

## CONCEPTUALISING THE RIGHTS OF A LESSEE UNDER THE PERSONAL PROPERTY SECURITIES REGIME: THE CHALLENGE OF ‘NEW LEARNING’ FOR AUSTRALIAN LAWYERS

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This paper focuses on a statutory provision common to Australian, New Zealand and Canadian personal property securities legislation which requires a grantor of a security interest generally to have ‘rights in the collateral’ before a security interest can attach to that collateral. It analyses the extent to which a particular construction of that provision, initially developed by Canadian courts and commentators in the context of certain lease transactions and now applied in New Zealand, may and should colour construction of the equivalent Australian legislation. The paper argues that ‘new learning’, which holds the interest of a lessee sufficient to enable a security interest to attach to leased goods, is capable of achievement through different reasoning to that currently adopted by New Zealand courts. Such reasoning has significant implications for understanding when a security interest may attach to personal property more broadly.

### I INTRODUCTION

As Australian lawyers come to grips with the *Personal Property Securities Act 2009* (Cth) (*PPSA*), one New Zealand case on the equivalent New Zealand legislation tends quickly to come to their attention – *Graham v Portacom New Zealand Ltd* [2004] 2 NZLR 528 (*Portacom*). This was, in fact, the first case to be decided by the High Court of New Zealand under the legislation and has gained some notoriety<sup>1</sup> amongst those encountering the personal property securities (*PPS*) regime for the first time. It highlights a critical difference between the legislative regime and the common law: the fact that a lessee of goods may be able to create security over the goods despite having merely a

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1 For articles and notes discussing the general impact of this case, see, eg, Mike Gedye, ‘What’s Yours is Mine: Attachment of Security Interests to Third Party Assets’ (2004) 10 *New Zealand Business Law Quarterly* 203; Barry Allan, ‘Personal Property Securities in the Courts: A New Era Begins’ (2004) 32 *Australian Business Law Review* 372; Duncan Webb, ‘Commercial Law: Personal Property Securities’ [2004] *New Zealand Law Review* 367; Richard North, ‘The New Zealand Personal Property Securities Act: Growing Pains’ (2005) 11 *Canterbury Law Review* 123.

possessory interest in those goods at common law. The case drives home a fundamental point, reflected in the very definition of a security interest,<sup>2</sup> that holding title to property is no longer a critical factor in creating a security interest over that property.

While New Zealand cases can obviously only be of persuasive authority on the interpretation of Australian legislation, the judicial approach is nonetheless of significant interest. The *NZPPSA* came into force in 2002 and there is now a growing body of case law on its interpretation and application. Australian courts are likely, at least in the early days of the operation of the Australian legislation,<sup>3</sup> to consider the reasoning of their New Zealand counterparts and to reflect on the extent to which that reasoning may shed light on the issues before them. In doing so, Australian courts are also likely to be drawn into considering Canadian case law, given the extent to which the New Zealand legislation is based<sup>4</sup> on Canadian legislation which was largely introduced across the provinces in the 1980s and 1990s, following its initial implementation in Ontario in 1976.<sup>5</sup> In *Portacom*, the High Court of New Zealand described the relevant Canadian authorities as directly applicable,<sup>6</sup> although in the following year the Court of Appeal in *Waller v New Zealand Bloodstock Ltd* [2006] 3 NZLR 629 (*Bloodstock*<sup>2</sup>) emphasised

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2 '[A]n interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, *without regard to – (i) the form of the transaction; and (ii) the identity of the person who has title to the collateral; ...*': *Personal Property Securities Act 1999* (NZ) s 17 (*'NZPPSA'*) (emphasis added). In Australia, see *PPSA* s 12(1): 'an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (*without regard to the form of the transaction or the identity of the person who has title to the property*)' (emphasis added).

3 It is currently expected to become operative in early 2012.

4 See Michael Gedye, Ronald C C Cuming and Roderick J Wood, *Personal Property Securities in New Zealand* (Thomson Brookers, 2002) especially Introduction, 1, 19. The New Zealand legislation is based on the Saskatchewan *Personal Property Security Act*, SS 1993, c P-6.2 (*'Sask PPSA'*): see generally Linda Widdup and Laurie Mayne, *Personal Property Securities Act: A Conceptual Approach* (LexisNexis Butterworths, revised ed, 2002) ch 1.

5 See generally Ronald C C Cuming, Catherine Walsh and Roderick J Wood, *Personal Property Security Law* (Irwin Law, 2005) ch 1. The Ontario legislation differs however in significant respects from that of other provinces. For a discussion of similarities and differences in Canadian and Australian legislation, see John Stumbles, 'Personal Property Security Law in Australia and Canada: A Comparison' (2011) *Canadian Business Law Journal*, forthcoming. Canadian legislation was itself modelled on Art 9 of the *Uniform Commercial Code* (US), which was first introduced in the US in the 1960s and most recently revised in 1999. See generally James J White and Robert S Summers, *Uniform Commercial Code* (West Thomson Reuters, 6<sup>th</sup> ed, 2010) chs 22–26.

6 [2004] 2 NZLR 528 [20].

that a decision will ultimately be based on the interpretation of the New Zealand legislation.<sup>7</sup>

Both New Zealand and Canadian courts have emphasised the need for ‘old learning’ to be set aside and for new approaches to be adopted.<sup>8</sup> With a considerable international body of jurisprudence to draw upon, a fascinating question is the extent to which Australian courts will adopt others’ learning on these new concepts. While there are differences in each statutory regime, both substantive and linguistic, there are also many common points, including, not surprisingly, some fundamental concepts. To what extent will this comparative body of ‘new learning’ prevail on the interpretation of the legislation? Of particular interest is a situation where that learning is specifically based on experience under a pre-PPS regime different to that of Australia or on interpretation of legislative provisions which achieve the same outcome as the Australian legislation but through different drafting.

This paper raises these general questions in the context of analysing one specific provision which is common in substance to Canadian, New Zealand and Australian jurisdictions and which was a preliminary focus of attention in *Portacom*. This provision<sup>9</sup> states that a security interest attaches<sup>10</sup> when, amongst other criteria, the person granting the security interest<sup>11</sup> has ‘rights in the collateral’. Drawing substantially on Canadian authority and commentary, *Portacom* acknowledges ‘new learning’ that certain lessees<sup>12</sup> have sufficient rights to enable the security interest to attach to the leased goods. *Portacom* holds that such lessees may have two distinct rights for the purposes of the PPS regime: a possessory interest at common law as well as a proprietary (in the sense of ownership) interest arising under the legislation. Such an approach was confirmed in 2005 by the New Zealand Court of Appeal in *Bloodstock*.

7 *Bloodstock* [2006] 3 NZLR 629, [16]. For criticism, see Mike Gedye, ‘A Distant Export: The New Zealand Experience with a North American Style Personal Property Security Regime’ (2006) 43 *Canadian Business Law Journal* 208, 229 who observes that ‘[t]he PPSA is not the type of legislation that can be interpreted by simply reading the Act, perhaps with the aid of a dictionary’. See also Anthony Duggan, ‘Some Canadian PPSA Cases and their Implications for Australia and New Zealand’ (2010) 38 *Australian Business Law Review* 161. Most recently, the New Zealand Court of Appeal observed in *Rabobank New Zealand Ltd v McAnulty* [2011] NZCA 212, [32] (*Rabobank*) that it was ‘sensible’ to look to Canadian authorities for guidance, although it noted that differences in drafting meant that the Canadian courts had not had to deal with the particular issue with which the Court was concerned.

8 See, eg, *Portacom* [2004] 2 NZLR 528; *Bloodstock* [2006] 3 NZLR 629; *Re Giffen* [1998] 1 SCR 91.

9 NZPPSA s 40. In Canada see, eg, *Personal Property Security Act*, SS 1993, c P-6.2, s 12(1)(b) (*Sask PPSA*). The equivalent provision in Australia is s 19. The provision has been described by one commentator as ‘rather enigmatic’: Allan, above n 1, 373.

10 Attachment is a ‘central concept’ (*Bank of Montreal v Innovation Credit Union* [2010] 3 SCR 3, [20]) under all PPS legislation as it indicates when the security interest becomes enforceable against a grantor and hence when it gives the secured party an interest in the collateral. It is a critical step in the process of perfecting the security interest to obtain what has been described as the ‘optimal level of protection’ for that interest under the legislation: *Portacom* [2004] 2 NZLR 528, [12].

11 Described as the ‘debtor’ under New Zealand and Canadian legislation and as the ‘grantor’ under Australian legislation.

12 Lessees under a lease for a term of more than one year under NZPPSA s 17(1)(b).

The question now confronting Australian lawyers is whether it is a conceptually necessary step under the Australian legislation to regard an equivalent lessee<sup>13</sup> as having some form of proprietary or 'deemed ownership' interest, as it has come to be described in Canada and New Zealand. Starting with the position of the New Zealand High Court in *Portacom*, this paper analyses the basis on which the Court found in favour of a proprietary interest and examines the rationale for that approach based on Canadian law. It considers whether that rationale warrants a similar conclusion under the Australian legislation or whether an alternative approach may be open. The paper contends that it would be possible under a requisite 'fresh approach' to recognise that:

- in conformity with New Zealand and Canadian jurisprudence and consistent with the 'new learning', such lessees have indeed sufficient rights to enable a security interest to attach to leased goods and not simply to the more limited common law possessory interest in those goods;

but to conclude that:

- holding a possessory interest under a lease at common law can provide the legal basis for the attachment of the security interest over the whole of the property as that possessory interest is of itself capable of constituting sufficient 'rights' for the purposes of the Australian legislation;
- development and implication of a further concept of 'deemed ownership' on the part of the lessee are unnecessary; and,
- such analysis provides grounds for exploring more generally a further notion that legal possession (that is, possession other than simply custody or bare possession) should be sufficient to enable rights to attach to the property possessed rather than to the possessory interest in that property.

It is important to emphasise that the analysis underlying this approach clearly recognises the attachment of the security interest to the leased goods themselves and, to that extent, the 'new learning' generally associated with Canadian PPS legislation. Individual Canadian judges who have characterised a lessee's interest as simply possessory rather than also proprietary have been criticised as having failed to understand the 'intentional transformation of the common law lease' effected by PPS legislation.<sup>14</sup> Insofar as their characterisation of the lessee's interest as possessory led to the conclusion that a trustee in bankruptcy of the lessee could only obtain the limited possessory interest, that criticism is undoubtedly warranted. The analysis advanced in this paper accepts that the trustee's interest is necessarily in the goods but argues that the Australian

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13 Referred to as a lessee under 'a PPS lease': see *PPSA* ss 12(3), 13. The definition also includes certain lessees for a term of 90 days or more where the goods are described by serial number.

14 See Jacob S Ziegel, 'Equipment Leases in Saskatchewan' (1986) 11 *Canadian Business Law Journal* 335, 340. See also Cumming, Walsh and Wood, above n 5, 166.

legislation does not require an ownership interest on the part of the lessee to be ‘inferred’.<sup>15</sup>

## II A LESSEE’S ‘RIGHTS IN COLLATERAL’ AS ‘PROPRIETARY’ UNDER *PORTACOM*

The proposition that a lessee has some form of ‘deemed ownership’ under PPS legislation is initially puzzling to a common law lawyer looking at the Australian legislation. On the face of the legislation, there appears to be no obvious reason for drawing such a conclusion. While section 19(5) indicates that a lessee under a PPS lease has ‘rights in goods’ for the purposes of attachment of a security interest to collateral when that lessee obtains possession of those goods, that wording does not in and of itself necessarily suggest that that lessee has anything other than a possessory interest. Section 40(3) (the equivalent New Zealand provision), however, was the basis for the High Court of New Zealand recharacterising the lessee’s rights as proprietary in *Portacom*. Although the wording of that provision differs in some important respects from the Australian provision,<sup>16</sup> it also envisages certain lessees as having rights in goods by obtaining possession of the goods.

### A The Issue

The issue before the Court was whether a security interest in favour of a bank had attached to portable buildings which the company giving the security (‘NDG’) had leased from Portacom New Zealand Ltd. Receivers appointed by the bank sought to enforce the security interest by selling those buildings. The leasing and security arrangements had been put in place<sup>17</sup> prior to the commencement of the legislation. Although the terms of the leasing arrangement clearly contemplated that the arrangement created a security interest under PPS legislation when in force, no registration in fact took place after the commencement date. By contrast, the bank registered a financing statement, thereby perfecting its security interest. Under the priority regime established by the *NZPPSA* a perfected security interest generally takes priority over an unperfected security interest. The Court stated that the receivers could sell the buildings, provided they could show that the bank had a perfected interest.<sup>18</sup> On

15 Cf Ziegel, above n 14, 339–340.

16 *NZPPSA* s 40(3) refers, for example, to a debtor having rights ‘no later than when the debtor obtains possession’. Compare *PPSA* s 19(5) which refers to the grantor having rights ‘when the grantor obtains possession’. *NZPPSA* s 40(3), unlike *PPSA* s 19(5), does not expressly refer to bailments: see *Rabobank* [2011] NZCA 212, [20]–[27].

17 Five buildings were leased between April 1998 and September 2002. The court noted that it was Portacom’s conditions of sale as at 1 April 2002 which were effective: *Portacom* [2004] 2 NZLR 528, [3]. The bank’s debenture had been created on 29 June 2000: *Portacom* [2004] 2 NZLR 528, [6].

18 The Court did not consider the source of any such power to sell: see discussion in Part IV(B).

the facts, it was clear that registration had taken place. The question, therefore, was whether the debenture created a security interest and whether that interest had attached.<sup>19</sup> Given the prerequisite for attachment that the person granting the security has ‘rights in the collateral’, a critical preliminary point lay in determining the nature and scope of the rights of the lessee.

Consistent with other PPS legislation, the term ‘rights’ under section 40 of the *NZPPSA* has not been defined. At common law, it is clear that a lessee of goods has only limited rights in those goods. Those rights represent a possessory interest and hence at common law a debtor (or grantor, in the Australian terminology) seeking to create a security interest over those goods is restricted to offering only its possessory interest. This is simply an example of the general principle of *nemo dat quod non habet*. The critical point in *Portacom* was therefore whether under the legislation the lessee could nonetheless have rights which would be sufficient for the claimed security interest to attach to the portable buildings.

In arguing that the bank was unable to exercise a power to sell the buildings, NDG adopted an analysis based on common law, namely that NDG had only possessory rights and therefore could not confer on the bank a right to sell the buildings.<sup>20</sup> The Court disagreed. It concluded that under PPS legislation NDG as lessee had two interests, which it described as ‘a possessory interest and a proprietary interest in the buildings’.<sup>21</sup>

### **B The Analysis of the High Court of New Zealand**

In reaching its conclusion the Court relied on two factors, which it regarded as interrelated and both of which it explicitly supported by reference to ‘Canadian authority and scholarship’.<sup>22</sup> First, the role of section 40(3) of the *NZPPSA* and second, the consequential treatment of certain types of lessee as owners for registration and priority purposes.

Section 40(3) was central to the Court’s analysis. The Court indicated that the provision created rights in the lessee over and above the common law possessory interest and stated that a proprietary interest arose: ‘by virtue of section 40(3) which *confers on* NDG rights in goods which it leases.’<sup>23</sup>

In explaining its reasoning the Court referred to the decision of the Supreme Court of Canada in *Re Giffen*<sup>24</sup> in 1998, which it described as the ‘leading case’.<sup>25</sup> In particular, the Court referred to a passage where the Canadian Supreme Court explained the equivalent of section 40(3) in British Columbia<sup>26</sup> as operating to

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19 *Portacom* [2004] 2 NZLR 528, [16].

20 *Ibid* [17].

21 *Ibid* [29].

22 *Ibid* [20].

23 *Ibid* [29] (emphasis added).

24 [1998] 1 SCR 91.

25 *Portacom* [2004] 2 NZLR 528, [21].

26 *Personal Property Security Act*, RSBC 1996, c-359, s 12(2).

‘deem or recognize that a lessee has a proprietary interest’.<sup>27</sup> Interestingly, the New Zealand Court did not analyse why on the facts the proprietary interest arose in *Re Giffen*.<sup>28</sup> Nor did it note the ambiguity inherent in that statement that the provision ‘deems or recognizes’ the proprietary interest, which leaves it unclear as to whether the interest is conferred or confirmed by the provision. Rather, the Court discussed and indeed disapproved an earlier decision of the Alberta Court of Appeal in *Sprung Instant Structures Ltd v Caswan Environmental Services Inc* (1997) 219 AR 1 (*Sprung Instant Structures*) which had taken a different view to *Re Giffen*, observing:

The Court of Appeal’s decision offers no answer to ... the careful analysis of the underlying principles of the personal property securities legislation in *Re Giffen*. ... Its comments on the nature of the lessee’s interest in the leased goods suggest no attempt to explore the fundamental changes made to established rights of ownership by the personal property securities legislation.<sup>29</sup>

Recognising, in line with the decision in *Re Giffen*, that a leasehold interest can be sufficient to found a security interest does not, however, explain why the lessee’s interest is also to be characterised as proprietary in nature. Nonetheless, the Court concluded from this discussion of *Re Giffen* and *Sprung Instant Structures*: ‘[t]he rights of a lessee in leased goods referred to in s 40(3) of the Act are not therefore confined to the lessee’s possessory rights.’<sup>30</sup>

This interpretation of section 40(3) then led to the view that the lessee was deemed to be an owner for certain purposes. The Court continued: ‘[a]s against the lessee’s secured creditors, the lessee has rights of ownership in the goods sufficient to permit a secured creditor to acquire rights in priority to those of the lessor.’<sup>31</sup>

The Court cited at some length an influential academic article on how ‘rights’ are to be understood and the reasoning of which the Court considered applied ‘with equal force’ to the New Zealand legislation:

The internal logic of the Article 9 and *PPSA* priority regime is premised on a rejection of derivative title theory in favour of registration as the principal mechanism for ranking priority both among secured creditors and as between the secured creditor and the debtor’s general creditors including the trustee in bankruptcy. To give effect to this intent, ‘rights in the collateral’ must be understood as requiring a mere bare right to possession or a power to convey a greater interest than has the debtor, a point confirmed in *PPSA* jurisprudence and expressly stated in some of the more recent *PPSAs*. On this interpretation,

27 *Re Giffen* [1998] 1 SCR 91, [36], citing Tamara M Buckwold and Ronald C C Cuming, ‘The *Personal Property Security Act* and the *Bankruptcy and Insolvency Act*: Two Solitudes or Complementary Systems?’ (1997) 12 *Banking and Finance Law Review* 467, 471. The Supreme Court in that passage also cited in support the decision of *International Harvester Credit Corp of Canada Ltd v Touche Ross Ltd* (1986) 30 DLR (4<sup>th</sup>) 387. The Saskatchewan Court of Appeal had simply stated in that case, however, that a trustee in bankruptcy succeeded to the ‘contractual or “possessory” interest’ as well as to the ‘statutory or “proprietary” interest’, without further analysis of the source of that latter interest.

28 See discussion in Part III where it is argued that the actual decision of the case rested on other reasoning which was based on the assumption that the lessee had a possessory interest.

29 *Portacom* [2004] 2 NZLR 528, [27].

30 *Ibid* [28].

31 *Ibid* [28].

ostensible ownership – in the radical sense of bare possession or control of the collateral – has effectively replaced derivative title for the purposes of determining the scope of the secured debtor’s estate at the priority level. Thus, *by the very act of deeming a true lease to be a PPSA security interest, ownership in the leased assets is effectively vested in the lessee as against the lessee’s secured creditors and trustee in bankruptcy*.<sup>32</sup>

While pointing out why possession of goods should be sufficient as a matter of policy to attract the operation of the legislative regime, the passage does not elaborate on why that recognition necessarily entails effective vesting or, in other words, deemed ownership on the part of the lessee. Rather it refers, perhaps rather cryptically for the Australian lawyer, to the impact of the action of deeming the lease to be a security interest. It suggests that it is the inclusion of the lease transaction within the definition of a security interest which requires special treatment to be accorded to the lessee.<sup>33</sup> Such a proposition also emerges in a further observation approved by the Court<sup>34</sup> and made by academic commentators in a New Zealand text whose co-authors include two leading Canadian commentators to the effect that a lease is ‘treated as a security agreement and *the lessee is treated as the owner of the leased goods for registration and priority purposes*’.<sup>35</sup> The Court again did not however discuss *why* the lessee should be treated as owner for these limited purposes.<sup>36</sup>

32 Ibid [28], citing Michael G Bridge et al, ‘Formalism, Functionalism and Understanding the Law of Secured Transactions’ (1999) 44 *McGill Law Journal* 567, 602–603 (emphasis added).

33 A more general explanation appears in an earlier passage: Bridge et al, above n 32, 588, which was relied upon by William Young J in *Bloodstock* [2006] 3 NZLR 629, [90] when discussing the nature of the lease transaction and the analysis of the ‘deemed ownership’ approach. Bridge et al observe in relation to title reservation arrangements: ‘PPSA analysts are of the unanimous opinion that it is necessary to reconceptualise the arrangement so as to involve an executed sale to the buyer followed by the grant back of a security interest to the seller in order to rationalize the application of the legislation to conditional sales and analogous title reservation security transactions. Pursuant to this approach, the seller is a “secured creditor and not an owner of the collateral; the owner of the collateral is the buyer,” and it is to the debtor’s undivided ownership interest that the security interest attaches.’ See also discussion in Bridge et al, above n 32, 598–605. Cf *Re Western Express Air Lines Inc* [2005] BCSC 53, [17] where the Supreme Court of British Columbia appeared to suggest that the security interest could only attach to the possessory interest of the lessee. Yet in *Re Perimeter Transportation Ltd* [2010] BCCA 509, [33] the British Columbia Court of Appeal noted, but without further discussion, the view in *Re Giffen* that the lessee’s interest was ‘not only “possessory”, but proprietary’.

34 *Portacom* [2004] 2 NZLR 528, [19].

35 Gedye, Cuming and Wood, above n 4, 156 [40.3.1] (emphasis added).

36 In a subsequent article, Gedye developed his argument in favour of reconceptualising the lessee’s interest as owner of the goods, which he appeared to regard as the ‘corollary’ of the lessor’s interest being regarded as a security interest: Gedye, above n 1, 206. Cf Allan, above n 1, 374, who observed that considering ownership as a step in attachment ‘seems inconsistent with the statutory rule cast by s 24 that the location of title is not to affect the application of the Act.’ In *Bloodstock* [2006] 3 NZLR 629, [85] William Young J observed: ‘The question I have just posed [“Does the PPSA create a deemed ownership interest in a debtor?”] is perhaps not entirely happily expressed as its language harks back to the nemo dat principle.’ Cf Widdup and Mayne, above n 4, 73–74, published prior to the decision in *Portacom*, where the authors regard the lessee as transferring more rights than the lessee actually has.



### C Implications of the Analysis for Interpreting the Australian Legislation

Given the similarities in the relevant wording of section 40(3) and section 19(5), an Australian court might be expected to follow the reasoning of its New Zealand counterpart in *Portacom*. Indeed, it could be contended that an Australian court might find such reasoning particularly attractive, given its direct roots in, and consistency with, Canadian authority. Yet the reasoning in the two grounds on which the New Zealand Court relied – the role of section 40(3) and the view that a lessee may be regarded as owner, albeit for limited purposes – seems open to question. The first ground is addressed briefly, although admittedly on the state of current New Zealand authority, inconclusively; the second ground, based on initial research into Canadian authority, is tentatively explored.

The conclusion reached by the Court in *Portacom* rests initially on its characterisation of the role of section 40(3); namely, that section 40(3) confers a proprietary right on the lessee. Yet, this provision is open to more than one interpretation. An alternative interpretation is that it simply confirms that a lessee has sufficient rights no later than possession (or on possession, in the case of the Canadian and Australian legislation). In other words, section 40(3) is a timing provision pinpointing the time at which rights arise rather than an operative provision conferring new rights.<sup>37</sup>

Such an alternative interpretation is not without support in the academic literature. Professor Ziegel, a leading Canadian scholar, described the equivalent Saskatchewan provision as simply clarifying when rights arose:

Section 12(2)(b) of the Saskatchewan Act is not at all concerned with characterizing the relationship between lessor and lessee, nor does it purport to define the lessee's rights in the collateral. All it does is to tell the reader *when* a debtor has sufficient rights in the collateral to enable the security interest to attach. Even this provision was inserted out of an abundance of caution ...<sup>38</sup>

Indeed, in *Portacom* the Court appeared to take a similar stance in an earlier part of the judgment when it said:

A lessee of goods may, by virtue of its possessory interest, grant a security interest in the goods. Section 40(3) ... provides that a debtor has rights in goods leased to the debtor. A security interest can therefore attach to the lessee's interest in the goods ....<sup>39</sup>

37 Interpreting s 40(3) in this manner – as a timing provision – does not detract from recognition that a lessor's proprietary rights are recharacterised for the purposes of PPS. The lessor's interest is still regarded as a security interest and its priority is determined in accordance with the rules of the PPS legislation rather than on the basis of its title.

38 Ziegel, above n 14, 341, referring also to an earlier co-authored article, Jacob S Ziegel and R C C Cumming, 'The Modernization of Canadian Personal Property Security Law' (1981) 31 *University of Toronto Law Journal* 249, 261–2 (emphasis in original).

39 *Portacom* [2004] 2 NZLR 528, [18].

Although the New Zealand Court of Appeal described section 40(3) as creating new rights in *Bloodstock* in 2005,<sup>40</sup> the High Court in 2007 discussed section 40(3) in terms more suggestive of a timing function:

attachment of the security interest would have arisen when the debtor ... had rights in the collateral: see s 40(1)(b).

The means of determining when this occurred is provided by s 40(3). Here, it may be said that the wool was either consigned to Feltex as debtor or sold to Feltex under an agreement to sell subject to retention of title. In each case, attachment of a security interest to the collateral would occur 'no later than when the debtor obtains possession of the goods'.<sup>41</sup>

Moreover, the apparently conflicting views in the High Court's articulation of the role of section 40(3) in *Portacom* was noted recently in the decision of the High Court in *Rabobank New Zealand Ltd v McAnulty* [2010] NZHC 1534 in August 2010. The High Court refused to grant summary application for an order for possession, stating that it would be 'beneficial to hear full argument on the role of s 40(3) for the purposes of the priority rules under the PPSA'.<sup>42</sup> It alluded to what it described as 'some confusion'<sup>43</sup> over whether the statutory (by which was meant 'proprietary') rights were created by section 40(3) or rather by section 17(1)(b), the provision that deems a lease for more than one year to be a security interest. The Court pointed to what it saw as ambiguity in *Portacom*. On appeal against the refusal to grant summary judgment, the Court of Appeal unfortunately found it unnecessary to address the arguments on section 40(3),<sup>44</sup> seemingly leaving the position still open to further debate in New Zealand.

Such uncertainty surrounding the role of section 40(3), and by analogy section 19(5) of the PPSA, makes it critical to look closely at the second factor: namely the observations on the recharacterisation of the lessee as a deemed owner. Although the High Court in *Portacom* linked the two factors, its subsequent discussion in *Rabobank*, and in particular its suggestion that the proprietary interest might arise by reason of the Act deeming the lease to be a security transaction suggests that the factors might be distinct, a view which finds support in leading Canadian academic commentary.

40 [2006] 3 NZLR 629, [64] (Robertson and Baragwanath JJ): 'Prior to 1 May 2002 [the date on which the New Zealand legislation became effective], because of the terms of [the lease] Glenmorgan [the lessee] had no proprietary rights in the stallion. With effect from that date s 40(3) created new "rights in goods" in favour of Glenmorgan. So Glenmorgan's rights did not remain the same.' See also *Glenmorgan Farm Ltd (rec apptd and in liq) v New Zealand Bloodstock Leasing Ltd* [2010] NZHC 2041, [68], [72].

41 *JS Brooksbank & Co (Australasia) Ltd v EXFTX Ltd (rec apptd and in liq) formerly known as Feltex Carpets Ltd* [2007] NZHC 1293, [56]–[57]. The Court of Appeal, while allowing the appeal, described s 40(3) in terms consistent with it operating as a timing provision: *JS Brooksbank & Co (Australasia) Ltd v EXFTX Ltd (rec apptd and in liq)* [2009] NZCA 122, [55]–[56] ('Brooksbank').

42 *Rabobank New Zealand Ltd v McAnulty* [2010] NZHC 1534, [47].

43 *Ibid* [36].

44 *Rabobank* [2011] NZCA 212, [13].

### III A LESSEE'S 'PROPRIETARY' RIGHTS ARISING THROUGH CHARACTERISATION OF A LEASE AS A SECURITY INTEREST

An argument that a lessee should be deemed an owner for certain purposes of the PPS legislation by reason of its inclusion as a security interest appears to stem specifically from Canadian rather than United States jurisprudence and scholarship. Unlike the Canadian and indeed now the New Zealand and Australian PPS legislation, the *Uniform Commercial Code* (US) ('UCC') does not define a security interest to include a true lease;<sup>45</sup> namely, a lease of goods which does not secure payment or performance.<sup>46</sup> Furthermore, while the Official Comment to Article 9 recognises that possession is sufficient for a person to have 'rights in the collateral' under § 9-203, it observes that the security interest can only attach to the rights that the person actually has;<sup>47</sup> namely the possessory interest. Exceptions to what the Official Comment describes as 'the baseline rule'<sup>48</sup> are found in provisions which explicitly confer identical title to that of the owner on the person in possession (such as the consignee) for determining certain priority disputes between the owner and a secured creditor.<sup>49</sup> In such circumstances there appears to be no room for any theory of 'deemed ownership'.

45 Often described in Australia as an 'operating lease' and contrasted with a 'financing' lease.

46 UCC § 1-201. Article 9 on Secured Transactions does not give a definition of security interest in § 9-102 but relies on the definition in § 1-201: "Security Interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. "Security interest" includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9. "Security interest" does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under § 2-505, the right of a seller or lessor of goods under Article 2 or 2A to retain or acquire possession of the goods is not a "security interest", but a seller or lessor may also acquire a "security interest" by complying with Article 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer under § 2-401 is limited in effect to a reservation of a "security interest". Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to § 1-203.' See also White and Summers, above n 5, 1155-1165.

47 See Corinne Cooper, *The New Article 9 Uniform Commercial Code* (American Bar Association, 2<sup>nd</sup> ed, 2000) 195, reprinting the official text of the UCC by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. See also Grant Gilmore, *Security Interests in Personal Property* (Little, Brown and Company, first published 1965, reprinted 1999, Lawbook Exchange) vol 1, 353: Gilmore states the general principle and contemplates the possibility of some exceptions: 'evidently less than full "legal title" will do and the secured party will get whatever rights the debtor had (or possibly, if the collateral is negotiable or the debtor has power to convey title to a good faith purchaser, more rights).'; White and Summers, above n 5, 1193. Interestingly, the American interpretation is reiterated in Australian Government Attorney-General's Department, *Revised Commentary to the Personal Property Securities Bill 2008* (December 2008) <[http://www.ag.gov.au/www/agd/agd.nsf/Page/PersonalPropertySecurityReform\\_PPSDownloads](http://www.ag.gov.au/www/agd/agd.nsf/Page/PersonalPropertySecurityReform_PPSDownloads)> (see 'Personal Property Securities', 'PPS Downloads' and 'Historic legislative documents'). Appendix B of the *Commentary* sets out a summary of key changes since the consultation draft PPS Bill of May 2008: see especially [B.33]. In the light of the Canadian and New Zealand cases discussed in this paper, this does not appear a likely interpretation of the Australian legislation.

48 Cooper, above n 47, 195.

49 UCC § 9-319.

In *Portacom*, the High Court of New Zealand was concerned with the true (or operating) lease and restricted its discussion of deemed ownership to this type of lease. Initial research suggests, however, that discussion of 'deemed ownership' in Canadian writings has taken place in the context of an analysis of not only a true lease but also a security (or financing) lease and that this distinction between a lease securing payment or performance (an 'in substance security interest') and a true lease (a 'deemed security interest' in certain circumstances) does not appear critical. Canadian commentators who argue in favour of a proprietary interest apply the same analysis in relation to both types of leases. In each case, ownership appears to be inferred from the fact of a lease being characterised as a secured transaction.

Examples of the argument can be drawn from a leading Canadian text. Professors Cuming, Walsh and Wood refer in discussion of a security lease to an 'implicit ownership' on the part of a lessee flowing from the relationship arising between secured party and debtor:

The courts have sometimes relied on the buyer's or lessee's possessory rights as constituting sufficient rights to support attachment of a competing security interest ... This approach fails to take into account the impact of the conceptual structure of the PPSA. Under the Act a conditional sale or security lease is characterized as giving rise to a security interest. A secured transaction is inherently a relationship in which the debtor owns the collateral and the secured party has only a charge on the debtor's title. The buyer's or lessee's implicit ownership means that a competing security interest will attach to the goods, not merely to the debtor's possessory rights in the goods.<sup>50</sup>

The same rationale appears in their treatment of true leases. Noting the Canadian provisions equivalent to section 40(3) of the New Zealand Act and section 19(5) of the Australian Act, they observe:

This provision should not be interpreted as meaning that the consignee or lessee has only possessory rights in the collateral. The Act characterizes the parties' relationship as a deemed security transaction with the result that ownership is deemed to vest in the lessee or consignee ... As deemed owner, the lessee or consignee has sufficient rights to grant a competing security interest in the goods themselves, not merely in the right to possession of the goods.<sup>51</sup>

Underlying the Canadian discussion are two concerns. First, there is a general concern to bring the security created by the lessee within the parameters of the legislative regime for the purposes of priority. Second, there is a more specific concern to ensure that title to the leased goods is available to the trustee in bankruptcy of a bankrupt lessee in the event of the lessor failing to perfect its security interest.

Both concerns – determining priority and the position of the trustee in bankruptcy – are apparent, for example, in an analysis by Professors Ziegel and Cuming, who observed in an article in 1981 in relation to the Saskatchewan Act:

Since a lessee does not have a proprietary interest in goods leased to him, the drafters of the Saskatchewan act decided *ex abundanti cautela* that it was

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50 Cuming, Walsh and Wood, above n 5, 166.

51 *Ibid* 167.

necessary to deem him to have such an interest in order to eliminate any confusion with respect to the application of the concepts of attachment and perfection.<sup>52</sup>

Professor Ziegel subsequently argued that the combination of this provision, the stated scope of the Act and the definition of security interest meant: ‘the lessor is only deemed to retain a security interest in the leased goods and by necessary inference the lessee is treated as acquiring the beneficial interest in them.’<sup>53</sup> He argued:

Unless this intentional transformation of the common law lease is understood and accepted, it is impossible to infuse meaning into the other provisions of the Act (other than Part V) and to apply them intelligently. These observations apply particularly to Part III of the Act dealing with Perfection and Priorities.<sup>54</sup>

He illustrated his argument by reference to the position on bankruptcy: ‘If the metamorphosis is grasped then the meaning ... readily falls into place. The trustee in bankruptcy succeeds to the debtor’s deemed beneficial interest in the collateral free of the unperfected security interest represented by the lease.’<sup>55</sup>

Under the Saskatchewan Act, if the trustee in bankruptcy is to prevail, there has to be some mechanism whereby the trustee can obtain title. It would appear on this argument that the relevant mechanism is the deeming of the lessee to have the beneficial interest.

In *Re Giffen* the issue was the priority of an unperfected security interest of the lessor of a car as against the trustee in bankruptcy of the lessee. The Supreme Court of Canada clearly stated<sup>56</sup> that the lessee’s interest in the car could be described as a proprietary interest in the car, basing that conclusion on the equivalent of section 40(3) of the New Zealand legislation and section 19(5) of the Australian legislation and citing in support the decision of the Saskatchewan Court of Appeal in *International Harvester Credit Corp of Canada Ltd v Touche Ross Ltd* 30 DLR (4<sup>th</sup>) 387 (*‘International Harvester’*).

In subsequently considering the position of the lessee’s trustee in bankruptcy and the latter’s ability to deal with title to the car, the Supreme Court reasoned, however, that the provision whereby the security interest was made ineffective against the trustee did not ‘grant title or any other proprietary interest to the trustee’<sup>57,58</sup> It simply precluded the lessor from exercising rights against the trustee. It found that the impact of that provision was nonetheless to: ‘modif[y] the principle that a trustee is limited to the rights in the property enjoyed by the bankrupt’.<sup>59</sup>

This was supported by a review of a series of provincial cases, including *International Harvester*. The Court then specifically examined the ability of the

52 Ziegel and Cuming, above n 38, 262. This Act was seemingly the first Canadian Act to include leases of more than one year: see Ziegel, above n 14, 335.

53 Ziegel, above n 14, 340. See also Ziegel and Cuming, above n 38, 262.

54 Ziegel, above n 14, 340.

55 Ibid 341.

56 *Re Giffen* [1998] 1 SCR 91, [36]–[37]. See discussion above.

57 Ibid [44].

58 *Sask PPSA* s 20(b)(i).

59 *Re Giffen* [1998] 1 SCR 91, [45].

trustee to confer clear title, taking into account both the defeat of the lessor's claim under section 20(b)(i), the provision whereby it is made ineffective against the trustee, and the failure by the lessor to file a claim with the trustee in bankruptcy under bankruptcy legislation which establishes a procedure for a third party to file claims with the trustee and provides for the abandonment of a claimant's interest in certain circumstances. This combination led the Court to conclude that in these circumstances the lessor's claim could be regarded as effectively abandoned or relinquished and therefore the trustee could sell and pass title.<sup>60</sup>

This reasoning appears predicated on the assumption that the lessee had only a possessory interest and although the Court had clearly described the lessee as having a proprietary interest in the earlier part of the judgment, the subsequent reasoning appears to give more weight to the possessory interest of the lessee. In the light of *International Harvester*, which it explicitly approved, and in the light of Professor Ziegel's observations, it is puzzling that the Court did not expressly consider an alternative argument that the lessee had a proprietary interest to which the trustee could succeed.

Whatever may be the position under the Canadian legislation, the reasoning on both these points of concern – priority and bankruptcy position – does not appear to be a *necessary* step in applying the equivalent Australian legislation:

- On the bankruptcy concern, the equivalent Australian provision is drafted quite differently. Section 267(2) simply provides that the 'security interest' vests in the grantor. In other words, the ownership interest of the lessor which is re-characterised as a security interest under section 12(3) and which is unperfected at the time of the insolvency vests in the grantor.<sup>61</sup> It is expressly conferred on the grantor. Hence, the grantor's property includes the title. There is no need for any ownership interest to be deemed.<sup>62</sup>
- On the more general issue of having the priority of the interests arising under the lease transaction determined by the PPS legislation, it is submitted that this is not dependent on the lessee having a deemed interest of ownership. Rather, it is dependent on recognising firstly, that the lessor's rights of ownership amount to a security interest for the purposes of PPS and secondly, that the lessee has sufficient rights to create a security interest in the leased goods. Neither, it is submitted, requires the lessee to have deemed ownership. An alternative conceptualisation, considered below, that a lessee can create security

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60 Ibid [59].

61 *PPSA* s 268 precludes the application of s 267(2) to a PPS lease only in very limited circumstances: *PPSA* s 268(1)(a)(ii), referring to leased goods which are serial numbered goods under a lease for a term (essentially) of more than 90 days but less than one year.

62 An alternative analysis based on 'deemed ownership' would seem to unduly complicate the position. If the lessee were deemed to have a proprietary interest and the unperfected lessor, a security interest, the impact of s 267 would be to vest that latter interest in the grantor which, when amalgamated with the deemed ownership interest, would confer full title on the grantor.

interests over the leased goods even though the lessee only has a possessory interest would be sufficient.

These grounds for distinguishing the Canadian approach are further supported by initial research which suggests that analysis of the Canadian provisions may have been influenced by the pre-PPS regime whereby bailees were treated under provincial Conditional Sales legislation as owners for certain purposes. For example, the Saskatchewan *Conditional Sales Act* of 1957 was said to be ‘patterned after’ the model statute prepared by the Commissioners on Uniformity of Legislation in Canada and included hire-purchase agreements within the definition of conditional sales.<sup>63</sup> Under this Act, failure to register a conditional sale under which the buyer had been given possession of the goods resulted in provisions purporting to leave title with the seller being rendered void as against a creditor and a subsequent bona fide purchaser or mortgagee for value without notice.<sup>64</sup> Commentators have, for example, observed in the context of a discussion of the differences in views of the Court of Appeal and the Supreme Court of Canada in *Re Giffen*:

It is true that the *CSAs*, unlike the *PPSAs*, expressly deemed the lessee under an unfiled lease to be the owner of the goods as against the classes of third parties protected by the filing requirement, including the lessee’s trustee in bankruptcy. The same conclusion is inherent in the operation of the *PPSA* attachment and priority structure, as the Supreme Court recognised.<sup>65</sup>

#### IV CAN A LESSEE’S INTEREST BE CONCEPTUALISED OTHER THAN AS A PROPRIETARY INTEREST?

If it is appropriate in the Australian context to query the characterisation of a lessee’s interest as a deemed ownership interest, how else can it be conceptualised so as adequately to explain the ‘new learning’ that a lessee has sufficient rights to enable the security interest to attach to the goods? There are at least two other possibilities. The first is to regard the PPS legislation as simply furnishing a new statutory example of an exception to the common law rule enshrined in the maxim *nemo dat quod non habet*; in which case the lessee’s interest is conceptualised as a possessory interest which through statute provides an exception to *nemo dat*. Such a conceptualisation is problematic, however, for

63 See Mervyn Woods, ‘Saskatchewan Legislation respecting Chattel Mortgages and Conditional Sales’ (1958) 12 *University of Toronto Law Journal* 303.

64 *Conditional Sales Act*, SS 1957, c C-25, s 3(1) (repealed). In considering a very distinct question of whether lessors and sellers under conditional sales arrangements could be regarded as secured creditors for the purposes of specific insolvency legislation as well as PPS legislation, Wood noted the Supreme Court of Canada’s willingness at common law in certain limited circumstances to regard a seller under Conditional Sales legislation as holding the legal title by way of security and recognising a buyer as holding an equitable beneficial interest: Roderick J Wood, ‘The Definition of Secured Creditor in Insolvency Law’ (2010) 25 *Banking and Finance Law Review* 341, 344–5, citing *CC Motor Sales Ltd v Chan* [1926] SCR 485 and *Humphrey Motors Ltd v Ells* [1935] SCR 249.

65 Bridge et al, above n 32, 601.

reasons outlined below. A further possibility, and the one for which this paper contends, is that the focus on the debtor's or grantor's power to create the security interest which is evidenced in attempts to deem the interest as that of ownership is misplaced in the Australian context. The lessee's interest is simply a possessory interest and the security interest attaches to the personal property *by force of law*.

#### **A Lessee's Interest as Simply a Further Statutory Exception to the *Nemo Dat* Principle?**

An interpretation based on conceptualising the lessee's interest as a statutory exception to *nemo dat* has some attraction insofar as it represents a familiar statutory approach falling within an established pattern – a situation in which the common law general principle is overridden in particular limited circumstances. In *Bloodstock*, the Court of Appeal noted with apparent approval the description by the Law Commission of England and Wales of the changed position of a lessee under a PPS regime.<sup>66</sup> The Commission described its draft scheme as involving:

widening the exceptions to the basic principle that a person cannot pass a title he or she does not have. [Often still expressed in the Latin tag, *nemo dat quod non habet*.] ... The hirer or lessee is not an owner, but if the financier has not filed, a sale or other disposition by the hirer or lessee should give the innocent purchaser rights in priority to those of the financier.<sup>67</sup>

Yet an examination of *Portacom* indicates that if that case is an illustration of a statutory exception to *nemo dat*, it is a very unusual exception insofar as the argument requires that the statute purport to give the transferor ownership. Normally, statutory exceptions to the *nemo dat* rule recognise that the transferor has only a limited right, but nonetheless is able to confer a greater right than he or she has through the operation of the relevant statutory provision.

Commentaries to date do not seem to consider whether there can be an intermediate analysis – where the lessee is recognised as having sufficient rights in the collateral to enable the security interest to attach without necessarily characterising the lessee as having a 'deemed ownership interest'.

#### **B Lessee's Interest as a Possessory Interest Enabling Attachment by Force of Law?**

An alternative approach is to consider that the security interest over the leased property simply attaches through force of law. Given that a lessee has *some* rights in the form of possession, a security interest can by operation of the statute attach to the goods themselves. It is no longer a question of the lessee having the right to transfer ownership. Statute simply makes the interest attach to the goods.

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66 *Bloodstock* [2006] 3 NZLR 629, [60] citing Law Commission of England and Wales, *Company Security Interests*, Consultative Report No 176 (2004) [2.107]–[2.109].

67 Law Commission of England and Wales, above n 66, [2.108].



In developing an analysis that attachment occurs by force of law, the wording of the provision becomes critical. The Australian provision in section 19 of *PPSA* is very simple:

- 19(2) A security interest attaches to collateral<sup>68</sup> when:
- (a) the grantor has rights in the collateral, or ...
- 19(5) For the purposes of paragraph 2(a), a grantor has rights in goods that are leased ... to the grantor under a PPS lease ... when the grantor obtains possession of the goods.

There is no reference to any transfer of rights.<sup>69</sup> Rather, the legislation simply provides for attachment to occur on the satisfaction of relevant criteria.<sup>70</sup>

Admittedly, this is all academic speculation. Ultimately, the conclusion that the security interest is attached by force of law comes back to the fundamental question of whether there is any necessary reason for there to be ownership in the grantor to enable the Australian legislation to operate. Although Canadian commentators and courts may refer to the lessee being the owner for purposes of priority and registration, ownership is not the only basis by which to ensure that the interests under the lease become regulated by the legislation. If statute makes the security interest attach to the goods by force of law, then the statutory rules relating to priority and registration apply without need for anything more. The secured party taking from the lessee does not require ownership for these purposes. This is clear from the examples of potential security interests given in section 12(2) of the *PPSA*. The legislation expressly contemplates that certain types of secured parties do not have ownership. Both a pledgee and a chargee as secured parties have interests that are less than title – possession in the case of a pledgee and a bundle of equitable rights in the case of the chargee.

68 The term ‘collateral’ is itself ambiguous, being defined in *PPSA* s 10 as ‘personal property to which a security interest is attached’. That definition is not only somewhat circular but also, and more importantly for the purpose of this discussion, gives no indication as to whether ‘property’ means the property itself or an interest in that property or both. Under the *UCC* the term ‘collateral’, defined in § 9-102 to mean ‘the property subject to a security interest or agricultural lien’, has been described as the ‘generic term for any tangible or intangible asset belonging to the debtor in which the debtor grants a security interest to its secured creditor’: White and Summers, above n 5, 1151. In Canada, Cuming, Walsh and Wood explain it as the ‘general term adopted by the Act to designate personal property that is subject to a security interest’: Cuming, Walsh and Wood, above n 5, 19.

69 It is noteworthy that the Australian provision refers to a grantor having rights, rather than a debtor which is the term used in the US, Canadian and New Zealand legislation. ‘Debtor’ under *NZPPSA* s 16 is, for example, expressly defined to include lessee and more generally a person who owes payment or performance ‘whether or not that person owns or has other rights in the collateral’. The Australian legislation refers to two terms – ‘debtor’ and ‘grantor’ – in *PPSA* s 10. ‘Debtor’ has the same general meaning as in the NZ legislation while ‘grantor’ is used instead as a person having an interest in the property to which a security interest is attached and specifically includes a lessee under a PPS lease. By using the word ‘grantor’, there might seem on initial reading to be an inference that it is the person who ‘grants’ the rights. Such an inference however can be argued to be unnecessary and indeed misleading, given the manner in which ‘grantor’ is used in the legislation in relation to reservation of title and conditional sale arrangements where the person taking possession does not *stricto sensu* ‘grant’ the rights but is nonetheless described as ‘the grantor’.

70 The other criterion is: either value given for the security interest or an act by the grantor by which the security interest arises: *PPSA* s 19(2)(b).

There is however one point at which it may be conceded that deemed ownership on the part of a lessee might nonetheless be critical: namely on enforcement pre-insolvency. If a lessee is regarded only as having a possessory rather than a proprietary interest and if a secured party having only a deemed security interest does not have access to the statutory remedies conferred by the Act,<sup>71</sup> what remedies can the secured party exercise? Having a security interest over the goods does not mean that the secured party therefore has the power to deal with those goods. This was a point that unfortunately was not discussed in *Portacom*. The Court appeared to assume that the receivers would have the requisite power of sale. While it could be argued that the recognition by the Court of the proprietary interest meant that the secured party would therefore have the relevant power on taking from the lessee,<sup>72</sup> such an argument would actually run contrary to the Canadian analysis. Those who argue in favour of a deemed ownership interest seem generally to recognise a limit on the extent of its scope. They restrict it – at least in the case of a true lease, if not a security lease – to perfection and priority purposes only: ‘Deemed security interests fall with[in] the scope of the PPSA only for the purposes of the rules governing perfection and priority. The Act does not otherwise deem the lessee ... to be the owner.’<sup>73</sup>

Consequently, whether a possessory or proprietary analysis is favoured in the conceptualisation of the deemed lessee’s interest,<sup>74</sup> the position on enforcement pre-insolvency appears under both analyses to be that only the possessory interest can be dealt with by the secured party.

## V CONCLUSION

Conceptualising a lessee’s interest as a purely possessory interest but one which is nonetheless sufficient to enable a security interest to attach to goods by force of law is in line with Canadian and New Zealand jurisprudence. It clearly recognises the impact of PPS legislation as resulting in a holding of rights which are less than ownership being sufficient to enable a security interest to attach. Only time will tell, however, whether an Australian court will follow Canadian and New Zealand courts in taking the further step of recharacterising that lessee’s interest as proprietary. Initial concern about Australian analysis differing from that in Canada and New Zealand may be capable of being allayed:

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71 *PPSA* s 109(1)(c) precludes the application of rights and remedies conferred by ch 4 where a PPS lease does not secure payment or performance of an obligation.

72 See, eg, Allan, above n 1, 373. Cf Gedye, above n 1, 214–215. Gedye also argues that the lessee under a deemed security interest could sell the leased assets, contrasting the position of a lessee of a lease outside the scope of the legislation who in his view would be confined to selling its possessory interest: Gedye, above n 1, 220.

73 Cuming, Walsh and Wood, above n 5, 168. See, eg, *Re Western Express Air Lines Inc* [2005] BCSC 53, [15].

74 If it were a financing lease and hence an ‘in substance’ security interest under *PPSA* s 12(2), s 112 would appear to restrict the secured party in exercising remedies under ch 4 to the possessory interest unless the lessee is regarded as having a proprietary interest.

- Through its explicit vesting of an unperfected security interest in the lessee as grantor on an insolvency, Australian legislation obviates any need to rely on a concept of deemed ownership to resolve competing claims between, on the one hand, a lessor holding an unperfected security interest through its legal title and, on the other hand, the lessee's perfected secured creditor or trustee in bankruptcy/liquidator;
- The development of the concept of deemed ownership may have been influenced by the operation of pre-PPS statutory regimes which have no counterparts in Australia;
- No advantage appears to be gained under Australian legislation in classifying the lessee's interest as other than a possessory interest, at least where the lease is a true lease; and
- Apparent approval of the concept of deemed ownership in New Zealand may still be open to challenge, given judicial uncertainty as to the role of section 40(3) on which the concept rested in *Portacom*.

If the analysis for which this paper contends is tenable, the radical step in any 'new learning' introduced by Australian PPS legislation is that it is sufficient for the attachment of a security interest that a person simply has possessory rights in the collateral. Where a person has those rights, a security interest attaches by force of law on satisfaction of the specified criteria. Such a proposition seems less complex (and, although it may no longer be viewed as adequate justification, does less violence to common law principles) than the proposition that the lessee has both a possessory interest and a proprietary interest. A simpler proposition may in turn mean less likelihood of courts experiencing difficulties in understanding the operation of the legislation. Experience in other PPS jurisdictions indicates some difficulty on the part of courts at first instance and of professional advisors<sup>75</sup> in initially grasping the reach of the new legislation.

However the lessee's interest is conceptualised, the fact that possession under a lease is sufficient to enable the security interest to attach has implications for those who hold other types of rights. Although discussion of such implications is beyond the scope of this paper,<sup>76</sup> at least two distinct questions are raised. First, whether holding possession by some means other than under a lease would be

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<sup>75</sup> See, eg, Gedye, above n 1, 221.

<sup>76</sup> In putting forward the argument that a lessee's possessory interest is sufficient to ground a security interest over the leased property, this paper forms part of a more extensive research project entitled 'Possessory and Other Rights as "Rights in Collateral" under Personal Property Securities Legislation' which explores the proposition that legal possession, howsoever obtained, is sufficient to ground a security interest over the property itself.

sufficient for a security interest to attach to the goods.<sup>77</sup> Second, whether by analogy or otherwise other rights (such as equitable and contractual rights) would be sufficient to enable the security interest to attach at least to the extent of that limited interest in the property, if not to the property itself.<sup>78</sup>

These are issues that merit debate. Identifying what rights may be sufficient to create security over the whole property as distinct from merely the grantor's interest in the property is fundamental to the operation of the legislation. Once that debate has taken place, consideration could usefully be given to inserting a statutory definition of 'rights in the collateral' with a view to making clear that 'rights' in this context means ownership and possession and – to the extent that other rights may also be considered appropriate for inclusion – such further rights. Given the uncertainties that have emerged and the clear move from a principles-based system to a rules-based system, it is perhaps surprising that no definition has to date been attempted in the Australian legislation. As William Young J observed in *Bloodstock* when finding in favour of the 'deemed ownership' interpretation under the New Zealand legislation:

it would have been very easy for the legislature to say in simple language that any chattel in the possession of a debtor which is subject to a retained title security is to be treated, for the purposes of all other securities, as being owned by the debtor and thus potentially subject to such other securities. Yet there is no express provision in the PPSA to that effect.<sup>79</sup>

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77 Some Canadian commentators have suggested that possession arising in circumstances outside provisions equivalent to s 19(5) may not be sufficient. See, eg, Cuming, Walsh and Wood, above n 5, 165, where the authority quoted is *Gray v The Royal Bank of Canada* (1997) 143 DLR (4<sup>th</sup>) 179. Other Canadian commentators seem to imply that possession could be sufficient, assuming that it is not simply custody or bare possession; see, eg, Richard H McLaren, *The 2011 Annotated Ontario Personal Property Security Act* (Carswell, 2010) 140. For discussion of the position under New Zealand legislation: see, eg, Struan Scott, 'The PPSA: The Continued Relevance of Conventional Legal Principles in Determining the Existence of a Security Interest' (2009) 15 *New Zealand Business Law Quarterly* 205, 212–215; and most recently *Rabobank* [2011] NZCA 212, [11].

78 There are at least two issues arising under a provision such as PPSA s 19: what rights are sufficient to enable attachment and to what do they actually attach? It is not uncommon to find statements that a person has sufficient rights for the purpose of attachment if that person has equitable or even contractual rights, without any further discussion as to whether such rights enable the security interest to attach to the property or rather to the relevant interest in the property (equitable or contractual, as the case may be). Underlying policy concerns, in particular the desire to avoid the oft-cited 'evil of apparent wealth' may provide a reason for recognising that possession can enable a security interest to attach to the property but that equitable and contractual rights are confined at most to enabling the security interest to attach to the limited interest in the property.

79 *Bloodstock* [2006] 3 NZLR 629, [87].