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Secured Transactions Law Reform, Priorities and the Nature of a Security Interest

Duncan Sheehan[*]

Bio:

I am Professor of Business Law at the University of Leeds, having joined in 2016 from the University of East Anglia.

[*] Professor of Business Law, University of Leeds; School of Law, University of Leeds, Leeds, LS2 9JT; d.k.sheehan@leeds.ac.uk; 0113 3439936

Abstract:

While Government interest is lacking in reforming the English law of secured transactions, there is interest in the academic and practitioner community in different models of reform. This paper examines what type of security interest a statutory security right along the lines of the Personal Property Security Act interest would be. It seems that such an interest would be common law right, but also a charge and resembles most closely a legal version of the floating charge. The paper examines some of the implications of that characterisation as regards priority vis-à-vis interests outside of the statutory regime, and the scope for the retention and use of equitable doctrines such as marshalling. It also compares the situation to that under the City of London Law Society's proposed Secured Transactions Code.

Key Words:

Secured Transactions Law Reform; Floating Charges; Marshalling; Legal Charges; Priority

There has been interest recently amongst academics and some practitioners in reforming the English law of personal property security. The Secured Transactions Law Reform Project has both academic and practitioner members, and the City of London Law Society, assisted by a working group of academics and practitioners, published its second draft Secured Transactions Code in July 2016. In 2013 amendments were enacted – via secondary legislation[1] – to the Companies Act 2006. Amongst other things, the general rule is now that all security interests created by companies should be registered.

Some, however, still question whether we ought to enact further reforming legislation, along the lines of the Personal Property Security Acts (PPSAs)[2] found in some commonwealth jurisdictions. That model provides a code as to the secured transactions regime and would involve a unitary security interest, existing in all circumstances where a property right in substance secures discharge of an obligation.[3] This would involve re-characterising a retention of title clause, for instance, as a security interest granted by the debtor. The City of London Law Society, whose project in this area is headed by Richard Calnan, however, have a very different scheme in mind. They reject re-characterisation of title retention devices as security interests,[4] and a choice would need to be made between these two models. It seems, however, there is little political will for further reform. BEIS have for instance indicated an unwillingness to set up or oversee any new register. That required a rethink of the Law Commission's proposals for reform in bills of sale; the latest proposals from the Government in implementing the Law Commission's recommendations therefore involve a reformed electronic register

[1] Companies Act (Amendment of Part 25) Regulations 2013
[2] PPSAs exist in New Zealand, Australia and all Canadian provinces except for Quebec; reform has also been enacted in Jersey and along different non-PPSA lines in the Republic of Ireland
[3] eg Personal Property Securities Act 2009 (Cth) s 12(1)
[4] R Calnan 'What Makes a Good Law of Security?' in F Dahan (ed), Research Handbook on Secured Finance in Commercial Transactions (Edward Elgar, 2015) 451, 471

remaining at the High Court.[5] This unwillingness to countenance a new register suggests that comprehensive secured transactions law reform is a long way off, but the process of understanding our options still remains important.

Elsewhere I explore the implications for nemo dat of registration of retention of title clauses and suggest that the logic of registration trumps that of re-characterisation by inevitably compromising the creditors' ownership of the retained goods.[6] This shorter paper attempts something else. We examine the juridical nature of a security interest under a Personal Property Security Act. As a shorthand, although an ugly one, we will refer to interests not covered by a PPSA or secured transactions code as "non-codal" interests. The implications of the juridical nature of a PPSA interest can be illustrated by the effect on the priority between registered interests and interests that lie outside the scope of the Act. We also examine the relevance of general priority doctrines such as marshalling within the PPSA system. Marshalling will likely be of relevance both where the PPSA interest is ranked against another such interest and where it is ranked against a non-codal interest. In fact, because of the enhanced priority ranking we suggest is appropriate for a PPSA interest, the doctrine could be used relatively more. These questions must be explored as a complete priorities code contained in a PPSA is impossible.[7]

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[5] Law Commission, Bills of Sale (Law Comm no 369, 2016), Law Commission, Goods Mortgages Bill: A Response to the Consultation and Update on the Current Draft Bill (2017); the department's unwillingness to set up or designate a registry was a point made by the BEIS representative at the January 2017 conference on Secured Transactions Law Reform. For final proposals see HM Treasury, Goods Mortgages Bill: A Consultation (2017) https://www.gov.uk/government/consultations/goods-mortgages-bill/goods-mortgages-bill-consultation#approach-to-registration (visited 25 September 2017); Goods Mortgages Bill 2017, cl 9.

[6] D Sheehan 'Registration, Re-Characterisation of Quasi-Security and the Nemo Dat Rules' [2018] Journal of Business Law forthcoming

[7] N Mirzai 'The Persistence of Equitable Doctrine in Priority rules in Personal Property Security law: Assessing the Impact of the Personal Property Securities Act 2009 (Cth)' (2011) 28 Journal of Banking and Financial Law and Practice 3, 16; RJ Wood 'Supplementing PPSA Priorities: The Use and Abuse of Common Law and Equitable Principles' (2014) 56 Canadian Business Law Journal 31, 35

The earlier paper identified two models of registration – the first was the unitary model and the second the registration-only model. The unitary model, we have outlined already. All interests with a security function are treated alike. The registration-only model was exemplified by Quebecois law[8] which requires the registration of retention of title clauses, but not their re-characterisation. Although the registration-only model will be mentioned, the models I mostly discuss in this paper are slightly different because we are not comparing the effects of different means of registering interests but the consequences of not registering them vis-à-vis non-codal interests.

A full Personal Property Security Act model encompasses the greatest range of interests and contains within itself priority rules governing their priority vis-à-vis each other. The most important of these rules will be that the first to register will gain priority, subject to exceptions for example regarding purchase money security interests.[9] The relationship between those interests and interests outside the scheme, such as a constructive trust, or possibly a Quistclose trust,[10] depends, as noted, on the characterisation of the PPSA interest. Within the scheme, however, it is irrelevant whether they are legal or equitable in nature. We suggest that the PPSA interest should be characterised as a legal charge. Although this characterisation impacts unexpectedly on trust beneficiaries it is thought that on balance the advantages outweigh the disadvantageous impacts on such actors. We will also see that the characterisation of these charges is surprisingly similar in some respects to current characterisations of floating charges. The second model is the City of London Law Society model. The CLLS refuse to register re-characterise title-based financing devices such as the retention of title clause, and maintain the

[8] Sheehan (n 6)
[9] D Sheehan The Principles of Personal Property Law (2nd edn Hart Oxford 2017) 379-383
[10] Excluded from the definition in Australia by Personal Property Securities Act 2009 (Cth) s 8(1). A policy decision would need to be taken to re-characterise trust interests to include them.

distinction between legal and equitable charges.[11] The CLLS model includes security over land, and we illustrate why this requires the retention of the distinction before moving on to examine the continued relevance of extra-statutory doctrines such as marshalling both under the PPSA and CLLS models.

(1) The Nature of a Security Interest and the Law of Priorities

The priority of PPSA interests against non-codal interests need not be left to the general law; the Cape Town Convention on International Interests in Mobile Equipment deals, in conjunction with the Aircraft Protocol, with security interests taken over aircraft. It provides for a new international security interest which can be registered at a Registry based in Dublin.[12] Article 29 provides for the priority of registered international interests over unregistered interests and over subsequently registered international interests.[13] The effect of this is to prioritise registered international interests and provide an incentive to the creditor both to require an international interest and once acquired to register it quickly to protect the priority position. As a matter of policy this is the appropriate outcome. However, the insolvency position is largely left to national law, and an unregistered interest is not necessarily void. An unregistered retention of title clause will be effective in England, because, although it is registrable as an international interest under the Convention, it is not registrable under domestic English law. It will be effective in an English insolvency even if not registered as an international interest.

[11] CLLS Secured Transactions Code (2016)
[12] Cape Town Convention art 7
[13] International Interests in Aircraft (Cape Town Convention) regulations 2015, r 16(1); R Goode 'The Priority Rules under the Cape Town Convention' [2012] Cape Town Convention Journal 95; M Bridge, L Gullifer, K Low, G McMeel (eds) The Law of Personal Property (2nd edn Sweet and Maxwell London 2018) para 30.128

If priority is left to the general law, it will depend on whether the interest under the new legislation is being legal or equitable in character. This provides a good reason to examine the question, despite some American commentators, including those involved in drafting article 9, seeing it as irrelevant.[14] The draft City of London Law Society secured transactions code illustrates this point. It retains the distinction between legal and equitable charges in articles 3.1-3.3; there is hardly any difference between the two except vis-à-vis non-codal interests. Where the code does not provide for an answer priority is decided under the general law; article 36.3 states that, "it may therefore depend on whether the charge concerned is a legal charge or an equitable charge."

This section is divided into a number of subsections. The first examines the characterisation of the security interest under a Personal Property Security Act and compares that characterisation to the current law; the second looks more briefly at the CLLS proposals. Finally we examine the continued relevance of marshalling.

(i) Characterisation of a PPSA Interest

There are Canadian decisions that suggest the PPSA security is a common law interest, and, it being a statutory right, that should not be surprising. However, in at least one context the cases depart from the position most easily defensible as a matter of policy. In iTrade v Bank of Montreal[15] for example iTrade Finance advanced funds to a company controlled by a fraudster. As a victim of fraud iTrade had a constructive trust, but some of the assets – shares - had been pledged to the Bank of Montreal, which therefore had a security interest under the PPSA prior

[14] G Gilmore Security Interests in Personal Property (LawBook Exchange 2008) 365
[15] 2011 SCC 26

to the point at which iTrade rescinded the transaction. Bank of Montreal was deemed to be a bona fide purchaser for value – of a legal interest - taking in priority to the equitable interest in iTrade. A pledge is also a security interest at common law in England so the priority position would not have been different if there were a pledge. That said, one difference worth pointing out is that shares being intangible cannot be pledged, although the certificates – assuming there are any – can be.[16] The priority position, however, would be different under current English law if the Bank of Montreal had an equitable charge rather than a pledge. The bank's priority position would be reversed because had the bank merely had an equitable charge. iTrade would take priority as the bank would have charged the legal title, already subject to a trust.

In Bank of Montreal v Innovation Credit Union[17] the bank had a federal Bank Act security, taken at the latest in January 2004. The process of taking security under the Bank Act is different from that under a PPSA, but, because of the doctrine of federal paramountcy in Canada, the provincial PPSA could not affect the Bank Act security's validity even though the bank had not completed the process of registration which would have been required under provincial law. ICU had a prior but unperfected PPSA right; it was taken in 1991 but not registered until June 2004. As against other PPSA rights an unperfected right is vulnerable. Re Giffen[18] has made it clear that an unperfected right cannot be enforced against third parties in an insolvency. The Supreme Court of Canada held in Innovation Credit Union, however, that the provisions of the Bank Act 1991 were based on property law[19] and so the Bank's subsequent right was subject to ICU's right on the basis of nemo dat; essentially a first in time rule was applied. ICU had a right encumbering the legal title held by the debtor and so all the debtor

[16] Harrold v Plenty [1901] 2 Ch 314
[17] 2010 SCC 47, [2010] 3 SCR 3
[18] [1998] 1 SCR 91
[19] 2010 SCC 47, [2010] 3 SCR 3, [16] (Charron J)

could give was a right over that encumbered title. The court also held that the Saskatchewan PPSA created a statutory interest in the nature of a legal charge.[20] The Court went on to hold that perfection was only relevant within the confines of the PPSA system and so, despite its unperfected nature, the PPSA interest took priority over the Bank Act security.[21] The bank had argued that this was an uncommercial result. Charron J seemed to agree, but argued that this did not prevent the conclusion, derived from the wording of the Bank Act, that the Credit Union had priority.[22] This is, as a matter of policy, though the wrong result and should not be replicated, even accepting that the Bank Act creates a peculiarly Canadian problem. The point of registration is to provide publicity to third parties and later creditors or third parties should be able to reply on the non-registration or lack of registration as meaning that no interest exists.

In Radius Credit Union v Royal Bank of Canada[23] the question related to priority over after-acquired property. RCU had executed a General Security Agreement over all present and future property under the provincial PPSA in January 1992, but only registered it in September 1998. The bank took a Bank Act security in June 1997. The Supreme Court held, as it did in Innovation Credit Union, that the bank – on the principle of nemo dat – could take no better title than the debtor had. The GSA, created prior to the Bank Act interest, albeit unregistered, attached automatically to future assets; consequently it attached automatically to assets acquired subsequent to the grant of the Bank Act interest. Priority then related back to the date of the GSA agreement,[24] which was, as noted, prior to the Bank Act security agreement. The bank's security was therefore over an asset already subject to the GSA and Radius had priority

[20] Ibid [4], [41-42]; see generally JH Stumbles, 'The Extended Reach of the Definition of the PPSA Security Interest' (2011) 34 University of New South Wales Law Journal 448
[21] 2010 SCC 47, [2010] 3 SCR 3, [49] (Charron J)
[22] Ibid [3-4]
[23] 2010 SCC 48, [2010] 3 SCR 38
[24] Ibid [34]

vis-à-vis future assets falling into the scope of the agreement. As noted, the Bank Act-PPSA relation is a peculiarly Canadian problem, but the question could still come up vis-à-vis assets acquired under a Quistclose trust, where the beneficiary competes with a prior security holder. Currently the trust beneficiary prevails,[25] but in the absence of legislation, presumably the prior legal security interest prevails.[26] This becomes ever more obvious if we accept the view in Radius that "that, as of the date of execution, the creditor… acquired an interest in the after-acquired property which derogated from the debtor's title."[27]

Currently a floating charge over present and future assets of the debtor attaches automatically, without either party's intervention, to future assets acquired within its scope. Priority is then backdated to the date of the original agreement.[28] The comparison suggests that a PPSA interest is a type of legal floating charge. The comparison is instructive – and was alluded to by Charron J in Radius itself where he refers to both the Bank Act interest and equitable interests in future property as being inchoate[29] - but care needs to be taken, not least because Charron J rejects the comparison with a floating charge in both ICU and Radius.[30] Legal title cannot exist in future assets. This is why statutory assignment of legal choses in action is only possible with regard to present and existing choses in action.[31] Indeed this insistence on present assets can be seen in the context of equitable charges where some cases insist that a floating chargee has no immediate proprietary interest in the collateral.[32] In Royal Bank of Canada v Sparrow Electric[33] for example Gonthier J said that for as long as a charge was floating the chargee had

[25] H Beale et al (eds) The Law of Security and Title-Based Financing (2nd edn OUP Oxford 2012) para 17.10
[26] Sheehan (n 9) 290
[27] Radius 2010 SCC 48, [2010] 1 SCR 38, [31]
[28] Re Lind [1915] Ch 345; Holy Rosary Parish Credit Union v Premier Trust [1965] SCR 503
[29] 2010 SCC 48, [2010] 3 SCR 38, [19-20]
[30] ICU 2010 SCC 47, [2010] 1 SCR 3, [45]; Radius 2010 SCC 48, [2010] 1 SCR 38, [23]
[31] Law of Property Act 1925, s 136
[32] eg Tricontinental Corporation v FCT (1987) 73 ALR 433
[33] [1997] 1 SCR 411, [46]

no proprietary interest in the collateral. He actually says legal interest, but he cannot have meant that to contrast with equitable, since a charge over personal property – whether floating or fixed - is equitable.[34] The gist of what he meant is, however, that only on crystallisation of a floating charge does a proprietary right attach to the assets. Support might also be drawn from comments relating to the floating charge in Spectrum Plus v NatWest to the effect that the asset is not finally appropriated as security until a future crystallising event.[35] By contrast in the context of the PPSA interest Gonthier J rejected the contention that any PPSA interest only crystallised on some future event.[36] This is critical to Charron J's argument in ICU, where he ruled against the bank's similar contention that the Credit Union acquired no interest affecting title to the collateral – ie that the interest had not attached.[37] Likewise, sitting in the Radius Credit Union case, Charron J accepted that, although the statutory interest was inchoate over future property, it necessarily attached at the time of the agreement.[38] In saying this, he drew on comments of Gonthier J in Sparrow to the effect that the charge under the Personal Property Security Act was a proprietary right in a dynamic collective of present and future assets.[39]

However, this is something of a mess. The first point to make is that Gonthier J's discussion of a right in a collective of assets implies that a common law interest reaches into the future and can amount to a property right in a fund. The idea of property in a fund provides the basis for the explanation of a floating charge found in Goode and Gullifer on Legal Problems of Credit and Security.[40] Goode and Gullifer understand the floating charge as an interest in a circulating

[34] Sheehan (n 9) 345; the only instance of a charge being legal is the registered legal charge that by statute takes the place of a legal mortgage over land.
[35] [2005] UKHL 41, [2005] 2 AC 680, 722
[36] [1997] 1 SCR 411, [60]
[37] 2010 SCC 48, [2010] 1 SCR 38, [47]
[38] Ibid [31]
[39] [1997] 1 SCR 411, [62]
[40] L Gullifer (ed) Goode and Gullifer on Legal Problems in Credit and Security (6th edn Sweet and Maxwell London 2017) paras 4.03-4.04

fund of assets and it is only on crystallisation that the chargee obtains an attached property right. If this is right as an explanation of the statutory PPSA charge, it provides a break with the past and our prior understanding of common law interests, but it is inconsistent with the idea in the Canadian cases – including Sparrow itself - that the PPSA charge attaches to individual assets at the date of execution of the agreement. The second point is that attachment and appropriation to the security need not be the same thing and this might allow a way out of the muddle.

Richard Nolan has argued that the better view of a floating charge is that the charge is overreachable by an authorised disposition. In such a case, just as under a trust where there is an authorised transfer by the trustee, the third party obtains clean title and the equitable interest is transferred to the proceeds of the original asset.[41] This is a better view because it is simply impossible to have property in a fund, separate from the assets contained within that fund.[42] The fund must be defined by reference to the assets within it and has no identity apart from those assets. In other words the charge attaches immediately to the assets. Goode and Gullifer on Legal Problems of Credit and Security rejects this,[43] arguing first that there would be no need for a notion of crystallisation in the context of the overreaching explanation.[44] This is false. Crystallisation is the removal of actual authority to deal with the assets (although apparent authority may yet remain) and appropriation to the payment of the secured debt; attachment occurs earlier as soon as the assets are acquired.[45] Secondly, they argue that the view equates the floating charge to a fixed charge with a licence to deal, a view rejected by

[41] R Nolan, 'Property in a Fund' (2004) 120 Law Quarterly Review 108; Sheehan (n 9) 357-359
[42] D Sheehan 'Property in a Fund, Tracing and Unjust Enrichment' (2010) 4 Journal of Equity 225, 229; Re Margart Pty Ltd [1985] BCLC 314
[43] Gullifer (n 40) para 4.05
[44] Ibid para 4.06.
[45] Nolan (n 41) 129; Sheehan (n 9) 357-358

Cretanor Maritime Co Ltd v Irish Marine Management Ltd.[46] The overreaching view of the floating charge does not require us to hold that the floating charge is a fixed charge with a licence to deal, however. For one the chargor has a right not merely a licence to deal.[47] Nonetheless with the primary difference being the presence or absence of authority, based on the express or implied terms of the charge, the overreaching view does hold both types of charge to be pretty much the same, despite the differences in terms of both priority - fixed charges, at least in theory, take priority over floating[48] - and insolvency consequences – eg clawback provisions.[49]

The importance of authority is instructive. Authorisation operates to give the chargor a right to pass unencumbered title to a transferee under a Personal Property Securities Act.[50] A transaction in the ordinary course of business[51] allows for unencumbered title to pass, although there may still be an action against the chargor if the transfer is unauthorised. Under a floating charge, transactions in the ordinary course of business are assumed to be authorised. This tends to suggest that the conceptual setup is similar, despite the term "overreaching" never being used under a PPSA and despite the admitted jurisdictional oddity of overreachable legal interests in personal property. That said, there may be a parallel. That parallel is with the common law power to re-vest title in Lipkin Gorman v Karpnale.[52] That case involved the claimant law firm recovering money stolen and then gambled away by a partner at the defendant's club. In the House of Lords the case was argued purely on common law grounds

[46] [1978] 1 WLR 966; Evans v Rival Granite Quarries Ltd [1910] 2 KB 879 (CA) 999 (Buckley LJ)
[47] Nolan (n 41) 125-126.
[48] Although the prevalence of negative pledges means that priority by time order is the norm in practice. Sheehan (n 9) 279; Gullifer (n 40) para 4.05
[49] On which see Beale et al (n 23) para 6.95. On possible changes to reflect the abolition of the floating charge see Sheehan (n 9) 385
[50] eg Personal Property Securities Act 2009 (Cth) s 34
[51] Ibid s. 46; for discussion see M Gedye 'The New Zealand Perspective' in L Gullifer and O Akseli (eds) Secured Transactions Law Reform (Hart Oxford 2016) 115, 121-222
[52] [1991] 2 AC 548

and the best interpretation, as I have argued elsewhere,[53] is that the firm had a legal power in rem to vest title in the money (or its traceable product) in themselves, just as in cases of a power to rescind a contract for fraud at common law.[54] The parallel is not perfect, but it does provide a precedent for a common law proprietary interest in personal property less than title and still vested in particular items from time to time subject to the power.

Although the City of London Law Society have not done significant theoretical work on this, a similar view lies behind their abolition of the distinction between the fixed and floating charge.[55] They suggest that the abolition of the distinction makes little difference because the debtor will still be able to sell and transfer property if it is agreed between the parties that he may.[56] In essence they accept that what matters is authorisation to deal, although they do not mention overreaching and their retention of the legal/equitable split minimises the effect against non-codal interests. Although Part X of the code deals with insolvency, currently there are no detailed proposals with regard to the insolvency consequences of the abolition.[57]

It cannot, however, always be the case that a statutory charge is legal. McCracken points this out cogently, while, from an Australian perspective, accepting that the PPSA charge will normally be legal.[58] Yet it is equally not clear this would make much difference in priority terms. In terms of non-PPSA interests, the security would only be additionally vulnerable to prior equitable rights and the chargee would be no worse off than currently. The prior

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[53] D Sheehan 'Proprietary Remedies for Mistake and Ignorance: An Unseen Equivalence' [2002] Restitution Law Review 69, 74-77
[54] See Banque Belge *pour l'Etranger* v Hambrouck [1921] 1 KB 321
[55] CLLS Secured Transactions Code and Commentary (2016) 9
[56] Ibid 9; CLLS Secured Transactions Code (2016) s 1.6
[57] By contrast the Secured Transactions Law Reform Project published a discussion paper by Sarah Paterson, The Insolvency Consequences of the Abolition of the Fixed/Floating Charge Distinction (2017) https://securedtransactionslawreformproject.org/discussion-papers/
[58] S McCracken 'The Personal Property Security Interest: Identifying Some Essential Attributes' (2014) 30 Law in Context 146, 165

constructive trust in the Bank of Montreal case, a prior Quistclose trust, or an equitable lien might be interests to which a charge of this type would be vulnerable. Potentially a constructive trust might arise in the context of a prior[59] sale or transfer for value of the trust interest,[60] but this would be factually unusual.

One less unusual context would be a competition between a security interest created by an express trustee and an earlier one created by the beneficiary.[61] PPSAs are all unable to help in these circumstances because the collateral is different (one a common law interest the other equitable). However, the analysis in iTrade provides priority against the secured creditor of the beneficiary for a bona fide purchaser from the trustee – the trustee's secured creditor,[62] as well as for a good faith purchaser of the title from the trustee not realising it was unauthorised.[63] This disadvantages the beneficiary's secured creditors. This alone should not dissuade us from such a characterisation of a PPSA interest over legal property rights. Nonetheless, if the results of the promotion of equitable rights to legal rights remains worrisome, it might be possible in some cases to use marshalling to ameliorate the position of the beneficiary consistently with the general PPSA policy.

(ii) Relevance of the Nature of the CLLS Security Interest

The CLLS proposals by contrast roughly maintain the current priority rules against non-codal interests because they retain the distinction between legal and equitable. The policy justification of encouraging creditors to use PPSA security is less compelling if retention of

[59] A subsequent sale would presumably come under the taking free provisions of the Act.
[60] Oughtred v IRC [1960] AC 206 (HL); Neville v Wilson [1997] Ch 144 (CA)
[61] If the trustee's charge was created first, it seems it prevails under both regimes, being first in time.
[62] RCC Cuming 'Equity and the PPSA: Strange Bedfellows' (2014) 55 Canadian Business Law Journal 171, 198
[63] Ibid 194

title clauses and other title financing devices are excluded.[64] The reform is simply not designed to create a single type of security interest to cover all (or almost all) scenarios. Another important point to remember about the City of London Law Society is that they include land. Given that, it is important to retain the legal/equitable division.

We can illustrate this by reference to the July 2015 discussion draft of the CLLS Secured Transactions Code which suggested a security interest would be legal if registered at the Land Registry. The only legal charge in registered land is the charge by way of legal mortgage, registrable under section 27 Land Registration Act 2002. Equitable charges are protected by way of a notice. However, it is not impossible to talk of the entry of a notice as being registration of the charge – depending on how "registration" is interpreted in the context of the code. If so, it becomes a legal charge under para 2.2(b) of the code, and if legal must be registered under section 27. This might change the priority position with unpredictable effects. Fortunately the revised 2016 draft code makes it clear that this was never the intention. The lesson is that if we wish to generally promote equitable interests the scope of the regime needs to be limited to personal property.[65]

(iii) Marshalling

Gedye raises the availability of marshalling.[66] There are two types – marshalling by subrogation and by apportionment. Essentially marshalling by subrogation occurs where the junior secured creditor has security in asset A and the senior in assets A and B. If the senior

[64] Calnan (n 4) 471
[65] Sheehan (n 9) 372
[66] Gedye (n 51) 132

enforces his interest in asset A and thereby adversely affects the junior, the latter will have an interest in asset B to the extent that he or she has been deprived of his interest by the former's recourse to asset A.[67] Cuming makes two points. First, he argues that marshalling by subrogation flies in the face of the statutory policy under the PPSA. One reason for this is simply that the Act provides a detailed code or set of rules detailing the priority positions in different circumstances. Marshalling, as an ex post equitable doctrine focused on fairness is inconsistent with the broad thrust of this policy to ex ante determine priority.[68] Secondly, it can transform an unsecured creditor into a secured creditor. The senior creditor has exhausted asset A. The junior creditor would therefore now be unsecured but is transformed back into a secured creditor by marshalling. Importantly he could have, but chose not to, protect himself from the possibility of becoming unsecured; he took the risk.[69] This argument may not apply in cases with the same force where registration is not mandatory. If, as in New Zealand, non-registration simply defers priority[70] without invalidating the security, the unregistered security holder could therefore be allowed to take advantage of marshalling.[71] Parenthetically, that outcome (deferment rather than invalidity) may well have been influential in persuading inventory financiers to accept reform in New Zealand and may (or not) gain similar traction in the UK. Cuming's second point is to reject the argument that the junior creditor is subrogated to the "remaining" security of the senior creditor. For him that makes no sense. There is no over-security to be subrogated to; the senior creditor's security vanishes as soon as the debt it secures is discharged.[72]

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[67] Serious Organised Crime Agency v Szepietowski [2013] UKSC 64, [2014] AC 338, [28-38] (Lord Neuberger PSC); Gullifer (n 40) para 5.34; P Ali The Law of Secured Finance (Oxford OUP 2002) paras 7.95–7.111
[68] Cuming (n 62) 206
[69] Ibid 216
[70] This was suggested as an option for English law by Sheehan (n 6)
[71] Gedye (n 51) 132
[72] Cuming (n 62) 207-208

Elsewhere MacDougall refers to this as the debtor obtaining a windfall[73] from the removal of the junior creditor's security because of the whim of the senior creditor. Complementing this, removing the doctrine would render the junior creditor worse off than currently vis-à-vis unsecured creditors. This is not the aim of the PPSA, and marshalling does not affect at all the position of the senior creditor.[74] Canadian law probably permits this type of marshalling in the context of the PPSAs,[75] and it is well accepted in the USA.[76] Further as Wood explains, not recognising it will lead to some interesting incentives for the junior creditor who has an incentive to induce the senior creditor to enforce against a different asset. This could lead to a profit being made by the senior creditor. In other words he extracts an economic rent.[77]

Another version of marshalling, marshalling by apportionment, exists. Imagine that senior creditor 1 has interest in assets A and B to secure £200; junior creditor 2A has an interest in asset A to secure £200 and junior creditor 2B in asset B. Marshalling by apportionment has the effect that part of 2B's security is reallocated to 2A if 1 enforces against asset A,[78] and leaves insufficient assets to satisfy 2A; it prevents creditor 1 from arbitrarily disadvantaging only one of 2A or 2B. For Cuming, however, 2B has no means of protecting himself against this and it is precisely the state of affairs that 2A originally took the risk of.[79] We might, however, question whether creditor 1 should have this power to decide who to disadvantage when losses should arguably be shared between 2A and 2B, and where 2A has an incentive to persuade creditor 1 to enforce against 2B. However, marshalling cannot be taken too far. MacDougall

[73] B MacDougall 'Marshalling and the Personal Property Security Acts: Doing unto Others...' (1994) 28 University of British Columbia Law Review 91, 122
[74] Ibid 98
[75] National Bank of Canada v Makin Metals Ltd (1994) 116 Sask R 236
[76] Shedoudy v Beverly Surgical Supply Ltd 161 Cal R 164
[77] Wood (n 7) 69
[78] Victoria & Grey Trust Co Ltd v Brewer (1970) 14 DLR (3d) 28; Bancorp Investments (Fund no 2) Ltd v Bhugra Holdings Ltd (2006) 23 CBR (5th) 108
[79] Cuming (n 62) 210

for instance refers to a range of cases where marshalling should not be allowed to impinge on statutory priorities.[80] Cuming also raises the question of the effect on a judgment or execution creditor. If the execution creditor is seeking recourse over asset B will the junior creditor take priority?[81] In Saskatchewan a judgment debtor obtains an interest directly equivalent to a PPSA security. Cuming's general point – leaving the specifics of execution creditors aside - here is that it is not accurate to say that unsecured creditors are unaffected by marshalling and that they may be worse off. This might, however, be prevented by the general rule that the doctrine not be applied if it would cause prejudice to third parties, [82] and there is US authority that unsecured creditors can count as third parties for these purposes.[83] Ultimately therefore it seems the balance in a PPSA-style system is in favour of allowing marshalling in principle, although its use needs to be sensitive to the interests of third party creditors.

We cannot expand marshalling to retention of title clauses if they are not re-characterised as they are under a PPSA, whether or not they are registered, and in fact marshalling is not mentioned in the CLLS Secured Transactions Code and Commentary which rejects re-characterisation. Marshalling in the context of a retention of title clause would provide for a lessening of the title "retained" by the creditor and a lessening of the respect provided for title. While it is inevitable in any system that requires registration of such devices[84] to at least defer priority of unregistered clauses to registered interests,[85] an extension of marshalling to registered, but not re-characterised, clauses goes further than what is required to make the

[80] MacDougall (n 73) 112-114
[81] Cuming (n 62) 212-213; on whether an unsecured creditor might be treated as secured as a result of an execution judgment see RCC Cuming 'When an Unsecured Creditor is a Secured Creditor' (2003) 66 Saskatchewan Law Review 255
[82] MacDougall (n 73) 100-101
[83] Ibid 112; Re Spectra Prism Industries 28 BR 397 (9th Cir Ct App 1983)
[84] Sheehan (n 6)
[85] As in Quebec. See Re Ouellet 2004 SCC 64, [2004] SCR 355

registration scheme viable. The unitary scheme carries with it, however, the possibility of expanding marshalling beyond traditional security interests to such re-characterised interests.

(2) Conclusion

How we conceive of a security interest under a Personal Property Security Act matters. The most likely characterisation is a common law (statutory) charge which, apart from being legal, will look very similar to the equitable floating charge which itself allows for the chargee's interest to be overreached in the hands of an authorised transferee. There are clearly significant differences to the law in insolvency that would need to be worked through on the abolition of the distinction, but the parallels with a floating charge remain. Rendering the charge a legal charge also creates a policy incentive to use the PPSA regime. One important consequence of this characterisation for priority competitions not dealt with by the Act might be in the competition between a charge from the trustee and from the beneficiary. The latter's chargee is rather disadvantaged by the application of the non-PPSA priority rules that require to be applied, but this might be ameliorated in some, but obviously not all, cases through the use of doctrines such as marshalling, which should be retained not merely in cases involving only PPSA interests, but also in the context of priority competitions between PPSA and non-codal interests.

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