Equity in Codified Secured Transactions Law

I. Introduction

By comparison to other common law jurisdictions, English commercial law remains largely based on precedent despite calls to codify it.[1] A codification here means a statute that comprehensively sets out legal principles that govern the major questions arising in connection with a particular type of transaction or legal activity.[2] In England, only a handful of areas of commercial law are codified: sale of goods[3], bills of exchange[4], insurance.[5] By contrast, in the US, most commercial law is now found in a single code, the Uniform Commercial Code (UCC), a project that began in the 1950s and was borne out of a realist desire to break clean with existing concepts. Other common law jurisdictions initially took their cue from the English statutes in codifying their sales and negotiable instrument laws,[6] but statutory reform has since been inspired by the UCC in the areas of securities transfer law and, in particular, secured transactions law. A Personal Property Security Act (PPSA), influenced by Article 9 of the UCC[7] on secured transactions, can now be found in each of the Canadian provinces,[8] as well as in New Zealand[9] and Australia.[10] Calls for a substantial reform of English secured transactions law have a long history[11] but a codification is yet to be accomplished.[12]

Commented [SE1]: Is this the right expression? What is the trend you have in mind? The wording suggests that the trend is to remaining uncodified, but I though the international trend in this area was toward codification?

Commented [MR2R1]: I see the issue. I've amended the wording - see if that sounds better.

Commented [MR3]: I think this should be capitalised as 'Article' here means 'Chapter'. In the literature, as far as I remember, I have always been capitalised; it looks odd to not capitalise it.

[1] See R Goode, 'The Codification of Commercial Law' (1988) 14 *Monash University Law Review* 135; M Arden, 'Time for an English Commercial Code?' (1997) 56 *CLJ* 516 reproduced in M Arden, *Common Law and Modern Society: Keeping Pace with Change* (Oxford, OUP, 2015) ch 13, 191; M Bridge, 'The Future of English Private Transactional Law' (2002) 55 *CLP* 191, 221 (favouring codification of some areas of commercial law); cf FH Lawson, *The Rational Strength of English Law* (London, Stevens & Sons Ltd, 1951) 24; A Burrows, 'Legislative Reform of Remedies for Breach of Contract: the English Perspective' (1997) 1 *Edinburgh Law Review* 155 (arguing against codification of contract, tort or restitution and in favour of non-binding restatements); M Clarke, 'Doubts from the Dark Side: The Case against Codes' [2001] *Journal of Business Law* 605. Note that codification of English law refers here to the law applicable in England and Wales, and not, for example, to codifications of English law in special economic zones such as the Dubai International Financial Centre, on which see, generally, B Reynolds, T Donegan, and O Linch, 'The Value of English Common Law for New "Special Zones": A Case Study of Two Contrasting Examples' (2022) 28 *Trusts & Trustees* 82.

[2] cf RJ Wood, 'The Codification of Commercial Law' (2016) 79 *Saskatchewan Law Review* 179, 182; Burrows (n 1) 156.

[3] First enacted as Sale of Goods Act 1893, repealed and replaced with the Sale of Goods Act 1979.

[4] Bills of Exchange Act 1882.

[5] Marine Insurance Act 1906 and Insurance Act 2015. A list of statutes codifying commercial law sometimes also includes Partnership Act 1890, Companies Act 2006, Insolvency Act 1986 and Arbitration Act 1996, but these legislative interventions – while relevant to commercial parties – govern areas much wider than commercial law understood as the law governing commercial activity.

[6] In Canada, see the federal Bills of Exchange Act 1985, and the provincial or territorial sales laws such as the Sale of Goods Act 1978 (Saskatchewan). In Australia, see the state and territorial sale of goods acts, eg, Goods Act 1958 (Vic).

[7] For brevity, Article 9 UCC in this chapter is referred to as UCC.

[8] The first Canadian province to undertake a comprehensive reform of secured transactions and to adopt a Personal Property Security Act was Ontario (1976). Others followed: Manitoba (1978), Saskatchewan (1981), Yukon (1982), Alberta and British Columbia (1990), New Brunswick (1995), Nova Scotia (1997), Prince Edward Island (1998), Newfoundland (1999), Northwestern Territories and Nunavut (2001). References below are made to the Acts in Ontario (OPPSA), Alberta (APPSA) and Saskatchewan (SPPSA).

[9] Personal Property Securities Act 1999 (referred to as NZPPSA). The reform in New Zealand was inspired by the PPSA in Canada.

[10] Personal Property Security Act 2009 (Cth) (referred to as AusPPSA).

[11] There have been numerous reports going back as far as the *Report of the Committee on Consumer Credit* (Cmnd 4596, 1971). See L Gullifer and M Raczynska, 'The English Law of Personal Property Security: Under-reformed?' in L Gullifer and O Akseli (eds), *Secured Transactions Law Reform: Principles, Policies and Practice* (Oxford, Hart, 2016) 271.

[12] Led by the Secured Transactions Law Reform Project, and a working party of the Financial Law Committee of the City of London Law Society ('CLLS FLC').

This chapter shows that a reflection on codification of secured transactions law offers insights into the role equity plays in commercial law. In England and in other common law jurisdictions prior to reforms, the law of security rights has been shaped by both common law and equitable principles, resulting in unnecessary complexity. UCC and PPSAs introduced a 'unitary notion' of a security interest.[13] Among other things,[14] this concept abolishes the distinction between legal and equitable interests. Proposals for reform of English law also contemplate a single concept of a security interest that would, at the very least, do as much.[15] A removal of the distinction between legal and equitable interests is not the same as abolishing common law or equitable principles. The question addressed in this chapter then is to what extent, if any, the principles and doctrines of equity are, and should be, reflected in the codified secured transaction laws, and what consequences follow from this for the supplementary role of equity in codifications.

The analysis sheds light on the commercial convenience of equitable principles and on the relationship between equity and secured transactions codifications. Moreover, the area is of practical importance. Security interests facilitate performance of obligations, which is especially relevant in banking and finance practice: creditors obtain, in addition to the promise to perform, rights and powers exercisable against some property with the purpose of enforcing the debtor's obligation in priority to at least some other creditors of that debtor.[16] Finally, the conclusions reached will help inform the debate on law reform in this area in England.

The argument is in two parts. It is first shown that while some notions of equity are inconvenient in the law of security rights, and not imported into reformed secured transactions codifications (notably, equity's priority rules including the bona fide purchaser defence), in key aspects the genius of equity is preserved in the codifications. In this discussion, the focus is on English law, which is used as a proxy for the law prior to the codifications. This in turn raises the question, addressed in the second part, whether a codified security interest could be equitable in character, or whether it is best understood as legal, or sometimes legal and sometimes equitable, for the purposes of resolving certain priority conflicts not governed by the codification. It will be seen that for those purposes a codified security interest should be seen as a legal interest. Possible downsides to this view, and solutions, will be suggested.

Commented [SE4]: At some points you call this the bona fide purchaser (or purchase) defence and at some points the 'darling defence'. I suggest you be consistent. My own preference is for the former.

Commented [MR5R4]: I am happy to replace the references to 'equity's darling' with 'bona fide purchaser' and have done so.

[13] *Warehouse Sales Pty Ltd & Lewis and Templeton v LG Electronics Australia Pty Ltd* [2014] VSC 644, (2014) 291 FLR 407 [27]–[32] (Sifris J); *Innovation Credit Union v Bank of Montreal* 2010 SCC 47, [2010] 3 SCR 3 [42] (Charron J for the Court), cited in *Stiassny v Commissioner of Inland Revenue* [2012] NZSC 106, [2013] 1 NZLR 453 [51] (Blanchard J); *Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (in liq)* [2017] WASC 152, (2017) 52 WAR 90 [358] (Tottle J); *Diversa Pty Ltd v Taiping Trustees Ltd* [2022] FCA 316, (2022) 401 ALR 161 [237] (Beach J); *Waller v Bloodstock Ltd* [2006] 3 NZLR 629 (NZCA) 633 [13] (Robertson and Baragwanath JJ); JS Ziegel, 'Canadian Perspectives on "How Far is Article 9 Exportable"?' (1996) 27 *Canadian Business Law Journal* 226, 232; RCC Cuming, C Walsh and RJ Wood, *Personal Property Security Law*, 2nd edn (Toronto, Irwin Law, 2012) 116–17; M Gedye, RCC Cuming and RJ Wood, *Personal Property Securities in New Zealand* (Wellington, Thomson Brookers, 2002) 4–5, 20–21; RCC Cuming, C Walsh and RJ Wood, 'Secured Transactions Law in Canada: Significant Achievements, Unfinished Business and Ongoing Challenges' (2011) 50 *Canadian Business Law Journal* 156, 166.

[14] These words are covering much ground here. It is one of the distinctive features of UCC and PPSAs to also replace the distinction between traditional forms of security interests (charge, mortgage, pledge and contractual lien) and functional equivalents such as title-based financing interests under a contract of sale with a retention-of-title clause, a financing lease or hire-purchase agreement (sometimes referred to as quasi-security). The fact that UCC and PPSAs do that is not important for the purposes of the argument developed in this chapter.

[15] See Secured Transactions Law Reform Project, 'General Policy Paper' (2016) para [2.2] <https://securedtransactionslawreformproject.org/draft-policy-paper/> accessed 21 September 2022 ; CLLS FLC, Draft Version of the Secured Transactions Code (2020), s 7 and Commentary <https://www.citysolicitors.org.uk/clls/committees/financial-law/> accessed 21 September 2022. There is a debate in English law whether a single concept of a security interest should follow the example of UCC and PPSAs but this is not addressed here.

[16] cf *Bristol Airports plc v Powdrill* [1990] Ch 744 (CA) (Sir Browne-Wilkinson VC).

In this chapter, the words 'equity' and 'equitable' are used to denote the system of legal principles derived from the Court of Chancery,[17] as opposed to broader ideas of 'equity'.[18] References to 'codes' are to the UCC and PPSAs. The words 'asset' and 'property' are used interchangeably.

II. Inconvenient Concepts of Equity

At one point in the history of codification of security interests equity has earned a bad reputation owing to the restricted enforceability of equitable security interests. This led the drafters of Article 9 of the UCC to reject the concept of equitable security interests altogether, as we see below. English law does not share such concerns, but – as this section also shows – there are problems with equity's distinct solutions to priority conflicts.

A. Early Concerns: Equitable Security Interests in Pre-UCC USA

The principal draftsman of Article 9 of the UCC, Professor Grant Gilmore,[19] argued that 'the word "equitable" should, so far as possible be avoided in legal writing (except as a useful device to obscure the issues)'.[20] He dismissed the term 'equitable' as unhelpful because the word carried a number of meanings, and deprecated the distinction between 'equitable' and 'legal' as obfuscating the discussion about proprietary interests.[21] Such criticisms are easily disregarded. First, the fact that a particular term has a multiplicity of meanings does not entail that no meaning is helpful.[22] Secondly, the dismissal of the use of the term 'equitable' is at odds with the fact that the UCC itself preserves the relevance of principles of law and equity as they continue to play a supplementary role.[23]

Nevertheless, such a spirited dismissal of the term 'equitable' is unsurprising considering that Article 9 UCC was based on the idea of functionalism, the core of which is to '[detach] the legal incidents associated with taking security from the parties' status and the formal label they place on their transaction'[24] and instead to draw distinctions along functional lines.

Gilmore's further issue with equitable interests is substantive and has more merit. He observed:

> In modern usage 'equitable', when attached to 'assignment', 'lien' and the like [meaning interests such as security interests], has come to have principally a pejorative meaning…nine times out of ten, to call an interest 'equitable' is a way of saying that, in this case, on these facts, it will not be enforced.[25]

It is easy to see why the enforceability of equitable interests in pre-code USA was problematic. Equitable security interests, like all equitable interests, are vulnerable to a bona fide purchaser defence. For example, where A grants a charge over an asset in favour of B, and A later transfers a legal interest in that asset to C, who is bona fide and unaware that the transfer is in breach of the terms

Commented [SE6]: Was he arguing that we should not recognise equitable interests or making a point about terminology?

Commented [MR7R6]: Your are right that in relation to the points I have just referred to Gilmore's qualm is terminological. But there was a substantive qualm, too, and I hope I have now made it clearer.

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[17] See FW Maitland, *Equity: A Course of Lectures*, 2nd edn by J Brunyate (Cambridge, CUP, 1936) 12–22.
[18] For broader concepts of equity, see, eg, Aristotle, *Nichomachean Ethics*, Book V, T Taylor tr (London, Prometheus Trust, 2002) 1137b 7–10 and F Tudsbery, 'Equity and the Common Law' (1913) 29 *LQR* 154, 161.
[19] An Associate Reporter with responsibility for Article 9, together with Professor Allison Dunham.
[20] G Gilmore, *Security Interests in Personal Property* (London, Little, Brown, 1965) vol I, para [7.2], 200.
[21] ibid 199.
[22] See RS Summers, 'General Equitable Principles under Section 1-103 of the Uniform Commercial Code' (1978) 72 *Northwestern University Law Review* 906, 930.
[23] UCC, s 1-103. In his treatise, Gilmore makes a perfunctory mention of this section in the Preface, noting that UCC 'was not designed, as the European Codes may have been, to abolish the past, even on the level of semantics or vocabulary' (Gilmore (n **Error! Bookmark not defined.**) viii). However, he omits to consider this section entirely when discussing the relevance of equity (at para [7.2]).
[24] Cuming, Walsh and Wood (n **Error! Bookmark not defined.**) 6.
[25] Gilmore (n **Error! Bookmark not defined.**) 199. He also decried equitable interests as 'good only between the parties and against purchasers with notice'.

of the charge with B, C – who would otherwise be bound by A's prior interest – may raise a defence against A's claim and hold the asset free of A's charge.[26] In practice, the availability of the defence turns on whether C has notice of B's interest, actual or constructive. Under pre-UCC law, the circumstances in which a person acquired notice of an equitable interest were limited.[27] Mortgages over after-acquired property (recognised by courts of equity, and not at law)[28] are a good example. Where a debtor agreed to mortgage goods to be acquired in the future (for example, wood once the mortgagor cuts timber into wood), the agreement could not create a mortgage at law until the asset was acquired but it was enforceable against the mortgagor and those claiming through him with actual notice such as execution creditors.[29] State laws made it possible to register such an agreement. However, registration did not constitute constructive notice to purchasers of the property.[30] Moreover, '[e]ven [actual] knowledge by the purchaser of the existence of such mortgage [did] not, in the absence of any fraudulent intent [on the part of the purchaser], prevent his holding the property as against the mortgagee not in possession'.[31]

Such a restrictive application of the bona fide purchaser defence was a deliberate policy levied against all non-possessory security interests that existed at the time in the USA. Until the early nineteenth century, the pledge and a mortgage with delivery of possession were the only types of security rights that could be taken over property other than land. Transfer or creation of an interest in personal property without delivery of possession was void as fraudulent conveyance[32] until state legislatures introduced registration as an alternative to delivery of possession.[33] But even then the distrust towards non-possessory security interests persisted.

Much of the concern about the enforceability of equitable interests seen in pre-code USA does not apply in England. One reason for this is the effect of registration on the doctrine of notice.[34] In English law, mortgages and charges created by companies[35] are registrable at Companies House.[36] Registration can be of relevance when determining purchaser's constructive notice of such interests. In consequence, the circumstances in which such notice can be established, and therefore the circumstances in which equitable security interests bind purchasers, are wider than in pre-UCC America. In addition, under English law, equitable mortgages and charges are enforceable against liquidators, administrators and against creditors who acquire property rights or interests in the encumbered assets such as execution creditors[37] and lien holders[38] provided they are registered at

[26] For leading authority under English law, see *Pilcher v Rawlins* (1871–72) LR 7 Ch App 259 (CA) 266 and 269; *Akers v Samba* [2017] UKSC 6, [2017] AC 424 [65] (Lord Neuberger).
[27] J Long, 'Notice in Equity' (1921) 34 *Harvard Law Review* 137, 140–41, 151–60 (arguing that the cases of constructive notice are 'few and special', resting on 'own peculiar ground').
[28] See L Jones, *A Treatise on the Law of Mortgages on Personal Property*, 5th edn, (Indianapolis, The Bobbs-Merrill Company, 1908) para [138].
[29] ibid para [156].
[30] The position was different under New York law: HF Stone, 'Equitable Mortgage in New York' (1920) 20 *Columbia Law Review* 519, 534.
[31] Jones (n 29) para [157].
[32] This was following the decision in *Twyne's Case* (1601) 3 Co Rep 80b, 76 ER 809.
[33] See, eg, the New York Lien Law, s 230 (repealed by UCC, Art 9).
[34] This point relates to registration under the Companies Act 2006. Registration at the High Court of security bills of sale under the Bills of Sale Acts 1878–1882 is notice to those who actually search it but it is unlikely to be constructive notice.
[35] Or limited liability partnerships, but for simplicity, the discussion that follows is limited to companies.
[36] Companies Act 2006, s 859A.
[37] *Re Ashpurton Estates Ltd* [1983] Ch 110 (CA) 123 (Brightman LJ).
[38] RM Goode and L Gullifer, *Goode and Gullifer on Legal Problems of Credit and Security*, 6th edn (London, Sweet & Maxwell, 2018) para [2-23].

Companies House.[39] This was not the case, or at least not always the case, in pre-UCC America[40], which further illustrates why Gilmore's criticisms levied against equitable interests might have been justified pre-UCC but are of limited relevance in England. Importantly, under English law, there is no difference on insolvency between equitable and legal security interests, subject to the separate regulation of the floating charge.[41] Yet, as shown immediately below, equitable security interests are problematic in English law in the sense that the application of equity's priority rules leaves much to be desired.

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Commented [MR9R8]: Completed, thanks for spotting.

B. Is There a Need for Equity's Distinct Priority Rules?

There are a few issues with equitable security interests in English law, all relating to equity's solution to priority conflicts. The first, addressed in this section, is existential: it concerns the need for a distinct rule in equity to resolve priority conflicts. The second and third relate to the way in which the bona fide purchaser defence and the rule in *Dearle v Hall*[42] operate. This section addresses the first point. The other points are discussed in the sections below.

It is sometimes argued that common law and equitable rights differ fundamentally in terms of their publicity, and the ease with which their existence and content can be detected.[43] Equitable rights are said to be hidden, private arrangements, which may have idiosyncratic content that is hard for a purchaser to foresee whereas legal property rights are public in the sense that the members of the public can expect their existence and can reasonably predict their shape thanks to the *numerus clausus* principle. One difficulty with this argument in the context of security rights is that legal security interests can be seen as just as hard to foresee as equitable interests, and much harder than legal ownership. The point is illustrated by a comparison of legal mortgage and ownership. A person might be expected to know from observation alone that an item of property she comes across is owned but she cannot know that it is subject to a legal mortgage. This is because nearly all objects in the world are owned, so it is reasonable for her to expect that if they do not own the object, someone else will (ie, she knows if the property is not hers). By contrast, the incidence of legal mortgages is much lower, so it is not possible to tell, purely by looking at a piece of property, whether it is mortgaged in favour of another, especially since property does not generally bear markings indicating that it is

Commented [SE10]: In this part you use the terms 'predict' and 'foresee' frequently. Is 'detect' a better word for your purposes?

Commented [MR11R10]: Yes, indeed. Thanks.

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[39] This is the effect of section 859H of the Companies Act 2006, which invalidates security interests for want of registration. There is an argument that this section replaces equity's bona fide purchaser defence (A Nair and I Samet, 'What Can "Equity's Darling" Tell Us about Equity?' in D Klimchuk, I Samet and HE Smith (eds), *Philosophical Foundations of The Law of Equity* (Oxford, OUP, 2020) 264, 282) but this seems to overstate the matters because the defence would not have applied anyway: most parties mentioned in section 859H would not qualify as purchasers. For example, liquidators, administrators and execution creditors are not purchasers as they do not acquire any interest in the debtor's property: see *Maddell v Thomas & Co* [1891] 1 QB 230 (CA) 238 (Lopes LJ). The decision in *Maddell* related to trustees in bankruptcy and execution creditors but the same applies, *a fortiori*, to liquidators and administrators because, by contrast to trustees in bankruptcy (in whom the bankrupt's estate vests under the Insolvency Act 1986, s 306(1)), the company's assets do not automatically vest in the liquidator or an administrator. A liquidator becomes merely a custodian of the assets, although in compulsory winding up he or she can apply to the court for a vesting order: Insolvency Act 1986, s 145(1).

[40] See Gilmore (n 21) 445–449 and ch 45, esp 1311 (suggesting that there was a difference in the treatment of equitable security interests on the grantor's insolvency depending on how they were created: mortgages over after-acquired property were always enforceable against trustee in bankruptcy by contrast to equitable interests created under a contract to pledge – when no delivery of possession followed, or under a contract to create a mortgage – where a mortgage was not registered); see also G Glenn, 'The "Equitable Pledge", Creditors' Rights and the Chandler Act' (1939) 25 *Virginia Law Review* 422.

[41] The holder of a floating charge is subordinated to claims secured by a fixed security interest (whether legal or equitable), expenses of the insolvency proceedings and preferential creditors: Insolvency Act 1986 ss 175, 176A, 176ZA and Sch B1, paras 65(2), 99(3) and 116; see, too, *Re Nortel GmbH (in liquidation),* also known as *Bloom v Pensions Regulator* [2013] UKSC 52 para 39 per Lord Neuberger (with whom Lord Mance, Lord Clarke and Lord Toulson agreed).

[42] (1828) 3 Russ 1, 38 ER 475.

[43] Nair and Samet (n **Error! Bookmark not defined.**) 264, 282.

encumbered.[44] In addition, creation of a legal mortgage can be just as hidden and private an arrangement as creation of an equitable security interest: in certain cases a mortgage can be created informally by agreement, without even a requirement for a deed (eg, legal mortgages over goods).[45]

It could perhaps be argued that a member of the public might be expected to know that a piece of property could be subject to any right on the closed list (*numerus clausus*) of property rights recognised in law. *Numerus clausus* captures the idea that a person can only create a property right if it corresponds in content to an established, recognised type of right. [46] The list includes legal property rights but not equitable interests[47], at least in the sense that equitable interests are based on obligations and courts generally allow their incidents to be more freely shaped than those of legal property rights. Such an understanding of the list's content fits with the argument that a member of the public is expected to know of legal but not equitable interests, which in turn warrants equity's different priority solutions. It is not immediately obvious, however, why inclusion of rights on the list would mean that the public should expect their existence. Hansmann and Kraakman argue that such a general expectation, which they call a 'universal presumption', is a way in which a legal system solves the problem of publicising property rights to third parties (which they call a 'verification' problem).[48] Such a general expectation can work as an effective notice to the public presumably[49] because people are motivated to learn about rules that bind them. This in turn ensures that they are not misled about the rights of others, and helps them avoid making uses of assets or asserting rights that would be inconsistent with the entitlement of the right-holder. But, as Hansmann and Kraakman note, such a general expectation is not the only way in which property rights on the *numerus clausus* list can be discovered by third parties. Other ways include registration and delivery of possession.[50] English law already makes provision for such means of publicising legal security interests: delivery of possession in relation to the pledge, and registration - for nearly all non-possessory security interests (legal as well as equitable).[51] It cannot, therefore, be the case that the reason a legal security interest is effective against third parties is because it is part of the *numerus clausus*. Lack of registration at Companies House invalidates legal and equitable security interests alike for certain purposes at least[52], which undermines an argument that there is a fundamental difference between legal and equitable interests in this area.

Commented [SE12]: Is this a good point in circumstances where the deed is not on any register? Either way the mortgage is unknowable.

Commented [MR13R12]: Yes, it was awkward. I have rephrased this: I hope this makes more sense now.

Commented [SE14]: I think you need another sentence to briefly explain why this might be.

Commented [MR15R14]: A bit more detail added but I appreciate that the explanation - whilst one that is given in literature - is a bit circular - is a bit circular - it just describes the practice of courts rather than gives it a normative basis but this is probably the best I can do in one line. Is that OK?

Commented [MR16]: I have re-drafted this part to make the point clearer, and took out the discussion about economic efficiency which was not necessary to make the key point. I hope this reads better now.

Commented [SE17]: Has the argument gone far enough to support this conclusion?

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[44] There are exceptions. In the modern world this typically applies to assets which have their own registers. For example, a legal mortgage over uncertificated securities held through the CREST system requires transfer of the securities from the mortgagor's account to the mortgagee's account held with the CREST system.

[45] See, eg, *Flory v Denny* (1852) 7 Exch 581, 155 ER 1080. Legal mortgages of goods requiring formalities for the purpose of their creation are exceptional, eg those created by non-corporate debtors (under Bills of Sale Acts 1878-1882) and mortgages over registered ships (under Merchant Shipping Act 1995). Note that while legal mortgages created by companies are registrable under Companies Act 2006, s 859A, such registration is not necessary for their creation.

[46] See, eg, B Rudden, 'Economic Theory v Property Law: The *Numerus Clausus* Problem' in J Bell and J Eekelaar (eds), *Oxford Essays in Jurisprudence: Third Series* (Oxford, Clarendon Press, 1987) ch 11, 244–45, citing, among others, *Keppell v Bailey* (1834) 2 My & K 517, 535–36; 39 ER 1042, 1049 (Brougham LC); *Hill v Tupper* (1863) 2 H & C 121, 127–28; 159 ER 51, 53 (Pollock CB). See, too, M Heller, 'Boundaries of Property' (1999) 108 *Yale Law Journal* 1163; T Merrill and H Smith, 'Optimal Standardization in the Law of Property: the *Numerus Clausus* Principle' (2000) 110 *Yale Law Journal* 1; H Hansmann and R Kraakman, 'Property, Contract, and Verification: The *Numerus Clausus* Problem and the Divisibility of Rights' (2002) 31 *JLS* S373.

[47] See, eg, L Smith, 'Trust and Patrimony' (2008) 38 *Revue Générale de Droit* 379, 394; B McFarlane and R Stevens, 'The Nature of Equitable Property' (2010) 4 *J Eq* 1, 2; cf S Gardner, '"Persistent Rights" Appraised' in N Hopkins (ed), *Modern Studies in Property Law* (Oxford, Hart, 2013) vol 7, 321, 331; R Nolan, 'Equitable Property' (2006) 122 *LQR* 232, 260–61.

[48] Hansmann and Kraakman (n 49).

[49] Hansmann and Kraakman do not explain why a universal presumption would work as an effective notice.

[50] They also include labelling and explicit contracting among the 'verification' rules: Hansmann and Kraakman (n 49) S385.

[51] Companies Act 2006, s 859A. For security interests granted by non-corporate debtors, see n 35.

[52] See text accompanying nn 37–41.

C. Bona Fide Purchaser Defence

The bona fide purchaser defence[53] comes at a hefty price of limited predictability and therefore, an inflated risk of litigation. Elsewhere in law there may be good reasons for preserving equity's distinct solutions to priority conflicts but in the context of security rights any benefits of the defence, it is argued, are outweighed by the costs. Let us see why.

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Key to the operation of equity's bona fide purchaser defence is the concept of notice. Under the general law, a purchaser (C) has constructive notice of a right of another (B) and takes subject to it 'if [he] knows of certain facts which put him on inquiry as to the possible existence of the rights of that other and he fails to make such inquiry or take such other steps as are reasonable to verify whether such earlier right does or does not exist'.[54] The failure to make reasonable enquiries could be deliberate[55] or careless.[56] Carelessness includes situations where a reasonable person in the position of the purchaser would have a 'serious cause' to investigate but the purchaser fails to do so.[57] This means the court considers the circumstances in which the purchaser finds herself, including her own attributes.[58]

Such an exercise comes at a cost of greater unpredictability of outcome, and increased likelihood of litigation and judicial mistake. But the costs are generally worth paying because the defence is desirable as a matter of justice (since it facilitates eg detailed enquiries into the purchaser's mind)[59] and – it is submitted – because it is systemically efficient in the following sense.[60] The circumstances in which a purchaser might acquire rights in property can be varied and unpredictable, and it would be impracticable, if not impossible, for a legal system to provide priority rules for every occasion if the objective is to achieve a balance between the interests of the two innocents (B and C). It would simply be too costly for courts or the legislature to devise, and for the users of a legal system to use, a plethora of priority rules.

In the context of secured transactions, however, the circumstances in which priority conflicts between B and C arise are in many ways predictable. It is not unusual for a company to have multiple dealings in relation to its assets, for example, by creating multiple security interests in the same assets in favour of different parties over time (say, C, D, E etc). Such dealings are not surprising because a security interest in an asset generally confers on the creditor a right to benefit from the asset only in part, ie, only to the extent needed to enforce the discharge of the debtor's obligation to the creditor. Since security interests are generally registered, the issue that any judge would need to consider in a dispute where C raises equity's bona fide purchaser defence is whether C had actual or constructive notice of B's registered interest. The question in practice is, then, whether C had a 'serious cause' to check the register. The type of right that C acquires is a circumstance that the court needs to consider in every dispute. The key question is, however, when C's acquisition of the right alone gives her a serious cause to check the register. Unfortunately, there is a dearth of authority on this point. The view prevailing in the literature, based on first principles, is that a creditor taking a charge or mortgage registrable at Companies House would, in normal circumstances, be expected to search the Companies House register whereas a buyer purchasing an asset in the ordinary course of business

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[53] An example of the defence is set out above: see the text accompanying n **Error! Bookmark not defined.**.
[54] *Barclays Banks plc v O'Brien* [1994] 1 AC 180 (HL) 195–96 (Lord Browne-Wilkinson). See, too, *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] EWCA Civ 347, [2012] Ch 453 [100] (Lord Neuberger MR); *Papadimitriou v Crédit Agricole Corp and Investment Bank* [2015] UKPC 13, [2015] 1 WLR 4265 [19]–[21] (Lord Clarke).
[55] See, eg, *Jones v Smith* (1841) 1 Hare 43, 55; 66 ER 943, 948.
[56] See, eg, *Oliver v Hinton* [1899] 2 Ch 264 (CA); *Hudson v Viney* [1921] 1 Ch 98 (Ch).
[57] *Papadimitriou* (n **Error! Bookmark not defined.**) [20] (Lord Clarke).
[58] ibid (Lord Clarke).
[59] Nair and Samet (n **Error! Bookmark not defined.**) 284–86.
[60] For other arguments favouring efficiency of the bona fide purchaser defence, see Nair and Samet (n 41) 287–89.

from the debtor would not.[61] It is less clear whether a creditor taking a pledge[62] or a security financial collateral arrangement,[63] ought reasonably to search the register: such creditors engage in secured finance, much like chargees (pointing to an expectation to search), but unlike chargees - they take unregistrable security rights (which suggests, probably more strongly, that they are not expected to search). Nevertheless, even if case law existed telling us whether a purchaser (eg a creditor) acquiring a particular right was expected to search the register, this would not give us the certainty needed because constructive notice cannot be established in the abstract. This lack of predictable outcomes is unfortunate. We should be able to know in advance whether a purchaser acquiring a right from the debtor is expected to search the register. Both the existence of a registered right and the purchaser's acquisition of a right from the debtor are circumstances that are knowable in advance and it is a missed opportunity not to have a priority rule telling us how to balance them. Forensic and finely-balanced investigations into a purchaser's state of mind are simply not worth paying for.

In addition, this uncertainty generates costs for individual lenders that might otherwise be avoided. The reason is that, in practice, cautious lenders and other financiers will search the register and, on discovery of a registered right, enter into a subordination agreement with the right-holder. Incurring the cost of a subordination agreement is preferable than bearing the cost of the uncertainty associated with the doctrine of constructive notice.

D. The Rule in *Dearle v Hall*

A further example of an undesirable priority rule stemming from equity is the rule in *Dearle v Hall.*[64] It governs the priority of successive assignments, including assignments by way of security, in the following way. Assume that X owes a contractual debt to A, who assigns that right to B and then to C. The priority between the assignees (B and C) depends on the order in which notice of the assignment is given to the debtor (X) provided that a subsequent assignee giving notice (eg, C) does not know of the earlier assignment (eg, that to B) at the time of taking its assignment or when it provides consideration. The rule stems from cases involving assignments of equitable interests under trusts where it was necessary to give notice to the trustee.[65] It has since been applied much more widely: to both equitable and statutory assignments,[66] absolute and by way of security,[67] and to assignments of legal choses in action[68] as well as equitable interests.

Commented [MR19]: If possible, I would prefer to refer to *The Law of Security and Title-Based Financing* by listing all the authors when mentioned the first time.It is not unusual, in the case of this book, to list all the authors.

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[61] Goode and Gullifer (n **Error! Bookmark not defined.**) para [2-31]; E Ferran and L Ho, *Principles of Corporate Finance Law*, 2nd edn (Oxford, OUP, 2014) 344; G McCormack, *Secured Credit under English and American Law* (Cambridge, CUP, 2004) 106–07; R Calnan, *Taking Security*, 4th edn (Bristol, Jordan Publishing, 2018) paras [8.290]–[8.304]. For a contrary view, see W Gough, *Company Charges*, 2nd edn (London, Butterworths, 1996) 836 and generally ch 32 (arguing that registration is notice to the world) and see rebuttal in H Beale, M Bridge, L Gullifer and E Lomnicka , *The Law of Security and Title-Based Financing*, 3rd edn (Oxford, OUP, 2018) paras [12.04]–[12.14].

[62] Pledges are distinct from charges and mortgages and therefore not registrable, see Companies Act 2006, s 859A.

[63] Companies Act 2006, s 859A(6)(c) *juncto* Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226), Reg 4(4).

[64] *Dearle v Hall* (n **Error! Bookmark not defined.**); see also Law of Property Act 1925, s 137(1).

[65] *Dearle v Hall* (n **Error! Bookmark not defined.**); *Foster v Cockerell* (1835) 3 Cl & F 456, 6 ER 1508.

[66] *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1987] BCLC 522 (QB) 533 (obiter); *Compaq Computer Ltd v Abercorn Group Ltd* [1993] BCLC 602 (Ch) 621–22 (obiter). See also *Harding Carpets Ltd v Royal Bank of Canada* [1980] 4 WWR 149 (Manitoba QB).

[67] *Colonial Mutual General Insurance Co Ltd v ANZ Banking Group (New Zealand) Ltd* [1995] 1 WLR 1140 (PC) 1144; *Pfeiffer* (n **Error! Bookmark not defined.**); *Compaq* (n **Error! Bookmark not defined.**).

[68] *Marchant v Morton Down & Co* [1901] 2 KB 829 (KBD).

The problems with the rule in *Dearle v Hall* are well known[69] and the key issues can be stated here briefly. First, the rationale for the rule has never been clear.[70] It is said to be based on the principle that giving notice equates to taking possession of the debt.[71] This might have worked as an (anomalous[72]) extension of the reputed ownership doctrine but the doctrine has since been applied narrowly and was eventually abolished.[73] In any case, taking possession is not needed to pass property in goods, nor to create a legal mortgage over goods. The analogy with possession is best understood as a means of protecting third parties (assignees such as C) from being misled by the appearance of (A's) ownership of the debt.[74] But this is surprising considering that the rule applies irrespective of whether C made any enquiries[75], so C need not actually be misled. It also only protects C if C herself gives notice (and thus only if she ensures further third parties are not misled); C is not protected solely because B failed to give notice.[76]

Further concern is that *Dearle v Hall* does not always lead to just outcomes.[77] For example, where an assignee (C) makes an advance to A not knowing of an earlier assignment by B but learns about it subsequently, and then gives notice to the debtor, she is not barred from taking priority over B.[78] This means that the rule fails to prevent sharp practice of 'people jumping in and taking advantage of a technical failure to give notice', which is the very thing the second limb of *Dearle v Hall* sought to prevent.[79]

Another problem is that it can lead to circularity. For example, if A makes multiple successive assignments, eg assigns first to B, then to C, and finally to D, and D gives notice to the debtor (X) before B or C give notice, when D knows about the prior assignment to C but not to B, D takes priority over B but not over C, while B takes priority over C under the first-in-time rule which applies where neither assignee gave notice; in result, the order of priority is C, D, B, C.

Further, the rule is not suited to modern receivables financing because it is not practicable (too expensive and time-consuming), especially in bulk assignments and assignments of future receivables, for financiers to give notice to debtors. The problem is not easily solved. For example, X might agree in a contract with A to a waiver of notice. In doing so, X might be able to remove the protections safeguarded by notice that apply to him (eg those relating to set-off) but not those that apply to other people. If notice is required under priority rules to protect assignees from being misled by the appearance of A's ownership[80], a term in a contract between A and X, will not remove the protection that the law confers upon assignees (B, C, D etc), so it would not be an effective way to work around the rule in *Dearle v Hall.* Each financier-assignee might of course choose not to give notice (as tends to happen in invoice-discounting as opposed to factoring of receivables), or assignees between themselves might agree to contract out of *Dearle v Hall* as it applies to them but this will not stop possible further assignees from relying on the rule.

Commented [SE20]: Why is this unjust?

Commented [MR21R20]: I tried to clarify: see if this sounds better.

Commented [SE22]: I'm not sure I understand this point and it may be the example is not working. In the example the resulting order of priorities is B > D > C. What is wrong about that?

Commented [MR23R22]: I muddled up the parties. Corrected now.

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[69] For fuller discussion, see, eg, F Oditah, *Legal Aspects of Receivables Financing* (London, Sweet & Maxwell, 1991) 140–142; C Brown, 'Preserving Priority in Receivable Financing: Time to Revisit *Dearle v Hall*' [1995] *Journal of International Banking and Financial Law* 3; McCormack (n 68) 244–45; Goode and Gullifer (n **Error! Bookmark not defined.**) para [5-08]; Beale and others, *The Law of Security and Title-Based Financing* (n 68) para [14.10].

[70] *Ward v Duncombe* [1893] AC 369 (HL) 387, 394 (Lord Macnaghten).

[71] *Dearle v Hall* (n **Error! Bookmark not defined.**) 22 (Sir Thomas Plumer MR).

[72] Oditah (n **Error! Bookmark not defined.**) 130

[73] Insolvency Act 1986, Sch 10. For an excellent discussion of the doctrine's development, see F Stolker, 'The Rise and Fall of the Reputed Ownership Clause' (DPhil thesis, University of Oxford, 2015).

[74] *Dearle v Hall* (n **Error! Bookmark not defined.**) 24 (Sir Thomas Plumer MR).

[75] *Ward* (n 77) 387, 390–391 (Lord Macnaghten); Beale and others, *The Law of Security and Title-Based Financing* (n 68) para [14.10].

[76] Cf Sale of Goods Act 1979, ss 21(1): in the context of transfer of property in goods, a defence based on apparent ownership is not dependent on the disponee taking herself possession of the goods.

[77] See *Ward* (n 77) 393 (Lord Macnaghten): 'I am inclined to think that the rule in *Dearle v Hall* has on the whole produced at least as much injustice as it has prevented.'

[78] *Mutual Life Assurance Society v Langley* (1886) 32 Ch D 460 (CA).

[79] *Rhodes v Allied Dunbar (Pension Services) Ltd* [1987] 1 WLR 1703, 1708, reversed [1989] 1 All ER 1161 (CA) but not on this point, and see Oditah (n **Error! Bookmark not defined.**) 133.

[80] See n 81.

Where the first assignment (the assignment to B) is by way of security, and A is a company, the impact of the rule may be abated if the assignment is registered at Companies House because C may then have constructive notice of the first assignment.[81] However, the operation of the doctrine of constructive notice in priority conflicts is problematic.[82]

D. Solution: The New Principles

In codified secured transaction regimes the problems caused by equity's priority rules are solved by a suite of new principles.[83] The general principle that governs a conflict between security interests taken by different creditors with respect to the same asset is that priority depends on the order of perfection, not the order of the date of creation.[84] Since perfection often takes place by registration, priority is usually determined by the date of registration in the register of security rights,[85] but the same generally applies to perfection by other means. For example, if one security interest is perfected by registration and another by possession, the one to perfect earlier prevails.[86] Exceptions do exist. For example, a security interest perfected by control prevails in some systems over one perfected by registration.[87] This is because a creditor taking control over financial assets generally takes security specifically over financial assets whereas a creditor perfecting only by registration generally takes a security interest over all of the debtor's assets which happen to include financial assets.[88]

The departure from the principles established in equity is clear.[89] First, the distinction between legal and equitable interests is irrelevant when determining priority. Second, priority conflicts can now be determined by the application of a simple rule, rather than requiring an investigation of what a reasonable person with the attributes of the claimant might have done in the given circumstances. Some PPSAs even provide that registration is not constructive notice of the existence or content of the registered security interest.[90] In result, the application of codified principles generates more predictable outcomes than those generated by the application of equity's priority rules.

Such a change of priority rules comes at a hefty price of legislative reform but, if the number of jurisdictions that have already reformed their priority rules in secured transactions along these lines is anything to go by[91], it is a price worth paying.

Commented [EK24]: Could the author please provide the full name for 'STC'?

Commented [MR25R24]: Done, thanks.

Commented [SE26]: Words seem to be missing here.

Commented [MR27R26]: Words added

Commented [MR28]: There was your comment here asking for clarity - see if this sounds better.

III. The Continuing Relevance of Equity's Distinct Solutions

[81] Beale and others, *The Law of Security and Title-Based Financing* (n **Error! Bookmark not defined.**) para [14.10].
[82] See the text accompanying nn 66–70.
[83] The statutory rules also replace, and solve the difficulties presented by, priority rules developed in common law, but these are not discussed here.
[84] See, eg, SPPSA, s 35(1); OPPSA, s 30(1); Cuming, Walsh and Wood (n **Error! Bookmark not defined.**) 419.
[85] See, eg, UCC, s 9-322; SPPSA, s 35; draft Secured Transactions Code (n 16), s 38.4.
[86] SPPSA, s 35; UCC, s 9-322.
[87] UCC, s 9-328.
[88] H Beale, 'An Outline of a Typical PPSA Scheme' in L Gullifer and O Akseli (eds), *Secured Transactions Law Reform: Principles, Policies and Practice* (Oxford, Hart, 2016) 7, 14.
[89] See *Warehouse Sales* (n **Error! Bookmark not defined.**) [27]–[32] (Sifris J) (referring to a paradigm shift from established principles).
[90] See, eg, SPPSA, s 47.
[91] The idea that priority of security rights depends in most cases on registration has been adopted in a number of civil law as well as common law jurisdictions, see generally M Dubovec, 'UCC Article 9 Registration System for Latin America' (2011) 28 *Arizona Journal of International and Comparative Law* 117; M Dubovec and L Gullifer, *Secured Transactions Law Reform in Africa* (Oxford, Hart, 2019) 28–29; L Gullifer, 'Conclusion' in L Gullifer and D Neo (eds) *Secured Transactions Law in Asia. Principles, Perspectives and Reform* (Oxford, Hart, 2021) 425, 462–64.

Having seen that secured transactions codes reject equity's solutions to priority conflicts, it is important to notice principles in those codes that preserve the genius of equity, even if they do not do so by preserving the exact concepts.[92]

The central concept of a security interest in PPSAs has been characterised as having the following features of an equitable charge. Where the debtor has or will have rights in property, the debtor and the creditor may agree that the creditor acquires an interest in the property by way of security. The debtor's rights are 'charged or to be charged with or encumbered with an interest granted in favour of the creditor for the purpose of securing performance of an obligation'.[93]

Another example relates to securing interests in future assets. PPSAs state that where the parties provide for a security interest in after-acquired property, the security interest attaches to that property without specific appropriation by the debtor, once the debtor has acquired rights in the asset (or a power to transfer rights in the asset to the secured creditor) and value has been provided.[94] This tracks very closely the principles that developed in equity, which dispensed with the common law requirement of a further act once the debtor acquired the property.[95] In addition, the equitable principles in this area continue to play a supplementary role where the codified regime does not provide for a rule to regulate priority conflicts. Assume that debtor creates two successive security interests in a car it intends to buy in favour of two creditors: C on Monday, and D on Tuesday. On Wednesday, the debtor acquires the car. If the security interests are registered they will rank in order of registration. However, if neither security interest is perfected, the interests would rank in order of attachment[96] (here, both on Wednesday). Where attachment is simultaneous, one Canadian authority suggests that priority is determined with reference to the dates of creation of the security interests, ie, the dates of the security agreements.[97] This conclusion was based on principles of equity, which the court considered were 'not inconsistent with the express provision of [the PPSA]'.[98]

In some areas, the law may have been re-written, but achievements of equity are functionally preserved. PPSAs and the UCC do not contain a distinct idea of a floating charge in the way that English law does. However, PPSAs recognise that a debtor may have authority (the 'right or ability') to dispose of goods or funds in the ordinary course of its business and the buyer, lessee or transferee may take free of the security interest.[99] This is similar to the debtor's authority under a floating charge that has not crystallised.[100] In relation to assets that are not disposed of in the ordinary course of the debtor's business, the security agreement may confer on the debtor the authority to dispose of an asset free of the security interest.

IV. Is a Codified Security Interest Legal or Equitable?

New laws do not operate in a legal void but within an established legal framework. Thus, the UCC and PPSAs expressly provide that common law and equitable principles supplement the statute and continue to apply unless they are inconsistent with the statute.[101] This is important when faced with issues not governed by the codified regime.[102] For example, codifications do not generally regulate

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[92] The idea that Equity's solutions are 'distinct' refers here to the uniqueness of rules that developed in the Chancery by comparison to those applied by common law courts, and not by comparison to all jurisdictions across the world. The solutions discussed in this section are also found in (reformed) civil law jurisdictions but it is unlikely that equitable principles were an inspiration for them, at least not directly and not uniquely.

[93] Cuming, Walsh and Wood (n **Error! Bookmark not defined.**) 118. This raises an interesting question about the extent to which a PPSA security interest, and an equitable charge, operate as 'rights against rights' (see, eg, McFarlane and Stevens (n **Error! Bookmark not defined.**). This must wait another day.

[94] SPPSA, s 13 *juncto* s 12.

[95] *Holroyd v Marshall* (1862) 10 HL Cas 191, 11 ER 999; *Tailby v Official Receiver* (1888) 13 App Cas 523 (HL).

[96] SPPSA, s 35(1), OPPSA, s 30(1).

[97] *National Bank of Canada v Merit Energy Ltd* [2001] 10 WWR 305 (Alberta QB) [47]. See, too, *Royal Bank of Canada v Radius Credit Union Ltd* 2010 SCC 48, [2010] 3 SCR 38.

[98] APPSA, s 66(3).

[99] UCC, ss 9-205 and 9-320; SPPSA, s 30. Note, however, SPPSA, s 31(2).

[100] Beale (n 95) 16–17.

[101] UCC, s 1-103; SPPSA, s 65(2); APPSA, s 66(3); OPPSA, s 72.

[102] The alternative.

priority conflicts between security interests and non-consensual proprietary interests,[103] that is interests which arise otherwise than by agreement. Examples of non-consensual interests are common law and equitable liens, statutory liens, statutory trusts[104] and constructive trusts. If a statute or body of law under which the non-consensual interest arises provides a rule resolving a conflict with a consensual security interest, that rule should apply.[105] But if neither the code nor the statute lay down a rule, a solution is sought by applying the rules of common law and equity, as directed by the provision stating their supplementary role. This requires us to characterise the codified security interest as legal or equitable, thinking from first principles, for the purpose of applying the priority rules under the general law.[106] There are three possible characterisations: legal interest, equitable interest, or either legal or equitable depending on the context. This section considers these alternatives.

Commented [SE29]: I am not clear what the nature of the exercise is here. Are we interpreting the codes? Or are we thinking from first principles about which solution should be preferred? Or something else?

Commented [MR30R29]: I hope I've clarified this.

A. An Equitable Interest

The idea that a codified interest is to be deemed equitable for the purpose of priority conflicts is easily dismissed. It was seen earlier[107] that there are a number of difficulties with equity's distinct priority rules, making the priority of the security interest undesirably unpredictable and vulnerable.

Commented [SE31]: This suggests that you are thinking from first principles about what the optimal solution would be.

Commented [MR32R31]: Yes

B. Legal or Equitable Depending on General Law

There is a view, expressed in the context of the Australian PPSA, that for the purpose of resolving a priority conflict, a statutory security interest ought to be characterised as either legal or equitable, depending on whether as a matter of general law it would operate as a legal or equitable interest.[108] A similar approach was suggested at one point in the draft Secured Transactions Code proposal in England. The proposal has since been abandoned, but it is worth setting it out here to illustrate what this option might look like:

> A [security interest] is a legal interest in the …[encumbered] asset concerned if:
> (a) the… asset is an interest in registered land, and the charge is a registered charge at Her Majesty's Land Registry; or
> (b) the… asset is an interest in unregistered land, and the… [security interest] takes effect as a charge by way of legal mortgage; or
> (c) the… [secured creditor] holds legal title to the … asset; or
> (d) the charge is a possessory charge [ie the creditor takes possession of the asset].[109]

In practice, the characterisation of a codified security interest as either legal or equitable seems simple enough where security agreements contain traditional (pre-PPSA) forms of charging clauses and such clauses are capable of giving rise to the intended form of security. However, a mere agreement is not always sufficient and a formality is needed. In such situations, parties would need to ensure they fulfil the requirements of two legal regimes: the pre-code and the code requirements. This would create a 'dual system for determining claims over shared collateral over personal property'[110] and would,

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[103] There are some exceptions: see, eg, APPSA, s 32; and OPPSA, ss 20(1)(1)(a)(i) and 31.
[104] See, eg, in Canada, the Income Tax Act, s 227 (deemed trust in favour of federal government), and see *Royal Bank of Canada v Sparrow Electric Corp* [1997] 1 SCR 411.
[105] RJ Wood, 'Supplementing PPSA Priorities: The Use and Abuse of Common Law and Equitable Principles' (2014) 56 *Canadian Business Law Journal* 31, 38.
[106] ibid 33.
[107] See the text accompanying n **Error! Bookmark not defined.**.
[108] A Waldman, 'Resolving Priority Competitions Between PPSA Security Interests and Non-PPS Interests' (2021) 44 *University of New South Wales Law Journal* 811, 834–35.
[109] *DV Secured Transactions Code* (n **Error! Bookmark not defined.**) s 3.1.
[110] J Stumbles, 'The PPSA: The Extended Reach of the Definition of the PPSA Security Interest' (2011) 34 *University of New South Wales Law Journal* 448, 455 (in the context of PPSA).

therefore, add to the complexity of the law and be highly unsatisfactory. It should also be added that, in English law, priority rules under the Land Registration Act 2002, similarly, do not depend on the legal/equitable distinction: neither the basic rule under section 28 of the Act nor its qualifications under section 29 depend on legal and equitable rights. For these reasons it was abandoned in English law reform.

In addition, for PPSA systems to import the legal/equitable distinction would contradict one of the key principles underpinning PPSAs: the unitary approach to security.[111] It is possible to apply the unitary approach more narrowly, by stipulating that where a priority conflict arises under the PPSA, the security interests are governed by the same rules, but that for purposes outside the Act the legal/equitable characterisation remains.[112] Such an approach is popular with some writers in Australia[113] considering the wording of the Australian PPSA but, it is suggested, it should not be followed elsewhere due to the complexities it is likely to generate.

C. A Legal Interest

The general view is that a codified security interest under a PPSA regime is a legal interest. A good illustration is the decision by the Supreme Court of Canada in two joint appeals, *Bank of Montreal v Innovation Credit Union*[114] and *Royal Bank of Canada v Radius Credit Union Ltd*.[115] The court considered the nature of a security interest under the relevant PPSA in the context of a priority dispute between a prior security interest and a subsequently acquired statutory interest arising under the (Canadian) Bank Act.[116] The court held:

> Two characteristics of the PPSA are relevant for the present case. First, it is clear that *PPSA* security interest, just as the Bank Act security interest, is a statutorily created interest and, as such, an interest recognized at law. While some of the historical forms of security created equitable rather than legal interests, the effect of the PPSA's functional approach, which covers all of these antecedent security interests, is to treat them all equally as 'security interests' under the PPSA.[117]

The dictum reveals two key reasons for characterising the security interest as legal in nature. One is formal: in the pre-fusion world statutory rights were enforced by a common law court, so a statutory interest must be a legal interest.[118] This is an odd argument to make post-fusion given that one set of courts administers both common law and equity.[119] It also overlooks the fact that the Chancery could enforce legislation if a matter came before it.[120] The second reason is more convincing. It is premised

Commented [SE33]: Or you could say "The general view" if you want to suggest that there is a near consensus.

Commented [MR34R33]: Of course, thanks.

Commented [SE35]: Please check the quote, it seems there may be words missing.

Commented [MR36R35]: Thanks, fixed it now.

Commented [SE37]: Also, would Chancery not have enforced legislation if a matter came before it?

Commented [MR38R37]: Yes, I agree.

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[111] See the text accompanying nn **Error! Bookmark not defined.**–**Error! Bookmark not defined.**.
[112] Waldman (n **Error! Bookmark not defined.**) 835.
[113] See, eg, D Loxton, S McCracken and A Boxall, 'PPSA Models: A Minimalist Approach' (2018) 32 *Commercial Law Quarterly* 3, 4–5; A McCracken, J Stumbles and GJ Tolhurst, 'Title Transfers Collateral Arrangements under the Personal Property Securities Act 2009 (Cth): Paper I, Setting the Scene' (2015) 33 *Journal of Contract Law* 1, 8.
[114] (n **Error! Bookmark not defined.**).
[115] (n 105).
[116] SC 1991, c46.
[117] *Innovation Credit Union* (n **Error! Bookmark not defined.**) [42] (Charron J for the Court), cited in *Diversa* (n **Error! Bookmark not defined.**) [237]; *Hamersley Iron* (n **Error! Bookmark not defined.**) [358].
[118] Surprisingly, the argument seems to have been adopted without criticism in the literature, see Cuming, Walsh and Wood (n **Error! Bookmark not defined.**) 515; D Loxton, 'New Bottle for Old Wine? The Characterisation of PPSA Security Interests' (2012) 23 *Journal of Banking and Finance Law and Practice* 163, 180–81 and S McCracken, 'The Personal Property Security Interest: Identifying Some Essential Attributes' (2014) 30 *Law in Context: A Socio-Legal Journal* 146, 165.
[119] While there is a debate about the kind of fusion the Judicature Acts 1873–75 brought about (see, eg, L Smith, 'Fusion and Tradition' in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Sydney, Lawbook Co, 2005); A Burrows, 'We Do This At Common Law But That In Equity' (2002) 22 *OJLS* 1), everyone would agree that the fusion was at the very least procedural.
[120] See, eg, *Re Lake* (1872–73) LR 8 Ch App 51.

on the idea that all security interests are to be treated the same;[121] such a unitary approach has the advantage of simplicity as pre-code distinctions become redundant.[122] And, given the choice between equitable or legal, treating them as legal avoids the unpredictability associated with equitable interests.

Characterising a PPSA interest as a legal interest is not without its problems. It might produce some 'commercially absurd results'.[123] For example, an unregistered (and so, unperfected) security interest, which is created first, wins over a registered, but later-in-time, non-PPSA interest. Such obvious absurdity could be easily avoided: only perfected security interests should be treated as legal interests.

Even with this correction, characterisation of a PPSA interest as a legal interest might render odd results in priority conflicts. There are two answers to this. One is that we ought to be prepared to question our assumptions to test why a particular result seems odd. This is illustrated below.[124] The second is that courts should be willing to resolve priority conflicts in alternative ways, for example through the notion of an implied consent. Consider the following example. A creates a security interest in favour of B in an asset on day 1. On day 2, a non-consensual statutory lien arises in favour of C over the same asset. Applying the *nemo dat* rule, B wins over C because B's legal interest in the asset was first. However, if it can be argued that B's security interest is such that B expressly or impliedly consents to a lien (or some other interest) arising in favour of C, C wins over B.[125] An implication of consent is likely to be rare: B is not likely to have impliedly consented to having its security interest subordinated to others in a wide range of circumstances as that clearly weakens B's secured position for which it bargained. However, this reasoning, while at times artificial, might help avoid unsatisfactory results in egregious cases.

D. Example: Secured Creditor v Trust Beneficiary

PPSAs do not generally contain rules for the resolution of disputes between a creditor holding a security interest and a beneficiary under a trust, whether express, constructive or resulting. An exception is where a trust is created for security purposes and so satisfies the (broad) definition of a security interest,[126] in which case the usual PPSA priority rules apply. Most trusts are not created for security purposes. Let us see what issues arise where a PPSA interest is characterised as a legal interest.[127]

Consider the following example:

> **Example 1:** On day 1, C becomes a trustee of certain shares for B. On day 2, in breach of trust, C creates a security interest in favour of A over the same shares. When A comes to enforce its security interest, B claims that A may not do so as the shares are trust property.

In the absence of a statutory rule, the dispute between A and B is resolved according to the general law. B might argue that *prima facie* A comes under a duty to B not to use its rights, as a secured creditor, inconsistently with the terms of the trust.[128] A might argue that B consented to the security

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[121] See also Stumbles (n **Error! Bookmark not defined.**) 454.
[122] Note, for example, that Canadian courts made it clear they are reluctant to apply pre-code characterisations. See, eg, *Royal Bank of Canada v Sparrow Electric Corp* (n **Error! Bookmark not defined.**) [54]–[56] (Gonthier J), [110]–[111] (Iacobucci J, in the majority) (characterising the PPSA security interest as a fixed interest even though under pre-PPSA law it would be floating, with both the majority and the minority agreeing on this point).
[123] *Innovation Credit Union* (n **Error! Bookmark not defined.**) [4].
[124] See the discussion in section IV.D.
[125] See *Fisk v Attorney General* [2016] NZHC 479, [2016] NZAR 551 (legislation was construed as impliedly granting priority to the statutory charge arising under the Customs and Excise Act 1996 (NZ)).
[126] Cuming, Walsh and Wood (n **Error! Bookmark not defined.**) 514.
[127] For the discussion below see ibid 514–16.
[128] See, eg, *Williams & Glyn's Bank Ltd v Boland* [1981] AC 487 (HL).

interest, or that A does not come under a duty to B. For example, A might seek to raise a defence of bona fide purchaser of the legal interest if it had no notice of the breach of trust, and in so doing, escape the imposition of the duty not to use its rights inconsistently with the trust. Trusts are not registrable, and notice of a breach of trust will not always be easy to establish, so the bona fide purchaser defence may well be available to A.

The matters are less straightforward where a security interest relates to future assets. Consider the following:

> **Example 2:** On day 1, X transfers property in shares to Y on trust for C. On day 2, B creates a security interest in present and future assets in favour of A to secure a loan A makes to B. The interest is duly registered in a personal property security register. On day 3, B acquires shares from Y in a transaction which was not authorised by the terms of the trust. B defaults on the loan, and both A and C claim the shares.

C's beneficial interest in the shares is first in time. However, A could argue that, under a PPSA, it holds a legal interest in the after-acquired property[129] which trumps C's interest. When the shares are acquired by B, A's legal interest defeats C's equitable interest provided A is bona fide and did not have notice of C's equitable interest.[130] In normal circumstances, it should not be difficult for A to show this. There is a question whether C could argue that A has constructive notice of C's equitable interest. This cannot be answered in the abstract but it is perhaps unlikely that making enquiries into the existence of (non-registrable) interests beyond the register is reasonable. Another reason is perhaps that the logic of PPSA is to do away with the doctrine of constructive notice. This means that unless A obtains actual knowledge of C's interest, for example, by conducting inquiries, A will not have notice of C's equitable interest. In result, A wins over C.

This result might be seen as surprising. Under pre-code law, A's interest in after-acquired property is equitable,[131] so it would not be open to A to invoke a bona fide purchaser rule;[132] C would win over A. This difference of results prompts us to ask whether the nature of a codified security interest is sufficiently different to warrant A benefitting from a bona fide purchaser rule. Intuitively, the answer is 'no' because in a codified system A does not seem to be more worthy than she would have been under pre-code law. The only thing that has changed is the codification and characterisation of A's interest.

One solution is to limit the scope of application of the bona fide purchaser rule so that it does not apply in circumstances such as those set out in Example 2. The reasoning, suggested in passing by Cuming, Walsh and Wood, is based on a particular (and uncommon) rationale for the bona fide purchaser defence.[133] On one view, the reason the defence exists is that it protects individuals against the prejudice they would suffer if they could not benefit from an interest in property for which they paid the price.[134] It might seem that a creditor who is granted a security interest in an asset in breach of trust (of which the creditor does not know), as in Example 1, would suffer the prejudice whereas a

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[129] In PPSAs, there is no difference in characterisation between a security interest in existing property and a security interest in after-acquired property: Cuming, Walsh and Wood (n **Error! Bookmark not defined.**) 262.
[130] It is clear that actual knowledge of C's equitable interest would preclude A from raising the defence but it is unclear to what extent the secured party would be required to make reasonable inquiries.
[131] See *Holroyd v Marshall* (n **Error! Bookmark not defined.**); *Tailby* (n **Error! Bookmark not defined.**) 545–49; in Canada: *Lloyd v European and North American Railway Co* (1878) 18 NBR 194 (New Brunswick CA) 206–07 (Allen CJ), cited in *Lite Enterprises Ltd v Atlantic Power Lines Ltd* (1978) 24 NBR (2d) 607 (New Brunswick QB) [8] (Stevenson J); *Vassie v Vassie* (1882) 22 NBR 76 (New Brunswick Supreme Court).
[132] Only exceptionally does the defence operate to protect a party acquiring an equitable interest, see, eg, *Thorndike v Hunt* (1859) De G&J 563.
[133] Cuming, Walsh, Wood (n **Error! Bookmark not defined.**) 516.
[134] See K Barker, 'Bona Fide Purchase as a Defence to Unjust Enrichment Claims: A Concise Restatement' (1999) 7 *RLR* 75, 76 (discussing the defence in the context of restitutionary claims arising out of similar circumstances of involuntary transfer); cf *Stanhope v Earl of Verney* (1761) 2 Eden 81, 85–86 (Lord Northington LC) (noting that the rationale for the defence is security of transfer, ie protection from the risk of unexpected liabilities on account of the transfer made).

creditor in Example 2 does not suffer similar prejudice because he does not specifically pay for *that* asset, or that when advancing the money against security over after-acquired assets, he took a risk that a future asset might never be acquired. This might work where a creditor takes a security interest over all present and future assets as a security that 'sweeps' any assets not subject to other people's interests. However, such reasoning is harder to justify in other cases of lending against future assets because the creditor in Example 2, similarly to the creditor in Example 1, provided a loan, against certain assets. While those assets are yet to be acquired, the creditor may well lend the money on the faith that they would be. .

A better way to view this problem is to flip the question and ask why, in a pre-PPSA system, a creditor taking a security over after-acquired property (and therefore necessarily an equitable interest in pre-PPSA law) should be in any worse position than a creditor taking a legal mortgage. We have already seen earlier[135] that there are similarities between a legal mortgage and an equitable charge. If a legal mortgagee can raise a bona fide purchaser defence, why should an equitable chargee not be able to? This is in fact an old problem of whether equity's bona fide purchaser defence should be available to purchasers of equitable interests as well.[136] The reason is not obvious, but it is possible that by characterising the codified security interest in after-acquired property as a legal interest, we arrive, in Example 2, at a better result. We might add that the beneficiary, while losing to the creditor, has a range of remedies available against a trustee who misappropriates trust assets and against third parties, for example for knowing receipt.

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V. Conclusion

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Commercial law and equity have always had a tempestuous relationship, reflecting the tensions between the legal policies that underpin them. The marketplace requires certainty, speed and respect for parties' autonomy while equity is generally seen as probing in detail into, and regulating, parties' conduct and motives. Lord Millett, writing extrajudicially in 1998[137], said that these policies were not irreconcilable but that an unbounded application of equity in the regulation of commerce risked undermining both policies. Two decades later, Lord Briggs[138] echoed this concern, arguing off the bench that in order to address this risk it was necessary to understand the principles that justify a particular intervention of equity.

This chapter has shown that codifications enable us to reflect on, and to formulate, the principles underpinning equity's operation, and in so doing help balance the policies of equity and commercial law. Not all of equity's principles are convenient in modern commercial practice, and so not all of them are, or should be, preserved in a codification. In secured transactions law, equity's priority rules – the bona fide purchaser defence together with the doctrine of constructive notice, and the rule in *Dearle v Hall* – are too costly and too uncertain solutions to the basic question of ranking of creditors holding security rights over the same asset. Where security rights are registered, we have seen that the law would be simpler and more certain if basic priority disputes among secured creditors were decided based on the date of registration of their respective security rights. Such a solution is found in UCC and PPSAs and it should also be adopted in English law.

The difficulties with equitable principles governing priority should not, however, overshadow the genius of equity's contributions in other areas of secured transactions. Concepts such as the charge, the floating charge and the principle that the validity of equitable security interests in future assets relates back to the security agreement are all important achievements. They have played a key role in facilitating financing transactions as they enabled borrowers to grant security rights in circumstances in which the common law would make it harder or impossible. It is unsurprising that the principles underpinning the application of these concepts have been adopted in modern secured

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[135] See the discussion in section II.B.
[136] Ames thought that the bona fide purchase defence applied to purchasers of equitable interests as well: J Ames, 'Purchase for Value without Notice' (1887-1888) 1 *Harvard Law Review* 1, 3, 8–12.
[137] Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 *LQR* 214.
[138] Lord Briggs, 'Equity in Business' (2019) 135 *LQR* 567.

transactions codifications. They should also be preserved in a future secured transactions reform in England. These concepts of equity should also act as a pointed reminder that equity functions not only through regulating a person's conduct and examination of their motives but also by perfecting obligations that relate to property. It is perhaps also unsurprising to see this function of equity grow into crucial principles of modern secured transactions laws and suggests that equity's capacity to convert personal obligations into proprietary interests is, at least in some areas, closely aligned with commercial needs.

Thus, the analysis in this chapter tells us something new about codified security interests: namely that they do have some equitable features, and in that sense can loosely be described as equitable. Nevertheless, they are not, and should not be, characterised as equitable for the purpose of priority conflicts that arise outside the codifications when a priority conflict needs to be resolved by resorting to general principles of common law and equity. This means that interests in property whose features in *uncodified* regimes would make them equitable, eg security interests in future assets, are not governed by equity's priority rules.

The foray into secured transactions codifications teaches us also something new about equity, which is that there is no necessary link between interests which have equitable features such as interests in future assets, and the bona fide purchaser defence. This in turn means that one of the basic truths about equitable interests told by the don of equity, Maitland, is wrong. Contrary to what he posited[139], the fundamental difference between legal and equitable interests does not rest in the way priority conflict is solved, with bona fide purchaser defence being characteristic of equitable interests.

[139] Maitland (n 18) 130.