IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY

CIV-2010-485-647

BETWEEN	RABOBANK NEW ZEALAND LIMITED Plaintiff
AND	ROBERT MCANULTY AND OTHERS First Defendants
AND	RON TAYLOR Second Defendant

Hearing: 17 August 2010

Appearances: P. Niven - Counsel for Plaintiff
S. Perese - Counsel for Defendants

Judgment: 23 August 2010 at 3.00 pm

JUDGMENT OF ASSOCIATE JUDGE D.I. GENDALL

This judgment was delivered by me ______________________ on 23 August 2010 at 12.45 pm pursuant to r 11.5 of the High Court Rules.

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Introduction

[1] The plaintiff seeks summary judgment against the defendants for an order for possession of a thoroughbred stallion, pleading conversion and detinue, named St Reims, on the basis of a claimed perfected security interest in the horse. Each of the plaintiff and the first defendants' group claims an ownership or priority interest in St Reims. The first defendants are members of the February Syndicate ("the Syndicate"), which is the registered owner of St Reims. The second defendant ("Mr Taylor") is the current bailee of St Reims following its removal to his property from a Waikato stud farm property known as Stoney Bridge Waikato. The plaintiff is the financier of interests which own the Stoney Bridge Waikato Stud Farm.

[2] The defendants oppose the plaintiff's application for summary judgment on the basis that the plaintiff's deemed security interest, with respect to what is here a bailment for a term of more than one year, is not a proprietary interest in St Reims.

Background

[3] The Syndicate purchased St Reims in 2001 for $1 million. The ultimate purpose of the purchase was said to be "to put St Reims to stud as a commercial enterprise". Ownership of the horse was registered with New Zealand Thoroughbred Racing Inc in early 2002.

[4] In 2006, the Syndicate entered into an Agreement entitled "ST REIMS – SYNDICATE AGREEMENT" ("the Agreement") for standing services with a company called Stoney Bridge Limited ("SBL"), which either itself or through its sole shareholder Mr Michael Tololi ("Mr Tololi") operated a stud farm. The Agreement was unsigned, undated and, according to the Syndicate, incomplete. It provided that St Reims would stand at the property in question known as Stoney Bridge Waikato, and that SBL would provide services associated with the standing. Stoney Bridge Waikato Stud Farm ("the SB Farm") it is said is owned by Mr Tololi, who is the sole director and shareholder of SBL. The Agreement also vested "sole management" of St Reims in "Stoney Bridge Limited".

[5] Clause 23(5) of the Agreement provided that:

> The initial term of this Agreement shall be three seasons but at the end of that period Stoney Bridge has the right of renewal for a further period of three seasons and shall thereafter have similar successive rights for similar periods so long as St Reims is in service. Such rights of renewal shall be deemed to be exercised unless notice of termination is given at or before the

> end of any season or within such time thereafter as the Committee may from time to time stipulate.

[6] The Syndicate suggests that there is some confusion as to whether the bailment was between the Syndicate and SBL, or between the Syndicate and Mr Tololi, as the owner of the SB Farm. However, given that the Agreement was expressed to be between SBL and the Syndicate, I will proceed on the basis that SBL was the bailee under the parties' arrangement.

[7] The plaintiff's argument is that the effect of the Agreement was that St Reims was bailed by the Syndicate to SBL for an initial term of three years to be put to stud commercially, and that the bailment therefore constituted a security interest for the purposes of the PPSA. The Syndicate did not register a security interest in respect of St Reims.

[8] The plaintiff provided banking services to SBL. On 12 March 2007, SBL signed a General Security Agreement (GSA) in favour of the plaintiff that granted security over all SBL's "present and after acquired property". The plaintiff then registered a financing statement on 14 March 2007 perfecting its security interest under the GSA.

[9] Default apparently occurred under the GSA and on 6 March 2009, the plaintiff appointed a Mr Downes and a Mr Simpson as receivers of SBL pursuant to the GSA. On 6 October 2009, the plaintiff instructed the receivers, as its agents, to exercise its security rights, and take possession of St Reims to effect a sale of the stallion. The receivers wrote to the Syndicate informing it of their intended action. The Syndicate, however, refused to allow the receivers to have access to St Reims, and St Reims was moved from the SB Farm to Mr Taylor's property.

[10] The Syndicate has since refused to allow the plaintiff to take possession of St Reims. As I have noted, the plaintiff, however, claims that it has a perfected security interest arising from the one year plus bailment of St Reims under the Personal Property Securities Act 1999 ("PPSA").

Counsel's Arguments and My Decision

[11] In making the claim I have noted in the preceding paragraph, the plaintiff's case is that its perfected security interest in St Reims has priority, in accordance with the rules in the PPSA, over the Syndicate's unperfected security interest. It argues that the bailment under the Agreement by the Syndicate of St Reims to SBL for a term in excess of one year was "a lease for a term of more than 1 year" as defined in

s 16 PPSA, and that the PPSA deems that bailment to create, first, a security interest in favour of the Syndicate as bailor and, secondly, a proprietary interest in St Reims in favour of SBL as bailee for the purposes of s 17(1)(b).

[12] Section 17(1)(b) PPSA provides that the term "security interest" means an "interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation", and includes:

> ... an interest created or provided for by a transfer of an account receivable or chattel paper, a lease for a term of more than 1 year, and a commercial consignment (whether or not the transfer, lease, or consignment secures payment or performance of an obligation).

[13] The term "lease for a term of more than 1 year" is defined in s 16 PPSA in the following terms:

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

[14] The plaintiff submits that its perfected security interest in all the present and after acquired property of SBL attached to SBL's rights in St Reims on 14 March

2007, and that this perfected security interest has priority over the Syndicate's unperfected security interest.

[15] In response, the Syndicate's position is that the plaintiff does not have a security interest in St Reims. Broadly, this argument is made on two grounds. The first argument is that the Agreement does not give rise to a security interest in the sense that it consists of a right in personal property, because the bailment does not convey ownership or any other equitable or proprietary right in St Reims. The second argument is that in any event the bailment was not a "lease for a term of more than 1 year" because the Syndicate was not "regularly engaged in the business of leasing goods"; and the exclusion in s 16(c)(i) PPSA applies.

[16] The present application before me is an application for summary judgment. As such the plaintiff must satisfy the Court that the Syndicate has no arguable defence to its cause of action. The principles of summary judgment were authoritatively summarised by the Court of Appeal in *Krukziener v Hanover Finance Ltd* [2008] NZCA 187, [2010] NZAR 307 in the following way:

> [26] The principles are well settled. The question on a summary judgment application is whether the defendant has no defence to the claim; that is, that there is no real question to be tried: *Pemberton v Chappell* [1987] 1 NZLR 1; (1986) 1 PRNZ 183 (CA), at p 3; p 185. The Court must be left without any real doubt or uncertainty. The onus is on the plaintiff, but where its evidence is sufficient to show there is no defence, the defendant will have to respond if the application is to be defeated: *MacLean v Stewart* (1997) 11 PRNZ 66 (CA). The Court will not normally resolve material conflicts of evidence or assess the credibility of deponents. But it need not accept uncritically evidence that is inherently lacking in credibility, as for example where the evidence is inconsistent with undisputed contemporary documents or other statements by the same deponent, or is inherently improbable: *Eng Mee Yong v Letchumanan* [1980] AC 331; [1979] 3 WLR 373 (PC), at p 341; p 381. In the end the Court's assessment of the evidence is a matter of judgment. The Court may take a robust and realistic approach where the facts warrant it: *Bilbie Dymock Corp Ltd v Patel* (1987) 1 PRNZ 84 (CA).

[17] It is clear that where the only real issue in contention is a question of law on a summary judgment application, there is usually no reason why the Court should not deal with the matter on the application, provided the question is clear-cut and the matter has been fully argued: *McGechan* at HR12.2.02. However, the authorities have sounded a note of warning in this area. As *McGechan* also notes, the summary judgment procedure should not be permitted to "stultify the natural development of the law which would otherwise occur through normal trial process": *BNZ v Maas-Geesteranus* (1991) 4 PRNZ 689 at 697. Similarly, a Court should be cautious to determine "novel or developing points of law [which] may require the context provided by trial to provide the Court with sufficient perspective": *Westpac Banking Corp v Kembla NZ Ltd* [2001] 2 NZLR 298 (CA) at 313.

Does the plaintiff have a security interest in St Reims?

[18] The plaintiff's case is that the Syndicate has a deemed security interest pursuant to the PPSA in St Reims as the bailor of the animal under a "lease for a term of more than 1 year" because the bailment of St Reims fell within this lease definition as set out at s 16 PPSA. Moreover, the plaintiff argues that the PPSA deems SBL to have a proprietary interest in St Reims as bailee, and that the plaintiff's security interest in SBL's property attached to that deemed proprietary interest in St Reims.

[19] The PPSA provides a system for personal property securities registration which focuses on priority between security interests created under the Act. A security interest for the purposes of the PPSA is an interest in personal property that is to secure payment or the performance of an obligation: s 17(1)(a). Importantly, however, some specified forms of transactions are still deemed to be security interests regardless of whether they secure any obligations: s 17(1)(b). These security interests include "an interest created or provided for by a lease for a term of more than 1 year". Personal property that is subject to a security interest is defined as "collateral": s 16.

[20] The PPSA provides optimal protection to the holder of a security interest that is "perfected". Section 41 provides that a security interest is perfected when the security interest has attached and either a financing statement has been registered or the secured party has possession of the collateral. Attachment of security interests is dealt with in s 40:

> **40 Attachment of security interests generally**
>
> (1) A security interest attaches to collateral when—
>
> (a) Value is given by the secured party; and
>
> (b) The debtor has rights in the collateral; and
>
> (c) Except for the purpose of enforcing rights between the parties to the security agreement, the security agreement is enforceable against third parties within the meaning of section 36.
>
> (2) Subsection (1) does not apply if the parties to a security agreement have agreed that a security interest attaches at a later time, in which case the security interest attaches at the time specified in the agreement.
>
> (3) For the purposes of subsection (1)(b), a debtor has rights in goods that are leased to the debtor, consigned to the debtor, or sold to the debtor under a conditional sale agreement (including an agreement to sell

> subject to retention of title) no later than when the debtor obtains possession of the goods.
>
> (4) To avoid doubt, a reference in a security agreement to a floating charge is not an agreement that the security interest created by the floating charge attaches at a later time than the time specified in subsection (1).

[21] Accordingly, three requirements must be fulfilled before a security attaches to collateral. It is necessary that (a) value was given by the secured party, (b) the debtor has rights in the collateral and (c) the security agreement is enforceable against third parties. And, as noted above, subs (3) provides that a debtor has rights in leased goods no later than when the debtor obtains possession of the goods.

[22] Priority between security interests is determined under s 66 PPSA, which provides that a perfected security interest has priority over an unperfected security interest in the same collateral. It appears to be accepted now that the implications of the PPSA priority rules are that the title of a secured party whose security interest has not been perfected may be subordinated to another's perfected security interest: *Waller v New Zealand Bloodstock Limited* [2006] 3 NZLR 629 at [75]; *Graham v Portacom New Zealand Limited* [2004] 2 NZLR 528 at [22]. It should be emphasised here that title can still defeat a registered security interest if it remains outside the PPSA and does not, in itself, form a security interest.

[23] The facts of *Waller v New Zealand Bloodstock Limited* are uncannily similar in many respects to the present case. In that case, the debtor, Glenmorgan Farm, had granted a general security interest over "all its present and future assets" to a financier, S H Lock (NZ) Ltd. The security interest was perfected by registration of a financing statement under the PPSA. One of the debtor's assets was a stallion that had been leased from New Zealand Bloodstock Ltd under a lease-to-purchase agreement. The lease was eventually terminated because Glenmorgan defaulted under the lease agreement, and New Zealand Bloodstock repossessed the stallion. However, New Zealand Bloodstock never registered a financing statement, and when Glenmorgan Farm defaulted under the general security interest agreement, the financier claimed that it was entitled to the leased stallion.

[24] In the High Court, Allan J found that the financier's security agreement encompassed Glenmorgan's interest in the stallion, relying both on the particular wording of the debenture and a broad reading of the expression "assets". The Judge considered that, because the charging clause was sufficiently wide to catch "the possessory, contractual and statutory interests" of Glenmorgan in the stallion, there was a relevant security interest within the meaning of s 17. The GSA created a

security interest by virtue of s 17(1)(a), while New Zealand Bloodstock had a security interest in the lease under "the general provisions of s 17(1)(a) as amplified by s 17(1)(b)" (at [62]). However, because New Zealand Bloodstock's security interest was never perfected, S H Lock's security interest had priority in terms of s 66(a) PPSA.

[25] Allan J rejected an argument by NZBF that the PPSA has no application where a lessor has retaken possession of leased goods and the security interest is "replaced by the absolute rights of an owner in possession" (at [69]). Referring to the following passage by the Canadian Supreme Court decision in *Re Giffen* [1998] 1 SCR 91, the Judge concluded that "the lessor's interest in the collateral takes or cedes priority as the case may be according to the Act's priority rules, not according to the dictates of the common law relating to legal title" (at [93]):

> [38] ... A person with an interest rooted in title to property in the possession of another, once perfected, can, in the event of default by the debtor, look to the property ahead of all others to satisfy his claim. However, if that interest is not perfected, it is vulnerable, even though it is rooted in title to the goods. ...

[26] This principle of "primacy of priority over title" was also captured in the judgment of Rodney Hansen J in *Graham v Portacom*, which, as noted by Allan J at [91], met with the approval of Mr M Gedye in an article titled "What's Yours is Mine: Attachment of Security Interests to Third Party Assets" (in (2004) 10 NZBLQ 203). The passage that was quoted in *Waller* reads as follows:

> In essence, under the PPSA the lessor under a lease that comes within the definition of security interest is effectively no longer the 'owner' of the leased asset when it comes to a conflict with other security interests. The leased asset is merely collateral of the lessor and the lessor's rights vis a vis third party claims to the leased asset are only those of a secured party. The corollary of this concept is that the lessee/debtor is effectively considered to be the owner of the collateral. The lessor's interest in the collateral is then prioritised according to the Act's priority rules. It is these priority rules that determine whether the lessor will win and not the common law notion of *nemo dat*. *This recharacterisation of the lessor's and lessee's rights allows both third party security interests to attach and the lessee to pass good title to the leased assets, even though the lessee had no contractual right to acquire title itself*. When Rodney Hansen J stated: 'A security interest can therefore attach to the *lessee's interest* in the goods,' (emphasis added) he was not referring to the lessee's leasehold interest as traditionally conceived. He made it clear that he was referring to the lessee's interest as reconceptualised by the PPSA when he said: 'the lease is treated as a security agreement and the lessee is treated as the owner of the goods for registration and priority purposes.' It is the lessee's interest as reconceptualised as owner of the goods to which a security interest can attach. (emphasis added)

[27] Allan J accordingly concluded that New Zealand Bloodstock's legal title to the stallion was "simply irrelevant" because New Zealand Bloodstock held an unperfected security interest and was in competition with a party which held a perfected security interest (at [93]). It was the lessee who was to be treated as the owner of the goods for registration and priority purposes, and not the lessor. The effect of this was that, although the lessee did not itself hold legal title to the stallion, "it [was] nevertheless capable of passing good title ... despite the fact it [had] no absolute contractual right to require title itself" (at [94]). Allan J accepted that, for those unfamiliar with the PPSA, this conclusion might be difficult to accept, but he emphasised that the result:

> [98] .... is a reflection of the extent to which the registration regime introduced by the Act has altered long established priority principles grounded in notions of legal title. Irrespective of title, it is paramount that security interests be the subject of registration if priority is to be preserved.

[28] The decision in *Waller* was appealed. On appeal, a majority of the Court of Appeal agreed that the lease amounted to a security interest for the purposes of the PPSA. The lease to purchase was a "lease for a term of more than 1 year", which meant that, for the limited purpose of priority of securities, the agreement to lease was "overridden by statute" (at [54]). Instead of enjoying its previous inviolable title to the stallion, New Zealand Bloodstock was deemed by s 17 to have a statutory "security interest", which was liable to be overridden by a competing security interest. The Court considered that this conclusion was also implied in s 24, which provides that the fact that title to collateral may be in a secured party rather than a debtor does not affect the application of the PPSA (at [29]).

[29] The Court further concluded that Glenmorgan had rights in the stallion that it could provide as security to S H Lock. S H Lock's security interest was based on Glenmorgan's "rights in [the stallion]" in terms of s 40(3):

> [55] If on its true construction the debenture was "effective according to its terms" (s 35 (see para [31] above) to subject Glenmorgan's "rights in [the stallion]" (s 40(3)) to Lock's security interest, in terms of s 36 (see para [34] above) the debenture is enforceable not only against Glenmorgan but also against New Zealand Bloodstock. That is because Glenmorgan had executed the Lock debenture, which also is a security agreement (defined in s 16: ". . . an agreement that creates or provides for a security interest"). The debenture would be enforceable against New Zealand Bloodstock in respect of the stallion (being "particular collateral"). Further, by s 40 (para [37] above), Lock's security interest (by receipt of the charge over Glenmorgan's rights in the stallion) would attach to the stallion, since:
>
> (a) Lock gave value; and

> (b) Glenmorgan had rights in the stallion; and
>
> (c) the security was enforceable against New Zealand Bloodstock (s 36).
>
> In terms of s 40(3), Glenmorgan "[had] rights in [the stallion] . . . no later than when [it] obtain[ed] possession of the [stallion]"; that is, on 1 August 2001.
>
> [56] On such analysis, from that date there was such relationship between Glenmorgan and the stallion as would from 1 May 2002, when the PPSA came into force, constitute "rights in [the stallion]" which it could in law provide as security to Lock.

[30] Moreover, the Court of Appeal was satisfied that S H Lock's debenture over Glenmorgan's "present and future assets" clearly captured the stallion as a security interest because, *in substance*, the transaction secured payment or performance of an obligation:

> [63] Section 17, however, emphasises that, for priority purposes, the form of the transaction is to be disregarded. This is a major consideration in our respectful decision to differ from William Young J on the point of construction. We do not see the case as turning on the fine nuances of how the charging clause was drafted. Rather, what matters is that the transaction "in substance secures payment or performance of an obligation".
>
> [64] While until 1 May 2002 the charge did not extend to the stallion, on that day Glenmorgan acquired "rights in goods" in relation to the stallion (s 40(3)). With respect to the view of William Young J (at para [116](b) below) that:
>
> > "Glenmorgan had the same rights in [the stallion] prior to 1 May 2002 as it did after 1 May 2002 . . ."
>
> it does not acknowledge the effect of s 40(3). Prior to 1 May 2002, because of the terms of cl 4(f) (see para [41] above), Glenmorgan 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. Such "rights" in our view fall clearly within the scope of the charging clause (see para [3] above), which embraces that part of Glenmorgan's "business undertaking" comprising the leasehold interest in the stallion as a revenue source which constitutes "after-acquired property". It would be difficult to find language more apt to embrace whatever security may be available than that contained in the charging clause. Since that leasehold interest constitutes "rights in goods", Lock's security interest attaches to the stallion (s 40(1)).

[31] The Court of Appeal also found that the security interest had attached to the stallion in terms of s 40:

> [68] ... We interpret s 40 (see para [37] above) as providing the criteria for attachment to collateral, including Glenmorgan's new statutory rights in the stallion (s 40(3)). On 1 May 2002, Lock had provided value (s 40(1)(a)); Glenmorgan had rights in collateral (s 40(1)(b) to which the security interest could attach and had attached by Glenmorgan's obtaining possession of the stallion (s 40(3)); and there was also an enforceable security agreement

> (s 40(1)(c); s 36). Lock therefore had satisfied s 40: on 1 May 2002, Lock's security interest attached to all of Glenmorgan's collateral (or assets), which included the stallion.

[32] Consequently, the Court of Appeal determined that the competing interests were given priority in accordance with the provisions of the PPSA, and that, since New Zealand Bloodstock had not perfected its security interest, S H Lock's security interest took priority. The principle of *nemo dat quod non habet* was ousted by the PPSA:

> [74] Such conclusion means that with respect to priority of competing security interests under the PPSA the nemo dat principle is ousted. The consequence is to empower Glenmorgan to add to the security passing to Lock under Lock's debenture a proprietary interest in the stallion, even though the agreement between New Zealand Bloodstock and Glenmorgan had provided to the contrary. We therefore reach the same conclusion on the appeal as Allan J for like reasons.
>
> [75] The result follows Parliament's decision that the kind of leasehold interest retained by New Zealand Bloodstock should, as a matter of policy, be treated as a mere security interest which requires registration to be perfected. Since that did not occur, Lock's competing security interest which was duly registered and so perfected took priority. The major lessons of the case are twofold: the statutory altering of the proprietary rights of a lessor; and the crucial importance of registration. These are policy choices which have been made and significantly alter what would otherwise have been the position.

[33] A helpful summary of the Court's conclusion that S H Lock's debenture took priority over New Zealand Bloodstock's title to the stallion is set out at [51]:

> [51] We set out in summary form the steps to our conclusion that Lock's debenture takes priority over New Zealand Bloodstock's title to the stallion.
>
> (a) The lease to purchase being for more than one year, for the limited purpose of fixing priorities of competing proprietary interests, New Zealand Bloodstock's title became a "security interest" (s 17(1)(b)).
>
> (b) By s 40(3) Glenmorgan, which apart from the PPSA had no property rights in the stallion, secured "rights in [the stallion]".
>
> (c) Whether the debenture as a security agreement is "effective according to its terms" (s 35) to capture Glenmorgan's rights in the stallion is a question of construction which we answer in favour of Lock.
>
> (d) Given such construction, Glenmorgan's statutory rights in the stallion potentially form part of Lock's security, provided they "attach" (s 40).
>
> (e) The attachment conditions of s 40 are satisfied by Lock because:
>
> (i) Lock has given value (s 40(1)(a));

(ii) Glenmorgan has rights in the collateral (s 40(1)(b)); and

(iii) by s 36, Lock's security agreement is enforceable against New Zealand Bloodstock's as a third party (s 40(1)(c)). That is because Glenmorgan has signed the debenture that contains a statement that a security interest is taken in all of the debtor's (Glenmorgan's) present and after-acquired property (s 36(1)(b)(ii)).

(f) Lock has perfected its security interest (s 41).

(g) Since New Zealand Bloodstock has not perfected its security interest, Lock's security interest takes priority (s 66(1)(a)).

[34] The Court of Appeal's decision was applied in *Stiassny v Dunedin City Council* HC Auckland CIV-2007-404-3463, 30 May 2008, where Winkelmann J determined that the respondent's argument that the bank's security interest could only attach to legal title would defeat the Act's purposes, "which are to provide a unitary concept of security focused on the substance of the transaction and to establish priority rules that depend primarily on registration, without regard to the form the transaction takes or to who holds title" (at [46]).

[35] The plaintiff submits that, for the purposes of the PPSA, a bailee is treated as the owner of the collateral and gains a proprietary interest in the collateral, provided the bailment meets the definition in s 16 PPSA of a "lease for a term of more than 1 year" which under (a) means a lease <u>or bailment</u> of goods for a term of more than one year. It is submitted that SBL, as the bailee, gained a proprietary interest in St Reims as the collateral; that the Syndicate, as the bailor, is deemed to have a security interest in the collateral; and that the plaintiff, as the secured party, can acquire a proprietary interest in the collateral from its attached security interest, on the basis that the security interest can attach to SBL's deemed rights in the collateral.

[36] Assuming for the moment that the bailment of St Reims here was in fact a "lease for a term of more than 1 year", the plaintiff's submission, at first, appears to be in line with the conclusions reached by the Court of Appeal in *Waller*. The starting point is that, if the bailment fits the definitional requirements of s 16, the Syndicate's title became a security interest pursuant to s 17(1)(b). According to the plaintiff, the effect of this security interest is that SBL, which apart from the PPSA had no property rights in St Reims, secured rights in the stallion. There appears to be some confusion, however, whether these statutory rights are created by s 40(3), which appears to have been the approach adopted by the Court of Appeal (see [51](b) and [64]), or whether the debtor's rights arise by virtue of s 17(1)(b).

[37] The plaintiff submits that s 40(3) PPSA, which states that a lessee has rights in goods *leased* to a debtor "no later than when the debtor obtains possession of the goods", is a mere timing provision, and that the rights in goods arise from the deeming by the PPSA of the creation of a security interest. It submits that it must be the deeming of the security that leads to the owner's interest, for the purposes of the PPSA, being reduced to a security interest. As such, the plaintiff insists that it is s 17(1)(b) which is the operative provision here, and which confers on the lessee "deemed proprietary rights". According to the plaintiff, therefore, a bailee has "rights" in the collateral at the time that it takes possession of the collateral, because it is from that time that it has a possessory right. If, however, the bailment is a "lease for a term of more than 1 year", the deeming of the security interest grants the bailee (deemed) proprietary rights on possession of the collateral, pursuant to s 17(1)(b), and a secured party's security interest attaches to these greater rights.

[38] This appears to have been the approach adopted in *Graham v Portacom* at [28], where Hansen J approved the statement that:

> ... 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.

[39] At [29], however, Hansen J concluded that:

> [29] NDG has therefore both a possessory interest and a proprietary interest in the buildings. The latter arises by virtue of s 40(3) which confers on NDG rights in goods which it leases. It could as a result grant a security interest in the buildings themselves, not just its leasehold interest in them. This is referred to in *International Harvester Credit Corp of Canada v Touche Ross Ltd* (1986) 30 DLR (4th) 387 as the statutory or proprietary interest conferred upon a debtor and is to be distinguished from its contractual or possessory interest. The question is whether these interests come within the charge.

[40] Although nothing would have turned on the question of whether the lessee's deemed proprietary rights were the result of s 40(3) or s 17(1)(b) in *Waller* (or, for that matter, *Portacom*), it is of some significance in the present case. Section 40(3) does not, on the face of it, extend to bailed goods. It provides that, for the purposes of subs (1)(b), which requires that a debtor has rights in the collateral before a security interest can attach, a debtor has:

> ... rights in goods that are *leased* to the debtor, consigned to the debtor, or sold to the debtor under a conditional sale agreement (including an agreement to sell subject to retention of title) no later than when the debtor obtains possession of the goods. (emphasis added)

[41] Accordingly, if s 40(3) is confined to goods that are leased, consigned or sold, but not bailed, and if, pursuant to *Waller*, a lessee's deemed proprietary rights are created by s 40(3), which in turn form the basis of attachment for the other secured party's security interest, then bailed goods could not give rise to a "full" security interest in favour of the creditor.

[42] Counsel for the defendants submits that a conscious decision was made in the drafting of s 17 to limit the definition of "security interest" to mere interests in s 17(1)(b), as opposed to interests *in personal property* in s 17(1)(a). It is submitted that a security interest under s 17(1)(a) attaches if ss 40(1)(a) and (c) are satisfied, but that an enquiry under para (b) is unnecessary because the security interest is already defined as an interest in goods. However, a security interest under s 17(1)(b) only attaches when all three subsections of s 40(1) are satisfied. It is submitted that an interest created by a lease under s 17(1)(b) can only amount to an interest in personal property if s 40(3) is applicable, which effectively creates a proprietary right.

[43] In my view, the focus on subs (3) as "creating" proprietary rights for the purposes of priority is misconceived. A distinction must be drawn between priority rules and rules of attachment. For the purposes of attachment, the relevant question is whether "the debtor has rights in the collateral". In the case of leases, the debtor has rights in goods (or collateral) when the debtor obtains possession of the goods. However, if the debtor is not the lessee under a deemed security interest pursuant to s 17(1)(b), or under a lease that in substance secures payment or performance of an obligation pursuant to s 17(1)(a), then the creditor's security interest under the security agreement cannot take priority over the true owner, the lessor. It is the existence of the lessor's security interest, therefore, that determines whether the lessee is treated as the effective owner of the collateral. At the same time, a third party's security interest can only attach to the collateral if the lessee has sufficient "rights" in the property. This also seems to be the approach adopted by Mr Michael Gedye in *Personal Property Securities in New Zealand* (Brookers, 2002) at 40.3.1.

[44] It follows that the exclusion of bailed goods from s 40 (3) does not mean that a debtor, as bailee, does not also have rights in goods. If it was otherwise, a bailee's interest could never give rise to a security interest by a third party, as the security interest could not attach. The relevant issue becomes whether, as with leases in s 40 (3), mere possession is sufficient to allow attachment in the collateral. Moreover, if the bailment is a lease for a term of more than one year, it would seem that the

bailee's deemed proprietary rights should be sufficient "rights in the collateral" in terms of attachment.

[45] In that context, the plaintiff's argument that s 40(3) is merely concerned with the timing of the lessee's rights in the collateral, and that the existence of a deemed security interest would be sufficient to create "rights in goods", holds considerable appeal. The wording "no later than", for example, is a strong indicator that subs (3) seeks to give some content to the concept of "rights in collateral", but that it does not purport to define it. Any "rights in goods", whether proprietary or – as under s 40(3) – possessory, will be sufficient to provide a basis for attachment. The scope of the security interest, however, is determined in accordance with the relationship between lessee and lessor. If the lease forms a security interest under s 17, the lessee can pass title to the goods although it never had a contractual right to this effect.

[46] To the extent that the Court of Appeal may have referred to subs (3) as "creating" proprietary rights, I consider that the Court was probably concerned with the *consequences* of attachment in favour of the creditor under s 40, which in that case meant that the creditor obtained a security interest in priority to the interest of the "true owner", whose interest had been reduced to a security interest under s 17.

[47] However, given that the approach adopted by the Court of Appeal is not entirely clear, it would in my view be beneficial to hear full argument on the role of s 40(3) for the purposes of the priority rules under the PPSA. I consider that these matters involve questions of considerable importance. Depending on which interpretation of ss 17 and 40 PPSA is adopted, SBL, as the bailee, either was or was not in a position to pass good title in St Reims to Rabobank as part of its security interest. Moreover, even if it was accepted that it is the deemed security right that allows the bailee to pass title to the goods, there may still be an issue as to whether the bailee's deemed proprietary rights were "rights in the collateral" for the purpose of s 40(1)(b) or, alternatively, whether the bailee's possessory rights were sufficient for the creditor's security interest to attach. Although this would appear to be the case here, given the nature of the agreement entered into between SBL and the Syndicate, this point was not addressed in submissions in any detail.

[48] In these circumstances, and given my conclusion on the exception point which I will discuss further below, I consider that the plaintiff has been unable to show here that there can be no real doubt or uncertainty as outlined in *Krukziener v Hanover Finance* Ltd that the defendants have no defence to its claims. Further, in my view this case without question raises novel questions of law that should not be

resolved on an application for summary judgment. The plaintiff's summary judgment application therefore must fail. For the sake of completeness, I will nevertheless go on to briefly consider the remaining issues in this case.

[49] The next matter for consideration is whether the GSA in favour of Rabobank was "effective according to its terms" (s 35) to capture SBL's rights in St Reims. This is a question of construction, albeit a simple one in the present case. The GSA is clear on its terms, granting security in all personal property. The term "personal property" is further defined as "all personal property and after-acquired property in which the Debtor has, or acquires, rights". In substance, therefore, the transaction secured performance of an obligation under the bailment agreement, and captured SBL's rights in St Reims as collateral: cf *Waller* at [64]. As a result, SBL's statutory rights in the stallion would have formed part of Rabobank's security, provided they "attached" in terms of s 40.

[50] As to attachment, I have already noted that s 40 provides that a security interest attaches to collateral when value is given by the secured party, the debtor has rights in the collateral, and the security agreement is enforceable against third parties within the meaning of s 36 PPSA. There appears to be no dispute that Rabobank has given value to SBL. Moreover, it seems that the GSA would be enforceable against the Syndicate in terms of s 36. This latter requirement is satisfied when the debtor has signed a security agreement that contains a statement that a security interest is taken in all of the debtor's present and after-acquired property. However, as is apparent from the preceding analysis, there is an issue as to whether SBL had deemed proprietary rights in St Reims as collateral. If SBL did have such rights in St Reims, it would probably follow that the plaintiff's security interest attached to St Reims on 12 March 2007.

[51] Finally, the Syndicate does not appear to dispute that, if Rabobank did have a relevant security interest, it perfected the security interest in terms of s 41. Subject to the effect of s 40(3) and the additional question of whether the bailment in this case satisfies the definition of a "lease for a term of more than 1 year", I would thus have concluded that Rabobank has a security interest in St Reims, arising from the bailment between SBL and the Syndicate pursuant to s 17(1)(b), that has priority over the Syndicate's unperfected security interest.

Was there a "lease for a term of more than 1 year"?

[52] At first sight, the bailment in this case clearly satisfies the definition of a "lease for a term of more than 1 year" in s 16 PPSA, as it was a bailment for a term of more than one year (para (a)). As I understand the Syndicate's position, it advances two reasons, however, why the bailment in this case does not fall within the definition of a security interest in the PPSA.

[53] The first argument is that St Reims was not bailed to SBL for a period of longer than one year because the period of bailment was measured in "seasons". The Syndicate submits that the bailment here was an "operational bailment", and that Parliament did not intend to capture agreements of this nature. It argues that the purpose of establishing the concept of "leases for a term of more than one year" was to capture leases that were in substance a device for financing and thus acquiring effective ownership of an asset. The bailment in the present case it is said does not fall within that category.

[54] In my view, this submission is founded on an incorrect understanding of the definition of the term "lease for a term of more than 1 year" in s 16. Paragraph (a) sets out the meaning of the term as "a lease or bailment of goods for a term of more than 1 year". The Agreement expressly provided that St Reims was to be bailed for an initial term of "three seasons". Mr Robert McAnulty, the first named defendant, in his affidavit appears to accept that one season is equivalent to one year (at para 22(b)), but disputes that the Agreement was intended to be for a term of three seasons, or that SBL did not have a right of termination. Even if the Agreement was on a season-by-season basis however, and not renewable, as alleged by the Syndicate, in my view, the bailment would have come under the definition in para (b)(iii) as:

> (iii) A lease for a term of 1 year or less where the lessee, with the consent of the lessor, retains uninterrupted or substantially uninterrupted possession of the leased goods for a period of more than 1 year after the day on which the lessee first acquired possession of them, but the lease does not become a lease for a term of more than 1 year until the lessee's possession extends for more than 1 year...

[55] Here, the bailment commenced in 2006 and continued, it seems, uninterrupted. Moreover, whether the transaction was in substance a transaction to secure payment or performance of an obligation is irrelevant, as we are here concerned with deemed security interests for the purposes of s 17(1)(b). It would seem to be immaterial in this context that the parties intended the Agreement to be an "operational agreement".

[56] In my view, the defendants' second argument however has significantly more merit. The Syndicate relies on the exception in para (c)(i) excluding from the definition of a "lease for a term of more than 1 year" a "lease by a lessor who is not regularly engaged in the business of leasing goods".

[57] The plaintiff submits that this exception does not apply to bailments and that, even if it did apply, it would not apply on the facts of the present case. As to the first argument, the plaintiff argues that, because paras (b) and (c) in the definition only refer to leases, those paragraphs do not apply to bailments, with the result that the exception does not apply to the bailment at issue in this proceeding. Paragraph (a), on the other hand, refers to both bailments and leases.

[58] Paragraph (a) sets out the definition of the term "lease for a term of more than 1 year" by describing it as a "lease or bailment of goods for a term of more than 1 year". Paragraph (b) follows on from para (a) and specifies what is included in the definition in (i), (ii) and (iii). Paragraph (c) provides exclusions to the definition. In my view, paras (b) and (c) are designed to further define the meaning of the term as set out in para (a). The term "lease" in para (c)(i) should therefore be properly read as referring to "a lease or bailment of goods". If a contrary interpretation was adopted, none of the inclusionary or exclusionary provisions in (b) and (c) would be applicable to bailments, which in my view cannot have been the intention of Parliament.

[59] The second argument advanced for the plaintiff, that para (c) does not apply on the facts of this case, is made on the basis that the Syndicate here clearly was "regularly engaged in the business of [bailing] goods". It appears that there are no New Zealand cases that have addressed this particular matter. However, the plaintiff in turn does rely on a number of Canadian cases dealing with the equivalent Canadian provisions excluding from the definition of a "lease for a term of more than 1 year" a lease by a lessor "who is not regularly engaged in the business of leasing goods".

[60] The thrust of the plaintiff's submission with respect to these cases is that, in interpreting and applying the exception, the focus should be on the business of the lessor, and whether leasing is a proper component of the lessor's business. The plaintiff contends that, if it is a proper component of the lessor's business, then the lessor must be seen as regularly engaged in the business of leasing goods for the purposes of the PPSA and the exception does not apply, even when either it is rare

for the lessor to enter into leases or it may be the very first occasion on which the lessor has entered into a lease.

[61] This was the approach adopted by the Alberta Court of Appeal in *David Morris Fine Cars Ltd v North Sky Trading Inc* (1996) 7 WWR 332, where the lessor had only entered into leases for one vehicle in 1986, one in 1988, one in 1990, three in 1991 and two in 1992. The Court concluded, however, that the frequency of leasing was not determinative, but that, "so long as leasing was a proper component of the business, it can correctly be said that leasing was regularly engaged" (at 4). The focus was "the business practice of the lessor" (at 5). Similarly, in *East Central Development Corp v Freightliner Truck Sales (Regina) Ltd* (1997) 5 WWR 231, the lessor only leased a truck in one per cent of transactions between 1991 and 1994, but the Court concluded that this was sufficient to qualify the lessor as someone "regularly involved in leasing goods". Both these cases relied on the decision by the Saskatchewan Court of Appeal in *Paccar Financial Services Ltd v Sinco Trucking Ltd* (1989) 3 WWR 481.

[62] The plaintiff submits that the bailment in the present case was a proper component of the Syndicate's business because it involved all of the Syndicate's commercial assets. In addition, the plaintiff submits that the Syndicate's business was for commercial gain, as it was formed with the intention of establishing St Reims "as a commercial stud and to realise its commercial value". The realisation of the asset's value in turn required "skilled and expert management" and, according to the plaintiff, was always going to require the bailment of St Reims to a commercial stud operation. As such, the plaintiff contends that the Syndicate was "regularly engaged in the business of [bailing] goods" for the purposes of the application of the exception.

[63] In response, the Syndicate submits that it would be wrong to consider the Canadian approach to be directly transferable to the present context, which is concerned with bailment as opposed to leases. Moreover, it is argued that the Syndicate has owned no other horse than St Reims, and that the Agreement with SBL was the first time St Reims stood as a commercial stallion. By reference to the Law Commission's Report on the PPSA ("A Personal Property Securities Act for New Zealand", Report No 8, 1989), the Syndicate submits that there is no evidence that the Agreement is a bailment that is a recurring situation and that is employed as an alternative to a hire purchase arrangement.

[64] In this report, the Law Commission at page 89 made the following observations:

> In practical and legal effect, many commercial leases are indistinguishable from hire purchase agreements or conditional sale contracts. They create the same degree of apparent ownership which justifies the traditional regulation of chattel mortgages and charges as well as the proposed regulation of title-based securities and assignments ... On the other hand, short term and operating leases, such as those whereby a builder acquires equipment for use on a particular job, entail a far lesser degree of apparent ownership and certainly do not serve as substitutes for hire purchase or conditional sale agreements.
>
> ... In the interests of certainty, this definition [of leases for a term of more than one year] establishes a category of leases which are automatically subject to the statute. Leases for more than one year generally serve as devices for financing acquisition of effective ownership of an asset. ... The one year requirement will also exclude most operating leases, the terms of which are usually measured in days or weeks.
>
> The exclusion in subsection (d) makes clear that automatic treatment applies only to those recurring situations where leases are employed by suppliers and acquirers of goods as an alternative to hire purchase or conditional sale contracts. Outside the definition are, for example, arrangements whereby a company leases an aeroplane to a subsidiary or associated company, or, where out of deference to the needs of a particular customer, a manufacturer disposes of used machinery under a finance lease when such disposals are not part of its normal business.

[65] This view expressed by the Law Commission that "automatic treatment applies only to those recurring situations where leases are employed by suppliers and acquirers of goods as an alternative to hire purchase or conditional sale contracts" does not appear to sit well with Canadian jurisprudence on this matter. Given that in the present case we are concerned with bailment as opposed to leases, and there seems to be no authority on whether a bailor can be said to be regularly engaged in the business of bailing goods if this business is confined to the bailment of one particular good, the position does not seem to be as clear-cut as suggested by the plaintiff. Moreover, it is at least arguable in my view that the bailment here was merely incidental to the Syndicate's business, and that the Syndicate therefore was not "engaged in the business of bailing goods".

[66] Accordingly, I consider that this matter would benefit from full argument in addition to a proper consideration of the issue mentioned earlier as to whether bailed goods under s 17(1)(b) give rise to proprietary rights in favour of third parties and, if so, whether these proprietary rights – or alternatively possessory rights - are sufficient to allow attachment to the bailed good under s 40.

Conclusion

[67] For all these reasons, the plaintiff's application for summary judgment is declined.

[68] Costs are reserved to be dealt with on final disposal of this matter at trial.

[69] This matter is now listed for call at 10.00 am on 20 September 2010 for further time tabling towards trial.

'Associate Judge D.I. Gendall'