THE LAW AND PRACTICE OF ASSIGNMENT OF HIRE-PURCHASE AGREEMENTS

The last official trading period for which figures relating to hire-purchase agreements are available is the last quarter of 1967. In this period, not a particularly good trading one, hire-purchase transactions involving goods with a cash value of 42 million dollars were executed. Of this sum, only an approximate 45% was paid in cash.[1] It is therefore obvious that, over the course of a year, retailers dealing in hire-purchase agreements must have a considerable outlay of capital. Yet every dealer must replace the stock he sells under hire-purchase, and usually must pay for these replacements in cash or on a monthly basis. Somehow the dealer must obtain finance to purchase this new stock-in-trade, and commercial lawyers have been productively engaged over the course of many decades in devising a great many schemes whereby he may do so. The systems available to him, and other retailers who grant consumer credit in ways other than by hire-purchase, range from short-term loans from banks to the granting of a floating charge or the entering into of elaborate field-warehousing arrangements. These, and many other forms of sales financing, are independent areas of study in their own right. It is the purpose of this paper, however, to study the law and practice of a system whereby the hire-purchase agreements themselves are used by the dealer to recoup immediately the bulk of his outlay tied up in unpaid instalments—the system of assignment of the hire-purchase contracts.

THE PRACTICE

The basics of an assignment transaction are simple. A hire-purchase agreement is concluded between the dealer and the "purchaser,"[2] the dealer then assigns his "interest"[3] in the agreement to a finance company for consideration. The details are complex, due mainly to differences in practice which occur. However, there is some degree of uniformity on the major points of practice, and most assignment transactions share the following characteristics:

1. They are executed in pursuance of a standing master agreement between the finance company and the dealer. This agreement usually sets out in some detail the terms upon which the finance company will take the assignment and the dealer's liability in respect of transactions he assigns. It will also usually fix the rate and method of payment by the finance company for the agreements (or the rate of advances on

1. These figures are taken from the *1968 New Zealand Year Book*, pp. 605-607.
2. In this paper the term "purchaser" has been used to signify both the hirer under a *Helby* v. *Matthews* [1895] A.C. 471 agreement and the conditional purchaser under a *Lee* v. *Butler* [1895] 1 Q.B. 333 agreement.
3. In respect of a hire-purchase transaction a dealer has two interests he can assign—his contractual interest in the agreement and his proprietary interest in the goods sold or hired under the agreement.

them, if the assignment is my way of mortgage[4]). Often, the first two matters above will also be included on the back of each individual agreement assigned, but the master agreement is in most cases the dominant document *vis-à-vis* the rights and obligations of dealer and finance company.

2. Under the terms of the above agreement (or in a few cases, in accordance with an oral agreement between the parties) the finance company undertakes to consider, at stated (usually monthly) intervals, proposals put forward by the dealer for assignment of agreements. Although not bound to take an assignment of every or any agreement proposed, in practice the finance company will in fact discount them all. There is practically no investigation by the company of the purchaser's credit-worthiness, nor a checking of the agreement to ensure it has complied with the Hire-Purchase and Credit Sales Stabilisation Regulations 1957. Although this prima facie appears to place the finance company in a financially dangerous position should the purchaser be a poor risk and default, or sell or destroy the chattel, or should the Regulations have been breached, its apparent carelessness is justified on at least two grounds: primarily, the cost involved in such investigations would absorb the little profit usually made on these transactions, and secondly, the risk of the purchaser's default is often borne by the dealer under a recourse clause in the master agreement or in the deed of assignment. Both these factors will be discussed at length subsequently.

3. In practice, most assignments are made in "block". Dealers collect all the contracts they have entered into, at the end of each month, and assign them together. Schedules are usually prepared preparatory to assignment, and on this schedule the agreements will be listed by number, together with particulars such as deposits and instalments paid. Assignment of individual agreements takes place to a far lesser extent, for reasons explained below.

4. Before assignment, usually on the basis of the particulars in the schedule, the sum due to the dealer from the finance company is calculated. Many considerations affect the discount rate, and before these can be adequately explained it is necessary to mention some points of overall financing practice. Finance companies which discount hire-purchase agreements are in much the same position as was Odysseus between Scylla and Charybdis. Looming on the one hand are the high administrative costs discounting involves—on the other the relatively high incidence of default among purchasers under hire-purchase contracts. Twenty, or even ten, years ago most finance companies took these risks and were prepared to lay out large sums of capital to discount agreements. In the last few years there have been many important changes in the New Zealand retailing economy, and the financing of many retail transactions. First and foremost there has

4. There are two basic forms of assignment: absolutely, or by way of mortgage. For all non-legal purposes they amount to the same thing; in both there is basically a sale of the dealer's interest to a finance company. For the law on this point, see pages 326 ff infra.

been the virtual closure of the new-car financing market to most finance companies. Such financing and specifically the discounting of hire-purchase agreements relating to such vehicles, is now monopolised by the three leading vehicle manufacturers through their own subsidiary finance companies. Most dealers are obliged under the terms of their franchise agreement to finance themselves and their clients through these subsidiaries. Other makes of cars, if sold on hire-purchase, are largely financed by three other private companies.

Secondly, there has been the growth and expansion of the large general retailing stores, particularly in the cities and the relative decline of the small, specialist retailer. The large retailers are usually capable of absorbing the outlay hire-purchase demands of a retailer. If they do finance their credit sales, it will usually be with and through their own finance department. Their growth has been both a partial cause and possible result of the decline of the small retailer. Dealers in electrical goods, furnishings, textiles and used cars are vulnerable to economic recessions, particularly if they specialise in one class of these goods. Particularly in the case of electrical goods suppliers, the fall-off in sales volume over the last few years and the competition from the larger stores has necessitated relatively frequent closures of business.

The end result of these two factors is plain. In car-sales financing, the would-be discounter has his potential market restricted to second-hand car dealers. Some of these are of unknown reputation, sell cars of such dubious age and quality and have such a high default rate amongst purchasers, that many finance companies refuse to deal with them. Similarly in the merchandise field many of the retailers who do seek to have transactions discounted are themselves in financial difficulties. Most finance companies work on the assumption that such retailers will not be careful with whom they enter into hire-purchase agreements, and refuse to discount for such retailers. In both retailing fields there are certain dealers who are good clients, usually the well-established, reputable and financially secure businesses of moderate size. It is for their discounting trade that companies compete. Such dealers are fully aware of their strong position, and will discount with the finance company with whom they can negotiate the best terms. The three main "bargaining" points between finance company and dealer are:

(a) The amount paid to the dealer immediately upon assignment;

(b) In the recourse clause;

(c) In the amount of the servicing charges made by the finance company.

(a) *The Amount Immediately Paid to the Dealer*

Not surprisingly, all dealers want as high a price as possible for the agreements they sell or mortgage. Perhaps the most common means of calculating sums due to the dealer is to pay him the difference between the amount he has already received from the purchaser (usually only the deposit) and the cash price of the chattel sold or hired under the agreement. This leaves the difference between the

cash price and the contract price for the finance company. However, it is often the finance company's policy to withhold payment of a proportion of the discounted price as a reserve, until the purchaser has completed payment under the agreement. Should the purchaser default or sell the chattel, the reserve (or as much of it as is required to satisfy the debt) is withheld by the finance company. The incidence and amount of the reserve depends directly upon the relative strength or weakness of the finance company and the dealer. A retailer whose business the finance company is anxious to secure or retain will be in a strong position to resist reserve trading. However, many finance companies, even when dealing with larger retailers, will insist upon a reserve of 10%-20%, if the agreements being discounted relate to electrical goods, home appliances or furnishings. Such chattels have, usually, very low resale value. Should the purchaser default and necessitate repossession by the finance company, the amount realised on the agreements is usually less than the balance owing under them. The security given by the reserve in such cases is often the only way the finance company can ensure it receives the full price owing. In the case of automobiles, resale value is usually closer to the contract price, and so the reserve is less frequently used in transactions when agreements relating to these are assigned. Although this appears to be the usual situation, it must again be stressed that the reserve, or lack of it, and the percentage it involves rests largely on a policy decision by the finance company. It may be willing—or forced—to forego it when discounting for a home appliance dealer to secure his business or prevent it going to another discounter.

(b) *The Recourse Clause*

In this connection there is again the conflict between the finance company's desire for maximum security *vis-à-vis* the agreements it discounts and the practical requirements of offering attractive terms to a retailer in this competitive field. Retailers, understandably, dislike recourse trading, which makes them liable (in general terms) to indemnify the finance company for any loss the latter suffers through discounting the agreement. Therefore, a promise by a finance company to make recourse free discountings is a strong inducement to a retailer to give this company his business, and the evidence tends to suggest that, especially in the used-car field, recourse-free discounting is becoming the rule rather than the exception. This has been forced upon finance companies due to the competitive nature of used-car discounting, and although individual recourse (i.e. the dealer guaranteeing specific agreements) may still take place, dealers are usually in a position to force recourse-free assignments.

Home appliance, electrical and furniture dealers are, as in the case of the reserve, in a less advantageous position. Recourse terms in the master agreement are usually insisted upon by all companies. This is not because the rate of default is any higher than among purchasers of new cars, but because the value of the chattels repossessed is often low, especially in the case of carpets, fittings and furniture. Because of the same considerations that prompt companies to institute the

reserve in this area, the recourse clause is a necessary security in order to make the practice of discounting these agreements viable from an economic standpoint. There is also another point to be borne in mind. Although default rates by purchasers of home appliances or electrical goods are probably no higher than among used-car purchasers, there are numerically far more agreements of the former type. Automobiles are movable but they are traceable. Transistor radios, television sets and even refrigerators and radiograms are not. If they disappear with the purchaser, or are sold by him, they are generally not recovered. So in this way too the potential loss ratio per agreement is far higher in this field. Even to win a desirable customer, finance companies are reluctant to dispense with recourse trading in areas outside used-cars.

(c) *The Finance Company's Service Charges*

"Service charges" are perhaps the greatest bargaining point between finance company and dealer, or, more correctly the greatest point of competition between the finance companies themselves. Most companies pay a dealer the difference between the money he, the dealer, has already received directly from the purchaser and the cash price of the chattel. The company's "profit" is therefore the difference between the cash and contract prices—about 10%-15% of the cash price. However, finance companies would regard this latter statement rather cynically, for two reasons, since out of this "profit" two main expenses must be met. The first is the charge for administering the agreement, about which more will be said presently. The second is the high cost of securing the assignment. That discounting is highly competitive, especially in the case of agreement relating to automobiles, needs no repetition. In order to secure the discounting business of the more desirable—and even slightly suspect—motor dealers, a finance company will often reduce its own profit margin to pay a bonus of $5, $10 or even $20 to the dealer in respect of each contract he executes and assigns. Such a bonus does, in effect, reduce the dealer's "loss" on each agreement. Premium payments are far less common in the other fields of retailing. In the merchandise area, the finance company is in a stronger bargaining position and it is only when the company is making a concerted attempt to secure a large amount of business that bonus payments will be offered.

The dichotomy of the used-car and what I have termed the merchandise practices is readily apparent if one studies the differences in the terms of master agreements in respect of each retailing field. Naturally, there are exceptions. To secure the business of a large merchandise trader, non-recourse, non-reserve terms may be offered. Conversely, a finance company may insist upon high-reserve dealing with some of the less reputable and, perhaps, financially insecure car dealers. This latter point is borne out by the case of one company which refused to take assignments from a Wellington dealer without a 40% reserve provision, an indemnity term, and an independent undertaking to pay on demand all sums owing under the assigned agreements. The dealer, to what one may suspect was the company's relief, refused.

5. After the execution of the assignment, there arises the question of the collection of instalments. Where the agreement relates to home appliances or other forms of merchandise, it is the usual practice for the dealer to act as collection agent for the payments. As the purchaser is not notified in such cases that the contract has been assigned, he may from beginning to end of the transaction be unaware that the debt is owed not to the dealer but to a finance company. The dealer usually holds the money received under a trust clause in the master agreement, though in all probability he will not keep it separate but put it straight into his bank account. At the end of each month (or the time specified) the dealer pays to the finance company the amount shown as due on the schedule which may be more or less than the amount collected. The advantage of this collection system is that it saves the finance company the time and expense of receiving individual payments, sending "reminder" notices and the myriad other functions a dealer is better equipped to do. And as such dealers are usually under recourse liability it is in their own interest to keep purchasers "on their toes". The greatest defect of the system, as several finance companies can testify, is that it places funds in the dealer's hands which can be misused by him. To minimise this risk companies keep a watchful eye on suspect clients, and give themselves the right, under the master agreement, to enter the dealer's premises and check his books and accounts at their pleasure.

When contracts relating to automobiles are assigned, the company will usually notify the assignee and require him to pay all instalments to the finance company itself. Because there are such large sums involved in each contract, the company will prefer to keep a close and watchful eye on each individual purchaser.

THE LAW

This rather general discussion of the basic practice completed, the legal aspects of the assignment transaction will now be analysed. Detailed attention will be given to some points, such as the question of the effect of illegality of the original contract and the need for registration of the assignment under the Chattels Transfer Act 1924. Although these points may not arise often in practice, the principles behind them are at the basis of this important commercial practice.

1. *Introduction*

Any standard text on equity or contracts discusses the growth of the concept of assignability and the present-day situation. It is of little value to repeat it here. Theoretically, when a dealer and a purchaser enter into a high-purchase agreement both have interests they can assign. In almost every case, however, the purchaser's rights of assignment are restricted or excluded. In any case, his rights of assignment are not the concern of this paper, the law relating to them can be found in Dugdale,[5] Leys and Northey,[6] Guest,[7] or Goode.[8] A dealer

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5. *New Zealand Hire Purchase Law*, 2nd ed. 1965.
6. *Commercial Law in New Zealand*, 4th ed. 1969.
7. *The Law of Hire Purchase*, Sweet & Maxwell, London, 1966.
8. *Hire Purchase Law and Practice*, Butterworths, London, 1962.

has two interests he can assign, his interest in the hire-purchase agreement and his property rights in the chattel hired or conditionally sold. As each of these interests is legally separate, he could assign his contractual interest to A and his property interest to B. Assignment of the latter alone is, however, commercially unrealistic. An assignee of such interests would take them subject to the contractual agreement in relation to the goods and would receive but a "reversion of diminishing value without any corresponding contractual right to receive the instalments paid".[9] Only in the event of the purchaser's default or termination do the property rights assume importance.

An assignee of contractual rights obtains a far more valuable interest, most importantly the right to receive instalments. But should the purchaser default, although he can sue for breach of contract, he has no right to repossess the goods, as this right is dependent on title. Since repossession and subsequent resale is the main way the finance company would recover the unpaid instalments value, it is seldom content to take an assignment solely of the dealer's contractual rights. To protect itself the finance company adopts one of the following courses:

(a) It may take an assignment of the contractual interest plus the right to repossess in the event of the purchaser's default;

(b) It may place a clause in the deed of assignment which obliges the dealer, at the company's request, to repossess the chattel;

(c) It may take an assignment of both contractual and property rights. This is the most common form, but it is far from being axiomatic that this is the universal practice, for, as will be subsequently seen, there are possibly some minor drawbacks with such an assignment.

It should be noted, however, that even if form (c) is adopted, there may be a limited class of contractual rights conferred upon the dealer in the hire-purchase agreement which are incapable of assignment. Despite the fact that the assignment may purport to transfer "all right, title, claim, interest and demand" in the agreement, a licence to enter and seize the goods in the purchaser's possession has been held, on basic common law principles, not to be assignable.[10]

2. *Registration Under the Chattels Transfer Act 1924*

From the definition in section 2 of an "instrument" it is obvious that assignments of a dealer's proprietary interest are prima facie instruments requiring registration. Dugdale, *New Zealand Hire-Purchase Law*,[11] however, differentiates between an assignment of property rights and contractual rights (the usual practice), and an assignment solely of the contract. In his view the latter is exempt from registration on the grounds that it constitutes the assignment of a chose in action. This writer agrees that contractual rights do constitute a chose

9. *Guest* (supra) p. 298.
10. *Chatterton* v. *McLean* [1951] 1. All E.R. 761.
11. Op. Cit. n. 5 supra at page 52.

in action, but disagrees with Dugdale when he says this fact exempts the assignment of them from the need for registration. Although choses in action are stated in section 2 not to be chattels, as a result of the 1939 amendment to the Act, book debts are; and it is submitted that instalments due under a hire-purchase agreement are book debts.

> Book debts include all such as are entered . . . in the account books of the vendor:[12]
>
> "Those words really appear to mean debts which are due to the business and which in the ordinary course of business, would pass through the business ledgers":[13]

These two judicial definitions appear to leave no doubt on the matter, but because Dugdale is recognised as being an excellent commentary and this writer is apprehensive in disagreeing with it, reference to two other decisions should be made. In *Olds Discount* v. *John Playfair*[14] the fact that instalments due under a hire-purchase agreement were book-debts of the dealer was assumed without question by the court. An even more direct authority is *Independent Automatic Car Sales Limited* v. *Knowles and Foster*.[15] In a decision directly upon the point in question the court held that hire-purchase instalments exist, at the date of the initial deposit, as book debts. "[The] fact they were not then immediately payable would not make them any less debts, nor, in my judgment, any the less book debts."[16] It is therefore submitted that even an assignment of contractual rights alone under a hire-purchase agreement constitutes an instrument and prima facie requires registration.

Yet in practice almost no assignments are registered, due to the relieving provision of section 57 (3) of the Chattels Transfer Act 1924. This subsection provides that:

> A customary hire-purchase agreement, and any assignment of a customary hire-purchase agreement, and of the chattels the subject of the agreement, whether absolute or by way of mortgage, is valid and effectual for all purposes without registration thereof.

As in all probability the contract between dealer and purchaser will be a customary one (as defined in section 57 (1)), an assignment of the contract and the property in the chattels does not require registration. Yet not all agreements are customary. The Seventh Schedule list of chattels is relatively exhaustive, but some chattels often sold on hire-purchase are not included therein.[17] It does occasionally happen that non-customary hire-purchase agreements are assigned and the assignment is not registered. It is not amiss therefore to examine

12. *Stanley Stamp Co.* v. *Brodie* (1914) 34 N.Z.L.R. 129, per Stout C.J. at 148.
13. *Haigh* v. *Haigh* (1907) 51 Sol.Jo. 343 per Parker J. at 343.
14. [1938] 3 All E.R. 275.
15. [1962] 1 W.L.R. 974.
16. Ibid., 984.
17. Especially boats, yachts and pleasure craft.

the situation where a registrable assignment is not registered and where a person detailed in sections 18 and 19 of the Chattels Transfer Act claims the assignment void as against them. As a preliminary to this discussion, it must be stated that the registration of the initial hire-purchase agreement by the dealer would afford no direct protection to the finance company. The deed of assignment is a new "instrument" and as such demands registration itself. The fact it relates to the same chattels as the instrument registered by the dealer would not appear to be relevant. This situation appears to be anomalous. Transfers or agreements to transfer instruments by way of security are stated in section 2 not to be instruments. The rationale behind the registration requirement is to give notice to the lending and buying public that certain goods in a person's possession or assets under his control are encumbered with a prior interest. The reason for excluding transfers of instruments by way of security from the term "instrument" would appear to be that since the instrument by way of security must itself be registered, notice is given to the lending public of a grantee's interest, but that the particular identity of the grantee is unimportant. If this rationalisation is correct, a strong case can be made out for excusing registration of already registered bailment agreements. In this class of instrument too, assignment does nothing but alter the identity of the secured party; it does not alter the fact that goods in a purchaser's possession are not his to freely dispose of. Registration should not be necessary when the hire-purchase agreement itself is registered. However, since registration is required, the consequences of failure to register the assignment must be analysed.

(a) *In the event of the dealer/assignor's bankruptcy*

Suppose a dealer assigns a non-customary hire-purchase contract and his property interest in the goods to a finance company; that the assignment should be registered and is not, and that the dealer then becomes bankrupt. Should his Official Assignee claim title to the chattel and the right to enforce the contract under section 18, could the finance company resist his claim? On a strict interpretation of section 18 (1) I feel it could. Although the subsection purports to make every (non-customary) agreement void against the Official Assignee if not registered, its application is limited to cases where the chattels in dispute are "in the possession or apparent possession of the person making or giving the instrument". "Chattels" here could mean the book debts or the chattel leased or conditionally sold, but in either case "possession" is not in the dealer, the person making the instrument. It is submitted that section 18 (1) would not therefore operate to render the assignment void. The peculiar wording of section 18 (1) does in effect limit the practical effect of the subsection to instruments by way of security, as this is the only common secured transaction where the chattels do in fact remain in the grantor's hands. The parent of section 18 (1) was the equivalent section in the English Bills of Sale Acts, but as this line of statutes did not deal with bailments in any case, the blame for section 18 (1)'s inapplicability to bailments

and their assignment rests solely on New Zealand draftsmen. The interpretation of section 18 (1) as above is supported by the *Booth MacDonald*[18] decision.

(b) *In the case of sale by the purchaser*

Now suppose a registrable assignment is made to a finance company which does not register, and that the purchaser fraudulently sells the chattel to a bona fide purchaser. In these circumstances, is the instrument of assignment void as against this third person under section 19? Section 19 prima facie gives the third party a good title: the finance company's sole chance to resist his claim would rest upon the possible application of *Carmine* v. *Howell.*[19] In that case a dealer and a purchaser entered into a *Helby* v. *Matthews*[20] type of hire-purchase agreement. Before having completed payment the purchaser sold the hired chattel to a bona fide purchaser. The hire-purchase agreement was held to constitute an instrument and the learned magistrate agreed it was void through non-registration. He nevertheless decided that the dealer was entitled to the return of the chattel on the basis that section 19 renders the instrument void, but does not preclude a person from proving his title independently of the void instrument. There are remarks of Myers, C.J. in the *General Motors Finance Co.*[21] case which show that Myers C.J. did not hold this view but they are dicta, and as *Carmine* v. *Howell* has stood for many years unchallenged directly by any higher authority, it must be accepted as correct law, and, it is submitted, good law. As far as *Lee* v. *Butler*[22] types of agreements are concerned there is no reason why the *Carmine* defence should not be available to a dealer there as well: but a dealer would obviously fail in his claim due to the operation of section 27 (2) of the Sale of Goods Act 1908 which would be sufficient to protect the bona fide purchaser.

Could a finance company successfully plead *Carmine* v. *Howell* in the circumstances outlined at the beginning of the previous paragraph? The short answer must be no. Its title to the chattel rests upon the deed of assignment, the very instrument struck down through non-registration. Unlike the dealer in *Carmine,* it has no way of proving title antecedent to the execution of the instrument. If there is a recourse clause in the deed of assignment or in a master agreement between dealer and finance company which is drafted sufficiently widely to place liability upon the dealer for losses to the company arising from the purchaser's unlawful disposition—the standard undertaking "The assignor will pay to the company on demand the total sum repayable . . . or the balance thereof for the time being unpaid" would seem sufficient—the company would not suffer loss in any case. But should there be no such clause, and should the chattel be of considerable

18. (1913) 33 N.Z.L.R. 110.
19. (1924) 19 M.C.R. 103.
20. [1895] A.C. 471.
21. *General Motors Acceptance Corp.* v. *Traders Finance Corpn. Ltd.* [1932] N.Z.L.R. 1.
22. [1893] 2 Q.B. 318.

value, there is one further line of argument the finance company could pursue. It could argue that as section 19 makes the instrument of assignment void, the instrument was not therefore capable of passing title from the dealer to the company. Therefore title must still be in the dealer, and as he can presumably prove his title independently of the void instrument, he is entitled to recover the chattel on behalf of the finance company. However, there are two objections to this argument:

(i) Section 19 makes the instrument void as against a bona fide purchaser. It does not appear to invalidate it *inter partes*, and so the instrument would effectively pass title to the finance company (only, of course, for the latter to lose it to the bona fide purchaser).

(ii) In *Singh* v. *Ali*[23], a case to be discussed in detail subsequently, the Privy Council held that title could pass under a void agreement. So even if section 19 was held to render the assignment totally void, the assignment could still be effective to pass title to the finance company, again for the latter to lose it as in (i) above.

Overall, therefore, the possibility of a bona fide purchaser acquiring an interest in the chattel through non-registration of a registrable assignment holds far more serious consequences for the assignee company than the claim by the Official Assignee of a bankrupt dealer in circumstances previously described. Dugdale, however, does hold out some slight glimmer of hope to a finance company in the section 19 situation. He states at page 53 (referring to assignment of non-customary agreements):

> Where by one instrument a vendor assigns his title and his interest in the chattel (i.e. his contractual interest), and that instrument is not registered and a bona fide stranger acquires an interest in the chattel, the assignment may be treated as severable.

"Severability" of an instrument into its constituent parts will be allowed in only a few cases, mainly in fact situations such as those of *In re Issacson.*[24] In that case there was an assignment, in the same deed, of the assignor's proprietary interest in a piano and of a hiring agreement in relation to the piano concluded between the assignor and a third party. The deed was not registered under the Bills of Sale Act 1878. Upon the assignor's bankruptcy his trustee in bankruptcy claimed the whole assignment was void through non-registration. The Court of Appeal held that although the assignment of title was void, that of the contractual interest could be severed and remain valid. Lord Esher emphasised "the two distinct things in the deed". He reasoned that had the assignment of the contract been made separately the Bills of Sale Act could not effect it—therefore it was not invalidated merely because it was made in the same deed as a void assignment.

23. [1960] A.C. 167.
24. [1895] 1 Q.B. 333.

Dempsey v. *The Traders Finance Company Ltd.*[25] is also cited by Dugdale in support of his claim. In *Dempsey* the Court of Appeal was faced with the following fact situation:

(i) The appellant, a bank, had been granted a floating charge over a motor company's premises and assets. The charge was in the form of a debenture, and was registered under the Companies Act 1933.

(ii) Contrary to their agreement with the bank, the motor company, in return for cash advances, assigned to the respondents in the same instrument

(a) The contractual rights in certain hire-purchase agreements.

(b) Their property rights in the chattels the subject of these agreements.

The Court of Appeal held that:

(i) Under section 4 (2) of the Chattels Transfer Act the respondent assignee was deemed to have notice of the appellant's debenture, which accordingly took priority over the assignment of the motor company's proprietary interests.

> S. 4 (2) applied to fix the corporation with notice of the debenture and its contents so far as it related to chattels, i.e. personal property completely transferable by delivery.[26]

(ii) Smith J. who delivered the majority judgment, also held that merely because the respondent was prohibited from asserting his alleged property rights, the assignment of the contractual rights was not necessarily void. He held that this latter assignment was severable and good against the appellants "as an assignment of the benefit of hire-purchase agreements".

Yet for several reasons I do not think Dugdale can deduce from these two cases the principle he does, or, to put it more correctly, the principle he does draw can have no application under the Act as it now reads. It is submitted that although *Dempsey* was correctly decided on the law as it stood in 1930, the amendment to the definition of "chattels" by the inclusion of book debts robs the possibility of severance of any real efficacy. On the view taken by this writer that the assignment of contractual rights does, if written, constitute an instrument under section 2, the assignment of both property and contract, whether separately or together, will be void as against a third person if not registered.

3. *Absolute or By Way of Mortgage*

Assignment can take one of two basic forms, absolutely or by way of mortgage. In this writer's opinion there is very little difference in the practical result of utilising either form. In both cases it can be argued that the finance company buys the contract and, probably, the

25. [1933] N.Z.L.R. 1258.
26. Ibid., per Smith J. at pp. 1298-1299.

goods. In the course of research for this paper the writer studied four assignment deeds from different companies in which the only material difference was that two of the deeds purported to "assign, transfer, and set over to the company by way of mortgage only . . . " and the other two purported to transfer absolutely. The obligations of the parties under the deeds were almost identical. Were it not for the operative words "by way of mortgage only" few people would conclude from the construction of the deeds by way of mortgage that they were anything but absolute assignments: not only was there no right of redemption (which admittedly could be implied) but it is obvious that there is no intention on the part of the assignor or assignee that the agreements should ever be reassigned to the dealer. Other deeds differ in the details of their terms, but I believe the above remarks apply to almost all of them.

It is nevertheless true that almost every finance company has a definite policy on the question whether assignment should be by way of mortgage or by assignment absolute. Each system has its benefits and corresponding disadvantages. The chief benefit of the mortgage form is that assignments incur no liability for stamp duty under the Stamp Duties Act 1954 whereas absolute assignments do incur duty under section 66 (b) of this Act. At a rate of 35 cents per hundred dollars, stamp duty may assume formidable proportions when a block of contracts worth several thousand dollars is discounted. As the finance company usually pays this charge it is in its financial interest to take assignments by way of mortgage.

Assignment by way of mortgage is for this reason the most common form of assignment. There are, however, several disadvantages in using this practice from which absolute assignments are free.

(a) Dealers may be precluded from pledging or mortgaging their assets under, for example, the terms of a loan by a bank or other finance company. Strictly speaking, a waiver would be required in such circumstances from the bank before the dealer could assign contracts by way of mortgage. But this is hardly a weighty argument against the mortgage form, as the party holding the charges or a lender will almost invariably consent to waive. In fact, in two agreements referred to this writer, a debenture-holding trading bank had apparently waived the non-mortgage term by an agreement with the dealer that assignments by way of mortgage of hire-purchase contracts were to be deemed part of the dealer's ordinary business and disposition of assets in the course of such business. The consent of such a debenture-holder is not needed, however, if the assignment is absolute.

(b) An assignment by way of mortgage of a non-customary hire-purchase agreement will require registration under section 102 of the Companies Act 1955, where the assignor is (as he usually will be) a company. This is a time consuming and therefore costly requirement. There is no such requirement in the case of absolute assignments.

(c) "An absolute assignment is not a moneylending transaction; an assignment by way of mortgage, except in the case of customary

hire-purchase agreements, is a moneylending transaction."[27] As the question of moneylending and assignments, in general, is an important one, and as I feel this statement by Dugdale is incorrect, it is proposed to deal with moneylending as a separate and independent question.

4. *Moneylending and Assignment*

The operative motive for a dealer assigning hire-purchase agreements is to secure finance to buy new stock-in-trade. This very fact makes it obvious that by their very nature assignment transactions run the risk of offending against the Moneylenders Act 1908. Finance companies which, in one form or another, finance hire-purchase agreements have come under greater attack through the Act than any other institution. This is probably due to the very fine legal distinction between financing agreements and lending, and the almost complete absence of a practical distinction between the two activities. Lord Denning's statement:

> It would appear to the unpractised eye that a hire-purchase finance company (is) nothing more or less than a lender of money on the security of (chattels)[28]

was echoed by Porter J. when, referring to "all bodies which finance hire-purchase agreements", he said " . . . what one has to remember is that their real function is the lending of money, and it must, necessarily be so".[29] But be this as it may, the law does recognise a distinction between transactions such as assignments, and moneylending; or to put it rather more realistically, it does not hold every lending transaction a moneylending one.

In analysing the actual application of the Moneylender's Act to assignments one may start with the general proposition that "it is now settled law that a hire-purchase finance company, when it carries on the normal business of financing hire-purchase transactions, is not a moneyender". This statement comes from Lord Denning's decision in *Premor Ltd.* v. *Shaw*[30] which was a case involving a direct collection[31] system of financing, but from the decisions he offers in support of his claim he obviously was referring to financing in general. His main authority was *Olds Discount Co. Ltd.* v. *John Playfair.*[32] In that case Branson J. held the discounting of hire-purchase agreements was not a moneylending transaction despite the fact that the parties could have achieved the same end (i.e. placing money in the dealer's hands to acquire stock-in-trade) by use of a simple loan.

It is the nature of the agreement entered into and not its object, at which the Court has to look in order to decide whether in any

27. Dugdale op. cit. n. 5 at page 54.
28. *Premor* v. *Shaw* [1964] 2 All E.R. 583, 585.
29. *Olds Discount Co. Ltd.* v. *Cohen* [1938] 3 All E.R. 281.
30. *Premor* n. 28 supra at 585.
31. A system whereby the dealer assigns the chattel to be hired to the finance company which then enters into the hiring or conditional sale agreement with the purchaser.
32. [1938] 3 All E.R. 275.

particular case the agreement is a money lending agreement or otherwise.[33]

The decision is clear authority for the proposition that bona fide practices of the purchase of hire-purchase contracts are not moneylending transactions, and, at least as far as absolute assignments are concerned, as long as the discounting transaction is not a sham to conceal a loan, any transactions of this type will not fall within the ambit of the Moneylenders Act. Both Guest[34] and Dugdale,[35] however, feel that assignments by way of mortgage do not share this immunity. Dugdale gives no reasons or authority. Guest merely states that if the company and the dealer transact "by way of a loan of money in return for a charge by the dealer on the security of the agreements, it is submitted that such a transaction would involve a contract for the repayment of the money lent".[36] There is certainly more chance of an assignment by way of mortgage being held to be a moneylending transaction, because of the very nature of such an assignment—the creation of a charge over assets for consideration—and most of the cases where a hire-purchase financing system has been caught by the Act have involved assignments by way of security.[37] But it is impossible to move from this position to that of roundly claiming "assignments by way of mortgage are moneylending transactions", for several reasons:

(a) Under section 2 (3) of the Chattels Transfer Amendment Act 1931 assignments by way of mortgage of customary hire-purchase agreements are deemed not to be moneylending transactions. Dugdale is naturally aware of this.

(b) There has not, to this writer's knowledge, ever been a case where the proposition Dugdale and Guest maintain has been upheld. Rather, in cases where assignments by way of mortgage have been under review, the courts have followed Branson J.'s principle in *Olds Discount* and asked, "what is the nature of the agreement entered into?" In deciding this question they have, it is submitted, adopted a realistic attitude to predominant commercial practices. The decision of Simonds J. (as he then was) in *Transport and General Credit Corpn.* v. *Morgan*[38] is a useful example. In order to finance the sale of electrical goods on hire-purchase, two companies, W. and R. (the latter a subsidiary of the former) entered into an agreement with several finance companies, including the plaintiffs. The latter undertook to discount notes issued by W. and R. on the security of existing and future hire-purchase agreements which were to be lodged with trustees. W. and R. eventually went into liquidation. Their receiver alleged (*inter alia*) that the plaintiffs were carrying on the business of moneylending and, being unregistered, their security over the hire-purchase agreements was void and unenforceable. Simonds J. held that the plaintiffs were not moneylenders, and remarked

33. per Branson J. at 277.
34. Op. cit. supra n. 7 at p. 61.
35. Op. cit. supra n. 5 at p. 54.
36. Guest op. cit. supra n. 7 at p. 61.
37. e.g. *Premor* v. *Shaw* [1964] 2 All E.R. 583.
38. [1939] Ch. 531.

> [I]t must be remembered that hire-purchase agreements take a very large part in the commercial and social life of the community. . . . It appears to me that financiers and the dealers co-operate in the common venture of making the whole business of hire-purchase agreements feasible and to regard one party to that common venture, which is now a recognised mercantile service, as carrying on the business of a moneylender is an abuse of language.[39]

This decision is important for two reasons. On a specific level, it shows that, although there was no direct assignment to the plaintiffs, the transfer of the beneficial interest of hire-purchase contracts as security was not regarded as the basis of a moneylending transaction. It seems to this writer that had W. and R. assigned the contracts by way of mortgage the result would have been exactly the same. On a more general level, it shows the generally realistic approach the courts have taken to hire-purchase financing.

(c) Based on (b) above, I am convinced that a court would not strike down a bona fide assignment by way of mortgage. Not only do broad general statements of principle such as Lord Denning's in *Premor*[40] support this conclusion but it would be illogical to do so. As was pointed out previously, the "realistic" consequence of both absolute and mortgage assignments is the sale of book-debts to the finance company. The form they take certainly differs, but the "nature of the transactions" are not basically dissimilar. In substance both involve sale and purchase rather than a charge on the security of contracts.

In view of the fact that many finance companies are registered moneylenders, it may appear that the above discussion is rather academic. However, even those that are registered are anxious to avoid any dealer-financing arrangements being deemed moneylending transactions, since the Act requires certain strict requirements to be fulfilled in regard to each such transaction, requirements which are costly and time consuming. Section 2 of the 1931 Amendment removes most risks in this area of discussion, however, and, as submitted above, there is little danger of bona fide non-customary assignments coming under attack from the 1908 Act.

5. *Illegality*

Considering the large number of hire-purchase agreements executed each year only a relative few are known to offend against the Hire Purchase and Credit Sales Stabilisation Regulations 1957. Those that do are void under Regulation 10. It is nevertheless relevant to analyse the rights of a finance company which takes an assignment of an illegal agreement. For the sake of convenience this question can be divided threefold:

(a) *Can the finance company enforce the contract?*

Quite obviously the answer is no. The agreement is unenforceable in the hands of the assignor/dealer, and this being so, a finance com-

39. per Simonds J. at 551.
40. *Premor* v. *Shaw Bros.* supra n. 37.

pany cannot enforce it even if it takes without notice.[41] The application of this principle can lead to harsh results. In *Stenning* v. *Radio and Domestic Finance Ltd.*[42] the agreement was held unenforceable against the purchaser even though it was shown that the purchaser and the dealer had deliberately falsified the facts and that the finance company would not have taken the assignment had it known the true circumstances. The finance company may, however, have remedies outside the contract against purchaser and/or dealer. In *Luhrs* v. *Baird Investment*[43] Turner J. suggested conspiracy as a possible basis for the finance company proceeding against dealer and purchaser, on facts similar to those in *Stenning*. However, conspiracy was not pleaded in this latter case, and it is submitted the evidentiary burden on the company to prove conspiracy precludes this remedy of efficacy in all but a few fact situations. The same can be said of an action in deceit. In an unreported judgment of the Court of Appeal[44] Cleary J. said "a dealer who prepares and hands over agreements to be discounted impliedly represents they are genuine", but in order to successfully plead deceit a company would have to show more than a breach of this representation; it would have to prove that that the dealer knew of the illegality and intentionally misrepresented that the agreements were valid in order to induce the finance company to discount them.

The chances of a company resorting to one of the above actions are remote, as illegality seldom arises in practice and when it does the company is more concerned to recover the chattel hired or conditionally sold under the illegal contract; if it does seek to recover any loss it incurs through the illegality it will usually try to do so through a recourse claim in the deed of assignment or master agreement.

(b) *Can title pass to the company under an illegal agreement?*

The law seems settled that even if the assignment of contractual rights is ineffective, and the rights unenforceable against the purchaser through the illegality of the original contract, an assignment of the dealer's property rights in the same deed of assignment is fully effective to vest title in the finance company. For it must be remembered that the assignment of an illegal contract is not itself illegal or void. Conceptually the contractual rights in an illegal contract are assigned: they merely remain unenforceable in the company's hands. In any case, it seems clear that it is possible to sever the two distinct things assigned. In passing his title to the finance company the dealer is assigning something independent of the void contract. On general principles of severance found in cases such as *In re Issacson*[45] this title should be effectively passed. That title does pass in these circumstances appears to have been accepted in recent decisions.[46]

41. *Luhrs* v. *Baird Investment* [1958] N.Z.L.R. 663.
42. [1961] N.Z.L.R. 7.
43. supra n. 41.
44. *Rural Finance Ltd.* v. *Official Assignee* (C.A. 13/60).
45. [1895] 1 Q.B. 333.
46. *Kingsley* v. *Sterling Industrial Securities* [1967] 2 Q.B. 747; *Portland Holdings* v. *Cameo Motors Ltd.* [1966] N.Z.L.R. 571, C.A.

Assuming this conclusion to be correct, the question now arises whether the finance company can pass its title in the goods to the purchaser, should the latter complete payment of instalments. It will be noticed that this is a distinctly separate question from whether title can pass to the company under an assignment. The question at issue now is, in effect, whether title can pass under an illegal contract: the problem will only arise in the few cases where both the finance company and the purchaser are unaware that the contracts infringe the 1957 Regulations. For this reason there is a dearth of authority on this particular point. Perhaps the most relevant case in point is the Privy Council decision in *Singh* v. *Ali*.[47] There the plaintiff and defendant entered into an agreement for the sale of a lorry. The contract was illegal under Transport Regulations made in Malaya in 1945, yet the plaintiff gave valuable consideration. The defendant subsequently seized the lorry and pleaded that as the contract of sale was illegal, no title could pass to the plaintiff under it. The Board (per Lord Denning) held that although the contract was illegal

> nevertheless it was fully executed and carried out, and on that account it was fully effective to pass the property in the lorry to the plaintiff.[48]

Later Lord Denning said:

> The transferee, having obtained the property, can assert his title to it against all the world not because he has any merit of his own but because there is no-one who can assert a better title to it.[49]

The *Singh* v. *Ali* facts obviously differ from those under consideration. In *Singh* v. *Ali* there was a contract of sale and purchase, not one of hire-purchase; in that case too there was no assignment of title by the vendor. But it is submitted that the principles stated by the Board are wide enough to justify disregarding these factual differences. Were the assigned illegal contract "fully executed and carried out" there would be no-one who could assert a title to the chattel better than the purchaser. In equity his title should be unimpeachable by the company.

(c) *Can the finance company recover possession of the chattels held by the purchaser under the illegal agreement?*

Leaving assignments momentarily aside and looking briefly at Regulation 10 of the 1957 Regulations, one notices that this regulation does not state or even imply that a dealer can take repossession of a chattel held under an illegal agreement. One must remember, however, that under contracts of hire-purchase title to the goods remains vested in the dealer until the purchaser has fulfilled his obligations, and this being so the *Bowmakers*[50] principle would allow him to assert his title

47. [1960] A.C. 167.
48. Ibid., 176, cf. *Joe* v. *Young* [1964] N.Z.L.R. 24, S.C. and C.A.
49. Ibid., 176, 177.
50. *Bowmakers Ltd.* v. *Barnett Instruments Ltd.* [1945] K.B. 65.

to the chattel. In his much quoted judgment in *Bowmakers* du Parcq L.J. said:[51]

> a man's right to possess his own chattels will, as a general rule, be enforced against anyone who without claim of right is detaining them

and that the owner can recover them

> even if the chattels come into the defendant's possession by reason of an illegal contract between himself and the plaintiff, provided that the plaintiff does not seek, or is not forced to found his claim on the illegal agreement or plead its illegality to support his claim.[52]

Although the learned Lord Justice seems to have misapplied his own principle,[52A] its approval in *Singh* v. *Ali*[53] establishes it as correct law. A dealer would not be forced to rely on the illegal contract; his action is based on his antecedent proprietary rights and the wrongful retention of the goods by the purchaser. An action by him in conversion would almost undoubtedly succeed.

It is submitted that the same principles would apply when a finance company is the owner of the goods by virtue of an assignment of title. The company would be forced to rely upon the assignment to establish its title, but as before stated, the assignment of title is probably effective and not dependent for its validity on the illegal contract.

6. *Recourse Clauses*

The law relating to these clauses is basically that of the common law rules of guarantee and indemnity. The most common form, whether in a master agreement or in an individual deed of assignment is simply a guarantee by the dealer of the purchaser's obligation to pay all the instalments coupled with an undertaking to reimburse the finance company for any loss it sustains in repossessing or reselling the chattel. As the most common (by far) occasion in which the recourse clause will be invoked is the purchaser's default in payment, such a clause as that above is fully adequate from the finance company's point of view in most cases. Contracts of guarantee, and therefore clauses of guarantee, do, however, suffer one defect which in some ways limits their effectiveness as a basis for a recourse clause; it is a basic common law rule that a guarantee of a void obligation is also void. "No man [can] guarantee anybody else's debt unless there is a debt of some other person to be guaranteed."[54] There is no debt and no obligation to pay, in a purchaser under an illegal hire-purchase agreement, and therefore a guarantee based recourse clause will be ineffective to bring home liability to a dealer for any loss suffered by a finance company which discounts an illegal agreement.

51. at 71.
52. per du Parcq L.J. at 71.
52A. *Joe* v. *Young* [1964] N.Z.L.R. 24, C.A.
53. supra n. 47.
54. *Lakeman* v. *Mountstephen* (1874) L.R. 7 H.L. 17 at 25 per Lord Selbourne.

The case of *Cotton* v. *Central Districts Finance Corpn. Ltd.*[55] illustrates the application of this principle. There the deed of assignment of an illegal (void under the 1957 Regulations) hire-purchase agreement contained a guarantee by the dealer of the purchaser's payment of all instalments. The purchaser defaulted and the finance company sought to enforce the recourse clause. The Court of Appeal held they could not. Although the case mainly developed around the question of whether the agreement was in fact illegal, the court accepted that if it were, the recourse clause could not be invoked as it would be a guarantee of a void obligation. As was said in *Cotton's* case

> The guarantee contained in the assignment from the defendant to the plaintiff in these hire-purchase agreements would also be tainted with illegality and unenforceable against the defendant.[56]

The decision in *Cotton* does not mean though that it is impossible to draft a recourse clause which will protect the finance company in the illegality situations. But it does mean that the guarantee concept cannot be used to give such protection. The answer to legal draftsmen's problems came in the Court of Appeal decision in *Portland Holdings Ltd.* v. *Cameo Motors Ltd.*[57]

In this case the respondent car dealer entered into a hire-purchase agreement with one Wiblin. The agreement contravened the 1957 Regulations in that it failed to specify at the time of execution particulars such as the number and amount of instalments and the due date for the payment of these instalments. These particulars, contained in a "working slip" were not filled in until the time for the assignment of the agreement to the appellant company came. Both the Supreme Court and the Court of Appeal agreed that this rendered the contract between Cameo and Wiblin void. The real issue, however, was whether this illegality rendered the recourse clauses in the assignment inoperative and so excused Cameo from liability for the appellant's loss. The relevant clauses read as follows:

> And for the consideration aforesaid the assignor hereby covenants with the Company as follows:
> 1. The assignor will pay to the Company on demand the "total balance owing" shown in the second schedule hereunder or the balance thereof for the time being unpaid.
> 2. The said hirer will punctually pay observe keep and perform all and singular his obligations under the said agreement to the extent that the assignor shall for all purposes be deemed to be jointly and severally liable as a principal debtor with the hirer to the Company notwithstanding that as between the hirer and the assignor the assignor may be a surety only.

55. [1965] N.Z.L.R. 992, C.A.
56. at pages 376-377 per Tompkins J. at first instance.
57. [1966] N.Z.L.R. 571.

It will be observed that whereas clause 2 above is basically a guarantee of the debtor's obligation, clause 1 is in essence an indemnity: it is the basis of an independent legal undertaking by the dealer. Because it is separate and divorced from the void hire-purchase agreement, it was held not to be "tainted" by the illegal contract. The clause in *Cotton* was a guarantee of a void obligation: it itself was void, as its enforcement would foster or promote the illegality. In *Cameo*, however, Turner J. held[58]

> In the present case I am unable to see what future illegal end was purposed by the covenants in the assignment. The illegality which is said to taint the assignment is already in the past.

Clause 1 was an independent obligation placed on the dealer, contained in an assignment which was not itself illegal[59] and therefore enforceable against the assignor.

Little more need be said with regard to the law of recourse clauses. In England, Lord Denning has successfully created a state of some judicial confusion by conflicting decisions on what appears to this writer to be similarly drafted clauses.[60] But *Cotton* and *Cameo* have settled the law in New Zealand, and despite confusion on points of detail in *Cameo*[61] the legal effect of most recourse clauses is ascertainable with some confidence. Most finance companies have altered their recourse clauses to replicas of those in *Portland Holdings* and the "separate legal obligation" now appears in almost every assignment with recourse liability.

THE FUTURE OF DISCOUNTING

"I can foresee the day when we and many other finance companies will be discounting no hire-purchase agreements at all." This statement by one company director was echoed, though usually less pessimistically, by several other discounters. It is an established fact that discounting is playing a smaller and smaller part in the activities of most companies. Some reasons for this were mentioned in the earlier discussion of finance company practices: the domination of the new car financing market by the manufacturers' finance companies; the growth of companies as ancillary subsidiaries to the larger retail stores, and the slow squeezing out of many small retail outlets by these larger concerns. Another basic reason is economic. Discounting is not as profitable as most other financing transactions. The finance company's profit on a discounting transaction is usually reckoned as the difference

58. Ibid., 581. The distinction between a guarantee which rests on the primary contract and an indemnity which is an independent undertaking was explained in *Yeoman Credit Ltd.* v. *Latter* [1961] 1 W.L.R. 828.
59. This is apparent from the opinion of Turner J. (at 581) and North P. (at 583).
60. *Unity Finance Co.* v. *Woodcock* [1963] 2 All E.R. 270 and *Yeoman Credit* v. *Apps* [1962] 2 Q.B. 508.
61. In particular whether the assignment of an illegal contract is itself illegal. See statement by Turner J. and North P. referred to in n. 58. See also McCarthy J. at 578.

between the cash and contract prices—say 10% of the cash value. A television set costs, say $300. The 15% deposit, $45, is retained by the dealer. Assuming there is no reserve, the finance company pays the dealer $255, less perhaps a fee (though usually there is no independent charge above the basic profit). The contract price for the chattel will be about $330, leaving the finance company with a "profit" of $30.

Out of this "profit" must be deducted the following:

(a) The salary costs of its own employees involved in forming a schedule and preparing a deed of assignment.
(b) Labour costs involved in checking off dealer's records of instalments against the company's records every month.
(c) The sending of "reminder" notices to "slow" purchasers (though this may be done by the dealer).
(d) The costs of repossession of any chattel when default has been made under the contract, and the advising of the purchaser of his rights under the Hire-Purchase Agreements Act 1939.
(e) The cost of resale—and storage until resale—of such chattels.

Even if expenses (d) and (e) are avoided, up to 60% of the company's profit could be absorbed by administrative costs in respect of any one agreement it discounts. There are also many attendant risks a discounter must take: many of his dealer clients must of necessity be the "rats and mice" retailers whose own financial situation is somewhat precarious and whose honesty in respect of the collected instalments may be suspect. A finance company can minimise this risk by the collection of instalments itself, but this practice is extremely expensive. When all of the above factors are taken into account, the discernible trend away from discounting is hardly surprising.

Of course, discounting is still a very important commercial practice. There are several finance companies which have a large percentage of their capital outlay tied up in hire-purchase financing. But in general these are the companies which have established relatively secure links with large retail outlets or which have an opening into the new-car financing field. Their dealers are usually well established and financially secure. But even these discounters are reluctant to transact with dealers unknown to them or dealers whose volume of business is so small that profits to them are minimal. This "crystallisation" of clientele appears to be a predominant trend today: any dealer not worth capitalising upon is unlikely to have his agreements discounted. Assigning from them "involves too much work for too little return".

Just where discounting is heading is a problematical question. But perhaps a brief study of another more commercially sophisticated system and the role and position of the equivalent practice there might help answer this question.

Discounting in the United States

The practice we refer to as discounting is usually called factoring in the United States. The 19th century factor was, of course, not a financier but a commission agent. Today he is little short of a bank

or finance company. Rising to importance during the automobile boom before and after the depression, an indication of his present importance can be gleaned from the fact that only ten of America's largest banks are as large (asset-wise) as any one of the three largest "Credit Corporations"[62]—the common name for factoring institutions. Unlike a New Zealand finance company, Credit Corporations are usually specialists: their business largely revolves around discounting and its associate activity of lending on future "account receivables". This latter term indicates the basis of the factor's activities. "Receivables" are the debts due under a "conditional sale" (a hire-purchase agreement) or an "instalment sale" (a credit sale as this term is used in the 1957 Regulations).

Though most factors merely purchase these debts after the agreement has been made between retailer and purchaser, many factors demand the right to veto the proposed agreement. Often the dealer/purchaser contract will be made on printed forms supplied by the factor. Whitney[63] has explained the factor's dominance in this way:

> The balance of bargaining power is generally so much in their favour as against conditional vendors (i.e. dealers) desiring their money at once at a discount, that these Credit Corporations not only dictate the terms of conditional sale contracts that conditional vendors may make with their customers, but even, in many instances, control the practical management and direction of the conditional vendor's business.[64]

The Credit Corporation and the dealer invariably operate under a master agreement. As does a finance company in this country, the former undertakes to consider applications for assignment forwarded by the dealer. He may alternatively, as suggested above, enter the picture at an even earlier stage and actually decide whether there will be an agreement between the dealer and consumer at all. In almost every case the factor will undertake intensive pre-investigation of the customer's credit rating.

When the Corporation does take the assignment, it generally does so without recourse. In view of Whitney's statement that the balance of bargaining power is usually in the factor's favour, the writer initially found this fact hard to explain. For from the New Zealand experience it seemed logical that the factor would take advantage of his strong position and cover himself against loss. But the American practice can be justified on the following grounds:

(a) The incidence of default, due to pre-investigation, is apparently lower than in New Zealand.

(b) The factor also has assigned to him the property interest in the case of conditional sales and the dealer's right to repossess in the case of credit sales. This gives the Corporation the

62. Whitney, *The Law of Modern Commercial Practices* (2nd ed. 1965) p. 935. Little Brown & Co., Boston, 1965.
63. Idem.
64. Ibid., 819.

rights of repossession and resale should the purchaser default. In view of the very close identity of interest between Corporation and dealer, in view of the fact that they are engaged in what really amounts to a joint venture, non-recourse may be the most desirable way to do business. Since recourse liability on the dealer would be to the dealer's economic detriment, and since the Corporation's aim is to keep the dealer as financially healthy as possible, the Corporation may decide to bear discounting losses itself. This seems a reasonable explanation of the facts, especially as American factors have specialist repossession and resale facilities. Since the "joint enterprise" of the factor and dealer must bear the loss through default, it seems natural that the part of the enterprise best equipped to do so at the least cost should bear this loss.

(c) No doubt, through its dictation of the dealer's business affairs and its determination of the terms of contracts between dealers and purchasers, the Corporation can pass this loss off on to the general public.

Factors "purchase" book debts; merely taking an assignment by way of security over them is not a common practice. Payment for the assigned book debts appears to take a slightly different form than in New Zealand—it is usually reckoned on a commission basis based on the annual value of the debts discounted. This commission, about 5% of the debt value, appears to indicate that the factor's profit in respect of an individual transaction is less than that of a New Zealand finance company.

The huge volume of goods and finance tied up in factoring agreements was the main reason for the enactment of the Uniform Conditional Sales Act. With 45 billion dollars worth of goods a year sold on various forms of instalment credit and 15 billion under conditional sales alone, uniform legislation was obviously required to regulate the rights of vendors, purchasers, assignees and bona fide purchasers from conditional purchasers. The adoption of the Uniform Commercial Code has meant the earlier Act's repeal, but most of its basic principles are incorporated into the scheme of the Code.

The U.C.C. is a complex document, calculated to "confuse the neophyte and alarm the uninitiated". Basic American texts deal with it in great detail[65] and it is only proposed here to deal very briefly with the law contained in it which relates to the debt-purchasing activities of Credit Corporations.

Article 9 is the basic article in this respect. The aim of the article is professedly

> . . . to provide a simple and unified structure within which the immense variety of present day secured financing transactions can go forward with less cost and greater certainty.

65. Whitney op. cit. n. 60; Gilmore, *Security Interests in Personal Property*, Little Brown & Co., Boston, 1965.

The basic concept behind the provisions of Article 9 is the "security interest" defined as follows:[66]

> "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods . . . is limited in effect to a reservation of a "security interest". The term also includes any interest of a buyer of accounts, chattel paper, or contract rights which is subject to Article 9 . . .

This section, and the precise definition of various terms within it, make it clear that the usual factoring activities are governed by the law of Article 9. As before stated, there are two kinds of book-debts a factor can purchase—those due under a credit sale and those due under a conditional sale. These debts are included by the Code in the terms "accounts" and "chattel paper". In both cases, sale by the dealer to the factor creates a "security interest", the factor becomes a "secured party" and the dealer a "debtor".

It is stated immediately above that the security interest in the factor is created upon the sale of the debts. Practically speaking, this is correct, although the Code does demand certain formal requirements for the interest to be enforceable.[67] Once these conditions have been fulfilled, the security interest is said to "attach". The term "attachment" is, in fact, basically synonymous with the term "execution", but under code law attachment carries with it certain important consequences. Primarily, the agreement is fully effective *inter partes*; secondly, in some cases mere attachment will give protection to the secured party against the assignee in bankruptcy or creditors of the "debtor". In cases of the sale of accounts and chattel paper, however, attachment alone is insufficient to secure the factor against these and other claimants of the dealer's assets. In order for a factor to be fully protected his interest must be "perfected".

The concept of "perfection" was borrowed by the Code draftsmen from Federal Bankruptcy Acts, where it meant "registered". It is now "a Code term of art which describes the rights a secured party has in collateral . . . and means the greatest bundle of rights . . . which it is possible for a party to obtain under the law of secured transactions".[68]

In order fully to comprehend this concept, it is necessary to realise that there are three main contingencies which could arise to threaten a factor's interest:

(a) The dealer could become bankrupt and his assignees claim the debts;

(b) The dealer could fraudulently resell the collateral if left in his hands;

(c) The conditional purchaser under a conditional sale agreement could fraudulently sell the chattel to a third person.

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66. Article 1-201 (37).

67. These are contained in Article 9-204. The interest is formed when the parties agree it shall be formed, when the secured party gives value to the debtor and, naturally, when the "debtor has rights in the collateral".

68. Spivack, *Secured Transactions*, at 33.

Perfection can best be understood by its effect: were the factor's interest perfected, he could assert his claim to the collateral against each of the third parties in the three situations above. The concept of perfection is therefore the basis of the priority system of Article 9, but it is not proposed to deal further with this system. Article 9–300 et seq., which deals with priority rules, has been described as "the product of some mad genius of draftsmanship",[69] and is of little relevance to this section of the paper; of more relevance is the way in which an interest does, become perfected. A Corporation's security interest in chattel paper and accounts achieves this state via different means, depending on the type of collateral. Filing of the agreement which creates the interest is essential to perfect an interest in accounts.[70] The Code makes provision for filing centres to be established and requires a "financing statement" to be filed within this centre. Section 9–402 sets out the formal requirements of such a statement; it provides that it shall be sufficient

> . . . if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating types, or describing the items of collateral.

No authentications by way of affidavit are needed. The sample copy of a statement in 9–402 (3) indicates that the philosophy of exact and precise description of the collateral is repudiated.

In the case of sales of chattel paper, perfection of the factor's security interest may be achieved both by filing[71] and by the factor's taking the paper into possession.[72] The procedure for filing is exactly the same as that described above. The second means of perfection, possession, illustrates the way in which chattel paper "ha[s] travelled a good part of the road towards negotiability".[73] Therefore a Credit Corporation need not register or file an agreement arising from the sale of conditional sale contracts as long as it takes possession of them.

The writer readily admits that the above account of the law of secured transactions, even so far as it relates to the purchase of book-debts, is sketchy and generalised. It is included mainly to provide a legal context for the discussion of the American factor's basic activities. Having done this, one is in a better position to analyse the differences —and the reasons for the differences—between American and New Zealand practices.

COMPARISON

If the main features of an American Credit Corporation were to be listed they would probably be these:

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69. Gilmore op. cit. supra n. 65. Introduction to Vol. 2.
70. This is not expressly stated, but is a conclusion arrived at by implication in section 9-305.
71. Section 9-304 (1).
72. Section 9-305.
73. Gilmore op. cit. supra n. 65, at p. 669.

(a) They are (by our standards) large;
(b) They are (by any standards) efficient;
(c) They are usually specialist institutions;
(d) They are in a strong position *vis-à-vis* retailers.

All these points combined explain the success of Credit Corporations. Currently in the midst of a domestic financial boom, there is an almost insatiable demand for consumer and retailer financing. Owing to this demand, Credit Corporations can specialise in their particular field of activity, and specialisation leads to efficiency. Also because of this demand, they can not only discount far more transactions than a New Zealand company, but they can choose which transactions they will discount and for which retailer. Administration costs are high, but the sheer volume of agreements factored and the efficiency with which this is done yields profits obviously comparable with almost any other form of financing transaction. Nor can one overlook the influence of the U.C.C.: with its simple and inexpensive requirements for transactions such as discounting, and its almost nation-wide application, the U.C.C. provides a progressive legal framework within which factoring can be carried out.

New Zealand finance companies suffer from two defects by comparison. They cannot specialise and they cannot choose their retailers. Dealing with this latter point first, although it may be strictly incorrect to claim they cannot choose their retailers, it is definitely valid to say that companies cannot secure the type of retailer they want, the type whose volume of business would make discounting pay. The chief demand for discounting in this country comes from dealers in a relatively small way whose business is often hardly worth having. This is of course a reflection of the limited "discountable market" in New Zealand. So too is the lack of specialisation. Even those finance companies which take assignments are in general ill-equipped facility-wise to deal with repossession and resale of chattels. It is not surprising for repossessed vehicles to sit in a rented yard for upwards of a year before they are resold. Our finance companies simply cannot enter the discounting market on the same scale as can American Credit Corporations, and perhaps this is the basic difference for the increasingly different importance discounting plays in the respective jurisdictions. One cannot blame the New Zealand law for the trend in this country. Indeed, because of the restrictions placed on after-acquired property clauses and inventory financing in the Chattels Transfer Act 1924, discounting acquired its importance by default. Should this Act be amended, however, to allow more realistic forms of dealer financing in line with those sanctioned by the U.C.C., it may well be that less expensive and burdensome forms of financing may rise to push discounting even further from the financing forefront than it appears to be today.

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* This article was presented as the writer's legal writing requirement for the degree of LL.B. Honours at Victoria University of Wellington.

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