

SUPPLIERS AND EQUIPMENT LESSORS – BEWARE THE PERSONAL PROPERTY AND SECURITIES ACT 1999

This article provides general information only and does not constitute legal advice.

Introduction

The PPSA is now approximately 10 years old. Despite this, there still seems to be many suppliers who either don't know of the PPSA or who have little understanding of it.

It is particularly important for suppliers of goods and lessors of equipment. In addition to ensuring that their terms of trade or supply agreements are up to date and practical, suppliers need to ensure that their terms adequately deal with the PPSA. Both suppliers and equipment lessors need to ensure that they comply with the mechanics of the PPSA to protect their interests.

Ownership is largely irrelevant

It may seem hard to swallow, but it's crucial to realise that under the PPSA, ownership is largely irrelevant – ownership will not protect a supplier or lessor who has not taken the proper steps to protect their interests under the PPSA.

When X sells goods and reserves title until payment, X has what is called under the PPSA a “**security interest**”. X has to “perfect” that security interest to protect it.

Say the buyer has given security over all of its present and future property to a bank. The bank will therefore also have a security interest in the equipment supplied by X to the buyer. If the bank's interest predates X's interest, the bank could have priority over X, even though X still owns the goods.

However, provided that X registers a financing statement on the PPS register in the manner and within the time prescribed by the PPSA, X will have a **Purchase Money Security Interest (PMSI)**, which confers a super priority on X – X gets a superior claim over the interests of all other parties in relation to the price payable for goods supplied by X.

To be effective against third parties, such as the buyer's bank, X's security interest must have been **assented to in writing by the buyer**. One of the simplest ways to do that is to have the buyer sign X's Terms of Trade (if there is a supply agreement, then both parties would normally sign it).

X's reservation of title clause may be valid and effective as between X and the buyer even if X doesn't register on the PPS register. It is the interests of third parties (like the bank) that affect X's priority. That can be a problem particularly where the buyer goes into receivership or liquidation.

Pre-PPSA, many reservation of title clauses purported to reserve title until all monies for all supplies were made (an “all monies” clause). Such a clause can still be used but a PMSI only secures the unpaid price for specific goods.

For example, if goods supplied in February were paid for but goods supplied in March were not, X could not claim a PMSI (super priority) over any February goods. However, X could claim a general security interest in February goods (because X has reserved a security interest over all goods supplied), but other interests may have priority over that general security interest. Whether X could deal with those goods or sale proceeds would depend whether any other party has a security interest in the those goods and if so, who has priority, which would be determined according to the general priority rules e.g. who was the first to perfect their security interest..

Once only financing statement may be sufficient

X can register a financing statement to cover all goods that will be supplied by X to the buyer from time to time.

Electronic Registration

Financing statements are registered electronically i.e. online, through the PPS website. It would be a good idea for anyone who would have the responsibility of registering financing statements to become familiar with the PPS site. It contains useful information.

Amending Financing Statements and Change Demands

There are various reasons for amending a financing statement.

The debtor may change their name e.g. in the case of a company, or a woman who gets married. The financing statement is amended by filing a financing change statement. X may lose priority in some circumstances if a financing change statement is not registered within the prescribed time (after X learns of the change).

A change demand may also be required by a debtor (such as a purchaser) when a financing statement should have been discharged but hasn't. If X won't register a discharge, the buyer can deal with the matter (unless X obtains a court order to the contrary).

Renewal

Financing statements need to be renewed every 5 years. It would be X's responsibility to diarise this and to ensure that it is done. Failure to renew in time will be mean a loss of priority.

All or only selected customers?

X might to decide to register financing statements in relation to all customers or only in relation to selected customers. That's a decision for X, having regard to how cautious X is and what credit risk X is prepared to take.

Information required to register

Certain information has to be obtained from the customer for the supplier or lessor to be able to register a financing statement.

If the debtor is a human person, X will in particular need their full "**official**" name (as on a passport or driver's licence) and their birth date.

As to the names, the reason for this is because the idea is that when searching the register, a party should only have to search for the official name of the debtor. It shouldn't be necessary to consider variations of the name (whether due to errors in registration or the use of several names by the debtor or abbreviations).

It won't be possible to register a financing statement at all without the **birth date** of the Debtor.

For companies, amongst other things, the **incorporation number** will be required.

Where there are certain types of "serial numbered" goods e.g. motor vehicles (with registration plates, chassis numbers etc), the "**serial numbers**" have to be included in the financing statement. The exception is where the relevant goods are supplied as inventory i.e. will be used by the buyer as inventory.

The keying in of information correctly is vital. Any error may mean that a financing statement is invalid (if it becomes seriously misleading as a result).

Discharge of Financing Statement

X should discharge any financing statements if nothing is owed to it and it no longer deals with a customer.

Deemed Security Interests – Equipment Leases

I referred to reservation of title clauses. I said that reserving title until payment gives rise to a security interest. The security interest is a **deemed** security interest and gives rise to a **PMSI** if a financing statement is correctly registered within strict time limits. It is not a true security interest because X has simply reserved title. X has not transferred title and then taken a charge over the goods. But the law says that the substance or economic effect of reserving title is no different to selling and taking a charge, so the reservation of title is deemed to give rise to a security interest.

More controversial are **equipment leases for a term of more than a year**. In such a case, a deemed security interest arises and again, it gives rise to a **PMSI** if a financing statement is correctly registered within strict time limits. It is as though the lessee owns the goods and the lessor has a charge over them.

Even now, some 10 years after the PPSA came into force, some lessors are paying the price for not being aware of the PPSA. A client was referred to me recently. Unusually, they decided to lease some equipment to a client who could not afford to buy it. The equipment was worth \$225K. The lessee went into receivership and the lessor wanted the equipment back. The receivers pointed out that the lessor had not registered a financing statement. Had the lessee not granted security interests to other parties e.g. banks, who had perfected their security interests by registering financing statements, the lessor may have been able to recover the equipment. However, there were secured parties with registered financing statements so the lessor lost out. Had the lessor registered a financing statement within the time prescribed by the PPSA, the lessor would most likely have been in a secure position. Needless to say, this was an expensive lesson.

Attachment and Perfection

To obtain the best priority, a security interest must have **attached** and must have been **perfected**.

Attachment occurs where a party has given value e.g. a lender has made a loan or at least committed itself to make a loan, and the other party has rights in the property. In addition, as noted previously, to obtain priority against third parties, the agreement should be in writing (or the debtor should have assented to it in writing).

Perfection may in some cases be obtained by possession but usually it is obtained by registering a financing statement. Where a financing statement is registered after attachment, perfection will occur upon registration. In that case, registration and perfection are in effect the same thing. However, registration can occur prior to attachment and where that occurs, perfection will occur upon attachment, so that registration and perfection are not in effect the same thing. Nevertheless, in that case, priority will be determined according to the time of registration, so that in all cases, the timing of registration is important. There is something to be said therefore for registering financing statements at the earliest opportunity.

PMSI's and timing of registration

To obtain PMSI, registration of a financing statement must be completed within strict time limits.

Proceeds

A security interest would normally extend to cash proceeds e.g. when the buyer or lessee sells the goods, the security interest will extend to the sale proceeds. But there are other forms of "proceeds" e.g. Y buys a car and exchanges it for a boat without paying the price. To cover the boat, the financing statement would have to be carefully worded.

A distinction needs to be made between accounts receivable and cash proceeds. Priority isn't automatically afforded to accounts receivable.

Steve Dukeson LL.M. (Hons.)
Dukesons Business Law
Auckland
steve@dukesons.co.nz