Secured Credit Legislation: Functionalism or Transactional Co-Existence

A. Introduction

(a) General

This paper is modest in scope. Its principal aim is to highlight a few features of modern personal property security legislation in an attempt to show that functional legislation does not expunge difficult proprietary issues. A further aim is to demonstrate that the inherently reductionist character of functional legislation does not mean that all transactions should be treated the same just because they fulfil in economic terms a security function. The legislation itself does not go this far and might even have been more restrained still and yet have fulfilled its core purpose.

With the enactment in the various states of Article 9 of the Uniform Commercial Code in the 1950s, the United States demonstrated a revolutionary approach to the subject of secured credit. This approach involved embracing under one legislative roof all forms of security and related devices that served the common purpose of facilitating the recovery of debts from a disposal of personal property. It involved, too, a common set of priority rules and a common set of creditor remedies, both personal and proprietary.

Article 9 was designed for both corporate and non-corporate debtors, and for commercial and consumer debtors. In its original version, it undoubtedly simplified a great deal of complex law, no small achievement in any case but especially compelling in the case of a federal country where the law on secured transactions is state-based law. The Article 9 approach has been replicated in other jurisdictions, notably and at different intervals in the case of Canada, New Zealand and Australia. It has been influential in the drawing up of international conventions, such as the 2001 UN Convention on the Assignment of Receivables in International Trade.

The influence of Article 9 is also manifest in soft law instruments, such as the UN Legislative Guide on Secured Transactions and the Draft Common Frame of Reference. To these examples, one might add an instrument that demonstrates a debt to Article 9 but that does not follow it all the way. This is the Cape Town Convention on International Interests in Mobile Equipment. It is the extent of its departure from Article 9 that interests me, partly because of a conviction that an attempt to sell the whole of the Article 9 package might fail, where a less ambitious attempt to sell certain of its essential parts might not. I shall come back briefly to the Cape Town Convention at the end of this paper.

A further subject of interest in this paper is perhaps the key characteristic of Article 9, namely, the extent to which functional thinking can be pursued when capturing a wide range of transactions in order to bring them under a single statutory roof. Considerations of time and length prevent me from considering the full range of transactions that might be covered by functional legislation. Hence, subjects such as *Quistclose* trusts, sale and leaseback agreements, subordination agreements and 'repo' transactions fall by the wayside.

(b) Desiderata of a modern secured transactions regime

The sought-after values of a modern secured transactions regime have been set out at some length in the UN Legislative Guide on Secured Transactions. In contrast with the UN recommendations, one might characterise as essentially uncommitted to such a legal regime a State that permits, or indeed requires, the proliferation of different types of security, each with its own arcane rules and each frequently limited to a particular type of collateral, with, overall, certain types of collateral eluding the reach of security, the whole amounting to less than might be encompassed by a general enterprise charge.

The UN list is premised upon the inherent desirability of secured credit as an engine that reduces credit costs. One stated value is that of fairness to all parties affected by a secured transactions regime. This is ambitious and perhaps unachievable. It is well known that certain categories of creditor, particularly involuntary creditors such as tort claimants, are adversely affected by modern schemes if these are allowed to operate unchecked. Older schemes, such as the one described above, might be said systemically, even deliberately, to impose a check on efficiency in order to protect vulnerable creditors. It is not my purpose in this paper, however, to deal in any detail with this theme. That said, vulnerable creditors may, broadly, be protected by a legal system in one of two ways: the first is by imposing limitations and restrictions on the taking of security (the concept of over-security in some legal systems is an example of this); and the second is by the use of claw back measures in insolvency proceedings. English law, for example, is broadly friendly to the taking of security but expropriates the holders of floating charges in favour of preference and general unsecured creditors (up to a financial limit) in the event of distribution via either administration or conventional liquidation proceedings.[1]

The values mentioned by the UN Guide that are intrinsic to the type of regime that enhances security and therefore the flow of credit are: the need for a simple and efficient system of security entitlement; access to credit deriving from a debtor's ability to use all of its assets for this purpose; the existence of a clear set of priority rules; transparency and certainty in the shape of a general registry of security interests; equality of treatment of diverse types of transaction serving a common credit purpose; and the efficient enforcement of creditors' rights. Of these values, my primary focus will be on the last two: how far should we go to embrace diversity of transactions? and how far does an effective system of creditors' rights demand uniformity of rights? The latter value prompts the further question whether we should override freedom of contract between debtor and creditor in the cause of uniformity.

In handling the various questions that arise out of these two latter values, the looming presence of ownership (or title) asserts itself. Is there something special about ownership that prevents its full equation with lesser, or at least different, property interests for the purposes of a modern secured transactions regime? It is notorious that the leading proponent of the Uniform Commercial Code, Karl Llewellyn, was a title sceptic: "Whoever saw a chattel's title?" Article 2 of the Code, on Sales, contains no rules on the passing of title (or property) between title and seller akin to those in the UK Sale of Goods Act 1979, instead defining the rights and remedies of buyer and

[1] Insolvency Act 1986, ss 176A and 386.

seller without the aid of title. Whilst it may be possible to avoid mention of title between buyer and seller, this is far from being the case when third parties intrude. A security agreement concerns rights in collateral that affect the position of competing secured credits, the trustee-in-bankruptcy or administrator or liquidator representing unsecured creditors and outright purchasers of the collateral from the debtor who expect to obtain a clear title.

B. What is the position in England and Wales?

(a) The Law Commission Project

To place the matter in a home jurisdictional context might be helpful. The Law Commission, as is well known, conducted an extensive inquiry into the subject of company charges in a consultation paper (2002), a consultation document (2004) and a report (2005).

From the very beginning, the Law Commission was hampered in its work in two principal respects: its terms of reference extended only to companies and they also did not include insolvency legislation. The former inhibited a general root and branch reform and the latter posed a particularly difficult problem in that the floating charge, even if eliminated from the general law of security, would necessarily remain because of the part it played in insolvency legislation. The amount of ground that the Law Commission covered in the two consultation documents in particular and the depth of that coverage were both impressive but, by the time of the Report, it was evident that late-declared opposition to the broader features of the Law Commission's proposed scheme of radical reform had administered a fatal blow to that reform project.

If I may venture the tersest of summaries, the consultation documents favoured notice filing and relieving the Registrar of Companies from the irksome task of checking the brief particulars of charge against the instrument of charge. A consequence of this, of course, would be the abandonment of the Registrar's conclusive certificate since, in addition, priority would derive not from the charge itself but from the date of so-called perfection, which would entail registration where this was the chosen route to perfection. Permission to register in advance of any security agreement was also recommended. Departing from the then existing approach of registration only for designated charges, the Law Commission in its consultation documents recommended the registration of all company charges unless good reason existing for exempting a particular type of charge. Going further still, the Law Commission recommended the bringing of quasi-securities, or at least some of them, into the proposed scheme of filing. This involved a recognition that certain quasi-securities might be integrated only to the limited extent of the rules on registration and priority (and not remedies). The sale (or discounting) of receivables would be such a case; consignment agreements, where one might have expected the same treatment, were not in fact marked out for it. The extension of registration and priority rules to quasi-securities involving title retention necessitated the recognition of an exception to the first-in-time approach to perfection, namely for the so-called purchase-money security interest. Assuming that the value added to the company by collateral subject to title retention was equal to the depletion of funds needed to acquire the collateral on credit terms, the advancement of the purchase-money security interest holder did not come at the expense of a prior general financier of record.

Finally, the second consultation document proposed a uniform scheme of creditor remedies. At this point, one might point to two aspects of the law of remedies. The first concerns the steps that a creditor might take to deal with collateral in the event of debtor failure, including resale and the treatment of any deficiency or surplus. This aspect was very much in the Law Commission’s line of sight. The second aspect concerns the intersection of creditor remedies and insolvency law, the subject of major reform in the Enterprise Act 2002 and outside the Law Commission’s terms of reference. My concern in this paper is only with the former aspect.

By the time of the Law Commission’s Report in 2005, the scope of the proposed reform had been substantially reduced. Notice filing remained, with the Registrar exempted from checking the particulars of charge against the instrument of charge. Priority, however, would continue to be dated from the creation of the charge and not from the date of perfection, despite the allowing of advance registration. All charges would have to be registered, except those for which a case could be made for exemption. The registration of quasi-securities was abandoned with one exception. That exception was the sale of receivables (subject to a few exceptions). Since title retention was left out of the reduced proposed reform, there was of course no provision made for a purchase-money security interest.

(b) The limited changes of 2013

Reform of the law of company charges has long been a vexed affair in the United Kingdom. Part IV of the Companies Act 1989, which would have introduced significant changes to the law though it would not have gone so far as was later proposed in the Law Commission's consultation documents, was never brought into force. A lesson to be drawn from this experience was the need, in this area of law at least, for a sustained process of consultation. It is by no means just a question of the inherent conservatism of the legal profession and the practical exposure of many of its members, operating at varying levels within the profession, to the law on company charges. The rapid pace of change in the financial markets and the evolution of new 'products' meant that legal change might have, or be thought to have, unintended consequences in those markets.

Further to powers conferred on the Secretary of State in the Companies Act 2006, regulations were made and came in to force in 2013 modifying the provisions on company charges in the 2006 Act that had been carried over without substantial changes (apart from an infusion of additional wording) from the Companies Act 1985. The major changes that may be noted here are that all charges, subject to limited exceptions, are to be registered if they are not to be void against liquidators and administrators, as well as competing secured creditors. Interestingly, the move towards the (near) comprehensive registration of charges places the spotlight upon the continuing exemption of title-based transactions. If selective registration of charges gives less than a complete picture, then what about a selective registration scheme that disregards title transactions? Registration either serves a useful purpose or it does not. The 2013 changes make no mention of the old rule that the Registrar's certificate was conclusive as to compliance with the registration scheme, even in those cases where the particulars presented for registration inaccurately reflected the content of the hidden instrument of charge, which defined the rights of the chargee. It is not entirely clear how the new scheme, under which the instrument of charge will be presented along with the particulars, will operate. Moreover, we are no nearer any rational system of priority than we were before the changes. It may be that the landscape has changed but the view from the carriage window is broadly the same.

C. The Nature and Limits of Functionalism

(a) The substance test

In well-known language, Article 9 provides that, with stated exceptions, 'this Article applies to...a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract'.[2] It then goes on to apply also to, *inter alia*, sales of accounts and consignments, though it does not seek to classify them as security interests properly so-called.[3] Consequently, the location of title as between debtor and secured party may be relevant here when this is not the case for a transaction falling squarely within the above definition.[4] A security interest is broadly defined as 'an interest in personal property or fixtures which secures payment for performance of an obligation'.[5]

A slightly different approach is to be found in the Saskatchewan Personal Property Security Act which applies to 'every transaction that *in substance* (emphasis added) creates a security interest, without regard to its form and without regard to the person who has title to the collateral',[6] which if anything places added emphasis on the functional character of the definition. The Saskatchewan Act goes on to apply the Act to transfers of accounts receivable and to commercial consignments, even though they cannot be said to secure payment or the performance of an obligation that has not yet arisen and may never arise.[7] A similar definition denying the relevance of the location of title is to be found in the Ontario Personal Property Security Act, the scope of

[2] Art 9-109(a)(1).
[3] Art 9-109(a)(3), (4).
[4] Art 9-202.
[5] Art 1-201(37).
[6] S 3(1)(a). Very similar language is to be found in the New Zealand Personal Property Securities Act 1999, s 17(1)(a) and in the Australian Personal Property Securities Act 2009, s 12(1).
[7] S 3(1)(b).

which extends to 'every transaction without regard to its form and without regard to the person who has title to the collateral that in substance creates a security interest'. Of interest is the Ontario Act's inclusion in that definition of consignments securing performance of an obligation.

The New Zealand Act retains a significant link to the old law. Like other non-US models, it simply disregards the location of title for the purpose of characterising an interest as a security interest; it does not deny the conditional seller's reserved title. It recites the functional definition of security and then for the avoidance of doubt in s 17(3) recite also a series of transactions that fall within it, namely, 'a fixed charge, floating charge, chattel mortgage, conditional sale agreement (including an agreement to sell subject to retention of title), hire purchase agreement, pledge, security trust deed, trust receipt, consignment, lease, an assignment, or a flawed asset arrangement, that secures payment or performance of an obligation'. This is tantamount to preserving old thinking whilst holding on to a functional definition for the rare case where it might be needed. It suggests that a great deal of rationality can be arrived at by clustering a variety of security or quasi-security transactions under the same statutory roof without obliterating the differences between them. This in turn suggests that a modern, rational system need not eliminate the distinction between security and title reservation.

Perhaps the first question that ought to be asked is whether a functional definition provides a greater measure of certainty than the existing definition of a charge. I am dwelling on charges instead of mortgages because in practice and for various reasons charges are significantly more important than mortgages in the world of secured lending. It is easy enough to define a charge as an encumbrance falling short of a proprietary transfer that applies the collateral towards the satisfaction of an obligation in the event of the obligor's default. In practice, however, significant difficulties of interpretation arise, especially if the word 'charge' is not employed by the parties. The distinction between a charge and a declaration of trust is far from being an easy matter: both involve a dealing with the beneficial interest and the terminology of the law relating to charges sometimes mingles with that of the law relating to trusts.[8] Furthermore a charge must involve a positive undertaking to apply collateral and not a negative undertaking to refrain from drawing upon it or dissipating it.[9] There is also some degree of tension in the case of appropriated funds: directing payment out of a particular fund may not necessarily involve the creation of a charge,[10] yet payment out of a fund has been authoritatively expressed to be the required means of discharging the obligation.[11] I do not want to make too much of the case law, now abated, where unpaid sellers sought unsuccessfully to carve proprietary interests out of new goods produced or manufactured by the buyer, or out of book debts due to buyers from sub-buyers who had bought the original or new goods.[12] These cases owed their existence largely to the energy or desperation of unpaid sellers in the face of an intractable English judiciary. That said, especially in the case of book debts, that judiciary if so minded might have taken the kinder line adopted by the Australian High Court when dealing with the claim of an unpaid seller to the buyer's book debts.[13] In sum, if a critic were to say that English law provides less than complete certainty when defining a charge, the criticism would be hard to rebut. That uncertainty, however, lies very much at the margins of the definition, though that might be said of a great deal of legal uncertainty.

It should not be supposed that a functional definition will be any easier to apply, especially if it is applied, as it will have to be, against an evolving commercial background, where new forms of transactions are thrown up, in such a way that prior case law may not be provide an effective guide in the application of the statutory test. There is a certain reductive character attaching to a functional definition that requires the brakes to be applied on the definition if it is not to be pressed too far. Just because a transaction is built upon a foundation of commercial risk avoidance or limitation should not mean that the devices it adopts to protect an obligee should be treated as security interests. The leading architect of Article 9, Grant Gilmore, once spoke in cautionary terms about 'a no-man's land, in which strange creatures do strange things'

[8] See M Bridge, L Gullifer, G McMeel and S Worthington, *The Law of Personal Property* (2013), para 7-083, citing *Tailby v Official Receiver* (1888) 13 App Case 523, 541.
[9] *Flightline Ltd v Edwards* [2003] EWCA Civ 63, [2003] 1 WLR 1200.
[10] *Swiss Bank Ltd v Lloyds Bank Ltd* [1982] AC 584.
[11] *Palmer v Carey* [1926] AC 703.
[12] See M G Bridge, *The Sale of Goods* (OUP, 2nd ed, 2009), paras 3.74 *et seq*.
[13] *Associated Alloys v CAN 001 452 106 Pty Ltd* (2000) 202 CLR 568.

for which ‘the rules which professionals have developed for professional transactions’ do not provide a measure. Yet the definition cannot be applied too narrowly, or else it will lose its evolutionary utility. One of its merits is that it provides a kind of statutory shorthand so that, if the draftsman wishes to bring a wide range of transactions under the same roof, there is no need constantly to mention mortgages, charges, conditional sales, pledges, trust receipts, equipment trusts and so on. Though too much should not be made of this as a measure of statutory achievement, a further virtue of the broader functional label is that it can attach to new forms of transaction that have not yet acquired a commercial existence at the time the statute is enacted. The pressure of regulatory need and regulatory predictability tends over time towards a security interest acquiring a conventional and more or less settled meaning in the way that an English charge is understood. Indeed, a well-known text, referring to a previous version of Article 9-109(1) adverted both to the paucity of litigation to which it gave rise and also to its success ‘even in bringing most deviant secured transactions under the umbrella of Article 9’.[14] As for transactions that evade even the broad reach of the functional language in Article 9, notably, sales of book debts and consignments, the need for a particular label continues. What is the alternative to this? The following is unattractive: ‘This statute applies to any other transaction where the rational application of a general scheme of public notice and priority rules requires this to be so.’

(b) Rights in the collateral

Any system of security must co-exist in harmony with principles of property law. A functional system of security presents its own challenges. Article 9-203(b)(2) requires that the debtor have ‘rights in the collateral or the power to transfer rights in the collateral to a secured party’ as a condition of the creation of a security right. The reference to power catches the case of a debtor who, as a result of the owner’s actions or statements, has the appearance of ownership of the collateral or the apparent authority to burden it with a security interest. The interesting question, nevertheless, is whether it goes further than that, which requires an analysis of the phrase ‘rights in the collateral’.

[14] J J White and R S Summers, *Uniform Commercial Code* (5thed, 2000), p.716.

The first and most obvious question to ask is whether the security attaches only to the debtor's rights or apparent rights in the collateral, or whether the existence of those rights acts as a threshold that must be crossed in order for the debtor to create an effective security interest. In a priority contest between two security or deemed security interests, then there would not really be a priority conflict in the first place if the former position were correct.

The Official Comment to Article 9-203 expresses the position in the following way:

> 'A debtor's limited rights in collateral, short of full ownership, are sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be'.

The reference here to attachment is somewhat puzzling. The Official Comment, repeating Art 9-203(b)(2), then goes on to say that in some cases the debtor has power to transfer greater rights than he in fact has. It then makes a cross-reference to the priority rules, including the rule that a registered security interest has priority over an earlier unregistered interest. This leads to a circular conclusion. Article 9 concludes that a later secured creditor with a perfected security interest has priority over an earlier unperfected interest because the rights that the debtor needs to encumber the collateral on the second occasion are to be found in the priority position accorded to the second creditor, which is itself dependent upon whether the debtor had rights in the collateral in the first place. This circularity expresses itself with particular force in those cases where title-based transactions are recharacterized as security agreements. At the heart of the matter lies the principle that the perfection of security interests creates a priority position; the failure to perfect does not invalidate a security interest. Someone taking a functionalist view of these provisions of Article 9, however, might conclude that deeming the debtor to have rights in the collateral for the purpose of creating the second security interest comes close to invalidating the first unperfected security interest as against the second security interest. Certainly, where the first security interest is perfected and exhausts the value of the collateral, a second security interest, even if perfected, is an empty vessel.

It is therefore unsurprising that a leading Canadian architects of modern personal property security legislation confesses that the functionalist approach of Article 9 to finance leases and other title-based devices really amounts to a denial that the seller or lessor, as the case may be, is the owner of the collateral:

> 'Since a title retention sales contractor a lease falls within a secured financing regime because it functions as security device, it follows that the seller or the lessor is not the owner of the goods sold or leased. What the seller or lessor has is a security interest; the owner of the goods is the buyer or lessee…What is troublesome is that outside this regime, the recharacterization might not be successful with the result that the same transaction is viewed differently depending upon the legal issues being addressed.'[15]

The point about a title-retaining seller not being the owner is starkly made in the UCC: Article 2-401 states that '[a]ny retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest'.[16] The Article 9 scheme, therefore, does more than disregard the relevance of title. A similar note is struck in the UN Draft Legislative Guide on Secured Transactions, where it is stated that the 'rationale for treating [secured] lenders equally, regardless of the form of the credit transaction, does not automatically apply to situations of acquisition finance, since the parties involved are not just lenders. They are also sellers.'[17] Two matters of considerable importance flow from the above observations. First, Article 9, as facilitative as it is of secured transactions, exhibits a legislative willingness to curtail freedom of contract in the cause of financial rationality. One may nevertheless observe the querulous note in the words 'in effect' on Art 2-401(1), as well as the fact that most of the aims of Article 9

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[15] R C Cuming, 'Internationalizing Secured Financing Law, in R Cranston (ed), *Making Commercial Law* (OUP, 1997), 523. The UNCITRAL Draft Legislative Guide on Secured Transactions reminds States that one version of the unitary approach as applied to acquisition financing is that the buyer would be treated as owner for all purposes, which would necessitate a change to taxation statutes if it were desired to tax the seller as owner: A/CN.9/631/Add.9, para 68.
[16] This provision is brought into Article 9 via Art 9-110.
[17] A/CN.9/631/Add.9, para 55.

can be accomplished without recharacterizing the seller's interest in this way. Secondly, the scheme laid down in Article 9 is deeply rooted in the remainder of the Uniform Commercial Code and in property law. A free-standing version of Article 9 cannot be transplanted into another legal system without considerable thought being given to all features of the legal terrain, especially the property law of the receiving jurisdiction, in which it is being transplanted.[18]

The functional view of security interest taken in Article 9 and in systems based upon it has a particular bearing on title-based schemes.[19] The definition of 'security interest' in Article 1 of the Uniform Commercial Code makes it explicit that a seller who delivers goods to a buyer on reservation of title terms is taking a security interest in those goods.[20] This absorption of title-based devices requires a major inroad to be made into the order of priority. The general priority rule, that the first in time should prevail, is set aside in the case of so-called purchase-money security interests.[21]

(c) Functionalism and the need for pmsis

Article 9 and cognate systems accord a super-priority to a so-called purchase-money security interest. A purchase-money security interest is one that secured a purchase-money obligation. An obligation of this kind is incurred as part of or all of the price of the collateral, which would involve the recharacterization of a retained title as a security interest. The purchase-money obligation also arises where an advance is given to the debtor for the purpose of acquiring rights in or the use of the collateral. It is strongly arguable that, apart from a few minor cases where English law explicitly recognises this super-priority, its recognition is also implicit in the very recognition of retention of title as not amounting to security. This is because collateral subject to a retention of title clause does not become part of the debtor's estate. For present purposes, a retention of title clause may be seen in an ordinary supply of goods on credit, as well as in the terms of a more structured conditional sale agreement or a

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[18] See M Bridge, 'The Law Commission's Proposals for the Reform of Corporate Security Interests', in J Getzler and J Payne, *Company Charges:* Spectrum *and Beyond*' (2006), 267, 288-89.
[19] For a general survey of the merits and drawbacks of a functional test for security, see UNCITRAL, *Draft Legislative Guide on Secured Transactions* (June-July 2007), A/CN.9/631/Add 1, paras 131-41.
[20] Art 1-201(35).So too Art 9.1 of the EBRD Model Law on Secured Transactions.
[21] A similar provision is to be found in the EBRD Model Law on Secured Transactions for vendors' charges (Art 17.3).

finance lease. Consequently, it prevails over even a pre-existing charge granted by the debtor, which therefore never attaches to collateral subject to title retention. The charge would only attach in the event of the buyer or hire purchaser of the collateral acquiring an unencumbered title on making the final payment for the collateral. In the case of a finance lease, the event would be any ad hoc agreement reached between lessor and lessee once the agreement had run to term. The concept of purchase-money security interest, therefore, amounts to a form of statutory corrective to the proposition that the distinction between title and security can be eliminated in a broad functional scheme of security. A further aspect of purchase-money security interests also demonstrates how hard it is to suppress considerations of title. In the event of a priority conflict between two or more such interests, in Article 9 an interest in respect of the price prevails over an interest arising from value given to enable the debtor to acquire an interest in or the use of the goods.[22] Some purchase-money financiers are superior to others, namely, those who own the collateral at the point of entry into the security agreement.

(d) Vesting and the trustee-in-bankruptcy

The Article 9 approach to conditional sales, involving a forced transfer of the property in the goods to the buyer, dictates in a way the response that is made to a seller who fails to perfect its security interest by the time the buyer becomes insolvent. According to Article 9-317(2), a trustee-in-bankruptcy, as a so-called lien creditor, takes priority over the non-perfecting conditional seller. Classically, priority contests erupt between competing interests in the same assets. A conditional buyer, if the reservation of title clause is effective, ought not in principle to have any interest in the subject matter of the contract to encumber in favour of another creditor. But by waving the legislative wand, the UCC has recharacterized the buyer as the owner and the seller as a security interest taker, thus giving rise to a priority contest between the seller and other creditors. As a result of the proprietary transfer to the buyer, there is no need to modify bankruptcy legislation to allow the trustee to prevail against the unperfected seller. The means chosen to effect these statutory purposes was not give the buyer a power to grant an interest in the collateral that overrides that of the seller:

[22] Art 9-342(g)(1).

whilst that would work for voluntary transactions, it does not work for property interests arising by operation of law, for example, those that arise when assets vest in a trustee-in-bankruptcy. Instead, the buyer has a proprietary right in the collateral that can vest in the trustee, who is in effect the buyer itself carried on by other means. The trustee thus succeeds to the buyer's rights and, unlike the buyer itself, can repudiate the seller's security interest.

Now, if one takes registration as the mode of perfection in a conditional sale case, it is not self-evident that a failure to register should benefit unsecured creditors, who represent the real 'clients' of the trustee. If the point is pressed that a debtor in possession of collateral presents a false appearance of wealth if the creditor's interest is unperfected, one response is to say that in a credit-driven world possession is a weak indicator of ownership. Moreover, to take England as an example, the doctrine of reputed ownership was expunged from bankruptcy law nearly thirty years ago and never applied to companies anyway. Moreover, whereas it might be common for secured creditors to search a register for competing interests, it is questionable how often unsecured creditors do this. And of course involuntary creditors never search. The New Zealand legislation, it should be noted, did not go down the road favouring the trustee-in-bankruptcy over an unperfected secured creditor. There is no provision that subordinates an unperfected security interest to the claims of unsecured creditors expressed via the company liquidator or trustee-in-bankruptcy. Given the long tradition of avoiding unregistered company charges as against trustees in bankruptcy and company liquidators, this is perhaps surprising. The position in other modern PPSA regimes, for example, Saskatchewan, is different.[23] The line taken in Article 9 is there followed but the means chosen are inadequate to get there as the Canadian case, *Re Giffen*,[24] demonstrates.

Re Giffen considers in some detail the bankruptcy effect of an unregistered ownership interest. It concerned British Columbia legislation modelled on the Saskatchewan Act. The ownership interest in this case was not that of a conditional seller but that of a lessor. A preliminary discussion of leases is in order before we turn back to the bankruptcy position. There are essentially two approaches to leases in modern

[23] S 20(2).
[24] [1998] 1 SCR 91.

personal property security legislation. One is to consider all of the terms of the transaction and to apply the substance test in order to separate leases which are functionally credit transactions from those that are simply bailments for the use of goods. This approach is taken in the UCC, where the definition of a security lease[25] is dauntingly complex and, at times, counter-intuitive,[26] though it is said often enough that it has given rise to little litigation. One of the advantages of modern personal property security legislation is that the cost of compliance is small, so that precautionary filing represents a real option in case of doubt about the susceptibility of a transaction to regulatory coverage by the legislation. The other approach, pioneered by the Saskatchewan Act, is to cut the Gordian knot and require compliance in the case of leases of more than one year in duration. The Saskatchewan approach, in contrast with Article 9, does not involve treating leases as security agreements for the purpose of remedies between lessor and lessee. Leases of this sort are deemed otherwise to fall within the Act, no attempt being made to capture them in the functional test that defines a security interest.[27] They do, nevertheless, give rise to security interests.[28]

In *Re Giffen*, a lessor had repossessed a car with the consent of the lessee's trustee-in-bankruptcy but a dispute had arisen between lessor and trustee about the fate of the proceeds of sale of the car. The lease, for a term in excess of one year, had not been registered. If the legislation had deemed title to the car to pass to the bankrupt, it would have been a straightforward affair to rule that a security interest of this unperfected type, rendered subordinate to the trustee-in-bankruptcy, had the consequence of preferring the trustee in a contest with the lessor. While Article 9 provides for title transfer in the case of conditional sale, it does not go so far in the case of security leases. It took the Supreme Court of Canada, overruling the British Columbia Court of Appeal, to conclude that the trustee defeated the unperfected lessor. The British Columbia provision specifically stated that the lessor's interest was 'not effective'[29] against the trustee, which arguably is less explicit than it needs to be

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[25] Art 1-203.
[26] An option given to the lessee to become the owner is not sufficient to give rise to a security interest: Art 1-203(c).
[27] S 3(1), (2).
[28] S 2(1)(qq)(ii)(C).
[29] The Supreme Court considered that this provision was stronger than the language of the Saskatchewan Act ('subordinate').

for the purpose of integrating the position with that prevailing in bankruptcy legislation,[30] while the federal Bankruptcy and Insolvency Act went to provide that there vested in a liquidator or trustee 'all *property* wherever situated of the bankrupt at the date of his bankruptcy' (emphasis added).[31] The question was how to fill the conceptual gap so as to confer upon the trustee rights greater than those possessed by the bankrupt lessee. This was found to be impossible in the Court of Appeal below but the Supreme Court ruled that the issue had to be resolved without reference to the person who had title to (or the property in) the car. Rather, the meaning of 'property' in the Federal Act captured the lessee's right to use and possess the car. Pausing there, we do not yet have a clear answer to the questions how the trustee is supposed to realize that property right and how much is that right worth. The Supreme Court's response was to apply the British Columbia Act so as first to prevent the lessor from asserting its claim against the trustee, and secondly, to assert the extraordinary proposition that the provincial Act modified federal bankruptcy legislation concerning the meaning of 'property'.

The conclusion one reaches is that, apart from cases where the contest involves other secured creditors, the subject of title or property does not go away. Either a fictitious transfer is deemed to be made to the debtor (conditional sale) or limited property rights of the debtor are inflated so as to be treated as title (leases). Modern personal property security legislation does not quite wipe the conceptual slate clean.

(e) The treatment of consignments

A consignment may for present purposes be designed as a bailment of goods by a prospective seller to a prospective buyer, coupled with an option given to the latter to purchase the goods at a pre-agreed price. The expectation is that the purchase will be made at the point of resale to a sub-buyer, failing which the goods will be returned to the bailor. The 'debtor' is in possession of goods, therefore, but is not yet under an obligation to pay for it. That obligation will arise at the point of resale, namely, when the title to the personal property passes evanescently through the buyer to the sub-

[30] The British Columbia Act goes on to define the scope of the claim that a lessor might make against the lessee's estate.
[31] Ss 67(1)(c) and 71(2).

buying customer. This means that the bailment arrangement in itself cannot when initially executed constitute a security agreement because there is no obligation yet resting on the bailee for it to secure.

At first sight, it looks extraordinary that a consignment arrangement should be treated, by anticipation as it were, as a type of secured transaction. Where are the competing creditors? A creditor who acquires a security interest in the debtor's inventory has to be treated, in the case of a consignment effected by another entity, as acquiring a property entitlement in something in which the debtor has no proprietary interest (apart from possession). Article 9 denies that a consignment gives rise to a security interest[32] and yet, whilst not subjecting consignment to the unitary system of default remedies, embraces it for the purpose of rules on perfection and priorities. The extraordinary thing about it is not what Article 9 does to the rights of the consignor but what it does by way of inflation to the rights of the consignee's creditors.

(f) The treatment of receivables

The language of Article 9, as we have already seen, whilst embracing a sale of accounts receivable does not place it in the category of 'a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract'. It does not deny that it is a sale. We might now conclude that the sale of accounts does not involve a property interest securing an obligation: the buyer ('creditor') has already paid for the accounts, present and future, which have already been transferred to him or will automatically transfer as soon as they come into existence. It is the very opposite of title retention. There is nothing left for the seller ('debtor') to do except not to interfere with payment (if this is a case of direct collection) or to remit the proceeds of the buyer's debts when they are received (in the case of indirect collection). If we are dealing with a case of facultative factoring, moreover, then we are looking at an executory agreement on both sides to offer and accept bundles of accounts. Even though it might be said that one might raise money on the basis of accounts in either of two ways, either by selling the accounts in advance of maturity outright or by using them as security for a loan to be repaid, one retort might be that

[32] Art 9-102(a)(20).

one can travel to Liverpool Street either by tube or by bus, but that does not mean that a tube train is a bus.

This, of course, is an oversimplification. Putting aside administrative costs and certain other charges, the discount rate applied to reduce a book debt to present value places in the hands of the seller an amount equivalent to a loan advance that, with interest, would have produced a repayment equivalent to the amount of the book debt. The calculations start from opposite ends but arrive at the same conclusion and are economically the same. The common presence in sales of receivables, moreover, of a recourse provision diminishes yet further the difference between loan and sale. The real difficulty in treating a sale as a secured lending operation seems to be to identify something that can be called collateral, which is a problem also in determining whether a repo amounts to a type of secured transaction. A considerable advantage in bringing sales of receivables into modern personal property security legislation is that a rational priority rule can be devised between competing sales and charges over the same receivables.

D. Models of Transactional Co-Existence

Finally, I pose the question whether it is in practical terms possible to have modern legislation whilst retaining old learning. It is a marked feature of Article 9 that it changed the terminology of secured credit. The old language and transactions fell away. Those in the secured credit industry could have clung on to what was familiar but they chose not to. The abandonment of the former legal culture is not an inevitable result of new personal property security legislation. Because their treatment under such legislation is less than comprehensive, sales of accounts receivable and consignments retain their existing character, whilst they are subjected to registration requirements that formerly may not have existed or may have been different. This process, in addition, fed them into a general scheme of comparative priority entitlement. For example, a consignor was considered to have the super-priority that went with a purchase-money security interest.[33] Had it not been for what is now Part 6 of Article 9, which deals with default by the debtor, it is quite possible that other transactional types, especially those of a title-retaining character, might have retained their separate identities. My argument is that the imposition on secured credit transactions, certainly if they are commercial in nature, of a unitary remedial regime, based on the remedies that formerly applied to mortgages, is an unwarranted interference with the freedom of contract of debtor and secured creditor. Moreover, it is also unnecessary to achieve the major goals of modern personal property security legislation, which are to facilitate the efficient and confident flow of credit in a transparent system of entitlement with predictable and rational rules of priority between competing creditors. Legislation of this sort can tolerate the co-existence of security properly so called and retention of title. The UN Legislative Guide on Secured Transactions recognises, in the case of acquisition financing, the possibility of two fundamental approaches, the unitary and the non-unitary. Whereas the unitary approach would obliterate the distinction between security and retention of title, this distinction would be maintained under the non-unitary approach. It is interesting to look at instruments that go down the latter road.

For the Cape Town Convention on International Interests in Mobile Equipment 2001[34] to apply, the interest in the relevant equipment must be that of a chargee under a security agreement, a seller under a conditional sale, or a lessor under a leasing agreement.[35] This flexible approach does not force on contracting states a functional approach to security, so as to compel them, for example, to treat a financial lease as the equivalent of a charge for the purpose of remedies.[36] The Convention thus accommodates different legal philosophies in the various contracting states. It deals

[33] Art 9-103(d).

[34] See R M Goode, 'Official Commentary on the Convention on International Interests in Mobile Equipment and the Protocol Thereto on Matters Specific to Aircraft Equipment' (2002) (as approved for distribution by the UNIDROIT Governing Council pursuant to Resolution No 5 of the Cape Town Diplomatic Conference).

[35] Art 2(2). The interest includes also the proceeds of that proprietary interest in the equipment: art 2(5).

[36] So far as it is necessary to distinguish security from conditional sale and leasing, this is a matter for the applicable law selected under the forum's rules of private international law: Arts 2(4) and 5(3).

severally with the separate remedies of chargees, conditional sellers and lessors.[37] We need not explore the precise extent of those differences here.

Can we in this country learn from the experience of the Cape Town Convention and park the difference between true security and title retention on one side, when considering default and remedies, whilst embracing in full the rules in modern personal property security legislation dealing with registration, future advances and priority? I am not optimistic. Major company law reform comes along every 20 years or so. The thought of a major reform embracing individuals, partnerships and companies being slotted into the crowded legislative timetable is almost impossible to contemplate.

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[37] Arts 8, 10, 12, and 14. Again, it encourages adoption by contracting states with different legal philosophies by allowing for declarations against certain remedies under Art 54.