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# STATES OF JERSEY



## **REFORM OF JERSEY LAW RELATING TO SECURITY INTEREST IN MOVABLE PROPERTY – STAGE 2: EXTENSION TO TANGIBLE MOVABLES – WHITE PAPER**

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**Presented to the States on 16th November 2011  
by the Minister for Economic Development**

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**STATES GREFFE**



# White Paper

**THE REFORM OF JERSEY LAW RELATING TO  
SECURITY INTEREST IN MOVABLE PROPERTY –  
Stage 2: Extension to tangible movables**

7th November 2011

**Purpose and type of consultation:**

To consult on the proposed amendments to the Security Interests (Jersey) Law 201-, intended to extend legislation on security interests to cover tangible movable property.

**Closing date:** Friday 13th January 2012

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**Summary**

The reform of the legal framework governing security interests has been undertaken in two stages. The first stage is almost complete – a draft Law (SIJL1) addressing security interests in intangible movables was recently approved by the States and will replace the Security Interests (Jersey) Law 1983 following Privy Council approval. The second stage, which is the focus of this consultation, proposes to extend the new Law to cover security interests in tangible movables.

The main changes proposed are –

- the extension of SIJL1 to cover goods and the classification of goods;
- the insertion of a number of additional definitions;
- the expansion of the concept of “security interest” to cover –
  - sales with reservation of title; and
  - hire-purchase agreements, leases and consignments where securing payment or performance of an obligation, or where not, their treatment as security interests for all purposes except Part 7 (enforcement of security interests);
- the provision of additional rules on attachment and perfection;
- special rules relating to consumer goods; and
- new provisions on the priority of purchase money security interests.

We welcome all comments on the proposed changes. This document should be read alongside a copy of the SIJL1, which can be found on the States Assembly website:

<http://www.statesassembly.gov.je>

**Please send your comments to:**

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Jersey Finance Limited will co-ordinate an industry response incorporating any matters raised by local firms or entities.

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## I INTRODUCTION

1. The legal framework for securities in Jersey requires modernisation to provide Jersey with a simplified, modern and efficient legal regime for the creation, perfection, priority and enforcement of security interests. Given the scale of the change, it was decided to progress the reform in two stages: Stage 1 to address security interests in intangible movables; and Stage 2, to extend this to cover security interests in tangible movables.
2. The first stage of reform is almost complete. The Security Interests (Jersey) Law 2011- (SIJL1) was adopted by the States Assembly on 19th July 2011 and, following Privy Council approval, will replace the Security Interests (Jersey) Law 1983. This consultation sets out the proposed changes regarding Stage 2 of reform (SIJL2).
3. SIJL2 will not be a separate, standalone Law, but will integrate a set of provisions relating to tangible movables into SIJL1. The structure of SIJL1 is well designed for this integration. Many of its provisions, for example, those relating to the enforcement of remedies and to registration, apply to movables generally, while others can be adapted simply by deleting the word “intangible”.
4. SIJL2, like SIJL1, draws on the experience of other countries, notably the United States, Canada, New Zealand and Australia, with a particular focus on the Saskatchewan Personal Property Security Act and the New Zealand Personal Property Securities Act.

## II THE CONCEPT OF SECURITY: PURCHASE MONEY SECURITY INTERESTS

5. SIJL1 adopts a unitary concept of security, so that “security interest” is a neutral phrase covering mortgages, charges, pledges and contractual liens. Jersey law has not previously recognised consensual non-possessory security interests in goods, such as the hypothec, apart from special cases – for example, registered ship and aircraft mortgages. The extension of SIJL1 to goods will, for the first time, permit non-possessory security interest in goods. However, security interests in ships and aircraft are typically subject to special regimes and will not fall within the Law except so far as prescribed by Order.
6. SIJL2 will also bring further types of interest for consideration as security interests. In line with the policy adopted in the other jurisdictions referred to above, SIJL2 would extend the traditional concept of “security interest” to cover conditional sale agreements, hire-purchase agreements, leases for more than a year and consignments. All these would be registrable, whether or not securing payment or performance of an obligation. This is so that third parties dealing with the debtor and proposing to advance funds against the security of the goods will be aware that the debtor is not the owner. However, a distinction would be drawn between conditional sale agreements and other interests as set out below.

### Conditional sale agreements

7. Conditional sale agreements would be treated for all purposes as security agreements, so that as well as being governed by the registration and priority rules, the title reservation they embody would be limited to that of a security interest. In consequence, if after default the goods are repossessed and sold, any surplus would belong to the debtor, and conversely, the debtor would be liable for any deficiency.
8. The policy reason for this is that title reservation is designed to fulfil a security function: the seller's concern is to ensure that it recovers payment of the agreed price and charges; not to make a profit from the debtor's default. That is why all the overseas statutes treat the interest of the seller as limited to that of a security interest, taking the approach of substance over form. However, the seller's reservation of a right of disposal of goods shipped under a bill of lading, by taking the bill of lading to the order of the seller or its agent, does not by itself create a security interest.

### Hire-purchase agreements, leases and commercial consignments

9. By contrast, hire-purchase agreements, leases and commercial consignments may or may not fulfil a security function, depending on how they are structured. Where they do not fulfil a security function, although they will be registrable in order to give notice to third parties and will be governed by the priority rules, when it comes to default the creditor will be treated as the full owner. They will be entitled to deal with repossessed goods as they choose and to retain any surplus resulting from sale. This would be achieved by a provision excluding such agreements from Part 7 of the Law.
10. Article 9 of the Uniform Commercial Code has elaborate provisions to determine when an agreement within one of these categories<sup>1</sup> is or is not to be treated as creating a security interest. For example, a transaction in the form of a lease is treated as creating a security interest if, among other things, the original term of the lease is equal to or greater than the remaining economic life of the goods, or the lessee has an option to renew the lease for the remaining economic life of the goods or to buy them for no additional consideration or for a nominal additional consideration. A commercial consignment will usually be considered to create a security interest if the consignee is obliged to buy the goods in due course whether or not it is able to sell them. In a true consignment, the risk of non-sale is on the consignor.
11. The underlying idea is to treat the hirer, lessee or consignee as the owner and the grantor of a security interest if the agreement transfers the risks and rewards of ownership. Indeed, statement 21 of the Standards of Accounting Practice (SSAP 21) treats leases in this way for accounting purposes.<sup>2</sup> Accordingly, instead of complex provisions on the characterisation issue, it is

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<sup>1</sup> Hire-purchase is not a separate category under Article 9 but simply a lease with an option to purchase.

<sup>2</sup> SSAP 21 divides leases into finance leases and operating leases, the former being regarded as transferring economic ownership to the lessee, the latter not. This division has been criticised and SSAP 21 is currently under review. Nevertheless, the concept of transfer of risks and rewards of ownership is likely to remain.

considered more appropriate to follow the economic model and provide that Part 7 of the Law will not apply to these 3 categories of agreement if they do not substantially transfer all the risks and rewards of ownership of the goods to the hirer, lessee or consignee.

12. In the case of a lease, experience has shown that lessors tend to register as a precaution if the lease is for any significant length of time. Therefore, the Canadian and New Zealand statutes require the registration of leases for more than one year in the interests of certainty and apply the priority rules to such leases, though they will be outside the rules on default remedies if they are not in substance security agreements.
13. It is proposed to adopt the same principle in SILJ2 but, as in the legislation referred to above, to exclude a lease, whatever its term, involving a lessor not regularly engaged in the business of leasing goods. It will also exclude a lease of household furnishing or appliances as part of a lease of land where the goods are incidental to the use and enjoyment of the land. The Law would define “lease for more than a year” to capture leases for an indefinite term and renewable leases where the total of the terms may exceed one year.

**Question 1:** Is the broad approach to distinguishing security from non-security types of agreement appropriate or should more detail be provided? If the latter, please explain the level of detail you think is required.

#### **Purchase money security interests**

14. SILJ1 already embodies the concept of a purchase money security interest – in essence, the interest taken by a seller securing the obligation to pay the purchase price of collateral or by a person advancing funds for the purchase of collateral. The designation of a security interest as a purchase money security is relevant primarily in determining priorities, in that for policy reasons, a purchase money security is in general given priority over a non-purchase money security interest (see paragraphs 29–33).
15. The expansion of the concept of security interest necessitates a corresponding expansion of the meaning of “purchase money security interest”, which will now extend to the interest of a lessor under a lease for more than one year and the interest of a consignor who delivers goods to a consignment under a commercial consignment. A commercial consignment is essentially a consignment of goods for the purpose of sale, lease or other disposition where both consignor and consignee are dealers in goods of that description. It does not include goods delivered to an auctioneer for the purpose of sale.
16. Registration of such agreements would create a level playing field with the forms of security covered by SIJL1, which under that Law become registrable for the first time. Registration would enable the supplier to protect itself against third parties, both as to the goods supplied and as to their proceeds. It would also allow third parties, including potential retention of title sellers or potential lessors, to discover whether anyone was ahead of them. Further, the notice filing concept embodied in SILJ1 and extended to goods in SILJ2 would allow a conditional seller, lessor, etc., to secure itself, not only for the

existing agreement, but for all future agreements covering the same class of collateral by a single filing, instead of having to register each transaction separately. In this way, title-retention suppliers and lessors would in effect be able to enjoy the same all-moneys security as the holders of charges. This is in contrast to the present Law, where security over proceeds of goods sold under reservation of title or leased cannot be protected at all.

**Question 2:** Should the law extend to agreements relating to vehicles with unique serial numbers and, if so, should the registration system provide a facility for registration of the vehicle identification number (VIN) in the financing statement and for searching by VIN alone?

### III CLASSIFICATION OF COLLATERAL

#### **Tangible movable property**

17. SIJL2 would extend the Law to cover tangible movable property, that is, it would cover goods and intangible movable property. “Goods” would be defined to include money, crops (whether growing or severed from the land), trees which have been severed, petroleum, gas or other minerals which have been extracted, the unborn young of animals and the bodily products of animals. The term would not include documentary intangibles.
18. In addition to money, which would be considered as a distinct category, SIJL2 would divide goods into 3 categories according to the purpose for which they held, namely –
  - (1) inventory, consisting primarily of goods held for sale or lease and raw materials;
  - (2) equipment, that is, goods held by a debtor other than as inventory or consumer goods; and
  - (3) consumer goods, that is, goods acquired for use primarily for personal, family or household purposes.

#### **Inventory**

19. Since inventory is not intended to be retained, but to be disposed of in the ordinary course of business, it is necessary to have special priority rules to protect buyers of inventory in the ordinary course of business and holders of purchase money security interests in inventory and proceeds. Security interests in inventory are transitory in nature, and what the secured party seeks to capture are the proceeds, such as the receivables arising from sale.

#### **Consumer goods**

20. Consumer goods are a distinct category for several reasons. Firstly, there is a need to provide for automatic perfection of a purchase money security interest in consumer goods without need for registration. This is to avoid swamping the registry system with security interests arising under large numbers of small

transactions. Secondly, for policy reasons, legislation elsewhere precludes a debtor from granting a security interest in after-acquired consumer goods, other than an accession given as additional security, unless the debtor acquires rights in the goods within 10 days after the secured party gives value. A similar rule is proposed for SILJ2. Thirdly, again for policy reasons, SIJL2 would require consumer goods to be described by item or type and would not permit a generic description. Fourthly, a corollary of the rule that security interests in consumer goods are perfected without registration is that the buyer or lessee of goods acquired as consumer goods should take free of a security interest in the goods if acquiring them for value and without knowledge of the security interest.

21. A separate question is whether a consumer should be able to give a security interest in goods he already owns: the pledge of goods to a pawnbroker is a long-established form of security and there seems no reason to interfere with this; equally, the consumer should be free to grant a non-possessory security interest in goods he already owns.

**Question 3:** Should a consumer be able give a security interest in goods he already owns?

**Question 4:** Should a security interest be able to be given in physical currency?

### **Equipment**

22. Equipment consists of all goods that are neither inventory nor consumer goods – primarily equipment held for use in the debtor’s business.

### **Overall classification of collateral**

23. The effect of the above is an overall classification of collateral as follows –
- (1) Tangible movable property:
    - (a) Inventory
    - (b) Equipment
    - (c) Consumer goods
    - (d) Money;
  - (2) Intangible movable property:
    - (a) Documentary intangibles:
      - (i) Negotiable instrument
      - (ii) Negotiable investment security
      - (iii) Negotiable document of title;
    - (b) Other (“pure”) intangibles.

#### IV ATTACHMENT AND PERFECTION

##### **Attachment**

24. The rules on attachment and perfection of a security interest have to be supplemented to accommodate what can be compendiously referred to as potential property – that is property growing out of existing property. It is envisaged that SILJ2 would provide that the grantor of a security interest would have no rights until the time that: crops become growing crops; the young of animals are conceived; fish are caught; petroleum, gas or other minerals are extracted; and timber is cut.

##### **Perfection**

25. Various additional provisions are necessary to deal with the perfection of a security interest in goods. The first would state that perfection of a security interest in a document of title to goods, for example by possession, perfects a security interest in the goods themselves. The second would add goods to the items of collateral a security in which is perfected by possession. The third would provide methods of perfecting a security interest in goods in the possession of a bailee: namely attornment to the secured party; issue of a document of title by the bailee to the secured party; and perfection of a security interest in a negotiable document of title where the bailee has issued one. The fourth would deal with temporary perfection of a security interest in a negotiable document of title or goods returned to the debtor for the purpose of sale, exchange or related matters.

#### V PRIORITIES AND TAKING FREE

26. The extension of the Law to goods would necessitate several additions to the priority rules.

##### **Priority of security interest perfected in a document of title**

27. The first additional rule is that a security interest perfected in a document of title to goods that are in the possession of the issuer of the document has priority over a security interest perfected in the goods by another method. Therefore, if goods shipped under a bill of lading are given in security while in transit without delivery of the bill of lading to the secured creditor, and the same goods are later pledged to another lender by delivery of the bill of lading while the goods are still in transit, the second lender has priority.

##### **Priority of security interest in crops**

28. A perfected security interest in crops growing on land has priority over a conflicting interest in the land if the debtor has an interest in the land or is in occupation of the land. The policy reason for this rule is that in most cases it is the debtor, rather than the owner of the land, who will be entitled to the crops.

### **Priority of purchase money security interest in goods**

29. Article 34 of SILJ1 also provides a priority rule for security interests in intangible movable property and its proceeds. SIJL2 would provide rules to determine priority between a purchase money security interest in goods or their proceeds and a competing security interest in the same collateral.
30. In principle, a purchase money security interest should have priority over an earlier non-purchase money security interest in the same collateral. The reason for this is that since it is the purchase money financier's advance that has enabled the additional collateral to be acquired, it would be unfair to allow an earlier non-purchase money financier to gain a windfall addition to its security under an after-acquired property clause in its security agreement. Moreover, without such a rule, the earlier non-purchase money financier would gain a monopoly over the debtor's financing, for no new party would be willing to advance funds for the purchase of additional collateral only to have this swept up into the earlier security interest.
31. English law currently arrives at a similar result through case law in which the courts have held that the after-acquired property clause can only attach to future property in the form in which it is acquired by the debtor, i.e. encumbered from the outset by the purchase money security interest. To put the matter another way, the earlier financier's interest attaches only to the debtor's equity in the after-acquired property. Though the purchase money security interest should in principle be given a special priority (subject to an exception in favour of a first-to-file receivables financier – see paragraph 38), the conditions in which this should be given should vary according to the nature of the collateral and the competing security interest.

### *Priority of purchase money security interest in inventory or proceeds*

32. In giving priority to the holder of the purchase money security interest in inventory or its proceeds, 2 safeguards need to be provided for the non-purchase money secured party. Firstly, the purchase money security interest must have been perfected at the time the debtor obtains possession of the collateral. Secondly, the non-purchase money financier, if its financing statement was filed before that of the holder of the purchase money security interest, needs to be given a notice prior to the debtor obtaining possession of the inventory. This must state that the purchase money financier or intended financier has acquired or expects to acquire a purchase money security interest in inventory of the debtor and describe the inventory.
33. The reason for these 2 rules is to ensure that the non-purchase money financier is not misled by the debtor's possession of additional inventory and production of invoices into thinking that the debtor is the unencumbered owner of the inventory and can therefore provide it as collateral for further advances, as is common with inventory financing. It is not necessary that the purchase money security interest shall have been perfected or even created at the time the notice is given; it suffices that the notice is given before the debtor obtains possession. A single notice, like the financing statement itself, can therefore cover not only existing security interests but those expected to be acquired in the future.

*Cross-collateralisation*

34. In order for a purchase money security interest in inventory to be effective, it is necessary to treat the financed inventory as a block rather than on a unit-by-unit basis, and therefore to cross-collateralise the security interest. If the security interest were to be treated as a purchase money security interest only on a unit-by-unit basis, then a security interest taken to secure the price of a particular unit and all other obligations of the debtor would be a purchase money security interest only to the extent that it secured payment for that unit.
35. For example, a financier, F, takes a purchase money security interest in unit 1 to secure the price of unit 1 and all other obligations, and a separate purchase money security interest in unit 2 to secure the price of unit 2 and all other obligations. The debtor, D, then sells unit 2, extinguishing F's security in that unit, and pays for unit 1 but not unit 2. If the purchase money security interest is treated on a unitised basis, the security interest in unit 1 would not be a purchase money security interest to the extent that it secured the price of unit 2. Such a result is highly inconvenient and would necessitate some control mechanism to ensure that payment for each unit was allocated only to that unit.
36. SIJL2 would therefore follow the approach adopted in Article 9-103(b)(2) of the Uniform Commercial Code. It would provide that a purchase money security interest in an item of inventory, which also secures a purchase money obligation incurred with respect to other inventory in which the secured party holds a purchase money security, is to be treated as a purchase money security with respect to the other inventory as well as the particular item financed. In short, each item of inventory financed by the secured party on the security of that unit serves as collateral not only for its own purchase price but for the purchase price of all other items of collateral so financed.

*Priority between receivables financier and purchase money inventory financier*

37. A much-debated question is how a priority dispute between an inventory financier claiming receivables as proceeds of inventory and a receivables financier claiming the same proceeds as original collateral should be resolved. For example, the debtor gives a purchase money security interest over inventory and proceeds to its bank, sells inventory, producing proceeds in the form of receivables, and then sells the receivables to a factor or invoice discounter. Jurisdictions that have adopted personal property security legislation are divided on whose security interest should be given priority: that of the bank or that of the factor or invoice discounter.
38. The approach taken in the Saskatchewan Personal Property Security Act, and followed by the English Law Commission, is that in this case priority should go to the factor/invoice discounter if it was the first to file, thus displacing the normal rule set out in paragraph 31. The reason is that protecting receivables financing is considered to be more important than protecting inventory financing. If factors and invoice discounters filing financing statements were to be subordinated to subsequent purchase money financiers they could never safely buy receivables at all, since they would have no way of knowing in

advance who would be coming in ahead of them and would therefore be unable to negotiate a waiver or subordination. By contrast, the inventory financier could negotiate with the receivables financier for a portion of the payments due to the debtor to be paid direct to the inventory financier, an arrangement not infrequently made between a factor or invoice discounter and the debtor's bank.

*Priority of other competing purchase money security interests*

39. Where there are two or more purchase money security interests falling outside the above rules, priority is determined by the residual priority rules in what is currently Article 29 of SILJ1.

**Buyer in ordinary course of business**

40. A buyer or lessee of goods in the ordinary course of business should be entitled to assume that his seller or lessor is entitled to sell or lease the goods whether or not the seller or lessor has granted a security interest. Typically the sale or lease will be of inventory, which the secured party knows is held for sale or lease in the ordinary course of business. Accordingly, the buyer or lessee should take free from the security interest, even if knowing of it, unless also knowing that the sale or lease was in breach of the security agreement.

VI ENFORCEMENT OF SECURITY INTERESTS

41. Some further provisions will be introduced in relation to the enforcement of security interests. First, the powers of sale and appropriation can in general be exercised, not only by the senior secured creditor, but also by a junior secured creditor, on the basis that the sale or appropriation will take effect subject to the senior interest if it is not discharged. However, this approach is inappropriate where the collateral consists of money, since there is then no way of preventing the senior secured creditor's interest from being overreached. Therefore, there is a new provision that only the senior creditor can appropriate or dispose of money. Secondly, there will be provisions to ensure that in calculating a surplus, account must be taken of the present value of any future obligation and the value of any contingent obligation. A party wishing to redeem must discharge not only present obligations but the present value of any future obligations and must provide adequate security for the fulfilment of any contingent obligations.

VII NEW AND AMENDED DEFINITIONS

42. The provisions outlined above will necessitate the following new definitions –

Commercial consignment

Conditional sale agreement\*

Crops

Equipment

Goods

Hire-purchase agreement\*

Inventory

Lease for term of more than one year

Movable property.

\*These terms can be defined by reference to the definitions in Article 1 of the Supply of Goods and Services (Jersey) Law 2009.

43. The following definitions in SILJ1 will require some amendment –

Documentary intangible

Intangible property

Purchase money security interest

Security interest.

#### VIII AMENDMENTS TO OTHER LEGISLATION

44. The Supply of Goods and Services (Jersey) Law 2009 will need to be amended to provide that any reservation of title by a seller under an agreement for sale is limited to a security interest and as such is governed by SIJL2.

#### IX TRANSITIONAL PROVISIONS

45. It was agreed that since Jersey law does not currently permit non-possessory security interests in goods, there was no need for the grandfathering clause in paragraph 1 of Schedule 2 and that the regime of paragraph 5 relating to the assignment of receivables should be extended to security interests in goods perfected under the 1983 Law. A new paragraph 6 has been added to Schedule 2 to cover this.

**Question 5:** Do you have any additional comments on any of the proposals outlined in this paper?

## **HOW TO RESPOND**

The deadline for responses is Friday 13th January 2012.

All respondents should indicate the capacity in which they are responding (i.e. as an individual, company, representative body, etc). If you are responding as a company or representative body, please indicate the nature of your business and/or your clients' business. Representative bodies should identify on whose behalf they are responding and the methodology they used to gather responses.

*Responses and any additional comments may be sent to any of the following:*

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Jersey Finance Limited will co-ordinate an industry response incorporating any matters raised by local firms or entities.

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