

REGISTRATION OF SECURITY INTERESTS

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SIGNIFICANCE OF THE PPSR

A central registry

The Personal Property Securities Register ("PPSR") is now, with limited exceptions, the central, online, debtor-based register of security interests in personal property for New Zealand.

The PPSR replaces the four registries previously constituted under each of the Chattels Transfer Act 1924, the Companies (Registration of Charges) Act 1993, the Motor Vehicle Securities Act 1924 and Part II of the Industrial and Provident Societies Amendment Act 1952.

One registration regime

Under pre-PPSA law, different registration regimes applied depending on the identity of the debtor, the nature of the secured party's interest and the type of personal property involved.

By contrast, with the PPSR the same registration and priority rules apply to:

- all debtors (companies, incorporated societies, incorporated charitable trust boards, industrial and provident societies, building societies, partnerships, friendly societies and credit unions, trusts, others);
- all security interests (regardless of form); and
- all types of personal property.

Note, though, that separate registries continue to exist for security interests arising under the Fisheries Act 1983, the Fisheries Act 1996, the Local Government Act 1974, the Radiocommunications Act 1989 and the Ship Registration Act 1992.

SIGNIFICANCE OF REGISTRATION

Why register?

As a secured party's claim to title in the collateral is irrelevant for the purposes of the PPSA (PPSA, s24), registration is vital as it:

- gives notice of a secured party's security interest in collateral; and
- serves as the principal mechanism for ranking priority between secured parties.

Notice of security interest

Registration serves as notice of a secured party's purported interest in personal property held by a debtor (but registration of a financing statement does not of itself constitute constructive notice or knowledge of its existence or contents to any person (PPSA, s20)).

The PPSR is a notice registry, rather than a document registry. Financing statements (identifying the debtor, the secured party and the relevant collateral) are registered; actual security agreements are not.

Principal mechanism for ranking priority

Registration is the principal mechanism for ranking priority both among secured parties and as between a secured party and the debtor's general creditors. An assessment of the priorities between competing security interests begins (but does not end) with a search of the PPSR.

Assuming a security interest has attached (PPSA, s40), a secured party may perfect the security interest:

- by registering a financing statement on the PPSR (PPSA, s4(1)(b)(i)); or
- by taking possession of the collateral (PPSA, s41(1)(b)(ii)).

A perfected security interest has priority over an unperfected security interest in the same collateral (PPSA, s66(a)).

With competing unperfected security interests in the same collateral, the first to attach has priority (PPSA, s66(c)).

When two or more security interests in the same collateral are perfected, priority is determined by the order of whichever of the following occurs first:

- registration of a financing statement;
- the secured party taking possession of the collateral;
- the temporary perfection of the security interest (PPSA, s66(b)).

By and large, the timing of attachment and perfection are irrelevant for determining priority between perfected security interests. As such, the timing of registration (as opposed to the timing of attachment or even perfection) can be crucial (but note that the priority of purchase money security interests depends on the timing of perfection and not the timing of registration (PPSA, s73, s74)).

Registration alone is not enough

Registration of a financing statement on the PPSR is not, by itself, sufficient for a secured party to assert priority over all other secured parties claiming security interests in the same collateral.

Registration does not achieve perfection of a security interest unless there has first been attachment of the security interest (PPSA, s41), and security interests are not enforceable

against third parties unless the formal requirements for security agreements have been met (PPSA, s36).

But failure to register is not always fatal

It is, ultimately, a commercial decision for a secured party as to whether it complies with the formal requirements of the PPSA, or not. Commercial issues aside, a failure to register a security interest will not necessarily be fatal for a secured party.

A security interest is enforceable against a debtor even if the formal requirements for security agreements (PPSA, s36) are not met and there has been no attachment (PPSA, s40) of the security interest.

Assuming the formal requirements for security agreements have been met, there has been attachment, and there are no other perfected security interests in the collateral, a failure to register a security interest is not fatal in and of itself: unperfected security interests are enforceable against third parties (PPSA, s36) with priority between competing unperfected security interests in the same collateral determined by the time of attachment (PPSA, s66(c)).

DATA REQUIRED TO REGISTER FINANCING STATEMENTS

Basic data

Financing statements are registered online (www.ppsr.govt.nz).

The basic data required (PPSA, s142; PPS Regulations) is:

- Debtor: full name, address, type of organisation (company; incorporated society; incorporated charitable trust board; industrial and provident society; building society; partnership; friendly society or credit union; trust; other), date of birth (if applicable), incorporation number (if applicable), name and address of person acting on behalf (if organisation);
- Secured party: name, address, name and address of person acting on behalf (if organisation);
- Collateral: description, type (goods: motor vehicles; goods: aircraft; goods: livestock; goods: crops; goods: other; documents of title; chattel paper; investment securities; negotiable instruments; money; intangibles; all present and after-acquired property; all present and after-acquired property except);
- Date of registration under pre-PPSA law.

Debtors

Companies

A "company", as a debtor for PPSR purposes, is a New Zealand-incorporated company. An overseas company should be classed as "other" and not a "company".

Trusts and partnerships as debtor organisations

Trusts and partnerships may be regarded as debtor organisations, even though neither trusts nor partnerships have legal personality separate from, in each case, the trustees or partners. From a PPSR registration point of view, this allows for administrative ease, particularly with large partnerships and when there are changes of trustees or partners. But a trust or partnership without a name gives rise to a registration dilemma: whether or not to register against all of the trustees or partners as individuals.

Serial numbered goods

Types of serial numbered goods

At this stage, only motor vehicles and aircraft which are consumer goods or equipment (and not inventory) constitute serial numbered goods (PPS Regulations, r3).

Data required for serial numbered goods

The data required for serial numbered goods (PPS Regulations, r9) is:

- whether the goods are a motor vehicle or an aircraft;
- the year of manufacture of the goods;
- the make or name of the manufacturer and the model of the goods;
- in the case of a motor vehicle, the registration number (if any) of the motor vehicle concerned and, if it has a vehicle identification number, that number or, if it has no vehicle identification number but it has a chassis number, its chassis number;
- in the case of an aircraft, the aircraft class and, if it has a registration mark and a nationality mark, those marks and, if it has a serial number provided by the manufacturer of the aircraft, that number.

TIMING OF REGISTRATION

A financing statement may be registered at any time (but, when priority is determined by the timing of registration (PPSA, s66(b)), a financing statement must be registered within the prescribed timeframes). Security agreements are not registered, so it is possible to register a financing statement on the PPSR before the relevant security agreement, which gives rise to the security interest, has been signed.

A registered financing statement serves as a warning to searchers that one or more security interests may, now or in the future, relate to the collateral referred to.

ACCURACY OF FINANCING STATEMENTS ¹

¹ For a more detailed discussion, see:

- Gedye, *Reflections on some Practical Issues which have arisen under New Zealand's Personal Property Securities Act and some lessons for Australia* (2004) 15 JBFLP 20.
- PPSA – *Seriously misleading financing statements* (2005) NZLJ 107.
- Widdup and Mayne, *Personal Property Securities Act: A Conceptual Approach*.

Importance of accuracy

The registration of an inaccurate, and potentially invalid, financing statement may be disastrous for a secured party. A security interest which remains unperfected due to inaccuracies in the financing statement, will be vulnerable to a loss of priority.

The PPSR does not identify defective financing statements at the time of registration. As such, a defect in a financing statement may remain undetected until it is too late. The responsibility falls to the secured party alone to ensure that there are no invalidating defects in a financing statement.

But there is some relief from this otherwise onerous responsibility: a defective registration will still perfect a security interest provided the defect is not seriously misleading (PPSA, s149).

Registration invalid only if seriously misleading

The validity of the registration of a financing statement is not affected by any defect, irregularity, omission, or error in the financing statement unless the defect, irregularity, omission, or error is seriously misleading (PPSA, s149).

The PPSA gives some (non-exhaustive) guidance as to when a financing statement will be invalid. A registration is invalid if there is a seriously misleading defect, irregularity, omission, or error in:

- the name of any debtors to be included in the financing statement (other than a debtor who does not own or have rights in the collateral); or
- the serial number of the collateral if the collateral is consumer goods, or equipment, of a kind that is required by the regulations to be described by serial number in a financing statement (PPSA, s150).

In order to establish that a defect, irregularity, omission, or error is seriously misleading, it is not necessary to prove that any person was actually misled by it (PPSA, s151).

(Broadly) two types of inaccuracy

Financing statements may be defective in one (or both) of the following respects:

- a defect in the information which forms part of the searchable criteria; and
- a defect of some other type.

Defects in searchable criteria

A defect in the information which forms part of the searchable criteria may be fatal.

This section of the paper summarises the key aspects of the discussions in each of these publications.

Although the PPSA identifies defects in debtor names and serial numbers as examples of when a defect in a searchable field may lead to invalidity (PPSA, s150), no guidance is given as to when the error will be seriously misleading so as to lead to invalidity.

The New Zealand courts are yet to consider when a defect in the information which forms part of the searchable criteria will be seriously misleading. Two approaches to this problem have emerged in Canadian jurisprudence:

- Would a reasonably prudent searcher have located the financing statement?

This approach begs the question of what searches a reasonably prudent searcher should undertake. The nature of those searches will, in turn, depend on the search capability of the relevant registration system. The New Zealand system utilises exact match software. There is no ability to search for inexact matches. The PPSR does, however, enable the use of “wildcard” searches, but even a wildcard search entry will only identify exact matches of the information entered. And where in the search field should the wildcard be placed? Should a searcher be obliged to execute a wildcard search with every attempted exact match search? In the case of companies, should a searcher be obliged to execute a wildcard search, a debtor name search and an incorporation number search when the registered information in any one or more of those criteria may be defective.

- Will a properly formatted search identify the financing statement in either the debtor name field or the serial number of the collateral?

This approach depends on the information retrieval capabilities of the relevant registration system.

Until these issues are considered judicially in New Zealand, a prudent secured party will take all necessary care to ensure accuracy of information in a financing statement which comprises a searchable field.

Defects of some other type – collateral descriptions

Defects in financing statements that do not relate to searchable fields will rarely be fatal, except for defective collateral descriptions.

Whereas the requirements for collateral descriptions in financing statements are reasonably prescriptive (PPSA, ss36-39), very little guidance is given as to the sufficiency of collateral descriptions in financing statements. A financing statement must contain a description of the collateral (PPSA, s142(1)(e)), but there is no reference to “item or kind” or a description which “enables the collateral to be identified (PPSA, s36). When registering a financing statement, a secured party selects one or more of thirteen categories of collateral (goods: motor vehicles; goods: aircraft; goods: livestock; goods: crops; goods: other; documents of title; chattel paper; investment securities; negotiable instruments; money; intangibles; all present and after-acquired property; all present and after-acquired property except) (PPS Regulations, Sch1, cl8(1)), and then is required to give a “further description” (PPS Regulations, Sch1 cl8(2)), but no guidance is given as to what is sufficient as a further description.

The risks for a secured party are two-fold:

- An overly specific collateral description risks omitting items of collateral; and

- An overly broad collateral description may prompt a debtor to file a change demand requiring the description to be amended.

Overly specific/omission

Failure to include a description of any item or kind of collateral in a financing statement does not affect the validity of the registration in respect of the description of other collateral included in the financing statement (PPSA, s152). As such, a financing statement will perfect the security interest in the collateral described, but not the security interest in the collateral the financing statement fails to describe.

Overly broad

There has been some recent (but possibly not final) judicial comment on this issue:

Service Foods Manawatu Limited (In Receivership and In Liquidation) v NZ Associated Refrigerated Food Distributors Limited (2006) 9 NZCLC 263,979. The relevant facts, issue and finding were as follows:

NZARFD supplied goods to SFML, and registered its security interest against SFML on 23 December 2004. In the financing statement, NZARFD selected "All present and after acquired property" as the collateral type, and recorded the collateral description as "Being all the debtors personal property and all other property".

Westpac Banking Corporation held a general security over SFML, perfected by registration of a financing statement on the PPSR on 22 October 2003.

When SFML went into receivership, the receivers made an application to the Court for orders determining whether NZARFD had a perfected purchase money security interest in respect of collateral held by the receivers at the premises of SFML.

Amongst other things, the Court considered whether there was any seriously misleading defect, irregularity, omission or error in NZARFD's financing statement so as to render it invalid.

Goddard J held that an overly broad collateral description would not render a financing statement invalid. In support of this finding, His Honour cited the following passage from Widdup and Mayne, "Personal Property Securities: A Conceptual Approach":

The PPSA does not penalise overly broad collateral descriptions in financing statements. The security agreement, not the financing statement, governs the terms of the security and reflects the intentions of the parties with respect to the collateral provided to secure the obligation. An overly broad financing statement collateral description should not be viewed as an attempt by the secured party to subject the collateral to the security agreement to which the debtor did not agree. The PPSA indicates that the secured party will only have a valid security interest in the property described in the security agreement and this is not affected by the fact that the financing statement defines the collateral.

For example if a secured party registers a financing statement describing the collateral as all of a debtor's present and after acquired property, but the security

agreement evidences that a security interest is taken in all of the debtors accounts receivable only, then the financing statement perfects the security interest in the accounts receivable only, but not in any other property.

It was also noted that NZARFD's security interest was not just in inventory supplied, or its proceeds, but in all of the present and after acquired property of SFML, if proceeds of the inventory was used to pay for that property.

Goddard J noted that the real mischief to which the concept of "seriously misleading" must be directed is the prevention of a searcher from being able to find a financing statement because of error in either the debtor name or the collateral's serial number – as opposed to potentially broad collateral descriptions.

Relationship between security agreements and financing statements

The possible permutations of errors between financing statements and security agreements which have been identified² are:

- *Ineffective security agreement, but valid financing statement:* A secured party should take immediate steps to rectify a defect identified in a security agreement. There is no time limit for compliance with the formalities of s36, but immediately prior to any enforcement procedures would seem to be the latest time. The options are to amend the current security agreement or enter into a new one. If the debtor does not agree, seizure of the collateral may be necessary. A key issue from the point of view of third parties is that a valid financing statement does not necessarily mean that a valid security agreement is in place. Third parties, receivers and the like must look behind the register to ascertain the true position.
- *Effective security agreement, but invalid financing statement:* The security interest will have attached, but the invalid financing statement will render the security interest vulnerable to the loss of priority. The problem may be rectified at any time before the secured party attempts to enforce its security interest. Rectification may be effected either by financing change statement (but this draws the attention of third parties to the initial problem) or by registration of a new financing statement. A key issue from the point of view of third parties is not to assume that a financing statement is necessarily valid.
- *Ineffective security agreement and invalid financing statement:* The problems are compounded here and rectification of both the security agreement and the financing statement is required.

Financing statements which may become invalid

A financing statement which is valid at the time of registration may become invalid due to a change in circumstances.

A change in some characteristic in the collateral may occur. To minimise the risk that a change may lead to invalidity, care should be taken to draft the collateral description broadly.

² See Gedye, *Reflections on some Practical Issues which have arisen under New Zealand's Personal Property Securities Act and some lessons for Australia* (2004) 15 JBFLP 20

A change in debtor name may render a financing statement seriously misleading. But the rules for determining priority between interests in that context suggest that the registration remains valid, but with priority issues potentially affected. A secured party who becomes aware of a debtor's change of name should register a financing change statement immediately. But as far as priority issues are concerned, to maintain priority the secured party must register the financing change statement within 15 days of acquiring the relevant knowledge (PPSA, s89).

A transfer of collateral by the debtor may expose a secured party to a loss of priority. If a secured party consents to the transfer, then a financing change statement must be registered within 15 days of the transfer (PPSA, s90). If the secured party acquires knowledge of the transfer, then the financing change statement must be registered within 15 days of the secured party acquiring the relevant knowledge (PPSA, s90).

Correction of errors

A secured party may amend its financing statement to correct any errors. However, the necessary financing change statement must be registered during the period that the registration is effective (PPSA, s160(1)). In addition, the amendment is effective only from the time that the financing change statement is registered to the date of expiry of the registration being amended (PPSA, s160(2)). This means that an amendment will not have retrospective effect and a financing statement which was seriously misleading until it was amended will not be valid until the amendment date.

DURATION AND RENEWAL OF FINANCING STATEMENTS

A financing statement expires five years after registration, or earlier if specified at the time of original registration (PPSA, s153).

Once a financing statement expires, the priority afforded by the registration may be lost. If a secured party discovers that a registration has expired due to effluxion of time, any reregistration will take effect only from the date of reregistration and not from the date of registration.

This may have the effect of delivering a windfall to subsequent secured parties. A subsequent secured party who takes a security interest knowing that it is subsequent to a prior registration will take priority by virtue of the lapse – even though the lapse did not disadvantage the subsequent secured party or alter its original expectations.

The PPSR provides no advance warning to secured parties that their registrations are due to expire. As such, renewal within time is dependant on secured parties diarying the necessary renewals.

A financing statement can be renewed for successive periods of up to five years, provided the renewal is effected before the financing statement expires (PPSA, s154).

The first rounds of expiring financing statements will be seen from May 2007.

SEARCHING – WHAT THE PPSR DOES NOT REVEAL

An assessment of the priorities between competing security interests begins (but does not end) with a search of the PPSR. A search of the PPSR will reveal the time at which various

financing statements were registered against a debtor, but by itself that information does not determine priority and does not necessarily give the full picture regarding the debtor.

Amongst other things, information as to the following may be required ³:

- Whether the debtor has changed its name such that there are financing statements registered against the debtor's old name (a search by incorporation number, where possible, will reduce the risk in this regard). A secured party with earlier security interests who registers a financing change statement or takes possession of the collateral within the prescribed timeframes (PPSA, s90) will be able to retain priority over subsequent registered security interests.
- Whether the intended collateral has been transferred to the debtor subject to security interests granted by the transferor. A secured party of a transferor with earlier security interests who registers a financing change statement or who takes possession of the collateral within the prescribed timeframes (PPSA, ss88-90) will be able to retain priority over subsequent registered security interests.
- An unperfected purchase money security interest held by another secured party in collateral that is not inventory may take priority (even though not yet revealed in a register search) if the secured party registers its security interest within the prescribed timeframes (PPSA, ss73-75).
- Subsequent registered security interests may be defeated by other secured parties who obtained temporary perfection or took possession of the relevant collateral at an earlier point in time.
- Whether there are any off-register subordination arrangements.
- When the debtor took possession of the relevant collateral (relevant for assessing whether a purchase money security interest has been obtained).

A searcher of the PPSR is alerted by the collateral description in a financing statement that certain assets may be subject to a security interest. But in the absence of an accurate collateral description, a searcher can only be sure of the position by requesting a copy of the relevant security agreement (PPSA, s177(1)(a)) or by asking the secured party to confirm whether one or more items are subject to the relevant security agreement (PPSA, s177(1)(c)).

A prudent searcher will seek further information from its intended debtor and any relevant third party creditors. A debtor, judgment creditor, person with a security interest in personal property of the debtor, or an authorised representative of any of them, may request from a secured party (PPSA, s177):

- A copy of the relevant security agreement;
- A statement in writing of the amount of the indebtedness and of the terms of payment of the indebtedness;

³ Eady and Jackson, *PPSA – a review four years on* NZLS, October 2006

- A written approval or correction of an itemised list of personal property indicating which items are collateral, unless the security interest is over all of the personal property of the debtor;
- A written approval or correction of the amount of indebtedness and of the terms of payment of the indebtedness.

A secured party must comply within 10 working days of receipt of a request for information (PPSA, s178) unless a court determines that it is unreasonable for the secured party to comply with the request (PPSA, s179).

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