10 years of the Personal Property Securities Act in NZ: Lessons and Trends

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TABLE OF CONTENTS

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Introduction

The priority of security interests in personal property has, in New Zealand, been governed by the Personal Property Securities Act 1999 since it came into effect on 1 May 2002. Like its Australian counterpart, the New Zealand Act was some time in the making. Reports as early as the 1970s criticised the unsatisfactory state of New Zealand's law in the area,[1] but the impetus that ultimately led to the statute was the wholesale review of New Zealand's company legislation in the mid 1980s. That review eventually led to the Law Commission's 1989 report.[2] It took a further decade for New Zealand to enact the statute proposed by the Law Commission.

Our statute is modelled on the Saskatchewan Personal Property Securities Act 1993, although the jurisprudence that has developed since has not been greatly influenced by Saskatchewan, or other Canadian, case law.

The Australian legislation, in turn, has borrowed from New Zealand's statute. The essential scheme of the Australian Act is the same as in the New Zealand statute. However, different and additional details in the Australian Act make it more complex in some aspects. It will be interesting to see the extent to which New Zealand decisions will be of relevance in the development of an Australian body of PPSA case law.

As our Supreme Court has recently confirmed, the PPSA introduced a fundamentally new system:

> *"The PPSA has introduced, in the place of the general law, an entirely new set of rules governing priorities in the case of an insolvency."* [3]

It took some time for the wider commercial community to get to grips with this new set of rules. Lessors and suppliers, for example, were often astounded to learn (usually at an inopportune time) that ownership was no longer the safeguard they thought it was. Attitudes initially varied amongst more professional users such as banks and insolvency practitioners, but over time it seems to have become generally recognised that the system provides certainty and simplicity. It is seen as helpful to have a single set of rules applying across the board.

The New Zealand Courts have responded well to the new Act. The cases have searched for, and developed, the principles and policies underpinning the new regime. They have generally applied the Act in a way that promotes the integrity of the PPSA regime, rather than being unduly swayed by sympathy for particular parties' unfortunate circumstances.

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1 See for example, SA Reisenfeld *The Quagmire of Chattels Security in New Zealand*, Occasional Paper No. 4, Legal Research Foundation, 1970, and *Chattels Securities, First Report of Contracts and Commercial Law Reform Committee* (September 1973), both of which criticised the existing legislation and recommended a single national register, but cautioned against the wholesale adoption of Article 9 of the US Uniform Commercial Code.

2 New Zealand Law Commission *A Personal Property Securities Act for New Zealand: Report No. 8* (NZLC R 8, April 1989).

3 *Stiassny & Ors v CIR* [2012] NZSC 106 at [49].

New Zealand's most recent textbook on the PPSA summed up the experience of the last decade well by saying that:

> *"Now that the unfamiliar concepts and strangeness have worn off, it is apparent that it is a well-knit piece of law, though not without its faults, which provides uniform rules that, in comparison to pre-PPSA law, operate and provide answers consistently and predictably."*[4]

Regrettably, the legislature has not responded as well. New Zealand's other statutes do not adopt or respond well to the new terms and concepts in the PPSA.

This paper will review New Zealand's PPSA experience first by noting some of the practices that have built up in relation to the documentation, registration and enforcement of security interests. Second, it will consider the nature and scale of the litigation that has led to New Zealand's court decisions. Lastly it will review the major issues that have arisen in the New Zealand cases, by reference to a number of major themes or issues.

Practice in New Zealand

Security documentation - financiers

At the turn of the millennium, New Zealand appeared not only to face the need to fix the Y2K bug, so that our computers would work in the new millennium, but also the need to fix our security instruments so that they would work in a post-PPSA world. New PPSA-appropriate forms were created and lawyers busily endeavoured to explain the new system to their clients.

In fact, New Zealand did not change its security instruments in a wholesale and immediate way. Other than to include some waivers by the debtor, of the right to receive certain notices and similar, it was not necessary. Rather, new forms were introduced slowly, as facilities were refinanced or amended and restated. Essentially, it was believed that old forms and documentation would continue to work successfully. The PPSA does not regulate the form required to create a security interest (other than the requirement that it be evidenced in writing or by possession). It regulates the relative priority of security interests.

One of the earliest New Zealand decisions confirmed that approach by ruling that a pre-PPSA debenture was no narrower in scope than a general security agreement drawn up with the PPSA firmly in mind.[5]

Fairly rapidly following the Act's introduction, new forms of security agreement became widely used for new lending. For personal property, the old legal classifications of charges and mortgages etc have all but disappeared. In their place, lenders will often seek merely a "security interest" on terms that are set out in the particular document. A financier will take either a general security interest, by a general security agreement ("GSA"), or a specific security interest, by a specific security agreement ("SSA"). Those abbreviations, as with "PMSI" (purchase money security interest), "ROT" (retention of title), "ALLPAAPP"

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4 L Widdup and L Mayne, *Personal Property Securities Act: A Conceptual Approach*, 3rd edition [LexisNexis NZ Limited, Wellington, 2013], at 4.

5 *Waller v NZ Bloodstock* [2006] 3 NZLR 629 (CA).

(all present and after-acquired personal property) and others have entered our commercial language.

Our new forms of security documentation do not generally refer to fixed or floating charges, or to circulating or revolving assets. In some GSAs, those terms will receive a mention in respect of assets that fall outside the PPSA. However, they are usually expressed more simply than in old-style debentures. The clause will provide that in respect of assets not covered by the PPSA, the debtor grants a charge which is of a fixed nature to the extent permissible, and is otherwise floating. A simple crystalisation clause will follow.

Security documentation – suppliers and lessors

Financial creditors, and in particular banks, responded well and promptly to the PPSA reform in New Zealand. As one might expect, they understand the system and protect themselves through appropriate documentation and registration.

Suppliers and lessors, being a larger and more diverse group, have struggled more with the new system. In the early years particularly, it was not uncommon for receivers to encounter suppliers of valuable inventory or equipment who were completely unaware of the Act's existence or requirements, and this is still encountered more frequently than might be hoped.

Suppliers who retained title often fell at the first hurdle, namely proof of the security agreement. New Zealand's statute requires that, where the secured creditor does not have possession, the security interests must be evidenced in writing, and in particular the debtor must sign or otherwise evidence their consent by writing.[6] Suppliers who relied on standard retention of title terms included in unsigned terms of trade were left without recourse to their goods, even where they had registered on the PPSR.

The New Zealand PPSA threshold is too high. The purpose of the provision is to prevent fraud by establishing a minimum evidential threshold for proof of the existence of a security agreement. Although a wholly oral GSA is unlikely to be credible, it is usually a simple exercise to establish whether unsigned, but written, terms of trade did in fact govern a long-standing supply arrangement. As between creditor and debtor, such a contract would be enforceable in New Zealand between the parties, but not as between a creditor and a third party.

Australia has adopted the same rule, but with an important further qualification.[7] Section 20 provides that the writing must either be signed by the grantor (note the special definition of "signed") or:

> *"Adopted or accepted by the grantor by an act, or omission, that reasonably appears to be done with the intention of adopting or accepting the writing".*

This development is, in this author's view, a very sensible one.

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6 NZ PPSA s 36.

7 Aust PPSA s 20.

Registration

It has always been understood in New Zealand that registration prior to completion of the security documentation is effective to establish priority, and recently that has been confirmed by the Court of Appeal.[8] Practice varies between financiers and banks as to whether registration occurs before the loan and security documentation is completed, but invariable practice is to ensure registration has been completed before drawdown.

Certainly for finance creditors, the starting point is a proper PPSR search. Prudent searchers will search against the debtor company, against its number and by way of a 'wild card' search (the first few letters of the name).

If a potential GSA creditor discovers an "ALLPAAPP" registration already on the register, or indeed anything broader than a retention of title registration, the proposed new creditor (assuming it is intending to rank above that registration) will seek to have the earlier registration removed or reduced in scope. It is not uncommon for suppliers or other holders of specific security interests to incorrectly register by ticking the ALLPAAPP box. An assurance from that creditor that it does not currently hold a GSA should be of no great comfort to the proposed new GSA creditor. Because registration can precede the creation of a security interest, that first-registered security holder could *later* obtain a wider security interest, which would then have priority over the second registered GSA, despite being entered into subsequently.

Retention of title suppliers usually register once, rather than in connection with each supply made. A well-advised supplier would therefore describe the collateral in the financing statement in terms sufficiently broad enough to capture all likely supplies of product.

Crucially, the supplier must also register in such a way as to perfect over *proceeds* of such supplies. There is some debate over how that is to be achieved. Is it enough, as many do, to tick the "All present and after-acquired property" box, with a further description along the lines of "being proceeds of collateral otherwise described in this financing statement"? Or must a more focussed attempt be made to identify the particular type of collateral that may comprise the proceeds?

Banks will often register multiple financing statements. A market practice has developed whereby banks will usually register their general and specific security interests separately.

Complications have arisen for many creditors in dealing with changes of names of debtors. Adverse priority results can follow if a creditor is aware of a name change, an amalgamation or a transfer of the collateral, but does not update its financing statement within 15 days of becoming aware of that change.

In order to release security interests, it is usual for parties to rely on a deed poll release. On an entire refinancing, the removal of the financing statement does not tend to be a settlement deliverable. Rather, the incoming financier will frequently rely on the undertaking to remove the financing statement within a reasonable period.

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8 *Healy Holmberg v Grant* [2012] 3 NZLR 614.

Where the bank's facility is to remain in place, but some or all of the debtor's assets are to be sold, banks would usually resist altering their financing statement in any way. Instead, where specifically required, they would execute a deed poll release making it clear that the assets in question had been released from the security interest.

A notable result of the PPSA in New Zealand has been the emergence of an industry (albeit small) whereby independent firms will manage PPSR registrations. Given the need not only to register in the first place, but to maintain and update registrations, significant users of the system (e.g. leasing companies) either need to develop or buy the capability to comply with the Act. Financiers of such entities will sometimes insist that a third party provider is retained, in order to reduce the risk that the security interests held by the debtor are prejudiced in any way.

Disputes

The priority rules in the PPSA are applied and tested in insolvency situations. Insolvency practitioners will, promptly upon appointment, search the PPSR and effectively create a small database of registered interests as at the time of their appointment. The High Court has recently confirmed that, as between competing interests, priority is to be determined at the point those competing interests come into conflict, which will usually be the time the insolvency practitioner is appointed (the case is discussed further below).[9]

Immediately after appointment, insolvency practitioners will typically ask creditors for, and systematically review, the documents that prove the existence of the security interest in question, the date of supply and the identification of the collateral. It remains surprising that many creditors are unable, promptly and comprehensively, to provide documents that explain the debt owed, prove the existence of the security agreement, show the link between the agreed terms and the collateral in question, and demonstrate that registration occurred in time for a PMSI to have priority above a prior GSA.

Often it is not enough to examine only the security agreement and registration. Evidence from other sources can, for example, be required to establish delivery dates (in the context of PMSI disputes), or serial numbers.

There can be significant practical difficulties in determining the various claimants' entitlements to inventory and receivables held by the company at liquidation or receivership. A retention of title creditor may hold a PMSI in inventory, and/or in a receivable, if the particular item in question was not paid for. If the item was paid for, the vendor will usually still have a security interest in it (if the vendor has a broad ROT clause). That security interest will not qualify as a PMSI, so will not enjoy super-priority. When these complications are combined with the statutory preference for certain creditors in accounts receivable and inventory,[10] it is easy to see how the process can become complicated for the insolvency practitioner. Two practices are therefore important:

- The insolvency practitioner needs accurate and detailed records of the precise state of the accounts receivable and inventory as at the date of appointment. The commonly

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9 *Gibbston Downs Wines v Perpetual Trust Limited* [2012] 2 NZLR 574.

10 Companies Act 1993, Schedule 7.

understood approach has recently been confirmed by the High Court for the first time.[11] That is, a receivable will only be available to preferential creditors if the "monetary obligation" was owed to the company at the time that the receivership or liquidation started. By analogy, the same must apply to inventory. Although the case is on its way to the Court of Appeal, the result on this point is in line with the pre-PPSA rules on the crystallisation of floating charges at the time that receivership starts so, in this author's view, ought not be overturned.

- Insolvency practitioners ought also to allow retention of title suppliers an opportunity to conduct a stock-take of the inventory held by the debtor upon appointment of the insolvency practitioner.[12]

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11 *Burns v Commissioner of Inland Revenue* (2011) 10 NZCLC 264,885.

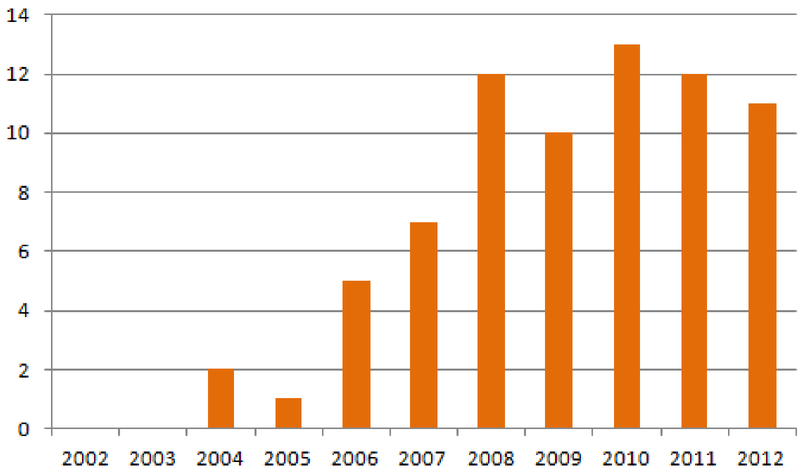
12 See *NZ Associated Refrigerated Food Distributors Ltd v Simpson* (unreported) 20 June 2008, Dobson J, HC Wellington, CIV-2007-485-1563; CIV-2005-485-1820 (HC), at [38], [39] and [61].

THE CASE LAW

It was nearly two years after the PPSA came into force that the first New Zealand judgment on the PPSA appeared. By the end of 2006, there were only eight decisions of substance. Seven followed the next year. Since 2008 there has been a fairly consistent number of decisions each year; between ten and thirteen. While this is not a great number, the cases have been on varied topics, and have identified and clarified both broad principle and technical detail.

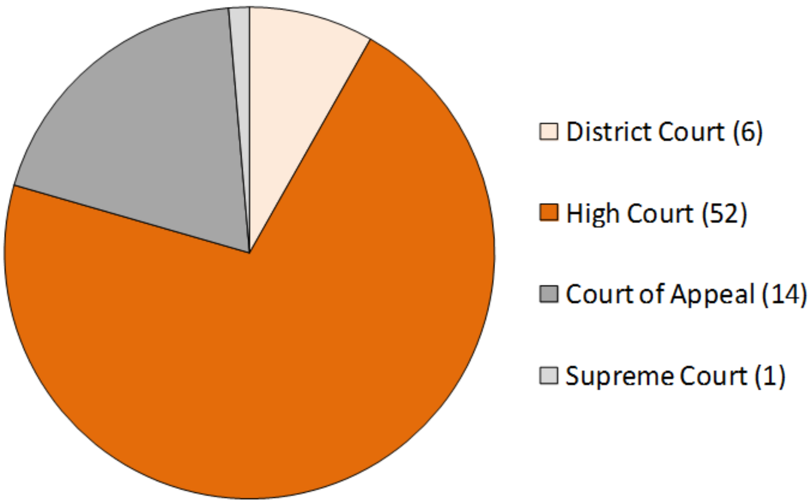
Having lived with the Act now for more than a decade, New Zealand has seen 73 judgments, arising out of 52 pieces of litigation, in which some significant discussion of the PPSA has featured.[13]

Judgments by Year:



[13] For a complete list of the cases see: https://extranet.chapmantripp.com/collaboration/Subweb188/default.aspx

Judgments by Court:



As mentioned earlier, the New Zealand Courts have, in general, applied the Act in a consistent manner, and in a way that promotes the integrity of the PPSA regime. An illustration of that consistency is the fact that, of the 13 substantive decisions of the Court of Appeal, appeals from the High Court were allowed only three times.[14] The Supreme Court has considered the Act only once, and upheld the Court of Appeal's decision.[15]

An interesting aspect of New Zealand's case law is the relative absence of reliance on Canadian and US authority and academic writing. Given that the regime is, as noted by the Supreme Court, "entirely new", and given that its only predecessors are in Canada and the United States, one might have expected to see a much greater reliance on precedent from those jurisdictions. Of the 13 substantive Court of Appeal decisions, only six referred to Canadian case law[16] and only four referred to Canadian academic texts or other papers.[17] The sole New Zealand Supreme Court decision referred to a number of Canadian cases, but relied on only one, despite being a decision that covers a variety of issues.[18] It also referred to a Canadian law reform commission report, and text.[19] No US authority or writings have been referred to in the New Zealand appellate decisions.

Finally, two features of the cases, as litigation, are notable. New Zealand clearly has a major primary sector economy; the property the subject of dispute in the cases has included racehorses, livestock, potatoes, wool, logging trucks, wine, timber and farming assets. Secondly, the names of the cases comprise a list of a large number of New Zealand's insolvency practitioners.[20] Clearly, it is in formal insolvency processes that the PPSA is applied and tested.

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14 *J S Brooksbank v EXFTX* (2009) 10 NZCLC 264,520; *Tubbs v Ruby 2005 Ltd* (2010) 9 NZBLC 103,051; *Commissioner of Inland Revenue v Stiassny* (2012) 11 NZCLC 98-002. The Court of Appeal did, however, disagree with the High Court's analysis on other occasions, without formally allowing the appeal. See for example *Healy Holmberg v Grant* [2012] 3 NZLR 614.

15 *Stiassny & Ors v CIR* [2012] NZSC 106.

16 *Waller v New Zealand Bloodstock* [2006] 3 NZLR 629; *Tubbs v Ruby 2005 Ltd* (2010) 9 NZBLC 103,051; *StockCo v Gibson* (2012) 11 NZCLC 98-010; *Rabobank NZ Ltd v McAnulty* [2011] 3 NZLR 192; *Commissioner of Inland Revenue v Stiassny* (2012) 11 NZCLC 98-002; *Marac Finance Limited v Greer* [2012] 2 NZLR 497.

17 *Waller v New Zealand Bloodstock* [2006] 3 NZLR 629; *Toll Logistics v McKay* [2011] 2 NZLR 601; *Rabobank NZ Ltd v McAnulty* [2011] 3 NZLR 192; *Commissioner of Inland Revenue v Stiassny* (2012) 11 NZCLC 98-002.

18 *Bank of Montreal v Innovation Credit Union* 2010 SCC 47, [2010] 3 SCR 3.

19 Law Reform Commission of Saskatchewan Proposals for a New Zealand Personal Property Security Act: Report to the Minister of Justice (Saskatoon, 1992); Ronald Cuming and Roderick Wood *Saskatchewan and Manitoba Personal Property Security Acts Handbook* (Carswell, Toronto, 1994).

20 Including Graham, Waller, Simpson, Dunphy, Fisk, Nicol, Downey, Stiassny, Hollis, Tubbs, McKay, Gibson, Grant, Burns, Reynolds and Noyce.

ESSENTIAL CONCEPTS

Of all the New Zealand cases, four stand out as explaining the fundamental design of New Zealand's PPSA regime. Four essential ideas have been explained:

- The scheme is an entirely new set of statutory rules,
- Title no longer determines priority,
- Order of registration, not perfection, determines priority, and
- The distinction between fixed and floating charges has gone.

The relevance of title

The first New Zealand cases upheld a central (and expressly stated) PPSA concept:

> *"The fact that title to collateral may be in the secured party rather than the debtor does not affect the application of any provision of this act relating to rights, obligations, and remedies."* [21]

Two cases each resolved a contest between an owner and a debenture-holder.[22] The location of title was irrelevant; what mattered was registration. The first to register won. Title was irrelevant because the contest was between two security interests. The owner of the collateral in each case had leased it to the debtor for a term of more than one year. In each case, ownership, being an interest in personal property, was a security interest.

The doctrine of *nemo dat quod non habet* (one cannot transfer a better interest in an asset than one holds) was very clearly no longer relevant in priority disputes between secured creditors. Title does not determine priority when the PPSA priority rules apply.[23] Suppliers and lessors were surprised to learn they could no longer rely on ownership.

In each of the *Portacom* and *Waller* cases, the debenture holder, having registered, had priority over the owner. Plainly, the debtor had not held title, so some lesser "rights in the collateral" held by the debtor had enabled the debenture holder's security interest to attach to the goods in question. The cases therefore confirmed that a security interest may include within its scope assets which the debtor does not own. It is essential to the design of the PPSA that title does not determine whether the debtor has sufficient rights in an asset to grant a security interest over it.

Some commentators have spent considerable time discussing the question of exactly what type of interest (held by the debtor in the collateral) is sufficient in order for a security interest to attach to that collateral. That debate is answering the wrong question in this writer's view. Any property interest is sufficient for the debtor to have "rights in the collateral" in terms of the New Zealand Act. That includes the right of possession. The

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[21] NZ PPSA s 24.

[22] *Graham v Portacom* [2004] 2 NZLR 528 (HC) and *Waller v NZ Bloodstock* [2006] 3 NZLR 629 (CA).

[23] In this context, the priority rules include the continuation and extinguishment rules, which in New Zealand are expressly described as priority rules; see Part 8 of the NZ PPSA.

real point is that in most cases the fact of attachment will be of no consequence. The competing interest will be pure ownership. That is, the owner's property interest (ownership) will not be a security interest. In that situation the PPSA priority rules do not apply. The result is that the security holder will have security in nothing more than the debtor's possessory right. The security interest in that situation cannot and does not defeat the true owner.

Such a situation occurred in the *J S Brooksbank* case.[24] A delivery by a supplier was made mistakenly, with the result that the supplier kept title and was entitled to demand return of the goods. Its ownership was not a security interest. The debtor's bank held a GSA, but the priority rules in the PPSA were not engaged, leaving the owner with the superior interest in the goods.

That was the result in the case, but in its discussion, the Court of Appeal made some questionable comments about whether the bank's security interest had attached.[25]

The Court of Appeal said that, while the bank clearly held a security interest, it had not attached to the wool. As the wool was not sold under the supply agreement but, rather, was mistakenly handed over by an agent of the owner, the debtor had no right of possession as against the owner. It followed, the Court believed, that the debtor had no "rights in the collateral" as required for attachment to occur under section 40.

The right to possession must be a right in the context of section 40. It is a property right. The debtor was entitled to retain possession as against the whole world, save for the owner. While the agent responsible for the mistaken delivery did not have the owner's authority to transfer possession, the agent nevertheless had lawful possession and had the ability lawfully to give possession to the debtor, which is precisely what occurred.

The Court of Appeal's finding that the bank's security interest had not attached runs contrary to leading academic commentary on the PPSA and Canadian law (upon which our Act is modelled). The leading New Zealand text, *Personal Property Securities in New Zealand*, summarises the generally understood position neatly:[26]

> *A debtor in possession of goods belonging to another has, by virtue of its possessory interest, sufficient rights to grant a security interest in the goods. However, the secured party obtains only a security interest in the defeasible possessory title of the debtor, which, although effective against any stranger, is not effective against the true owner. Therefore, the true owner enjoys priority over the secured party.*

In the writer's view, the Court of Appeal should have held that, although the bank had a perfected security interest, that interest was merely in the debtor's possessory title.

It must be correct that any property right, held by the debtor, will allow attachment to occur. The Court of Appeal's comments in this paragraph (which are not binding) conflict

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24 *J S Brooksbank v EXFTX* (2009) 10 NZCLC 264,520.

25 Paragraph 55 of the judgment.

26 M Gedye, RCC Cuming QC and RJ Wood, *Personal Property Securities In New Zealand* (Brookers Ltd, Wellington, 2002) at [40.3.1].

with the very firm rejection of the *nemo dat* principle set out by the Court of Appeal in *Waller v NZ Bloodstock Ltd.*[27]

First to register has priority – not first to perfect

More recently, the Court of Appeal has made it very clear that, as between competing registered security interests, the Act determines priority according to the order of registration, not the order of perfection.[28]

The High Court had been concerned that injustice would result if that rule applied. A creditor who registered on the PPSR early, but without completing its security agreement, could get priority over a creditor who was first to complete its security agreement, but who registered second. The High Court therefore treated section 36 (the requirement for a security agreement to be in writing etc), as a priority rule that prevailed over the default priority rule in section 66 (first to register wins). That analysis was promptly criticised.[29]

The Court of Appeal disagreed with the High Court, in part because of the plain wording of section 36. On its face, section 36 does not deal with priority. Further, the High Court's approach would compromise "the predictability and simplicity of the PPSA regime". The Court of Appeal was concerned that a "first to perfect" priority rule:

> *"would mean that a search of the register would not provide an answer in a priority dispute, and there would then need to be the obtaining of evidence from the parties as to the exact time at which the steps necessary to perfect the security interest took place."*

A "first to register" rule is much more workable. As the Court pointed out, it gives clarity to secured creditors by enabling them to search the register, understand immediately their relative priority position and make an informed decision before committing themselves to providing credit.

The scheme is statutory in nature – the floating charge is gone

The Supreme Court, in its first PPSA decision, has recently clarified some fundamental aspects of the regime.[30] In particular, all security interests are fixed in nature, and assets are permitted to circulate by operation of the statutory rules.

The case concerned a priority dispute over part of the sale proceeds of a forest. The receivers had arranged the sale, and had remitted the GST portion of the proceeds to the Commissioner. In the proceeding, the receivers' appointing creditors argued that their security interest should prevail over the Commissioner's claim to the funds, as the Commissioner was an unsecured creditor. In effect, they said he had received their money. When the taxpayer had received the sale proceeds, it had held them for the secured creditors, as bare trustee only.

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27 *Waller v NZ Bloodstock* [2006] 3 NZLR 629 (CA); see also the very clear explanation of this aspect of the PPSA in paragraphs 44-46 of *Stiassny v Dunedin City Council*; 30 May 2008, Winkelmann J, HC Auckland, CIV-2007-404-3463 (HC).

28 *Healy Holmberg v Grant* [2012] 3 NZLR 614.

29 Professor Gedye "First to Perfect?" [2011] NZLJ 123.

30 *Stiassny v Commissioner of Inland Revenue* [2012] NZSC 16.

The Supreme Court disagreed. The creditors could not rely on any common law or equitable interests to resolve the priority dispute. Under the PPSA regime, the priority of a security interest, and the secured creditor's entitlements arising from it, depend entirely on the rules in the statute. Common law notions of title, equitable notions of beneficial interest and the equity of redemption are simply not relevant. Instead:

> *"Any secured creditor simply has a security interest whose priority depends upon the rules".*

That is, key attributes of any security interest are now prescribed by the statute. By operation of the Act, all PPSA security interests are, at all times, fixed in nature, even where they cover circulating assets. This had been widely assumed but it is helpful to have Supreme Court confirmation, particularly as it represents a departure from the former regime of fixed and floating charges.

It is for this reason that section 95 is necessary. It gives priority to a creditor who receives payment of a debt through a "debtor-initiated payment". The absence of such a rule could result in a (fixed) security interest continuing in funds after they had been used to pay an ordinary business debt. That would have a "suffocating effect" on debtors' businesses. The Court considered it would be highly unlikely that creditors would accept encumbered funds as payment of a debt if not for section 95.

The same analysis applies to section 94, which allows for the free circulation of money (being notes and coins only, for the purposes of the Act). Sections 94 and 95 (and others) are a replacement for the rules that allowed assets to circulate under a floating charge, before its crystallisation.

Between them, the *Portacom*, *Waller*, *Healy Holmberg* and *Stiassny* decisions have confirmed the basic structure of the PPSA in New Zealand. Substance matters over form, ownership is not required for a debtor to be able to grant a security interest and all security interests are fixed in nature. Above all, the time of registration,[31] and not title or any other pre-PPSA property law concept, determines priority when the Act applies.

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[31] Or the time of possession where perfection is by possession.

WHAT IS PERSONAL PROPERTY?

A difficult issue encountered often in practice, but which is not yet the subject of comprehensive judicial discussion in New Zealand, is the dividing line between real and personal property for the purposes of the PPSA. Put another way, in what circumstances does a connection to land take property out of the scope of the PPSA?

Two cases have dealt with this issue.

Crops

The first examined whether interests in certain crops were governed by the Act. In *Fisk v Grace*,[32] the bank held a GSA over the company that had planted the crops. At the time, the company leased the land from the owner. Both the bank and the owner claimed the better right to the crops growing in the land. For the Judge, the "fundamental question" was "whether the crops … are chattels or part of the land". If they were chattels, then they belonged to the company and the bank had first-ranking priority under its security. If they were part of the land, they fell outside of the scope of the bank's security, as it obviously had no security over the land.

His Honour came to the view that crops in the ground form part of the land. It followed that any security interest the bank had in the unplanted seeds disappeared as the seeds themselves became annexed to the land.[33]

The judgment does not contain a complete analysis of the PPSA provisions relevant to a competition between a security interest in crops and a lessor's interest in the land. In particular, the Judge did not refer to sections 51 and 101 of the PPSA. When read together, those sections, and section 100, establish a scheme that does not destroy personal property security interests in seeds when they are planted and thus become part of the land. A perfected security interest in crops is not defeated by a subsequent sale, lease, mortgage etc of the land in which the crops are growing: section 101. Where the security in the crops is perfected after the lease or mortgage rights are created, then those lease or mortgage will prevail over the perfected security interest, unless the lessor or mortgagee consents in writing to the creation of the security interest: section 100.

These rules represent a statutory exception to the usual indefeasibility of title under the Land Transfer Act.

Rental

Section 23 of the PPSA provides that the Act does not apply to interests created or provided for by:

- the creation or transfer of interests in land, or
- the transfer of a right to payment arising in connection with an interest in land.

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32 *Fisk & Anor (liquidators of Whaitiri Potato Company Ltd (in liq)) v CR Grace Ltd & Ors* (2008) 10 NZCPR 12.

33 Much of the case concerns the doctrine of emblements, being a rule that allows tenants to return to land to harvest their crops, but the doctrine did not apply in this case.

The latter of those provisions was considered by the Court of Appeal in *Marac Finance v Greer*.[34] A receiver appointed by a lender with a mortgage over land had received rental from the land. Another lender held a GSA, which was registered on the PPSR ahead of the mortgagee. Was priority governed by the PPSA?

The parties agreed that rental, being a contractual right to receive payment, was personal property. The question was whether the above provisions excluded the mortgagee's interest in that personal property from the reach of the Act.

The Court agreed with the mortgagee that, as assignee of the rental under an express clause to that effect in the mortgage, the mortgagee's interest had been created by "the transfer of a right to payment arising in connection with an interest in land", such that section 23(e)(ii) applied. In explaining its decision, the Court commented:

> *"The ability of a mortgagee to get the rent in the event of a default by the mortgagor is an important aspect of the funding of tenanted properties. If the land mortgagee does not have a first ranking PPSA security interest it will have to enter into a complex priority arrangement with the prior PPSA security interest holder. All that adds complexity to the transaction which, in turn, may lead to an increased cost of funds for the debtor.*
>
> *"We are satisfied that, where the right to rental passes from the mortgagor to a mortgagee as a result of a mortgage agreement, that should be a transfer for the purposes of s 23(e)(ii). To do otherwise would be to dissect unnecessarily constituent parts of the mortgage and subject them to different statutory regimes."*

The Court did not go on to analyse whether a mortgage that did not contain an express assignment would yield the same result.

Copyright

It was argued, in the *Viacom* case,[35] that copyright was not personal property covered by the Act. A supplier of DVDs, which had retained title pending payment, had failed to register on the PPSR, so needed another basis to argue for the first-ranking interest. In the result, the supplier lost to the bank's interest under a registered security. The bank's receivers would not breach copyright by selling the collateral. If the sale of the DVDs breached a licence agreement between the parties, that would be a contractual matter between supplier and purchaser.

34 *Marac Finance Limited v Greer* [2012] 2 NZLR 497 (CA).

35 *Viacom Global (Netherlands) B.V. v Scene 1 Entertainment Ltd (in Receivership)* (unreported) 18 September 2009, Andrews J, HC Auckland, CIV 2009-404-4305 (HC).

WHAT IS A SECURITY INTEREST?

A security interest is first and foremost an interest in personal property. The law of property is therefore vital to an understanding of the PPSA. Transactions must first be analysed in terms of orthodox property law in order to understand the property interests involved. Only then can those interests be examined in order to determine whether they are, for example, security interests such that the Act applies.

Retention of title

The orthodox law of property applies to determine whether a party has an interest in the collateral. In *Segard Masurel v Nicol,*[36] the High Court applied the Sale of Goods Act to determine that the seller had passed title, and therefore no longer held an interest in the goods. It therefore did not hold a security interest, despite being an unpaid vendor under a contract that required payment before delivery (delivery in fact having been made).

It will be a rare case where the supplier parts with possession, retains title, does not register and yet prevails over the GSA creditor. A second case arising out of the same receivership was one such rare case. The facts of *JS Brooksbank & Co v EXFTX Ltd*[37] are, at one level, very similar to *Segard Masurel*. JSB supplied wool under a cash on delivery arrangement, albeit more strictly worded than in the earlier case. The agreement expressly provided that title would pass (and delivery would be made) upon payment in cleared funds. Prior to the receivership, a delivery was made without payment having been made. The Feltex receivers argued that JSB had not registered so lost out to the bank, which had registered.

The Court of Appeal disagreed. It said that the cash on delivery clause was not intended to operate as a retention of title clause as generally understood. The substantive purpose of the agreement about title was not to secure payment. Rather, it was “specifically formulated to prevent JSB from having any credit exposure to Feltex”.

The crucial factual difference between this case and *Segard Masurel* is that, in *JS Brooksbank*, JSB itself had not intended to deliver the wool. Rather, a broker on its behalf had mistakenly dispatched the wool to Feltex, the employee concerned not appreciating that she needed to check that cleared funds had been paid prior to delivery. Because of that mistake, JSB had not agreed or intended to transfer title in the wool to Feltex, so it remained the owner. Its claim in conversion succeeded (against the company in receivership and the receivers), and ANZ’s GSA was irrelevant.

The key to the decision is that JSB’s ownership did not amount to a security interest. As a mere (or “true”) owner, it was simply not subject to the PPSA priority rules.

Title therefore remains relevant. The law of personal property also remains relevant. It is the underlying foundation on which the PPSA is built.[38]

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[36] (2008) 10 NZCLC 264,386 (HC).

[37] (2009) 10 NZCLC 264,520 (CA).

[38] The Sale of Goods Act will also be relevant to determine whether a buyer (from the debtor) has acquired an interest in the collateral which is protected by s 53. Other aspects of non-PPSA

Trusts

Three New Zealand decisions have held that a trust can, but won't always, constitute a security interest.

In *Stiassny v North Shore City Council*,[39] the High Court decided that a trust relationship could indeed amount to an "in substance" security interest, depending on the purpose of the transaction, the role and relationship of the parties, the practicality and commercial reality, and the parties' intentions. An implied trust (a resulting or constructive trust) would fall outside the scope of the PPSA,[40] but an express trust could, in certain circumstances, fall within the definition of security interest. A similar case in the High Court, arising from the same receivership, reached the same conclusion. [41]

The Court of Appeal agreed.[42] The key factor that rendered a trust a security interest was the nature of the obligations. Where the trust obligations were the only obligation owed by the trustee (such as in an orthodox family trust), no security interest was created. Where the trust obligations existed to ensure performance of some separate obligation, the beneficiary of those obligations would hold a security interest.

Liens

It is now clear that a contractual lien is a security interest under the PPSA. As a result, the priority of a contractual lien relative to other security interests will be determined according to the priority rules under the PPSR and the contractual lien will obtain priority according to the date of registration or possession.

The Court of Appeal has confirmed that section 93 of the PPSA gives special priority to common law and statutory liens ahead of security interests governed by the PPSA.[43] Contractual liens will not gain special priority under section 93. To obtain special priority under section 93:

- the materials or services must have been provided in the ordinary course of the lien holder's business, and
- the lien's priority must not be negated by any statute, and
- the lien holder must not have known, at the time materials or services were provided, that a competing security agreement prohibited the debtor from creating a lien.

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property law are also relevant and important, such as the law of conversion, which the NZ courts accept is a claim available to the holder of a security interest: *Harvestpro v Logging CordyLine* (unreported) Doogue AJ, HC Auckland, CIV-2006-404-3107. Also, the common law and equitable rules of tracing are important in order to understand the concept of proceeds; an essential part of the structure of the PPSA: *The PPSA and the Common Law,* A Duggan (2005) 11 NZBLQ 122.

39 *Stiassny v North Shore City Council* [2008] 1 NZLR 825 (HC).

40 Section 23(b) excludes from the Act interests in personal property created "by operation of any rule of law".

41 *Stiassny v Dunedin City Council*, (unreported) 30 May 2008, Winkelmann J, HC Auckland, CIV-2007-404-3463 (HC).

42 *Stiassny v North Shore City Council* [2009] 1 NZLR 342 (CA).

43 *McKay v Toll Logistics* [2011] 2 NZLR 601 (CA).

Often, statutory, common law and contractual liens may arise together. In these circumstances, it will be necessary to determine which lien can be relied upon by the party in possession of goods.

In *Toll Logistics* the Court of Appeal confirmed that a party may not be able to claim a common law lien where they have contracted for a lien on different terms. It will be necessary to consider whether the contractual lien and the common law lien are sufficiently at odds to warrant the exclusion of the common law lien. Where there is a sufficient inconsistency between the liens, the lien holder will not be able to rely on a common law lien. The lien holder will not be able to take advantage of section 93 of the PPSA and will be required to rely only on the contractual lien.

It is less clear whether the presence of a contractual lien will negate an inconsistent *statutory* lien (as opposed to a common law lien). The Court of Appeal was not required to consider this point in the Toll Logistics case.

Bailments

For some time, it was uncertain whether all bailments for more than a year were deemed to be security interests. In many cases, there either is no payment for the use of the goods (the goods are merely loaned as part of a wider commercial relationship), or the payment flows the other way (the person in possession is paid a fee for looking after the goods).

In *Rabobank New Zealand v McAnulty,*[44] the Court of Appeal confirmed that bailments of more than one year will qualify as security interests under the PPSA only if the person in possession makes a "payment for the use of the goods". It is not enough that the owner is going to profit from the wider transaction.

According to the Court, the policy reason for treating leases of more than one year as security interests is that it is otherwise too difficult to distinguish between operating and finance leases. Instead, Parliament set out a clear, albeit arbitrary, distinction. If a lease is, or could be, longer than one year, it is caught by the PPSA. There is no need for gratuitous bailments to be drawn into that net, as they could not possibly be confused for finance leases. So bailments where there is no rent or similar payment for the use of the goods are not security interests under the PPSA.

This means that New Zealand's PPSA is consistent with the Australian Act, which makes the same point expressly:

> "*This section only applies to a bailment for which the bailee provides value*".

44 [2011] 3 NZLR 192.

ENFORCEABILITY IN LIQUIDATION

Vesting upon liquidation and bankruptcy

A significant difference between the New Zealand and Australian regimes is the treatment of unperfected security interests on the bankruptcy or liquidation of the debtor.

With some very limited exceptions, unperfected security interests will, in Australia, vest in the grantor upon bankruptcy and liquidation. They are, in effect, cancelled. They are ineffective against trustees in bankruptcy and liquidators. That conforms to most PPSA jurisdictions around the world, and reflects the position in New Zealand prior to the PPSA, but only in respect of certain charges. Significantly, ROT creditors and lessors did not have any registration obligation in New Zealand prior to the PPSA coming into effect.

New Zealand has adopted the opposite policy. Unperfected security interests are effective in bankruptcy and liquidation. That policy is not limited to the PPSA; the Companies Act also no longer contains a requirement that charges be registered. In New Zealand, lack of registration affects priority, not validity. In other words, the purpose of the register is to provide information to other potential and actual creditors. It is not, in itself, an evidential foundation for the security interests registered on it.

This policy does not seem to have led to any widespread concern amongst those who apply the PPSA on a daily basis.

Is the liquidator a "third party"?

The evidential requirement in New Zealand is merely the requirement that a security agreement be evidenced in writing in order that it be "*enforceable against a third party".*[45]

In *Re King Robb Limited*,[46] the question arose whether a liquidator was a "third party". Both the High Court and Court of Appeal held that, because in orthodox company law the liquidator acts as the agent of the company, the liquidator was not a third party. The liquidator is a mere agent of the debtor. Accordingly, an unsigned, or even unwritten, security agreement will be enforceable against a liquidator.

As a matter of interpretation of the existing statute, that conclusion is undoubtedly correct. As a matter of policy, it does seem wrong. The liquidator, after all, is primarily tasked with recovering assets for unsecured creditors. If an unsecured creditor were to execute a judgment against assets secured by an unsigned security agreement, the execution process would be unaffected and the unsecured creditor could seize the asset. The opposite effect occurs in a liquidation, despite the fact that the same asset is being realised for the benefit of the same unsecured creditors. Further, the position in liquidation appears to be the opposite of the position in bankruptcy. In bankruptcy, the Official Assignee is not the agent of the bankrupt, so must be a third party. That must be an unintended distinction. Nevertheless, until the PPSA is amended, *Re King Robb Limited* clearly remains the law.

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45 NZ PPSA s 36.

46 (2006) 2 NZCCLR 959 (HC) and [2007] 3 NZLR 802 (CA).

New Zealand officials did at one stage recommend changing the Act to deem liquidators to be third parties, but no amendment has yet been made.

This issue is likely to matter less in Australia, due to the vesting rules (discussed above).

REGISTRATION

Overly broad is not misleading

The test of whether a financing statement is seriously misleading is an objective one, which does not depend on a specific searcher in fact being misled.[47] Given the purpose of the register, whether a financing statement is misleading depends on whether it can be found. It is not misleading, for example, for the collateral to be described in unduly broad terms.[48] In *Re Service Foods* the financing statement described the goods subject to the security interest as "all present and after acquired property". In fact that was wrong. Only specific goods were subject to the security interest. The financing statement was held not to be seriously misleading and was therefore not invalid under section 149.

The purpose of the register is to alert potential secured parties and transferees as to the possible existence of other security interests. Registration does not create or confirm a security interest. It is merely notification of a *claim* to a security interest. It may or may not be accurate. Any person searching the register can then seek more information from registered secured parties as to the exact nature and scope of their claimed interests.

It follows that it is the *absence* of a registration that prospective secured creditors rely on. If that premise is accepted then, as the New Zealand Courts have explained,[49] over-stating the nature or scope of a security interest, in a financing statement, should not cause the financing statement to be invalid. The problem that the rules (against defective financing statements) address is the risk that a search will not *find* the registration, not that the searcher will find one that is broader than the actual interest.

That policy is contrary to the Australian provision which renders misleading, and therefore ineffective, a financing statement that claims a PMSI, when the interest is not a PMSI.[50] New Zealand does not have a corresponding provision, so it will be interesting to see how the judicial approaches to accuracy in registrations develop in each jurisdiction.

Is registration after enforcement effective?

Following appointment of a receiver, other creditors will ask the receiver to hand over goods and other collateral. Discussions will commence and, in the early days, both parties will be busy trying to obtain information and work out their respective legal entitlements. If, at that time, a party realises it has failed to register, or that its registration contains an error, can that party register on the PPSR in order to improve its position? A common example is in respect of vehicles. Banks will not usually include serial numbers when registering their GSAs but, on receivership, the receivers will want to take vehicles for the bank's benefit if they are available. If the receivers realise that the PMSI supplier of the vehicles has also failed to register, or has registered incorrectly, can the receivers obtain an advantage by having their appointor register and obtain priority, even though that occurs after the receivers' appointment and while they are busy debating priorities with the PMSI creditor?

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47 NZ PPSA s 151.

48 *Re Service Foods: Simpson v New Zealand Associated Refrigerated Food Distributors Limited* [2007] 2 NZLR 130 (CA).

49 *Re Service Foods* at [29].

50 Aust PPSA s 164(1)(b) and s 165(c).

The PPSA itself is silent on the issue, save for providing that a financing statement may be registered before or after the agreement is made, and before or after attachment.[51]

This was perhaps the most-discussed unresolved issue in New Zealand until the High Court ruled, in 2012, that priority between competing security is to be assessed at the time those interests come into conflict.[52] This will usually, but not always, be when receivers are appointed. The point at which the conflict arises will be a question of fact in each case, with the central focus being on the security agreement between creditor and debtor.

Most practitioners prior to that decision had assumed that to be the case, relying on a Canadian decision in the *Sperry* case.[53]

The New Zealand decision is subject to an appeal, although the case has not yet been heard by the Court of Appeal and it is not clear whether or when it will proceed to hearing. The decision in the High Court was, strictly, not binding as it was not essential to the result. Its conclusion on this point is not universally accepted, and amounts to the Courts reading into the Act a restriction not expressly contained in it. It may be, therefore, that the High Court's decision is not the end of the matter in New Zealand. Creditors, in deciding whether to correct a registration after a receivership or similar, may be wise to not rely on the ruling completely at this stage. The prudent advice in that situation may still be to register and ask questions later. There is no downside to registration beyond the modest cost.

Again, the position will be a little different in Australia, due to the vesting rules. It will not be possible to correct a registration after liquidation, but the above issue will arise in receiverships. Indeed it will be more acute in one sense. The appointment of receivers does not result in the vesting (or forfeiting) of an unperfected security interest. There will be a real commercial need to perfect prior to a later liquidation, so as to avoid the vesting rules applying.

Detailed evidence may be required to determine whether a name is misleading

The New Zealand High Court, in *Rabobank New Zealand Limited v StockCo Limited,* declined to give summary judgment, because the secured party's financing statement was arguably seriously misleading.[54] StockCo had registered against "AM & MJ Campbell" as partners. It had not been aware of a formal partnership deed stating "Awapapa Station" as the partnership name. In the Court's view, it was arguable that StockCo's failure to register the correct partnership name would have prevented a "reasonable searcher" from finding any relevant registered financing statements.

The case went to trial where the opposite result was achieved. On closer analysis of the facts, including production to the Court of bank statements, invoices, correspondence and

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51 NZ PPSA s 146.

52 *Gibbston Downs Wines Ltd v Perpetual Trust Ltd* [2012] NZHC 1022 at [48].

53 *Sperry Inc v Canadian Imperial Bank of Commerce and Thorne Riddell Inc* (1985) 17 DLR (4th) 236, PPSAC 314.

54 *Rabobank New Zealand Ltd v StockCo Ltd* (unreported) 17 February 2010, Associate Judge Gendall, HC Napier, CIV-2009-441-207 (HC).

other material showing how the business described itself, the Court found that the name on the financing statement was in fact a name of the business so was not misleading. The partnership name had not been used by the partnership.[55]

The case demonstrates the importance of checking all documents when taking security over a partnership's assets. A cautious approach is needed such that multiple names should be included in the financing statement where there is doubt. Presumably, the same logic would apply to trusts.

It is surprising that, even in respect of companies where names are very easily checked, many financing statements are registered in New Zealand against incorrect company names. The risk of misstatement of company names in Australia may be a little lower due to the structure of the relevant section, and the wider use of company and business numbers.

55 *Rabobank New Zealand Ltd v StockCo Ltd* (unreported) 11 March 2011, Simon France J, HC Napier, CIV-2009-441-207 (HC).

CONTROVERSIAL DEFINITIONS

Ordinary course of business

Under the New Zealand Act, a buyer takes goods free of a perfected security interest where goods are sold in the seller's "ordinary course of business", and the purchaser is not aware that the sale is in breach of a security agreement.[56] This is one of a number of provisions in the PPSA designed to allow assets to circulate, yet be available as security. It will be discussed in more detail elsewhere in this conference.

The exact meaning of "ordinary course of business" has been litigated in a number of cases, many of them concerning transactions in which assets were moved to related parties, but outside the charging group. In some cases, such transactions have, due to their repeated and routine nature, been effective to transfer the collateral free of the security interest. They key to those outcomes seems to have been the long history of such trading, a business reason for the practice, and the exchange of fair, and real, value.[57]

The Court of Appeal has emphasised the factual nature of the relevant enquiry.[58] The test is wholly objective: that it asks what the seller's business actually was at the time of sale, not what the customer or the lender thought. Determining whether a transaction was within the seller's ordinary business requires reference to all the factual circumstances, including the purpose of the transaction, whether the transaction was of an isolated type, and whether the sale was part of a wider transaction that was out of the ordinary.

Account receivable

Another problematic phrase in the Act is "account receivable". It is of particular importance in New Zealand as preferential creditors are payable from accounts receivable and inventory. In 2008, the High Court held it to have a very narrow meaning, restricting it to trade debts, or book debts.[59] Later, another High Court Judge adopted a much broader interpretation of "account receivable".[60] Essentially, any monetary obligation will be an account receivable.[61]

That later decision is under appeal, with the hearing yet to be held, but it is submitted that the broader view is correct. First, the broader definition is more consistent with the words of the statute.

Secondly, historically, preferential creditors had priority over secured claims in respect of "floating charge assets". Those were typically book debts and stock in trade, but were not limited to those categories. The PPSA has created a unitary concept of a "security interest", eliminating the need for a distinction between fixed and floating charges. All

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56 NZ PPSA s 53.

57 See *New Zealand Associated Refrigerated Food Distributors Ltd v Donley* (2010) 10 NZCLC 264,626 (HC); *Tubbs v Ruby 2005 Ltd* (unreported) 26 February 2010, French J, HC Timaru, CIV-2009-476-615 (HC); [2010] NZCA 353 (CA); [2011] 3 NZLR 551 (HC); *Nichibo v Lucich* [2011] NZCCLR 31 (HC); *Swindle v Matakana Estate Ltd (in liquidation)* [2012] 1 NZLR 806 (HC).

58 *StockCo v Gibson* (2012) 11 NZCLC 98-010 (CA).

59 *Commissioner of Inland Revenue v North Shore Taverns Ltd (in liq)* (2009) 10 NZCLC 264,429 (HC).

60 *Burns v Commissioner of Inland Revenue* (2011) 10 NZCLC 264,885 (HC).

61 That interpretation may not be permissible under the narrower Australian definition.

security interests are now statutory fixed charges, including those over circulating assets. The concept of accounts receivable and inventory was intended to be a practical approximation for the former floating charge assets.

UNRESOLVED ISSUES

To conclude, although the Courts in New Zealand have analysed the PPSA in some depth, with helpful and thoughtful judgments, there are a number of issues not yet fully resolved. They include:

- Whether an account receivable does include *any* monetary obligation, or has some narrower meaning,
- Whether it is effective to register on the PPSR after a receivership or other enforcement event,
- How the PPSA resolves a priority dispute between unperfected security interests which attached simultaneously (eg where a GSA is in place prior to the supply of a vehicle and neither creditor registers with the correct serial number), and whether that is a question ever likely to arise given the answer to the previous question,
- Whether a mortgage of land, containing no express assignment of rental, creates an interest in land that is governed by the PPSA priority rules,
- More generally, where exactly is the dividing line between assets or interests governed by the PPSA, and those with a sufficient connection with land that they fall outside the Act?
- Whether a financing statement, containing the correct legal name of partners or trustees, can be seriously misleading on the grounds that the commonly used name for the partnership or trust is different,
- What form of financing statement is required to perfect an interest in proceeds of collateral?

There will, no doubt, be many more. The next ten years of PPSA litigation in New Zealand is hardly likely to be less interesting than the last decade.

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