapse between related legislations. The mechanism proposed for New Zealand to effect the invalidation rule is essentially a hybrid Canadian- Australian approach (see Appendix A). Though the proposed provisions largely resemble the Canadian and Australian sections, they do not suffer the same technical deficiencies. The proposed provisions achieve the intended effects without being linguistically or conceptually cumbersome. They can be easily applied across a broad range of scenarios (see Appendix B).
The provisions proposed give primacy to key considerations of secured transactions law – that is, certainty and uniformity. The rules uniformly apply to all transactions (with no exemptions) within the umbrella of the Personal Property Securities Act whether it be created by individuals or incorporated companies. This approach is largely consistent with the initial vision the reformers had for the PPSA in New Zealand. Rules which can clearly define the rights of parties will increase the value of credit transactions and expediency in the credit industry. Subsequently, the value of assets can be fully realised and the welfare of the economy as a whole will be promoted.
Appendix A

Personal Property Securities Act 1999

Recommended amendments in the PPSA are as follows:

1. Primary provision

Section 107A unperfected security interests invalid against certain persons

(1) A security interest is not effective

(a) against a liquidator appointed pursuant to Part 16 of the Companies Act 1993 if the security interest is unperfected within 6 months prior to the day that the liquidator is appointed, or;

(b) against an Official Assignee in bankruptcy appointed pursuant to Part II of the Insolvency Act 2006 if the security interest is unperfected within 6 months prior to the day that the debtor is adjudicated bankrupt, or;

(c) against a receiver appointed by the court to administer the debtor’s assets in the interests of creditors generally if the security interest is unperfected within 6 months prior to the day that the receiver is appointed;

unless the security interest was perfected within 15 days from the day the security agreement that gave rise to the security interest came into force

(2) Any security interest that is affected by the operation of subsection (1) shall vest in the grantor

(3) For the avoidance of doubt, a security interest registered after

(a) the day the liquidator is appointed, or;

(b) the day the debtor is adjudicated bankrupt, or;

(c) the day the receiver is appointed by the court

is not effective for the purposes of subsection (1) and shall be subjected to subsection (2)

2. Security for after-acquired property

Section 107B certain security interests that attaches after winding up does not vest in the grantor:
(1) A security interest does not vest in the grantor under s107(2) for the reason that it attached to the collateral after the relevant time if at the relevant time there was a registered financing statement that would perfect the security interest when it attached

(2) For the purposes of subsection (1), relevant times is:
   (a) 6 months prior to the day that a liquidator is appointed; or
   (b) 6 months prior to the day that the debtor is adjudicated bankruptcy; or
   (c) 6 months prior to the day that a receiver is appointed

3. Measure of damages for deemed secured parties

Section 103C certain lessors, bailors and consignors entitled to damages

(1) This section applies if either of the following security interests is vested in the grantor under s107A(2):
   (a) A security interest of a consignor under a commercial consignment;
   (b) A security interest of a lessor or bailor under a lease for a term of more than one year

Entitlement to damages and compensation

(2) The consignor, or lessor or bailor:
   (a) Is taken to have suffered damage immediately before the time the security interest vests in the grantor under s107A(2); and
   (b) May recover an amount of compensation from the grantor equal to the greater of the following amounts:
      (i) The amount determined in accordance with the lease, bailment or consignment;
      (ii) The sum of the market value of the leased, bailed or consigned property immediately before the time mentioned in s107A(1) and the amount of any other damage or loss resulting from the termination of the lease, bailment or consignment

Note: The lessor, bailor or consignor may be able to prove the amount of the compensation in proceedings related to the bankruptcy or winding-up of the grantor
4. Terminology

The term grantor should be defined for the purposes of Part 9 Enforcement of security interests

Section 104A meaning of Grantor:

“Grantor” means:

(a) A person who has the interest in the personal property to which a security interest is
attatched (whether or not the person owes payment or performance of an obligation
secured by the security interest); or

(b) A person who receives goods under a commercial consignment; or

(c) A lessee under a PPS lease; or

(d) A transferor of an account or chattel paper; or

(e) A transferee of, or successor to, the interest of a person mentioned in paragraphs (a)
to (d); or

(f) In relation to a registration with respect to a security interest

(i) A person registered in the registration as a grantor; or

(ii) A person mentioned in paragraphs (a) to (e)

Terminology amendments in related legislations

Recommended terminology amendments for the Companies Act 1993 and the Insolvency Act 2006 are as follows:

“Secured creditor”, in relation to a debtor, means:

(a) In the case of a debt secured by a security interest – the PPSA secured party in relation to
the interest, if the interest:

(i) Arose as security for the debt; and

(ii) Is perfected (within the meaning of the Personal Property Securities Act 2009); or

(b) In the case of any other debt – a person holding a mortgage, charge or lien on property of
the debtor as a security for a debt due to him or her from the debtor

Security interest, means a perfected security interest in accordance with the meaning provided
by the PPSA 1999
Property

For the purposes of Part 16 Companies Act 1993: “property” of the company includes PPSA retention of title property, if the security within the property is vested in the company because of the operation of s107A(2) of the Personal Property Securities Act.

There is no need to broaden the definition of “property” under the Insolvency Act 2006 as s101 takes into account property which has “vested” in the bankrupt.

PPSA retention of title property

Companies Act 1993

(1) Property is PPSA retention of title property of a company if:
   (a) the property is personal property; and
   (b) the property is used or occupied by, or is in the possession of the company; and
   (c) the company does not have title to the property; and
   (d) a PPSA security interest is attached to the property, within the meaning of the Personal Property Securities Act 1999; and
   (e) the company is the grantor in relation to the PPSA security interest, within the meaning of that Act.

Insolvency Act 2006

(1) Property is PPSA retention of title property of a person if:
   (a) the property is personal property; and
   (b) the property is used or occupied by, or is in the possession of the person; and
   (c) the person does not have title to the property; and
   (d) a PPSA security interest is attached to the property, within the meaning of the Personal Property Securities Act 1999; and
   (e) the person is the grantor in relation to the PPSA security interest, within the meaning of that Act.
Appendix B (2)

1. DebtorA grants FinanceA a security interest in its all present an after- acquired property. FinanceA registers its security interest 10 days after the creation of the security interest. DebtorA becomes insolvent 30 days after the security interest is granted. FinanceA’s security interest would be effective because registration was made within the required 15 day period (despite the fact the registration was made within 6 months prior to the insolvency).

2. DebtorA grants FinanceA a security interest in its all present and after- acquired property. FinanceA registers its security interest 20 days after the creation of the security interest. DebtorA becomes insolvent 30 days after the security interest is granted. The security interest would be ineffective under s107A(1) because FinanceA did not register the security interest within the required 15 day period or within six month period prior to the critical time. As a result, the security interest would vest in DebtorA under s107A(2).

3. DebtorA grants FinanceA a security interest in its all present and after- acquired property. FinanceA registers its security interest 20 days after the creation of the security interest. DebtorA becomes insolvent eight months after the security interest is granted. FinanceA’s security interest would be effective because it registered its security interest prior to the six month period before the critical time thus falling outside s107A(1).

4. DebtorA grants FinanceA a security interest in its all present and after- acquired property. FinanceA registers its security interest 10 days after the creation of the security interest. DebtorA becomes insolvent 6 months and 5 days after the security interest is granted. FinanceA’s security interest would be effective because registration was made within the required 15 day period (despite the fact the registration was made within 6 months prior to the insolvency).

5. DebtorA grants FinanceA a security interest in its all present and after- acquired property. FinanceA registers its security interest 20 days after the creation of the security interest. DebtorA becomes insolvent 6 months and 5 days after the security interest is granted.
The security interest would be ineffective under s107A(1) because FinanceA did not register the security interest within the required 15 day period or within six month period prior to the critical time. As a result, the security interest would vest in DebtorA under s107A(2).

6. DebtorA grants FinanceA a security interest in its all present and after-acquired property. FinanceA registers its security interest 10 days after the creation of the security interest. DebtorA becomes insolvent 5 days after the security interest is granted. The security interest would be ineffective under s107A(3) as a security interest cannot be registered after the critical time. As a result, the security interest would vest in DebtorA under s107A(2).
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