

**IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY**

CIV-2010-404-4957

BETWEEN	MARAC FINANCE LIMITED First Plaintiff
AND	K DOWNEY AND A ISAAC AS JOINT RECEIVERS OF PETHERICK PROPERTIES LIMITED (IN LIQUIDATION & RECEIVERSHIP) Second Plaintiffs
AND	M J GREER First Defendant
AND	EQUITABLE PROPERTY HOLDINGS LIMITED Second Defendant

Hearing: 24 January 2011

Appearances: Mr M J Tingey for Plaintiffs
Mr M D Arthur for Defendants

Judgment: 17 March 2011

JUDGMENT OF ASSOCIATE JUDGE DOOGUE

*This judgment was delivered by me on
17.03.11 at 10 a.m., pursuant to
Rule 11.5 of the High Court Rules.*

Registrar/Deputy Registrar

Date.....

Counsel:

*Bell Gully, P O Box 4199, Auckland
Chapman Tripp, P O Box 2206, Auckland*

Introduction

[1] On 16 December 2003, the second defendant, Equitable Property Holdings Ltd (“Equitable”) held first-ranking registered mortgages over properties at 105–109 The Terrace, Wellington and 132 The Terrace, Wellington. These properties were owned by an entity called Petherick Properties Ltd (in rec and in liq) (“Petherick”). The mortgages supported advances for the purchase of those properties by Petherick. Ultimately, the loan pursuant to which the advances were made went into default and the properties were sold by mortgagee sale by Equitable. On 22 October 2009, Equitable appointed the first defendant (Mr Greer) as receiver of rental income of the two properties under the mortgages. Equitable thereafter received nearly all the rents of the properties — with the exception of approximately \$100,000 which was initially collected by the plaintiffs but thereafter passed to Equitable.

[2] For the reasons which I will set out shortly, the plaintiffs claim that all the rent ought to have been paid to them and they say that they have a claim against the defendants to the extent of the rental which the defendants received, with that claim totalling the sum of \$1,872,614.83. The plaintiffs also seek interest on that sum, and costs. That is the amount sought from Equitable. As against Mr Greer, the plaintiffs seek the same amount but only to the extent that the Mr Greer is in fact indemnified by Equitable.

Background

[3] The first plaintiff, MARAC Finance Ltd (“Marac”) entered into a loan facility pursuant to which it agreed to advance \$3 million to Petherick, which was to be secured by a General Security Deed (“the GSD”). On 11 July 2007, Marac perfected its security interest by registering a financing statement over all present and after-acquired property of Petherick and advanced the \$3 million to Petherick.

[4] Equitable acquired a further security on 26 February 2009 when Petherick executed a General Security Agreement in Equitable’s favour securing Petherick’s present and after-acquired property. Equitable registered financing statements in respect of all present and after-acquired property of Petherick on 4 March 2009.

[5] On 11 July 2009, Petherick defaulted under its loan to Marac and on 13 October 2009, Marac appointed the second plaintiffs as receivers and managers under the terms of the GSD.

[6] The two Wellington properties were sold by mortgagee sale in April and August 2010, respectively.

Is the second defendant's interest in the rental moneys subject to the Personal Property Securities Act?

[7] The dispute between the parties is whether Marac, as holder of a first-ranking security interest over Petherick's personal property or Equitable, as holder of first-ranking mortgages over the properties, has the prevailing claim to rent generated by the properties. Marac says that its security interest has priority to Equitable's security interest under s 86 of the Personal Property Securities Act 1999 ("PPSA"), as the financing statement for the Marac security interest was registered prior to the date when Equitable registered its security interest under its GSA.

[8] The defendants in their notice of opposition assert that Equitable's interest in the rental is not subject to the PPSA by operation of ss 23(e)(i) and (ii) of the PPSA. The defendants' position is that priority in the rental monies is therefore unaffected by the PPSA. Equitable also says that its mortgage interest in the rental was created prior to any right that Marac may have in the rental, those mortgages being registered in December 2003, whereas Marac's GSD was entered into on 9 July 2007. It is not disputed that Equitable executed and registered its mortgages over the properties before Marac obtained its GSD.

[9] The defendants say that the mortgages operated not only to secure Petherick's estate in the properties, but also to transfer and assign the rental monies to Equitable and assign those monies to Equitable "absolute[ly] ... and ... by way of security".

[10] As a preliminary to discussing this issue, it will be helpful to give some consideration to the source of the plaintiffs' entitlement to the rental payments,

which the lessees of the mortgaged property made and which were collected by Mr Greer, as the receiver appointed by Equitable.

The basis of Equitable's entitlement to the rent

[11] It is necessary to analyse further the nature of Equitable's interest in the light of relevant authorities and other materials, statutory and otherwise, and come to a conclusion on whether its interest falls within the provisions of the PPSA when properly construed.

[12] The mortgages that Equitable took over the properties contain provisions referring to the rent which the mortgagor might derive from the properties. Specifically, rental is included in the category of "earnings" under the mortgage. In the definition section of the deed, "assigned property" includes "earnings".

[13] Clause 4 of the mortgage provided as follows:

4. Security

4.1 **Security:** The security created by this mortgage operates and takes effect as:

- (a) a charge on all your right, title, estate and interest in the Property; and
- (b) security for payment to us of the Secured Moneys and the performance by you of the Secured Obligations and compliance by you with the terms of this mortgage; and
- (c) an absolute transfer and assignment to us by way of security of all your rights, title, entitlements and interests (present and future, legal and equitable) in and to the Assigned Property ... [.]

The issues

[14] This case gives rise to the following issues:

- a) whether Equitable's interest in rental payments derived from the properties is a security interest which is caught by the PPSA;
- b) the relevance, if any, of the defendants being mortgagees in possession; and

- c) if Equitable's interest is not covered by the PPSA, which of the two parties has the prior interest in the rental payments.

Provisions of the PPSA

[15] Section 17 of the PPSA, so far as relevant, provides as follows:

17 Meaning of security interest

- (1) In this Act, unless the context otherwise requires, the term **security interest**—
 - (a) means an 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 ... [.]

[16] Also relevant is s 23 of the PPSA which provides:

23 When Act does not apply

This Act does not apply to— [...]

- (e) an interest created or provided for by any of the following transactions:
 - (i) the creation or transfer of an interest in land:
 - (ii) a transfer of a right to payment that arises in connection with an interest in land, including a transfer of rental payments payable under a lease of or licence to occupy land, unless the right to payment is evidenced by an investment security:

Submissions

[17] For the defendants, Mr Arthur's approach was essentially that even if the rights under a mortgage included a charge over personal property (the right to rental income), that did not alter the position. It was the statutory regime which applied to interests in land that ought to govern matters of priority and other related issues.

[18] It was also part of the defendants' case that it could not have been the intention of the legislature when enacting the PPSA that one would have to inspect

both the land transfer register and the PPSA register in the case of a mortgage where there was a charge given over rental income. This would be commercially undesirable and would add to the expense of transactions if it were a requirement of the legislation.

[19] Mr Arthur said that rental income was historically regarded as real property, in that it “emanates from the land”, but, he noted, there is more recent authority for the proposition that rental income is personal property, being money due under a contract: *United Scientific Holdings Ltd v Burnley Borough Council*;¹ *Escalus Properties Ltd v Robinson*.² But he went on to say:

43. But that dichotomy (between rent as real or personal property) does not dictate the answer to the question of whether the PPSA applies to a mortgagee’s interest in rental. It must be remembered of course that a mortgagee is relying on a property right (the right of possession) in order to lay claim to the rental receipts. In enforcing its right to rentals, it is enforcing a real property right.

44. Therefore, to answer the question of whether a mortgagee’s rights to rental is covered by the PPSA, it is necessary to interpret the specific provisions of the Act, in light of its purpose.

[20] Mr Tingey, for the plaintiffs, submitted that it was correct to regard rent as a contractual money payment made by the tenant for use of the landlord’s land. He said that was the effect of *United Scientific Holdings*, to which Mr Arthur had made reference.

[21] Mr Tingey referred to a decision of the Ontario Supreme Court where the Court considered the limits of the Ontario PPSA in the context of mortgages of land in *Re Urman*.³

¹ *United Scientific Holdings Ltd v Burnley Borough Council* [1978] 1 AC 904 (HL) at 935.

² *Escalus Properties Ltd v Robinson* [1995] 3 WLR 524 (CA) at 531–532.

³ *Re Urman* (1983) 3 DLR (4th) 631 (ONSC).

[22] In *Re Urman*, the mortgagee had charged his interest as mortgagee as security for a debt. That is, there was a mortgage of the land mortgage. It was argued that the mortgage of the mortgage was subject to the PPSA because the right to receive payments from the land-owning underlying debtor was intangible personal property. On appeal, the Supreme Court accepted that in equity, the right to receive payments under a mortgage was indeed personal property and therefore, on a literal reading, the PPSA applied to the security interest taken in that right. But in arriving at its decision, the Court relied on a 1901 English Court of Appeal authority *Taylor v London and County Banking Co.*⁴ This last named case did not involve PPSA-type legislation. In it, the following passage appears:⁵

Although a mortgage debt is a chose in action, yet, where the subject of the security is land, the mortgagee is treated as having “an interest in land,” and priorities are governed by the rules applicable to interests in land, and not by the rules which apply to interests in personalty. The reason is thus stated by Sir William Grant in *Jones v Gibbons* [9 Ves 407, 410]: “A mortgage consists partly of the estate in the land, partly of the debt. So far as it conveys the estate, the assignment”—that is, of the mortgage—“is absolute and complete the moment it is made according to the forms of law. Undoubtedly it is not necessary to give notice to the mortgagor, that the mortgage has been assigned, in order to make it valid and effectual. The estate being absolute at law, the debtor has no means of redeeming it but by paying the money. Therefore he, who has the estate, has in effect the debt; as the estate can never be taken from him except by payment of the debt.”

[23] That approach, I consider, underlies s 23 of the PPSA, which is relevant in the present case.

Discussion

[24] Clause 4.1(c) of the memoranda of each of the mortgages states:

4.1 **Security:** The security created by this mortgage operates and takes effect as: ...

- (c) an absolute transfer and assignment to us by way of security of all your rights, title, entitlements and interests (present and future, legal and equitable) in and to the Assigned Property[.]

⁴ *Taylor v London and County Banking Co* [1901] 2 Ch 231 (CA).

⁵ *Ibid*, at 254–255 per Stirling LJ.

[25] “Assigned Property” is defined under the lease to mean all earnings, monetary rights, lease rights, insurance benefits and purchase moneys. “Earnings” is defined as well to mean “all rent and other moneys whatsoever ...”.

[26] It is correct, as Mr Tingey pointed out, that a mortgage of land in New Zealand does not operate as a transfer, but instead operates as a charge.

[27] Clause 4 contains a transfer of a right to payment that arises in connection with an interest in land, including a transfer of rental payments. Mr Tingey did not contend that the excepting provision “unless the right to payment is evidenced by an investment security” in s 23(e)(ii) covered the situation.

[28] In relation to land, s 23(e)(i) places the focus upon the interest in the land which is created. A mortgage security is an interest in land. In s 2 of the Land Transfer Act 1952, it is provided: “Estate or interest means every estate in land, also any mortgage or charge on land under this Act[.]”

[29] The transaction in question here falls literally within the provisions of s 23. It is a transfer of a right to payment. The wording of the mortgage says so: see [24] above.

[30] The fact that the objective of giving and taking the security is to better secure the transfer of personal property from one party to the other (in this case the money representing the rental payable) does not alter the nature of the interest in the land which has come into existence by virtue of the parties’ agreement to mortgage. It is not necessary that the fruits of performance of the contract which is secured by the mortgage should itself constitute an interest in land. It could be, as in this case, the payment of rent, but it could equally be the performance of other obligations which are the familiar subject matter of mortgage securities, such as fulfilment of a guarantee.

[31] As Mr Arthur pointed out, the wording of s 23(e)(ii) focuses on the type of transaction which brought the interest to be in existence, in contrast to the interest itself. The argument for the defendants is that the charge over the rent was created

or provided for by the transaction which gave rise to the mortgage. I have already made reference at [13] to cl 4, which is the relevant provision of the mortgage.

[32] The effect of the granting of the mortgage was to give security to Equitable over rights, title, entitlements and interests “in and to the Assigned Property”, which was defined to include “all rent and other moneys”. The starting point is that this is a security interest.

[33] But it is provided by s 23(e)(ii) that interests which might otherwise come within the purview of the Act do not include a transfer of a right to payment that arises in connection with an interest in land. That would seem to be sufficient on its own to cover an assignment of rent, but the subsection explicitly states that such a right to payment includes a transfer of rental payments. These statements are made in the context of an Act which is concerned with transfers and assignments by way of security. In this case, the assignment can plainly be viewed as “an interest created or provided for” by a transfer of rental payments payable under a lease.

[34] The form of security created over the secured property in this case is described as “an absolute transfer and assignment to us by way of security”.⁶ The interest created by the dealing between Equitable and the mortgagor in this case would therefore seem to be an interest “created or provided for by ... a transfer of a right to payment” within the meaning of the s 23(e)(ii).

Legislative intention

[35] When considering the meaning of the subsection, it is important to have regard to the purposes of the legislation. The purpose relevant to the present case is the fixing of priorities between two competing creditors. Where the meaning of the section is unclear, doubts can be resolved by having regard to the intention of the legislature present when enacting the section.

[36] The question that can be asked is whether excepting the type of property in question from the PPSA will cause problems because the position is not adequately covered under other legislation such as the Land Transfer Act: this provides an

argument justifying a restrictive interpretation of s 23(e)(ii) in order to prevent prejudice to a subsequent chargeholder.

[37] While the point is not entirely clear from the argument and materials placed before me, it would seem that registration of the mortgage pursuant to the Land Transfer Act would provide notice to parties such as the plaintiff of the extent of the secured property so that it would be obvious that the rental to which the mortgagor was entitled was the subject of a security under the mortgage. If such a contention is correct, it would displace any need to apply the PPSA to mortgages containing a clause of the kind which the present one does.

[38] As I see it, the result of the exclusion of s 23(e)(ii) is that the process of determining priority of securities over land is not prescribed by the regime brought into existence by the PPSA but must be resolved by other means. This results from the plain language of the section. There is no policy reason why the Act should be differently interpreted. A regime is already provided for the ranking of real estate mortgage securities under the Land Transfer Act.

[39] If anything, policy considerations provide a counter-indication to the interpretation which Marac would have the Court adopt. That is to say, I agree with the submission of Mr Arthur that it would produce inconvenience and uncertainty if the rules relating to the relative priorities of mortgages over land had to be sought in not one statute but two. I also note the submission that he made to the following effect:

74. The Law Commission's reason for excluding certain transactions, including mortgages of land, was that they "concern arrangements which, although they involve security, are adequately regulated elsewhere": Law Commission *A Personal Property Securities Act for New Zealand* (NZLC R8, 1989) 103.

[40] In the context of this case, that means that determining the question of who has the prior claim to the rental payments under the leases is to be determined in the same way that any other contest as to priority between mortgages would be — under the Land Transfer Act.

Result

[41] Counsel were agreed that an answer to the substantive question would resolve the issue of Marac's claim. It follows from my conclusion on the substantive issue that the plaintiff's application for summary judgment should be dismissed and I order accordingly. The parties should confer on the question of costs and if necessary, file brief memoranda for my attention in the event that an order is required on that issue.

[42] I reserve leave to the parties to seek further directions or orders necessary to give effect to my judgment.

J.P. Doogue
Associate Judge