THE SCOPE OF 'RIGHTS IN THE COLLATERAL' IN SECTION 19(2) OF THE *PPSA* – CAN BARE POSSESSION SUPPORT ATTACHMENT OF A SECURITY INTEREST?

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I INTRODUCTION

A Objective of this Paper

The *Personal Property Securities Act 2009* (Cth) ('*PPSA*')[1] revolutionises the law of personal property securities ('PPS') in Australia. At the heart of this revolution is the fact that the *PPSA* takes a functional (or 'in substance') approach to determining whether a transaction gives rise to a security interest.[2] Section 12(1) of the *PPSA* states that a *security interest* is

> an interest in relation to personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property).

It is clear from this definition, and the examples of security interests given in section 12(2) of the *PPSA*, that a person can be the grantor of a security interest over an asset even if they do not have title.[3] This is a significant change from non-PPS law, and in particular from the general law principle of *nemo dat quod non habet* (a person cannot dispose of something that the person does not have).[4]

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1 For a more general explanation of the operation of the *PPSA*, see, eg, Craig Wappett, Bruce Whittaker and Steve Edwards (eds), *Personal Property Securities in Australia* (LexisNexis, 2011); James O'Donovan, *Personal Property Securities Law in Australia* (Thomson Reuters, 2011); Del Cseti, *Understanding Personal Property Securities Law* (CCH, 2010).

2 The *PPSA* also deems some arrangements to be a security interest, whether or not they serve a security function: *PPSA* s 12(3).

3 The examples given in *PPSA* s 12(2) include an agreement to sell subject to retention of title: s 12(2)(d); a hire purchase agreement: s 12(2)(e); and a lease of goods: s 12(2)(i).

4 While the location of title is not relevant, at least as between a secured party and grantor, in determining whether a transaction can give rise to a security interest, the location of title to personal property will still be relevant in other ways. For example, a purchase money security interest held by a lessor can have priority over other purchase money security interests in the same personal property: *PPSA* s 63. The operation of a number of other rules in the *PPSA* also depend on the location of title to the collateral: see, eg, *PPSA* ss 112(2)(a), 339(1)(b).

While the *PPSA* can permit a person who is not the owner of an asset to grant a security interest over it, this does not mean that anybody can grant a security interest over anybody else's property. Under sections 19(1) and 20(1)(a) of the *PPSA*, a security interest will only be enforceable against a grantor or a third party if, among other things, the security interest is 'attached' to the collateral. Under section 19(2), a security interest can only attach to collateral if the grantor 'has rights in the collateral, or the power to transfer rights in the collateral to the secured party'.[5]

This paper explores the meaning of the phrase 'rights in the collateral', and in particular the extent to which a person who is in possession of property, but is not its owner, is able to grant an effective security interest over the property. That person could have possession:

- with the owner's agreement or acquiescence, such as under a lease or a bailment;
- because the owner lost the property, and they found it; or
- because they took it from the owner without the owner's agreement or acquiescence.

B 'Power to Transfer Rights in the Collateral to the Secured Party'

As a general rule, a security interest can only attach if the grantor has 'rights in the collateral'. As an alternative, however, section 19(2) also provides that a security interest can attach if the grantor has 'the power to transfer rights in the collateral to the secured party'.

The *PPSA* does not indicate what this alternative language might encompass. The *Personal Property Securities Act 1999* (NZ) in New Zealand ('*NZPPSA*') does not include this wording,[6] so no guidance can be found there.

The additional language can be found in Article 9 of the *Uniform Commercial Code* (US) ('*UCC*'). Article 9, which was first enacted in the 1950s, is the conceptual progenitor of the *PPSA*. While the form and content of the *PPSA* varies from Article 9 in many ways, the structural underpinnings of the *PPSA* still reflect many of the concepts that were introduced by Article 9.

As an example of this, the requirements in Article 9 for the attachment of a security interest are very similar to the requirements in section 19 of the *PPSA*. In particular, Article 9 provides that a security interest can only attach to collateral

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The location of title to collateral will also continue to be relevant where the *PPSA* does not apply. For example, there will be some competitions between interests in property for which no priority rule is prescribed by the PPSA. In these situations, it will fall to the general law to resolve the competition, and a secured party is likely to be able to maximise its priority position by ensuring that it has title.

5 The other requirement for attachment is that either 'value is given for the security interest', or that 'the grantor does an act by which the security interest arises': *PPSA* s 19(2)(b).

6 *NZPPSA* s 40(1).

if the grantor[7] has 'rights in the collateral', or 'the power to transfer rights in the collateral to a secured party'.[8]

The meaning of the phrase 'rights in the collateral' in Article 9 is discussed below.[9] The Official Comments to Article 9 indicate that the alternative test for attachment, that the grantor have 'the power to transfer rights in the collateral to a secured party', is intended in Article 9 to have only limited operation. According to Official Comment 6 to § 9-203, the words are included to accommodate specific priority rules in Article 9 that can apply even though a grantor does not have sufficient rights in the collateral to support the grant of one of the competing security interests.

In particular, the language appears to be directed at the Article 9 equivalent of section 71 of the *PPSA*. Section 71 has the effect that a person who acquires an interest in chattel paper for new value and in the ordinary course of that person's business can take priority over certain other security interests in the chattel paper, including (if the person takes possession of the chattel paper) over pre-existing perfected security interests.

According to the Article 9 analysis, a grantor who transfers chattel paper by way of a legal assignment will cease to have any 'rights in the collateral'. If the grantor later attempts to grant a second security interest over the chattel paper to a secured party who also takes possession then (according to this analysis) section 71 will only be able to operate in a meaningful way if the second security interest is also able to attach, even though the grantor no longer has any rights in the chattel paper. For the purposes of section 71, the grantor continues to have the power to transfer rights in the collateral to the secured party, despite the legal assignment.[10]

There is an uncomfortable element of bootstrapping in this argument, as it appears to require that section 71 be the source of the power to transfer rights in the collateral to the secured party, even though section 71 would only be engaged if the grantor already had the power. The narrow basis for including the language in Article 9 does however suggest that 'the power to transfer rights in the collateral to the secured party' as a source of attachment in section 19(2) is likely to have only limited relevance under the *PPSA*.

The original form of the Canadian personal property securities legislations did not provide for 'the power to transfer rights in the collateral to the secured party' as an alternative source of attachment.[11] The language has however been included over the course of the last five years in most of the Canadian personal property securities legislations, as part of a package of amendments that were

7 Referred to in Article 9 of the *UCC* as the 'debtor'.

8 *UCC* § 9-203 (2011).

9 See Part IV(A) of this paper.

10 A similar line of analysis could be applied to the transfer of an account by way of a legal assignment.

11 See, eg, *Personal Property Security Act*, RSA 2000, c P-7 ('*Alberta PPSA*'); *Personal Property Security Act*, RSO 1990, c P-10 ('*OPPSA*'); *Personal Property Security Act*, RSBC 1996, c 359 ('*BCPPSA*').

made in response to the introduction in Canada of model securities transfers legislation.[12]

That legislation introduced into Canadian law the concept of a 'security entitlement', similar to the concept of an 'intermediated security' under the *PPSA*. Under the scheme established by that legislation, the holder of a security entitlement does not have property rights in the underlying securities. It appears that the expression 'power to transfer rights in the collateral to the secured party' was included in the Canadian personal property securities legislations[13] in order to enable the holder of a security entitlement to grant a security interest over it.[14]

Again, this suggests that the expression is likely to have only limited relevance under the *PPSA*.

C Structure of the Paper

The balance of this paper commences with a summary of the nature of 'possession' at general law. The paper then examines the relevant provisions in the *PPSA*, and considers the position in the United States of America, Canada and New Zealand. It then analyses a number of possible models for the extent to which mere possession of collateral, as distinct from ownership of it, might support the grant of a security interest over that collateral, and concludes by recommending one of the models as the preferable approach.

II THE NATURE OF 'POSSESSION' AT GENERAL LAW[15]

A Potential Meanings of 'Possession'

The general law has 'never worked out a completely logical and exhaustive definition of "possession"'.[16] The difficulties that this can produce are compounded by the fact that case law and commentaries use a variety of terms in ways that are not always consistent, and by the fact that the meaning will often depend on the context in which the term is used. Depending on the circumstances, 'possession' can mean any one or more of the following:

- actual possession;
- legal possession; or
- constructive possession.

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12 See, eg, *Securities Transfer Act*, SA 2006, c S-4.5; *Securities Transfer Act*, SO 2006, c 8; *Securities Transfer Act*, SBC 2007, c 10.

13 See, eg, *Alberta PPSA* s 12(1)(b); *OPPSA* s 11(2); *BCPPSA* s 12(1)(b).

14 See, eg, Richard H McLaren, *The 2011 Annotated Ontario Personal Property Security Act* (Carswell, 2011) 140: 'The phrase "power to transfer rights in the collateral" permits the debtor to attach a security interest to a security entitlement in addition to directly holding securities.'

15 The classic exposition on this topic is Sir Frederick Pollock and Sir Robert Samuel Wright, *An Essay on Possession in the Common Law* (Clarendon Press, 1888). For other useful reference works, see also Michael G Bridge, *Personal Property Law* (Oxford University Press, 3rd ed, 2002), Royston Miles Goode and Ewan McKendrick (eds), *Goode on Commercial Law* (LexisNexis, 4th ed, 2009) 45–9.

16 *United States of America and Republic of France v Dollfus Mieg Et Cie SA and Bank of England* [1952] AC 582, 605 ('*United States v Dollfius Mieg Et Cie SA*').

Actual possession refers to effective occupation or control of the item in question. Physical custody of the item is not an essential prerequisite – for example, a person can have actual possession of an item where they have hidden it effectively so that others are unlikely to discover it except by accident.[17] The occupation or control must however be sufficient to exclude strangers from interference with the occupier or controller's use and enjoyment.[18] The level of occupation or control necessary to meet this requirement will depend on:[19]

- the kinds of physical control and use of which the thing is practically capable;
- whether there was an intention to possess the thing in question; and
- whether another person, able in law or in fact to object to the occupation or control, has consented or acquiesced to it.

Possession of keys or other means of access to goods will give actual possession if it grants sufficient physical control over them.[20]

Legal possession refers to the state of being in possession in the eyes of the law.[21] It is usually founded on actual possession, however it may exist without it. For example, a person will still have legal possession even though that person's employee,[22] agent or bailee at will[23] has physical custody of the item in question.[24] Legal possession of an article can also remain with the owner even if it has been lost or abandoned.[25]

The general law also recognises a concept of *constructive possession*. The term has been used in a number of ways, but is best used to refer to a situation where a person has legal possession, but not actual possession.[26]

B 'Possession' Contrasted with 'Ownership'[27]

At general law, rights are generally classified as rights *in rem* or *in personam*. Rights *in rem* (also referred to as 'real rights') are rights in or over an item of property that can be asserted against third parties. Rights *in personam*, in

17 *Williams v Douglas* (1949) 78 CLR 521, 527.
18 Pollock and Wright, above n 15, 13.
19 Ibid 14.
20 *Re Wasserberg; Union of London & Smiths Bank Ltd v Wasserberg* [1915] 1 Ch 195.
21 Pollock and Wright, above n 15, 26.
22 *Willey v Synan* (1937) 57 CLR 200.
23 At least if the bailment is a gratuitous bailment: see, eg, *United States v Dollfus Mieg Et Cie SA* [1952] AC 582, 611; *Perpetual Trustees & National Executors of Tasmania Ltd v Perkins* (1989) Aust Torts Reports 80–295.
24 Pollock and Wright, above n 15, 21, 146.
25 Pollock and Wright, above n 15, 19.
26 LexisNexis, *Halsbury's Laws of England*, vol 35 (reissue) (at 12 July 2011) Personal Property, '2 Possession' [1211]. See also Goode and McKendrick, above n 15, 47.
27 For a deeper discussion of this, see Bridge, above n 15, 14; Goode and McKendrick, above n 15, ch 2.

contrast, are personal rights that can generally only be asserted against the person who is obliged to perform the relevant obligation.[28]

The general law recognises two main types of real right in personal property: ownership, and possession.[29] While possession and ownership are generally treated as distinct concepts, and it is possible to have possession but not ownership, or ownership but not possession, the two notions are closely linked. For example, one of the hallmarks of ownership of an asset is the fact that the owner is entitled to possess it. And seen from the reverse perspective, possession is often the main indicator of ownership. Indeed, possession of property can lead to a person becoming its owner (for example, if the asset had been abandoned).[30]

The distinction is further blurred by the fact that the law goes to considerable lengths to defend possessory interests, by giving a person who is in possession of property with the intention of assuming ownership the same protections as are available to an owner, enforceable against everyone except a person who has a superior title.[31] For example, a person who finds and takes possession of property that has been lost (but not abandoned) by its owner will have possession of the property, but not ownership.[32] Even though the finder's interest in the property is founded in possession rather than ownership, however, the law goes to considerable lengths to defend the finder's possessory interest, and the finder will be able to defend that interest, as if it were the owner, against all comers other than the owner itself.[33]

The same principle even applies to a thief, or a person who acquires possession to goods, knowing the goods to be stolen. The thief, or person taking from the thief, will be able to defend his or her interest in the property against all persons other than those that have a superior title, and will for example be entitled to bring proceedings to recover possession, if they subsequently lose possession of the goods.[34]

Some commentators argue that ownership and possession are not distinct concepts, and challenge the notion that the common law ever did more than determine the relative strength of different rights to possession. If this is correct,

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28 Rights *in personam* may also be broken down into rights *in personam ad rem* (a personal right to require the obligor to deliver over property), and purely personal rights (*in personam*), a right to performance of other types of obligations.

29 The third important type of real right in personal property is the equitable charge.

30 The true owner will be able to bring proceedings to recover the property, or to recover damages for its conversion: *A L Hamblin Equipment Pty Ltd v Commissioner of Taxation* (1974) 131 CLR 570, 587–8 (Jacobs J); *Moorhouse v Angus and Robertson (No 1) Pty Ltd* [1981] 1 NSWLR 700, 702 (Hutley JA); *Munday v Australian Capital Territory* [1998] ACTSC 62 (8 July 1998) [135] (Higgins J).

31 See *Costello v Chief Constable of Derbyshire Constabulary* [2001] 1 WLR 1437, and the authorities discussed in that case.

32 *Armory v Delamirie* [1558–1774] All ER Rep 121; *Parker v British Airways Board* [1982] 1 All ER 834. 836.

33 *Parker v British Airways Board* [1982] 1 All ER 834.

34 See *Costello v Chief Constable of Derbyshire Constabulary* [2001] 1 WLR 1437, and the authorities discussed in that case.

then 'ownership' is simply the name given to the most superior of those possessory rights.[35]

It is not necessary for the purposes of this paper to explore whether this is correct, as the analysis set out below will apply whether ownership is distinct from possession, or whether an owner of property is simply the person who has the most superior right to possession. It is however customary to refer to 'ownership' as something that is distinct from 'possession', both in the literature and in the case law, and for convenience this paper will do so as well.

III RELEVANT PROVISIONS IN THE *PPSA*

The *PPSA* does not define the expression 'rights in the collateral'. The only direct guidance as to the meaning of the expression is provided in section 19(5). That section provides, for the purposes of determining when a grantor has 'rights in the collateral', that:

> a grantor has rights in goods that are leased or bailed to the grantor under a PPS lease, consigned to the grantor, or sold to the grantor under a conditional sale agreement (including an agreement to sell subject to retention of title) when the grantor obtains possession of the goods.

It is not clear whether 'possession' as used in section 19(5) is actual possession or legal possession.[36] It should be noted that section 24(2) provides that a grantor cannot have possession of personal property, if the property is in the actual or apparent possession[37] of the secured party or another person on behalf of the secured party. This is likely to mean in most cases that the grantor will need to have actual possession. This may not always be the case, though, and there may be circumstances where a grantor has legal possession but not actual possession (that is, constructive possession) in a way that is sufficient to invoke the operation of section 19(5), as long as the actual or apparent possession of the property is not with the secured party – for example, where the property is held by a third-party custodian or bailee.[38]

35 See, eg, W W Buckland and Arnold D McNair, *Roman Law and Common Law* (Cambridge, 2nd ed, 1965) 67; *Waverley Borough Council v Fletcher* [1995] 4 All ER 756, 764.

36 For an example of a circumstance where 'possession' was given a broad meaning in a statutory context, see *Re Atlantic Computer Systems plc* [1990] BCC 859, discussed in Goode and McKendrick, above n 15, 46.

37 The *PPSA* does not indicate what is meant by 'apparent' possession.

38 Indeed, if 'possession' for the purposes of s 19(5) were limited to actual possession, there would have been no need to refer to 'actual' possession in s 24(2) at all.

IV THE APPROACHES OVERSEAS

A The Position in the US[39]

As noted earlier, the principles underpinning the *PPSA* are based in part on Article 9 of the *UCC*. While there are many differences in both the broad structure and the detail of Article 9 and the *PPSA*, some of the language in the *PPSA* derives originally from concepts in Article 9. Relevantly, Article 9 also provides that a security interest can attach to collateral if the grantor has 'rights in the collateral'.[40]

The breadth of the expression 'rights in the collateral' as used in Article 9 appears to have been the source of some uncertainty for US courts. It seems, however, that possession alone is not considered to be sufficient rights in collateral under Article 9 to support attachment of a security interest to the collateral as a whole.[41] In contrast, if a person has possession of collateral under a transaction that is designed to serve a security function, US courts will assume that the transaction is in reality a sale, and will treat the person in possession as having title to the property, as well as possession of it. That combination of title and possession is then sufficient to support attachment in those circumstances.[42]

Whether or not bare possession amounts to sufficient rights in collateral to support attachment under Article 9, US case law states that a thief is unable to give any valid security interest in the stolen property, on the basis that a thief has no title or other property interest in the collateral that would suffice to support attachment.[43]

B The Position in Canada

The structure of the *PPSA* is much more closely aligned with the Canadian personal property securities legislations, than it is with Article 9 of the *UCC*. Canadian courts have also generated (and continue to generate) a substantial body of case law on the Canadian personal property securities legislations, and it is likely that Australian courts will look to Canadian jurisprudence as a source of guidance when interpreting the *PPSA*.

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39 This part of the paper draws in particular on the helpful article: Margit Livingston, 'Certainty, Efficiency, and Realism: Rights in Collateral under Article 9 of the Uniform Commercial Code' (1994) 73 *North Carolina Law Review* 115.

40 UCC § 9-203 (2011).

41 See *Re Sitkin Smelting and Refining, Inc; Eastman Kodak Company v Harrison* 639, F 2d 1213 (5th Cir, 1981), discussed in Livingston, above n 39, 131. This analysis is also supported by the Official Comments to Article 9 of the *UCC*. They acknowledge that a grantor's limited rights in collateral, short of full ownership, can be sufficient for a security interest to attach, but then go on to say: 'However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a [grantor] may have': see Official Comment 6 to *UCC* § 9-203. This suggests that a person who has bare possession will only be able to grant a security interest over that possessory interest. See the discussion in Part V(E) below.

42 Livingston, above n 39, 126.

43 Ibid 120. This appears to differ from the position under Australian law: see Part II(B) above.

A number of Canadian cases have considered whether possession can constitute sufficient rights in collateral to support attachment of a security interest. In *Euroclean Canada Inc v Forest Glade Investments Ltd*,[44] for example, the Ontario Court of Appeal considered whether a person in possession of laundry equipment under a conditional sale agreement had sufficient rights in that equipment to support attachment of a floating charge given to a third-party bank. The Court held that the person's right to immediate possession of the equipment, coupled with the right to receive legal title on payment of the full purchase price, did constitute sufficient rights in the equipment for the floating charge to attach.

The same conclusion was reached (on similar facts) by the British Columbia Supreme Court in *Haibeck v No 40 Taurus Ventures Ltd*[45] and again by the Ontario Court of Appeal in *Canadian Imperial Bank of Commerce v Otto Timm Enterprises Ltd*.[46]

In all these cases, the possession was acquired under a transaction that was itself a security interest. None of them considered whether possession could support attachment in other contexts. This question fell squarely for consideration, however, in *Gray v Royal Bank of Canada*,[47] a decision of the British Columbia Supreme Court in 1997. In that case, one Gray was the owner of a motor home.[48] Gray entered into an arrangement with an individual named Mitran to sell the motor home. Unfortunately, Mitran appears to have been something of a scoundrel – he convinced Gray to hand over possession of the motor home to facilitate the sale, and arranged behind Gray's back to take over the existing financing of the motor home. Mitran then forged a transfer of the motor home to himself.

Armed with possession of the motor home and the forged title documents, Mitran purported to transfer title to the motor home to unwitting purchasers named the Hayhoes. The Hayhoes financed their purchase with a secured loan from Royal Bank of Canada, and the bank registered its security interest under *BCPPSA*. When Gray learned of Mitran's actions, he brought proceedings for recovery of the motor home.

The court began its analysis by confirming that the Hayhoes did not have an ownership interest in the motor home. The purported transferor, Mitran, did not own the motor home, and it followed, based on *nemo dat quod non habet*, that the Hayhoes could not acquire a superior interest in the motor home from him.

The Hayhoes were however in possession of the motor home. Royal Bank of Canada argued that the Hayhoes' possessory interest in the motor home

44 (1985) 16 DLR (4th) 289 ('*Euroclean*').

45 (1991) 2 PPSAC (2d) 171 ('*Haibeck*').

46 (1995) 130 DLR (4th) 91 ('*Otto Timm*').

47 (1997) 143 DLR (4th) 179.

48 In fact, the true owner of the motor home may have been a Mrs Smith. Gray had however taken over servicing the payments on Smith's financing of the motor home, and the case proceeded on the basis that Gray, rather than Smith, was the true owner: *Gray v Royal Bank of Canada* (1997) 143 DLR (4th) 179.

constituted sufficient 'rights in the collateral' to support the grant of a security interest over the motor home to the bank.

The court was in qualified agreement with this proposition. The court considered the decisions in *Euroclean*, *Haibeck* and *Otto Timm*, but distinguished them, in part on the basis that none of those cases considered a situation where there was a dispute between a secured party and the true owner.

Having decided there was no directly relevant precedent, the court turned to the academic literature, in the form of a text book *British Columbia Personal Property Handbook*, by Ronald CC Cuming and Roderick J Wood ('*BC Handbook*').[49] The Court accepted the view expressed in the *BC Handbook* that a bare possessory interest can indeed be sufficient to support the grant of a security interest. That security interest, however, was a defeasible one, in that it was vulnerable to the interest of the true owner. This meant that the bank's security interest was capable of being defeated by Gray's interest, as owner.

Cuming and Wood express the principle in the *BC Handbook* in the following way:

> A person in possession of goods belonging to another has, by virtue of his possessory interest, sufficient rights to grant a security interest in goods. However, the secured party obtains a security interest in the defeasible possessory title of the debtor which, although effective against a stranger, is not effective against the true owner. The true owner therefore enjoys priority over the secured party.[50]

A similar view is expressed in some other Canadian commentaries.[51]

The Canadian position is however clouded by the 2006 decision of the Ontario Court of Appeal in *994814 Ontario Inc v RSL Canada Inc and En-Plas Inc*.[52] In that case, a manufacturer of three large pieces of injection moulding equipment ('En-Plas') entered into a conditional sales agreement to sell the equipment to RSL Canada Inc ('RSL'). The equipment was delivered to RSL's premises. The agreement made it clear that title to the equipment would remain with En-Plas until RSL had paid the purchase price. The parties also agreed however that RSL was under no obligation to purchase the equipment until certain safety approvals had been obtained from the Ontario Electrical Safety Agency.

En-Plas did not register any security interest in the equipment.

Another company, 994814 Ontario Inc ('Ontario Inc'), held a registered general security agreement over all RSL's assets. RSL defaulted, and Ontario Inc appointed a receiver to RSL. The receiver refused to return the equipment to En-Plas, on the basis that Ontario Inc's security interest had attached to the equipment – in other words, the receiver maintained that RSL had sufficient 'rights in the collateral' for Ontario Inc's security interest to attach to it.

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49 Ronald C C Cuming and Roderick J Wood, *British Columbia Personal Property Handbook* (Carswell, 1998).

50 Ibid 115.

51 See, eg, Ronald C C Cuming, Catherine Walsh and Roderick J Wood, *Personal Property Security Law* (Irwin Law, 2005) 165.

52 (2006) 9 PPSAC (3[d]) 240 ('*Ontario v RSL*').

The court at first instance[53] held in a short judgment that RSL did not have sufficient rights in the equipment for Ontario Inc's security interest to attach. While the equipment may have been located at RSL's premises, the court took the view that RSL had not acquired rights in the equipment because it had not yet become the grantor of a security interest under the conditional sales agreement with En-Plas. As RSL was not yet under any obligation to purchase the equipment (because the safety approvals had not been obtained), there was as yet no secured obligation, and accordingly no security interest.

The court at first instance did not address the argument that RSL's physical possession of the equipment could itself be sufficient rights to support attachment of Ontario Inc's security interest, whether or not a security interest had arisen under RSL's arrangements with En-Plas. The judgment does not explore this question, and makes no reference to *Gray v Royal Bank of Canada*.[54]

The decision was then upheld on appeal. While not necessarily agreeing with all of the trial judge's legal analysis, the Court of Appeal accepted the judge's finding that, on the particular facts of the case, RSL had not yet acquired an interest in the equipment to which Ontario Inc's security interest could attach. Similar to the decision at first instance, the Court of Appeal did not analyse whether RSL's bare possession could support attachment of Ontario Inc's security interest. The Court of Appeal also made no reference in its judgment to *Gray v Royal Bank of Canada*.

It is not easy to reconcile the decision in *Ontario v RSL* with *Gray v Royal Bank of Canada*, as the case appears to suggest that mere possession of personal property will not constitute sufficient rights in that personal property to support attachment of a security interest. It is not apparent from the judgment whether the court declined to follow *Gray v Royal Bank of Canada*, or whether the point was simply not argued by Ontario Inc.

In contrast to *Gray v Royal Bank of Canada*, which contained a careful analysis of relevant authorities, the decision in *Ontario v RSL* did not analyse the legal underpinnings for its conclusions. It may be that *Ontario v RSL* will be confined to its particular facts, and will not be taken as supporting the proposition that bare possession of collateral cannot be sufficient rights in that collateral under Canadian law to support attachment of a security interest.[55]

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53 *994814 Ontario Inc v RSL Canada Inc* (2005) 8 PPSAC (3[d]) 272.

54 (1997) 143 DLR (4th) 179.

55 While the reasoning in *Ontario v RSL* may be difficult to reconcile with *Gray v Royal Bank of Canada*, this does not mean that the case produced an inconsistent outcome. Even if the court had followed *Gray v Royal Bank of Canada* and held that RSL's possession of the equipment gave it sufficient rights in the collateral to support attachment of Ontario Inc's security interest, En-Plas would still have prevailed. If the court had applied the reasoning in *Gray v Royal Bank of Canada*, it would have concluded that Ontario Inc's security interest, being based solely on RSL's possession, was a defeasible one, and was not effective against En-Plas as the true owner.

C The Position in New Zealand

1 *Case Law*

The question whether bare possession can be sufficient to support the grant of a security interest has been considered in a number of cases in New Zealand.

In *Graham v Portacom New Zealand Ltd*,[56] Portacom New Zealand Ltd ('Portacom') leased a number of portable buildings to NDG Pine Ltd ('NDG'). The leases were for more than one year, and so were deemed to be security interests under the *NZPPSA* by section 17(1)(b) of that Act, the equivalent of section 12(3) of the *PPSA*. NDG also granted an all-assets security to a bank, HSBC. HSBC perfected its security interest by registration, but Portacom did not.

NDG defaulted under its facilities with HSBC, and HSBC appointed receivers. HSBC argued that its security gripped the portable buildings, and not just NDG's possessory interest in them, so the court needed to decide whether NDG's possessory interest in the buildings, acquired under the leases from Portacom, constituted sufficient rights in the collateral to support a grant of a security interest in the buildings as a whole to HSBC.

The court held that it did. The court analysed the Canadian position, and concluded (based on the NZ equivalent of section 19(5) of our *PPSA*[57]) that NDG, because it was in possession under a lease for more than one year, had 'rights in the collateral' that were sufficient to support not only the grant of the security interest back to Portacom, but also the grant of security over the portable buildings to HSBC. As a result, the receivers were able to sell the buildings and apply the sale proceeds towards the obligations owed to HSBC, even though Portacom was (technically) the owner.

Portacom was followed by the New Zealand Court of Appeal in *Waller v New Zealand Bloodstock Ltd*.[58]

The decision in *Portacom* is clearly supported by the language of section 40(3) of the *NZPPSA*. The possessory interest of a lessee under a lease for more than one year constitutes sufficient rights in the collateral to support a grant by the lessee of a security interest in the entire collateral, not just its possessory interest. The same conclusion should follow under section 19(5) of the *PPSA*.

Portacom and *Bloodstock* do not shed any light on the extent to which a person in possession of collateral might have sufficient rights in the collateral to grant a security interest over it for the purposes of the *NZPPSA*, where section 40(3) does not apply. That question did however fall for consideration by the New Zealand Court of Appeal in 2009, in *JS Brooksbank and Company (Australasia) Ltd v EXFTX Ltd (rec apptd & in liq)*.[59]

In that case, Brooksbank supplied wool to Feltex Carpets Ltd. Feltex got into financial difficulties, and Brooksbank was no longer prepared to supply wool on credit terms, so Brooksbank and Feltex entered into new arrangements under

56 [2004] 2 NZLR 528 ('*Portacom*').
57 *NZPPSA* s 40(3).
58 [2006] 3 NZLR 629 ('*Bloodstock*').
59 [2009] NZCA 122 (6 April 2009) ('*Brooksbank*').

which Brooksbank would only supply Feltex with wool after Brooksbank had received payment for the wool.

Brooksbank's wool was stored with a number of wool brokers. Despite the new arrangements, some of the brokers released wool to Feltex before Feltex had paid for it. Before the wool was returned to Brooksbank, however, Feltex's bank appointed receivers to Feltex under the equivalent of a fixed and floating charge.

The receivers declined to return the wool. They argued that Brooksbank's interest in the wool was an unperfected security interest, on the basis that the supply agreement was an agreement to sell the wool subject to retention of title. They also maintained that Feltex, because it had possession of the wool, had sufficient rights in the collateral for the bank's security interest to attach to the wool as well. As the bank had perfected its security interest by registration and Brooksbank had not, the bank took priority.

The court at first instance agreed with these propositions, and held for the bank. The Court of Appeal, however, agreed with Brooksbank. The court accepted that Feltex would have sufficient rights in the wool for the bank's security interest to attach, if Feltex had possession of the wool under a conditional sale agreement. This was based on section 40(3) of the *NZPPSA*, the equivalent of section 19(5) of the *PPSA*. In contrast to the judge at first instance, however, the Court of Appeal held that the supply arrangement between Brooksbank and Feltex was not a conditional sale agreement for the purposes of section 40(3), and that Feltex had no right of possession as against Brooksbank. The Court of Appeal held on this basis that Feltex, while it clearly had possession of the wool, did not have rights in the wool that were sufficient to support attachment of the bank's security interest. In other words, mere possession of the wool was insufficient to support attachment of a security interest to a third party. The Court did not cite any authority in support of this proposition, and in particular did not refer to any of the Canadian authorities discussed in Part IV B above.

This approach was also adopted by the recent decision of the New Zealand Court of Appeal in *Rabobank New Zealand Ltd v McAnulty (February Syndicate)*.[60] In that case, a racehorse syndicate owned a stallion, St Reims. The syndicate entered into an arrangement with a stud farm to stable, care for and arrange service nominations for St Reims. Pursuant to the arrangement, the stud farm took possession of the horse.

A financier, Rabobank, separately provided finance to the stud farm, and took a general security agreement from it. Rabobank perfected its security interest by registering a financing statement against the stud farm under the *NZPPSA*. The syndicate, however, did not.

The stud farm defaulted under its obligations to Rabobank, and Rabobank appointed receivers.

Rabobank claimed that it had a perfected security interest in St Reims that had priority over the interest of the syndicate. Rabobank argued that the

60 [2011] NZCA 212 (23 May 2011) ('*Rabobank*).

syndicate's interest in St Reims was a security interest, on the basis that the bailment arrangement with the stud farm was a 'lease for a term of more than one year', and accordingly a security interest under section 16(1)(i) of the *NZPPSA*. The syndicate, in contrast, argued that its interest in St Reims was not a security interest at all, and that the priority rules in the *NZPPSA* did not apply to it.

The decision of the Court of Appeal focused principally on the meaning of the expression 'lease for a term of more than one year' and the fact that the *NZPPSA* provides that such a lease will only be a security interest if the lessor is 'regularly engaged in the business of leasing goods'. (Similar language can be found in section 13(2)(a) and (b) of the *PPSA*.) Importantly for present purposes, however, the Court of Appeal made it clear that the fact that the stud farm had possession of St Reims did not of itself mean that Rabobank's security interest attached to the horse. Rabobank's security interest would only attach to the horse if the arrangement between the syndicate and the stud farm was itself a security interest – that is, the stud farm would have sufficient rights in St Reims to be able to grant a security interest over the horse to Rabobank if it was the grantor of a security interest under the arrangement with the syndicate, but not otherwise. In the words of the Court of Appeal:

> If, the Syndicate does not have a security interest in St Reims, it is a third party holding title to St Reims, and Rabobank's security does not attach to St Reims, but only to the rights held by [the stud farm] in St Reims which are the rights of a bailee only under the terms of the agreement.[61]

Similar to the Court of Appeal in *Brooksbank*, the Court of Appeal in *Rabobank* did not appear to regard this as a point of any controversy, and stated the conclusion without citing any authority, or discussing the Canadian position.

2 *Academic Commentary*

A number of New Zealand commentaries have also expressed a view on whether possession can be sufficient 'rights in the collateral' to support attachment of a security interest.

One leading commentary agrees with the position adopted in Canada in *Gray v Royal Bank of Canada*.[62] An article published in 2009 in the *New Zealand Business Law Quarterly* also supports this approach, by expressing the view that possession can support the grant of a security interest over collateral, but that the security interest is not effective against a true owner.[63] The author of that article adds a qualification to this, however, by suggesting that possession would not constitute sufficient rights in the collateral for the purposes of attachment, if the possession was acquired wrongfully.[64]

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61 Ibid [11].

62 Mike Gedye, Ronald C C Cuming and Roderick J Wood, *Personal Property Securities in New Zealand* (Thomson Brookers, 2002) 156. It is perhaps not surprising that this commentary reaches the same view, as two of the three authors were also the authors of the *BC Handbook*.

63 Struan Scott, 'The *PPSA*: The Continued Relevance of Conventional Legal Principles in Determining the Existence of a Security Interest' (2009) 15 *New Zealand Business Law Quarterly* 203.

64 Ibid 211.

Other New Zealand commentaries take a different approach. One commentary suggests that rights in the collateral only include proprietary (or ownership) rights, and that a grantor can only grant a security interest in the rights that are held by the grantor.[65] The same view is expressed in the recent publication *Personal Property Securities Act 1999 – Act and Analysis*.[66]

V WHICH APPROACH WORKS BEST FOR THE *PPSA*?

A The Options Summarised

It can be seen from the discussion in Part IV that case law and commentaries overseas have considered a number of models for the question being considered by this paper. Those models can be summarised in the following way.

Option 1

Mere possession can constitute sufficient 'rights in the collateral' to support attachment of a security interest. However, that security interest will be vulnerable to the rights of a person who has a superior interest in the collateral to that of the grantor. This is referred to below as the '*bare possession model*'.

This is the approach taken in *Gray v Royal Bank of Canada*,[67] and some Canadian and New Zealand commentaries.[68]

Option 2

The *bare possession model*, with the qualification that bare possession will not constitute sufficient rights in the collateral to support attachment if the grantor obtained that possession wrongfully. This is referred to below as the '*qualified bare possession model*'.

This is the approach proposed by some academic commentary in New Zealand.[69]

Option 3

Mere possession of collateral is only sufficient to support attachment of a security interest in the examples given in section 19(5) of the *PPSA*. Unless section 19(5) applies, only an ownership interest in collateral can constitute sufficient rights to support attachment of a security interest in that collateral. This is referred to below as the '*ownership model*'.

65 Linda Widdup and Laurie Mayne, *Personal Property Securities Act – A Conceptual Approach* (LexisNexis, 2002) 70.

66 Barry Allan, *Personal Property Securities Act 1999 – Act and Analysis* (Thomson Reuters, 2010) 82–5.

67 (1997) 143 DLR (4th) 179.

68 See Cuming, Walsh and Wood, above n 51; *Portacom* [2004] 2 NZLR 528; Scott, above n 63.

69 See Widdup and Mayne, above n 65.

Option 4

Possession of collateral is sufficient to support attachment of a security interest back to the owner of the collateral, either under section 19(5) of the *PPSA* or under a title-based 'in substance' security interest under section 12(1) of the *PPSA*. A grantor under such a security interest then has sufficient rights in the collateral to support attachment of security interests granted to others. Absent these circumstances, however, bare possession of collateral is not sufficient to support attachment of a security interest over the whole of the collateral, only over the possessor's interest in it. This is referred to below as the '*modified title model*'.

This is the approach taken in the United States,[70] and by New Zealand case law.[71]

B The Bare Possession Model

It is not difficult to see why the expression 'rights in the collateral' might be thought to include possessory rights. Possession is a recognised legal interest in property, and gives the possessor rights that are capable of being defended against all third parties that do not have a superior interest.[72]

There are however grounds to question whether this approach is the most appropriate model for the *PPSA*.

1 *Inconsistency with* Nemo Dat

It is clear that the *PPSA* overrides the general law principle of *nemo dat* in a number of ways. Section 12(1) makes it clear that a person can be a grantor of a security interest even if the person does not have title to the property. If a person is the grantor of a security interest over collateral, that person can then also grant security interests in that collateral to third parties, or dispose of the collateral, whether or not they have title at general law.

This does not mean, however, that the *PPSA* abrogates the principle of *nemo dat* entirely. Both commentaries and case law overseas make it clear that the principles of general law, including *nemo dat*, will continue to apply unless the legislation provides otherwise. This is confirmed in the case of the *PPSA* by section 254(1).

There will be situations where it is not clear whether the *PPSA* is intended to override *nemo dat*. If there is no compelling argument to the contrary, it would not be surprising if courts were to interpret the *PPSA* as far as possible in a way that is consistent with pre-PPS principles, rather than contrary to them. This may mean, in cases of doubt, that courts will give effect to the principle of *nemo dat*, rather than accept that it no longer applies.

70 See the discussion in Part IV(A) above.
71 See the discussion in Part IV(C) above.
72 See the discussion in Part II(B) above.

It does need to be acknowledged that section 12(1) states that a person can grant a security interest even if they do not have title. As one commentator points out,[73] however, this could be read as a recognition of the fact that the location of title is not relevant *as between the grantor and the secured party* in determining whether a transaction is a security interest. It does not need to be read as a more general form of *carte blanche* for non-owners to grant security interests over property belonging to others.

2 *Contrary Indicators in the* PPSA *Itself*

There are two aspects of the *PPSA* itself that suggest that bare possession may generally not be sufficient 'rights in the collateral' to support attachment.

(a) Section 19(5)

As discussed earlier,[74] section 19(5) states that a grantor will have sufficient rights in collateral to support attachment of certain types of security interest when the grantor has possession of the collateral. This could clearly be taken to imply that possession will not constitute sufficient rights in the collateral to support attachment in other contexts.

The *NZPPSA*[75] and all of the Canadian personal property securities legislations[76] except in Ontario, contain a similar provision, and it might be argued that section 19(5) was included to enhance consistency of the *PPSA* with the overseas models or for the avoidance of doubt, rather than because bare possession is not otherwise sufficient to support attachment. As a matter of legislative analysis, however, it could be argued that language is included in legislation in order to have a substantive effect. If this approach is correct in this case, then the implication is difficult to ignore.

The analysis is however complicated by the fact that section 19(5) applies to PPS leases, but not to leases that are 'in substance' security interests under section 12(1) but not PPS leases as well.[77] The *PPSA* clearly contemplates that a lease can be a security interest under section 12(1), whether or not it is also a PPS lease. If section 19(5) was included because a lessee's possession of the leased goods under a PPS lease would otherwise not constitute sufficient rights in the

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73 Allan, above n 66, 82.

74 See Part III.

75 *NZPPSA* s 40(3).

76 *Alberta PPSA* s 12(2); *BCPPSA* s 12(2); *Personal Property Security Act*, CCSM, c P-35, s 12(2); *Personal Property Security Act*, SNWT (Nu) 1994, c 8, s 12(2); *OPPSA* s 12(2); *Personal Property Security Act*, SS 1993, c P-6.2, s 12(2); *Personal Property Security Act,* SNB 1993, c P-7.1, s 12(3); *Personal Property Security Act*, RSPEI 1988, c P-3.1, s 12(3); *Personal Property Security Act*, RSY 2002, c 169, s 11(2); *Personal Property Security Act*, SNL 1998, c P-7.1, s 13(3); *Personal Property Security Act*, SNS 1995-1996, c 13, s 13(3). Quebec, being a civil law jurisdiction, has not enacted similar legislation.

77 Admittedly, most leases that are 'in substance' security interests under *PPSA* s 12(1) will also be PPS leases. It is however possible to have a lease that is a security interest under s 12(1) that is not also a PPS lease – for example, if the lessor is not 'regularly engaged in the business of leasing goods': see *PPSA* s 13(2)(a).

collateral to support attachment of the security interest under the PPS lease itself, then it would be difficult to see how a security interest could attach under an 'in substance' lease, as the only potential rights of the lessee that could support attachment of the security interest would be the lessee's possession of the goods.

Because the *PPSA* so clearly contemplates that it can apply to a lease that is an 'in substance' security interest, and because the only relevant rights of a lessee under most leases are likely to be its possession of the leased goods, the inescapable implication seems to be that a lessee's possession of leased goods is sufficient rights in those goods to support attachment of (at least) the security interest under the lease itself.

It does not necessarily follow from this that the lessee's possession of the leased goods is sufficient by itself to support attachment of other security interests. If the *PPSA* characterises a lease as a security interest, it is clear that the lessee is able to grant a security interest over the leased goods to third parties as well. It is not necessary to argue, however, that this means that bare possession is sufficient to support attachment of those security interests. Rather, where the *PPSA* characterises a lease as a security interest, it is sufficient to accept that the *PPSA* treats the lessee as if it were the owner of the leased goods and, by doing so, regards the lessee as having sufficient 'rights in the collateral'[78] to support attachment of security interests in favour of third parties as well.

(b) Definition of 'Interest' in Section 10

A security interest can only attach to collateral if the grantor has 'rights in the collateral'. In contrast, a security interest itself is not described (in section 12(1)) as a 'right' in collateral, but rather as an 'interest' in the relevant property. While this formulation is again consistent with overseas models, it is not inappropriate to expect that Parliament, by using different terms, may have intended them to have different meanings.

One way of distinguishing between the two terms would be to treat possession as being an 'interest' in personal property for the purposes of the definition of security interest in section 12(1), but not as a 'right' in collateral for the purposes of section 19(1). For example, it is clear that a pledge or a possessory lien can be a security interest under the *PPSA*, and that a secured party's possession of collateral will be an 'interest' in the collateral for this purpose. Accepting that 'interest' in personal property includes possession, but that 'rights' in collateral does not (except to the extent expressly included by section 19(5)), could be a meaningful way of distinguishing between the two terms.

78 Or alternatively, the 'power to transfer rights in the collateral to the secured party' (engaging the other source of attachment in *PPSA* s 19(2)(a)).

3 *Counterintuitive Outcomes*

It is possible to conceive of fact patterns where the *bare possession model* produces unexpected and (in the author's view) inappropriate outcomes. Take the following example.

A construction company gives an all-assets security to its bank. Some time later, the company rents an excavator for 60 days for a particular building project. That rental arrangement is unlikely to be a security interest, under either of sections 12(1) or 12(3) of the *PPSA*. If bare possession is sufficient rights in collateral to support attachment, however, then the bank's all-assets security will attach to the excavator itself (rather than just the construction company's possessory interest in the excavator). If the bank enforces its security during the term of the rental arrangement, it would be able on the face of it to sell the excavator and keep the proceeds.

Fortunately for the owner of the excavator, this would not be the outcome, even using the *bare possession model*. As the rental arrangement is not a security interest, the excavator's owner remains its owner for PPS purposes, and is not reduced to being only a secured party in relation to it. For this reason, the *PPSA*'s priority rules are not engaged, and it is necessary instead to turn to the general law. The principle of *nemo dat* will apply, and the owner will prevail.[79]

What would happen, however, if the competition was not between the secured party and the owner, but instead between the secured party and another bank that held security over the excavator from the owner? This would now be a competition between security interests, a competition that *is* regulated by the *PPSA*. If the construction company's secured party registered its security interest before the owner's secured party, then it would seem that the construction company's security would prevail. It is hard to see how this could be a commercially justifiable result.

Similar results would appear to follow where the person in possession of the property is a finder of the property, or even a thief. While *nemo dat* will protect the owner from a claim by the finder or thief's secured party, a person holding security from the owner may find, if the *bare possession model* is correct, that a security granted by the finder or thief could prevail over the security granted by the owner.

It is likely that courts would go to some lengths to avoid this outcome.

C The Qualified Bare Possession Model

The *qualified bare possession model* raises most of the same problems as the *bare possession model*. This model, however, seeks to deal in part with the counterintuitive outcome described in Part V(B), by providing that possession held by a thief (or a person who knowingly takes possession through a thief) is not sufficient rights in the collateral to support attachment of a security interest over the stolen property.

79 For a useful explanation of this see Scott, above n 63, 210–13.

At a policy level, it is not difficult to understand the rationale for this qualification. As a matter of statutory interpretation, though, it is difficult to see where support can be found in the *PPSA* itself for the proposition that possession can be sufficient rights in the collateral if it is obtained lawfully, but not otherwise. The general law does not appear to draw such a distinction – a thief in possession of property has an interest that he or she can defend against all third parties other than those with a superior interest,[80] in the same way as a finder. While it is of course possible to infer into the *PPSA* an intent to draw such a distinction, this would need to be done despite the language of the *PPSA*, not because of it.

D The Ownership Model

It is generally recognised that the *PPSA*'s functional or 'in substance' approach reduces the importance of ownership as a determinant of a person's ability to deal in personal property. While the *PPSA* looks past formal notions of ownership in order to determine whether a transaction gives rise to a security interest, though, it does not do away with the concept of ownership entirely. So despite first appearances, it is not inconsistent with the *PPSA*'s conceptual underpinnings to suggest that a person will generally only have sufficient rights in collateral to support attachment of a security interest, if their interest in the collateral is an ownership interest.

The *ownership model* overcomes the difficulties inherent in the *bare possession model* and the *qualified bare possession model*, discussed above. It is more consistent with the general law principle of *nemo dat*, is consistent with the definition of 'interest' in section 10 of the *PPSA*, and side-steps the counterintuitive outcome described in Part V(B).

The *ownership model* fails however to explain what supports attachment of the security interest under a lease that is an 'in substance' security interest under section 12(1).

E The Modified Title Model

The *modified title model* proposes that possession of collateral can constitute sufficient rights in the collateral to support attachment of a security interest, in two situations:

- in the circumstances described in section 19(5); or
- under a lease that is an 'in substance' security interest under section 12(1).

Indeed, there is no reason in principle why the second leg of this proposition could not be extended to other title-based security interests – that is, possession of collateral should be sufficient to support attachment of any security interest that is granted back to the owner of the collateral.

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80 See the discussion in Part II(B) above.

It is true that section 19(5), on its face, is not limited to determining when attachment occurs under the types of security interests listed in the section. Section 19(5) could be read, for example, as stating that the lessee of goods under a PPS lease, when it obtains possession of the goods, has sufficient rights in them to support attachment of security interests to third parties, as well as the security interest under the PPS lease itself. It may be, however, that it is not necessary to decide whether section 19(5) has that additional reach. As discussed earlier, it is clear that the *PPSA* treats the grantor of a security interest over collateral in many respects as if it were the owner of that collateral, whether or not they are the owner at general law. If a security interest has attached to collateral under section 19(5) or under an 'in substance' security interest under section 12(1), the grantor will have sufficient rights in that collateral to support attachment of security interests in favour of other parties as well. Except in these circumstances, however, possession alone should not be sufficient rights in collateral to support attachment of a security interest over it.

1 *Possession as Collateral in its Own Right*

The *modified title model* does not however require that a person in possession of another person's property is incapable of granting any security interest at all in relation to that property. Their very possession of the property is itself an asset, and there should be no reason why they could not grant security over that (more limited) asset. The 'collateral' in this case, however, is not the physical asset in their possession, and their possession of the asset does not give them 'rights' in the asset that can support attachment of a security interest over the asset itself. Rather the 'collateral' is made up of the more limited rights that they have by virtue of their possession of the asset, and it is their ownership of those rights, rather than possession of the physical asset, that gives them sufficient 'rights in the collateral' to support attachment of a security interest to those rights (but not to the asset as a whole).[81]

2 *Comparison with the Other Models*

The *modified title model* is consistent with the position under Article 9 of the *UCC*,[82] except in relation to thieves (where it seems that the general legal position in the United States, which accords no property or other rights to thieves, may be different in any event to the position under Australian law).[83]

This model also achieves outcomes that are consistent with the Canadian position as stated in *Gray v Royal Bank of Canada*,[84] even though it formulates the analysis differently. *Gray v Royal Bank of Canada* states that a person in possession of collateral can grant a security interest over the collateral to a third party, but that the third party's security interest is defeasible as against the owner

81 *Rabobank* [2011] NZCA 212 (23 May 2011) [11].

82 See Part IV(A) above.

83 See Livingston, above n 39, 120; above n 43 and accompanying text.

84 See *Gray v Royal Bank of Canada* (1997) 143 DLR (4th) 179.

in the same way as the grantor's possessory interest. The *modified title model* produces the same result, by providing that the third party's security interest is only over the grantor's possessory title in the first place.[85]

The model is also consistent with the decisions of the New Zealand Court of Appeal in *Brooksbank* and *Rabobank*.

The *modified title model* overcomes the difficulties of the *bare possession model* and *qualified bare possession model*, in that it is more consistent with *nemo dat* and the definition of 'interest' in section 10 of the *PPSA*, and side-steps the counterintuitive outcome described in Part V(B). The model also overcomes the difficulty faced by the *ownership model* in dealing with attachment of security interests under 'in substance' leases.

IV CONCLUSION

In the author's view, for the reasons given in Part V(E), the *modified title model* provides the most satisfactory structure for determining the extent to which possession of collateral can support attachment of a security interest. That model can be reduced to three propositions.

1. A person in possession of collateral can grant a security interest over the collateral back to the owner,[86] including in the circumstances described in section 19(5).
2. Except in the circumstances described in proposition 1, a person can only grant a security interest over collateral if either:
   a) the person has an ownership interest in the collateral; or
   b) the person is treated by the *PPSA* as if it were the owner of the collateral, by virtue of being the grantor of another security interest over it.
3. A person who is in possession of property, but who does not have an ownership interest in it and cannot rely on proposition 2, can only grant a security interest over the rights that flow from the fact of their possession, not over the property itself. It is their ownership of those possessory rights, not the fact that they are in possession of the underlying asset, that enables the security interest to attach (to those rights, not to the asset as a whole).

It is acknowledged, however, that the *PPSA* does not indicate with any certainty that this is the correct analysis, and it may be that Australian courts will

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85 Indeed, it could be said that this approach is supported by the academic commentary on which the court relied in *Gray v Royal Bank of Canada* (1997) 143 DLR (4th) 179. That commentary, as quoted by the court in its judgment, states in part that 'the secured party obtains a security interest in the defeasible possessory title of the [grantor]'. See Cuming and Wood, above n 49.

86 It may be that the reference to 'owner' here is too narrow. For example, a person who holds goods under a lease may sublease the goods to someone else, and the sublessee, on taking possession of the goods, should have sufficient rights to support attachment of a security interest back to the lessee/sublessor.

follow one of the other models discussed in this paper, or perhaps even some other line of analysis that has not yet occurred to the author. We will await with great interest the first decisions on the operation of the *PPSA*, to see how Australian courts approach this and the many other issues that are raised by this novel and challenging piece of legislation.